RUSSIA'S WARPED TRANSITION:

THE DESTRUCTIVE CONSEQUENCES OF ETHICALLY UNCONSTRAINED UTILITY SEEKING

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The Bolsheviks believed that autocratic, feudal and market economies were all exploitative. Autocrats imperiously ruled by decree; feudal lords subjugated their vassals, while capitalists appropriated surplus value. Lenin's solution was to abolish Czarist autocracy, the remnants of feudalism and the market, replacing them with communist administrative command planning. These actions were supposed to deter exploitation by nationalizing the means of production, requisitioning factors, fixing wages, planning production, rationing credit and collective goods (housing), and distributing consumer products at state-set prices.

The strategy had the effect of criminalizing private ownership and coercive wage and price negotiations, which were seen as the primary causes of unfair exchange. The tactic succeeded in suppressing private monopoly and oligopoly power, and the amassing of significant private wealth; it was accompanied by strict supervisory controls that deterred the embezzlement of state revenues and enterprise profits, the misappropriation of state assets, the mis-rationing of collective goods and retail supplies, and other forms of non-governmental labor exploitation. But these successes were achieved at a high price. People couldn't get what they wanted because state supply planning, including the determination of product characteristics, production, prices, wages, and distribution were carried out independently without regard for consumer demand.

The Gorbachev and Yeltsin revolutions were supposed to purge these microeconomic inefficiencies, without compromising economic justice, macroeconomic stability, and growth by installing a "social" (social democratic) form of laissez-faire advocated by the International Monetary Fund and the World Bank, which assured fair and just exchange[Yavlinsky, 1991].[1] But "free enterprise" was interpreted by the Communist nomenklatura, the security services, state appointed managers and the Mafia just as Lenin had foreseen, as the decriminalization of economic injustice, and the use of coercive and predatory power to secure the advantages of non-equivalent exchange characteristic of the pre-Soviet order, not as general competition under the rule of law. Russian liberals understood the distinction, but did not take effective countermeasures because many were corrupt or ineffectual, or they seemed to believe that under extraordinary circumstances, might was right.

The evolution of Russia's post-communist "transition" is best understood from this perspective. Segments of the old communist elite (including organized criminals)

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saw the collapse of Soviet power as an epochal opportunity to enrich themselves, living lavishly above the law. They sought to strip assets, illegally privatize state property, wrest enterprise control from other shareholders (especially workers), embezzle enterprise revenues, swindle the population through voucher privatization, Ponzi schemes, bank and insurance fraud, bogus lotteries, and by freezing savings rates as inflation soared. They openly engaged in traditional criminal businesses like commercial extortion, gambling, racketeering, prostitution, narcotics and murder. They stole state resources by under-invoicing petroleum and natural gas sales abroad, and by obtaining monopolies for the importation of foreign consumer goods. They used state power to emit money and credit for their own personal gain, obtained privileged state contracts, laundered money in many ways including the overpayment of interest to elite banks on treasury loans. They put their hands deep into the State's coffers treating tax revenues as personal assets, and squirreled their gains abroad [Goldman, 1996; Hedlund, 1999; Sachs, 1997; Millar,1998; Blasi, Kroumova and Kruse, 1997; Silverman, 1997; Yavlinsky, 1998; Makarov and Kleiner, 1996; Rosefielde, 1998; Tikhomirov, 1997; Webster, 1997; Gaddy and Ickes, 1998].

This phenomenon, which can be described as kleptocratic pluralism (the rule of diverse thieves, including the President and his entourage, ministers, bureaucrats, security services, managers, financial institutions and the Mafia) is a free-form game with no fixed rules, where winning is less about maximizing optimally sequenced lifetime consumption than acquiring privilege and wielding power. It is the antithesis of the principles of natural law, and golden rule ethics (do unto others as you wish others to do unto you) that guide the invisible hand and undergird the efficiencies attributed to general competition [Rosefielde, 1996; Rosefielde, 1999]. Russia's klepto-elites desire wealth, but they don't want to work honestly for it. They prefer to seize it, or receive it as an entitlement. Instead of trying to create wealth, they focus on protecting their turf.

Thus it isn't surprising that Russian "liberalization" has belied the predictions of Jeffrey Sachs, Anders Aslund and Roy Laird [Aslund, 1995; Sachs, 1996].[2] Russia's elites oppose general competition and have engineered the wrong "privatization," the wrong "stabilization," and the wrong "decontrol." Until the August/September 1998 financial crisis in which the Kremlin defaulted on 40 billion dollars of post-Soviet, and 20 billion dollars of Soviet-era commercial debt owed to the London Club,[3] and froze domestic and foreign ruble denominated accounts in the nation's banks, abruptly aborting its elusive economic recovery [Hardt, 1997],[4] the G-7 countries pretended that once Russia embarked on its post-Soviet transition, path dependence would guide it to what Gorbachev declared was its "common European home." But as the economy continues to founder, the catastrophic consequences of the decriminalization of economic injustice have become increasing evident.[5]

The issue no longer is whether Russia is mired in klepto-laissez-faire where the state retains substantial ownership and control rights over key assets, but declines to exercise them vigorously or adopt the rule of law, allowing officials, owner-agents and others to perpetually squabble over the distribution of the spoils, instead of creating new wealth. Rather it is how this degenerate version of Lange's "competitive" model founded on the radical separation of ownership and state agent control will evolve

[Lange and Taylor, 1938]. The free-form character of intra-elite power, wealth and consolidation seeking doesn't permit reliable prediction, but Russian history provides some clues. There are four alternatives, which can be described in order of their likelihood. First, borrowing Gertrude Schroeder's famous adage, Russia may find itself permanently trapped on a "treadmill of economic reform," where a succession of liberals, communists, conservatives, and nationalists promise the people anything, but only give them the illusion of change. Second, the impasse may be broken by an authoritarian leader, a Peter the Great who will emerge on a wave of nationalism (in response to NATO expansionism?) to restore authoritarian order (a command system emphasizing compulsion, with or without market assistance). Third, Russia may veer to a "rentier state," where the klepto-elites declare an armistice, divide up territories, and enlist the state to institutionalize their powers and privileges, providing restricted opportunities for everyone else. Fourth, Russia may achieve European social democratic capitalism, complete with corporatist competitive markets, European Union-style liberalization, and the rule of law.[6]

The last option is the most familiar and requires little comment. It entails the recriminalization of abuses of state power, as well as economic subjugation, compulsion and coercion. And it requires governance in the national interest, nearly comprehensive privatization of the means of production, and reliance on semi-competitive corporatist markets to provide socially just economic outcomes.[7] The authoritarian alternative likewise reinstitutes the sanctity of state property and power, but for other ends and with less commitment to markets, competition, negotiated wage and price setting, egalitarianism and social justice. It can take many forms including regimes of the type symbolized by Pinochet, Gorbachev, Stalin, and Hitler, but for the moment the odds seem to favor the more benign variants opposed to foreign military adventures and despotism (despite the Duma's decision in December 1998 to re-install Feliks Dzerzhinsky's infamous statue in front of KGB headquarters at 9 Bolshaya Liubyanka, and the new deployment of the Topol-M truck-launched single warhead ICBM [Beichman, 1998],[8] the accelerated development of short range tactical nuclear missiles, and anger over NATO's use of force in Serbia). Its efficiency characteristics would probably look something like those of Communist Hungary in the late eighties.

Finally, a rentier state can be conceived as a mild version of kleptocratic laissez-faire featuring the re-criminalization of the more blatant forms of misappropriation and usurpation, and the codification of entitlements and tolerated abuses. The market here as in the more free-form variants is primarily designed to serve the interests of the klepto-elites, but with an extended employment of contract and the rule of law as tools for adjudicating conflict and providing some encouragement to small businesses, farmers and entrepreneurs. Its performance is likely to approximate the stagnation that beset Russia during the forgotten years between the reigns of Ivan the Terrible and Peter the Great, and between Peter's rule and the ascension of Catherine the Great.

All four models deviate significantly from the requirements of free enterprise disciplined by the invisible hand and the rule of law. Economic efficiency under classical laissez-faire depends for the most part on the competence with which individuals strive to maximize their utility in the marketplace, given the criminalization of democratically disapproved forms of economic misconduct, whereas in the other regimes the legitimation of economic injustice depresses and warps performance.

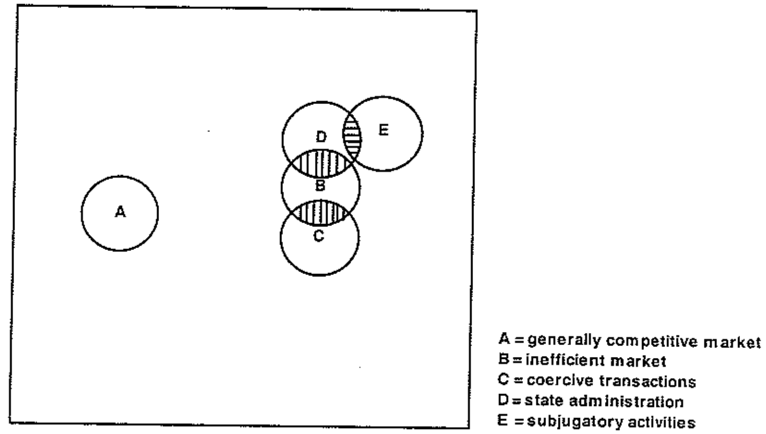
The inefficiencies exhibited by klepto-laissez-faire, authoritarianism, the rentier state and European-type social democratic capitalism have many shared attributes. They mis-allocate factors and credit, misuse factors, mis-produce, and mis-distribute goods, degrade production potential, and diminish Pareto-efficient social welfare. But klepto-laissez-faire and the rentier state on the one hand, and Soviet-type authoritarianism and European social democracy on the other are strongly distinguished by the effect economic misconduct has on aggregate economic activity. Ethically unconstrained power seeking, and the suppression of rivals make klepto-laissez-faire and the rentier state inherently resource- and effort-demobilizing, whereas the (re)criminalization of anti-productive and unjust activities in the authoritarian and social democratic models should spur employment and rapid economic growth.

The ascendence of klepto-laissez-faire from this perspective provides the basic explanation for Russia's dismal postcommunist economic performance. The problem isn't so much that Russia has more than its fair share of criminals, but that the state itself condones and abets inefficiency and production-repressing forms of business, instead of building the prerequisites for general competition. The G-7 countries had prepared itself for a bout of robber barony and was resigned to live with the injustice, but expected this thievery to be constructive, propelling recovery and modernization up the post of the "J" curve. This was a blunder. Russia's klepto-elites never had any intention of emulating Rockefeller, Harriman and Hill by maximizing Benthamite utility, wealth, lifetime consumption, or giving precedence to their civic responsibilities. Winning for them in a culture that esteems power above social welfare, where might is right, has nothing to do with Schumpeterian entrepreneurial pioneering. It means just the opposite: suppressing workably competitive markets, empowering coercion and legitimizing bureaucratic abuse and subjugation,[9] which have visible impacts on the efficiency structure of aggregate economic behavior.

Most economies can be divided into five components, or subsystems: (A) generally competitive markets for some generic products, (B) inefficient markets attributable to incomplete profit and utility maximizing, (C) coercive markets ruled by private market power, (D) state administrative bureaucracies, which ideally regulate and command in the public interest, and (E) subjugatory activities where private authorities compel others to act against their will (criminal compulsion). These subsystems defined for classes of economic exchange operations (voluntary, coerced, regulated and compulsory) between and among individuals are illustrated in Figure 1, the universal set of economic activities. The blank spaces separating the system subsets (the complement) refer to utility-enhancing activities excluded from conventional definitions of gross domestic product like hugs and kisses.

Only the first subsystem, conspicuous by its absence in post-Soviet Russia is consistent with the axiomatics of market efficiency. It is micro- and macroeconomically self-regulating. The behavioral characteristics of the other subsystems are less predictable. Profit and utility maximizing may be incomplete in varying degrees for a host of reasons that depend more on context than universal principle. The same is true for monopoly, oligopoly, oligopolistic competition and criminal extortion, which

FIGURE 1
Universal Systems Set



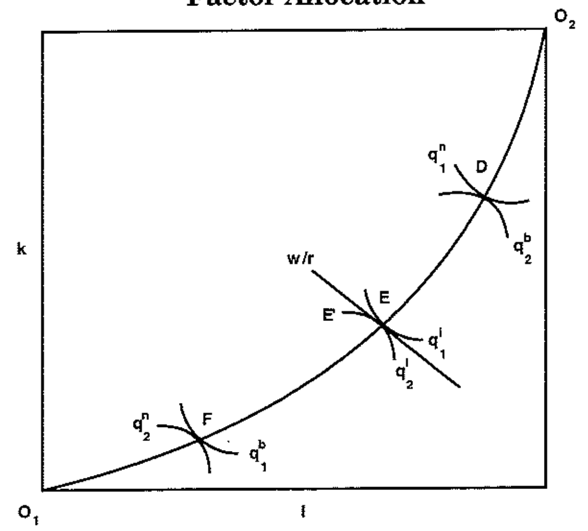
compel victims to accept disadvantageous terms of exchange up to the point where they voluntarily switch to close substitutes.[10] Subjugation ranging from criminal compulsion to slavery allows masters to impose their will on those they control no matter how onerous the terms of exchange.[11] And of course while it is possible to imagine an efficient bureaucracy, there are no automatic mechanisms disciplining the state to attentively respond to its clients needs, or to cost effectively provide services.[12]

Economists influenced by the theory of the second best, believing that all major economies today are governed by imperfectly efficient markets (B), are inclined to infer that the comparative performance potentials of diverse market systems are broadly alike, paying scant attention to the rest of the universal economic activities set. They assume that B, or the union A U B is the universal set, and discount the repressive influence coercive market power (C), state bureaucracy (D), and subjugatory activities (E) have on free markets. These attitudes cause them to disregard the obvious heterogeneity of predominantly market systems, and the role diversity plays together with technical failures and policy errors in explaining observed behavior.

Coercive market power not only distorts distribution, it diminishes factor effort, productivity and market size. State bureaucratic mis-regulation has similar effects, which may be exacerbated by prohibitive commands restricting entry and dampening competition. Tariffs, quotas, non-market barriers, state licenses and cronyist contracting are just a few of the ways that this is accomplished. And private subjugatory actions may be even more dysfunctional. Thugs harassing rival workers and managers, denial of credit by importer controlled banks to import substituting domestic industry and other such practices necessarily shrink production potential and diminish social welfare further through the proliferation of criminal disservices like prostitution and drug trafficking.

These effects can be visualized by varying the size of the subsystems sets. Russia is distinguished by its null perfectly competitive sector, its small imperfectly efficient market (B) dominated by coercive market power ($C \cap B$), crony-influenced bureau-

FIGURE 2
Factor Allocation



cratic regulation (D∩B) and an administrative state sector that controls components of the industrial capital stock [Earle and Estrin, 1997; Radygin, 1999; Perevalov, Gimadi and Dobrodei, 1999][13] together with nearly all land and resources (D), and a vast crime intensive subjugatory sector (E).[14] This degenerate configuration of the economic activity space, epitomized by the compressed and coerced state of the system's inefficient market and its bloated subjugatory subsystem, illustrates why Russia's economy is egregiously under-productive compared with Continental Europe [Rosefielde, 1994].

But the size of the subsystem sets and their configuration are only half of the story. The extreme under-productivity imposed by the structure of the economic activity set is exacerbated by Russia's anticompetitive rules of subsystemic interaction. When kleptocratic laissez-faire reigns, efficiency is sacrificed to a free-form game in which monopolists, the bureaucratic elite and criminal subjugators alternatively vie for hegemony and collude in exploiting the hapless, so that the weight of oppression is greater than the sum of its parts. When these same players consolidate their privileges and agree to abide by rules institutionalizing their gains, the system is afflicted with state-codified elite rent-seeking (the rentier state). And should authoritarianism be reinstalled, the dominant source of inter-subsystemic under-productivity will be state bureaucratic. Better outcomes are possible if C, D and E are eradicated, but this can only be accomplished through a political revolution embodying the values and institutions of the developed West.

These principles can be illustrated by examining how incomplete profit- and utility-maximizing, coercive market power, criminal subjugation and bureaucratic misadministration cause the Russian market to deviate from the classical efficiency ideal.

The properties of Russia's distorted market can be analyzed in each of its four primary components: factors, production, finance and distribution, and collectively as an interactive whole. Violations of Pareto-efficiency caused by the incompetent and

FIGURE 3
Product Transformation

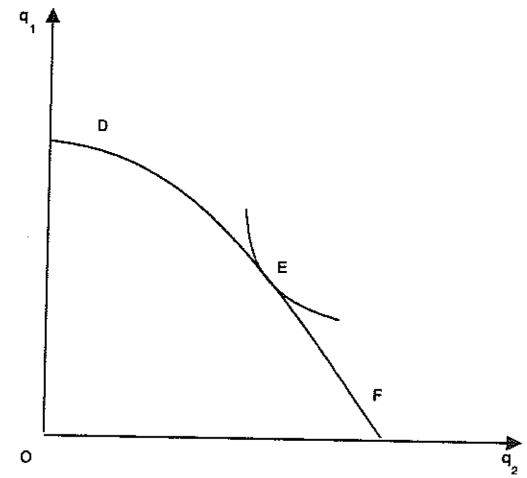
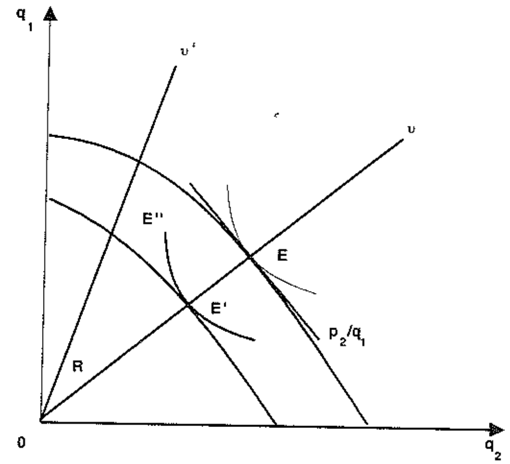


FIGURE 4
Economic and Technical Efficiency



anti-competitive behaviors associated with B, C, D, and E can be graphically illustrated with the aid of Edgeworth-Bowley production and consumption boxes, and diagrams depicting production possibilities and community indifference curves. As is widely understood, the functions considered here, and the associated equilibria can be realized in theory either through perfect competition, or perfect simulated planning. Supply-side relationships shown in the Edgeworth-Bowley production box, (Figure 2), and the production frontier spaces, (Figures 3 and 4) take two forms, deviations along the contract curve away from the generally competitive equilibrium (E), and points off this locus. The Edgeworth-Bowley production box shows the geometric relationships between primary factors of production (capital, k and labor, l) along the sides of the box; and the isoquants of firms producing two different goods(q_1 and q_2) radiating in increasing order from their respective origins. The locus of joint tangencies of these isoquants represents Pareto efficient allocations and employments of capital and labor, given the wage-rental ratio, and the output-price ratios that would hold if the product and input mixes were optimally responsive to different configurations of competitive demand. This nuance is important because it defines the sense in which every point along the production possibilities frontier is consistent with a "potential" rivalrous, non-coercive competitive efficiency equilibrium. If other input and output prices were utilized, different frontiers could be generated, but they wouldn't be generally competitive.

Deviations from the general competitive equilibrium point E on the contract curve thus have very specific meanings. They imply that market participants may be occasionally irrational and lax, demanding a sub-optimal product mix, but otherwise maximize profits and utility in all four core markets. This type of distortion is depicted in Figure 3 as a movement either to the left or right of the universal equilibrium point E along the production possibilities frontier, and is often described as "economic" inefficiency rather than a "technical" shortcoming because while demand isn't optimized, supply is "technically" efficient.

All other lapses of competitive discipline including coercive violations of antitrust law, subjugation and bureaucratic mis-administration degrade supply efficiency and consequently necessitate production beneath the production possibilities frontier in Figure 3. If these inefficiencies proportionally diminish product quality, or the factor productivity of both products, the assortment of goods and services will be the same as that of a generally competitive equilibrium (assuming demand is efficient), but the amounts produced and distributed will be reduced. The set of all such points is illustrated in Figure 4 as a ray (expansion path) lying between the origin and point E, and corresponds in the Edgeworth Bowley production box with a downward renumbering of the isoquants (and a contraction of the box). The larger the numerical reduction in isoquant values, the steeper the shortfall from the production possibilities frontier; of course, any violation of the double tangency requirement constitutes a further decrease in supply. Just as the points along the production possibility frontier other than E in Figure 3 are "technically" efficient with respect to supply, the points along the specified segment of the expansion path can be described as "economically" efficient with respect to the desired universal equilibrium assortment, although the term economic efficiency sometimes is reserved solely for point E.

All other inefficiencies that involve both demand and supply whether stemming from incomplete individual sense, search, evaluation and negotiation, or from the assertion of market power will push production off the contract curve in Figure 2, and off the expansion path segment between the origin and point E in Figure 4, implying that the economy is both technically and economically inefficient. This is conventionally illustrated in Figure 4 by point E" which lies on a "production feasibility frontier" analogous to the production possibilities frontier, but subject to additional inefficient technical constraints.

The degree of inefficiency for any particular case, given these concepts, can be gleaned by considering all supply-side lapses in competitive discipline. Starting with factors, any irrationality that distorts judgment, effort and input service-time, or external coercion may cause capital and labor (including management) to be mis-supplied and mis-allocated. Laziness and business pessimism may reduce voluntary input supply and inflict involuntary factor unemployment. Or in euphoric periods, people may voluntarily overexert themselves, or be pressured into working overtime. In either case, the size of the Edgeworth-Bowley production box may shrink or expand, and isoquants may be reordered (due to under- or over-exertion).[15] Aggregate economic activity in the production space will be sub-optimal regardless of whether factors are being under- or over-utilized. Any input misallocation, for example due to excessive union pay scales, will further degrade productivity and welfare, and mis-education and mis-training distort growth.

The degree of state-approved coercive distortion in the Russian collectivist klepto-lassez-faire (and in a future rentier state) factor space is remarkable. The supply of both capital and labor are depressed and mis-allocated by the inadequacies of private property rights, subjugation and related government restrictions. As previously noted, all natural resources, most land, and forty percent of the industrial capital stock remain state-owned. This means that the insiders who control these assets have no pecuniary incentive to maximize profits from current operations, or the present discounted value of the capital stock. In the absence of a market for the exchange of securely titled goods and assets, they are inclined instead toward asset-stripping, rent-seeking and anti-competitive subjugation. During the Soviet period corresponding inefficiencies were partly mitigated by state ownership, mandated managerial bonuses and centralized procurement of capital durables, but insiders now are left to their own devices. Moreover, the problem is compounded by the peculiar character of Russian private industrial property, which is mostly majority-labor-owned, but manager controlled. This not only creates severe conflicts of interest, but impairs labor mobility. The persistence of collectivized control and/or ownership in the agricultural sector has the same disordering impacts. As a consequence of all these constraints, mis-incentives, and anti-competitive distortions the size of the Edgeworth-Bowley production box has drastically contracted. Approximately seventy percent of the industrial capital capacity is idle (judged by production during the Soviet era) and labor unemployment (including underemployment) is in the high double digits.

The isoquant levels within the production space have also been reduced because capital and labor are mis-incentived and inadequately rewarded. And of course, factor prices are in acute disequilibrium due partly to entry barriers and partly to economic disorder. It has been variously estimated by Valerii Makarov and George Kleiner [1996, 1999] that more than 70 percent of all intermediate inputs are bartered helter skelter at diverse terms of trade in the industrial wholesale market.[16] Thus instead of operating at E' on the normal imperfectly competitive production feasibility frontier illustrated in Figure 4, production actually occurs on a drastically lower feasibility frontier at point R.

Moving upstream to the product market, attention shifts to product characteristics, technology and competitive profit maximizing. A nation cannot realize its full competitive potential unless it produces goods with the right characteristics. The qualitative aspects of q_1 and q_2 must be ideal from the standpoint of equilibrium demand. Misjudgment, irrationality and market power could all cause severe supply inefficiencies. In the extreme, outputs may turn out to be "bads" instead of "goods," and so unsaleable. Such losses can be illustrated by converting inferior goods into smaller quantities of superior outputs at the equilibrium marginal rate of transformation and renumbering isoquants accordingly. The same kind of adjustment is required when the technologies embodied in isoquants do not reflect the optimal rate of introduction of best practice techniques.

Likewise, when managers fail to optimally organize and incentivize their enterprises and entrepreneurs do not capture rents and pioneer new ventures as fully as they should, realized output is below potential, necessitating a lowering of the isoquant values in the Edgeworth-Bowley production box and an inward shift off the production possibilities frontier.

Production inefficiencies in one or both activities may also occur if firms incompletely profit maximize by failing to acquire inputs at the least competitive cost or hire them to the point where marginal cost equals price. And of course, proprietors who illegally exert market power by restricting output, or engage in other anti-competitive practices that enlarge market niches and artificially create economic rents drive production off the Edgeworth-Bowley contract curve to points on production feasibility frontiers that are inefficient from the perspective of both supply and demand.[17]

Yeltsin's klepto-laissez-faire is gravely afflicted with all these ills. Most products were designed in the Soviet period when consumer preferences were flagrantly disregarded and are virtually unsaleable in the global marketplace. The relaxation of state standards and lax enforcement has resulted in widespread product adulteration, while the introduction of improved products is negligible, with the exception of new service sector construction and housing for the elite based on foreign designs and built largely under the supervision of western contractors. These failures are partly attributable to state ownership and the contradictions of Russian industrial and agrarian collectivist property rights. Insiders in state-owned enterprises often don't care what they produce, while managers, workers and collective farmers are preoccupied with other concerns. Inattentiveness to product characteristics is also explained by elite preference for foreign goods and the lack of capital to finance redesign and innovation.

These same forces degrade productivity and output supply. Most firms and farms in Russia incompletely profit maximize [Kleiner, 1998]. State enterprise managers, directors of worker-owned firms, and collective farmers have little reason to minimize cost or produce to the point where marginal cost equals marginal revenue (or price when they are price-takers). Derived demand for inputs consequently is deficient and misdirected and enterprise organization is inefficient.[18]

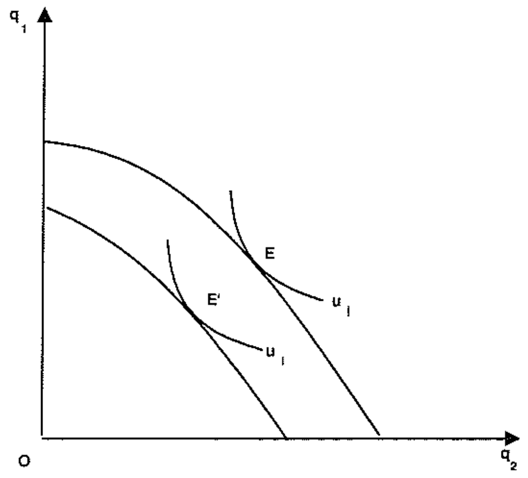
Some firms, however, have prospered. But unfortunately most of these cases are exceptions that prove the rule. The surest path to riches in Yeltsin's Russia comes from asset-grabbing (unjust acquistion of state property by misappropriation, looting and underpayment); asset-stripping (state-sanctioned divestiture, scrapping and sale of otherwise useful collectively owned assets for personal gain), and rent-seeking (securing non-competitive government contracts and market restricting regulations to obtain unearned income and excess profits). The beneficiaries of these practices including various large banks (some owned by the Mafia), the conglomerates assembled by Russia's tycoons, and natural resource processors beholden to state officials (kleptocrats) owe their good fortune entirely to collusion and coercion in restraint of trade and governmental abuse. They are contemptuous of textbook profit maximization and cause enormous material harm by squandering resources and repressing competition. For example, the same kleptocrats who control resource exports, dominate the importation of foreign consumers goods and retailing, making it difficult for domestic producers in the traditional sector to market their products effectively. Their operations are treated as positive contributions to Russia's gross domestic production in accordance with the rules of national income accounting and are sometimes rationalized as essential stepping stones toward the construction of generally competitive capitalism, but their net effect is wholly deleterious.

All these sources of productive inefficiency might warrant only passing concern if entrepreneurship were ebullient. Schumpeterian theorists often suggest that every inefficiency provides profit opportunities for wealth-creating entrepreneurs. Russia consequently should be a gold mine for industrial venture capitalists. But it has proven instead to be a wasteland because the state, tycoons, and Mafia always seem to find ways of appropriating entrepreneurial profits and assets. As a consequence, Russia's productive efficiency is wretchedly low, judged from either the competitive ideal, or western coercive standards. Its only real substantial source of non-illusory income comes from the sale of natural resources.

Laxness and malfeasance in financial markets by lenders, investors, speculators and governmental regulatory agencies may significantly compound factor and managerial inefficiencies. If governments mis-regulate credit, interest and foreign exchange rates, bankers exercise unusually poor judgment in evaluating credit risks, and investors and speculators under- or over-borrow, the economy may become macroeconomically depressed, or overheated. Contractions and excessive expansions of the Edgeworth-Bowley production box may be exacerbated, isoquant levels may be diminished or augmented in ways that reduce utility, and factor misallocation and product mis-assortment intensified. These distortions may be persistent or generate the familiar boom-bust pattern characterized by intermittent periods of over and under full employment, under and overinvestment, inflation and deflation, prosperity and depression. Supply in all these various ways may be gravely inefficient, even in the absence of government-sanctioned economic coercion.

The collapse of Russia's financial system in August/September 1998 speaks for itself. The state, and kleptocratically supported private banks, have been involved in one financial fraud or another from the outset.[19] During the first two years after Yeltsin came to power on 21 December 1991, the government resorted to un-collateralized currency printing to pay its bills, wiping out the personal savings of ordinary people and diverting vast sums to the elites [Brainerd, 1998]. This was then followed by a new scam in which banking became primarily a business of lending overnight deposits to the government at above competitive rates instead of making productive loans to commerce and industry. The government covered these disguised transfers by floating dollar denominated paper in the West at ludicrous rates in the vicinity of 100 percent per annum that could not be sustained, leading directly to default and the subsequent collapse of the entire financial system. Although some of these tactics have been applauded for curbing inflation, Russia's financial sector obviously is a

FIGURE 5
Aggregate Consumer Demand



fiasco. The government and its cronies not only mismanaged the supply of credit, and the allocation of loanable funds, starving traditional industrial enterprises for operating capital, but dysfunctionally manipulated interest and foreign exchange rates compounding the nation's under-productivity and inefficiency.

Any supply-side inefficiency, large or small, must degrade social welfare because the community will have fewer goods and services than it could have enjoyed, often with the wrong characteristics in dis-preferred assortments. Matters will be worse if product demand is partly ineffective and the distribution of outputs is inefficient and inequitable. In the competitive paradigm lapses can be ascribed to two causes: irrationality and laxness on the one hand and government abuse of authority and private coercion/subjugation on the other. Their consequences can be highlighted with the aid of community indifference curves overlaid on the production frontier space in Figure 5, the Edgeworth-Bowley consumption box illustrated in Figure 6, and the social utility frontiers in Figure 7.

Recalling that the universal competitive optimum is depicted by the joint tangency of the community indifference curve and the production possibilities frontier at point E in Figure 5, aggregate demand inefficiency can be described as any composite consumption occurring on a community indifference curve lying beneath point E at point E'.[20] If suppliers want to be responsive to consumers' preferences, but buyers are reticent or fail to effectively communicate, competitive potential may be unrealized due to Keynes' inadequate aggregate effective demand. The micro distribution of the observed gross domestic product may be similarly impaired. If some market participants are unusually lax in sensing, searching, evaluating and negotiating market consumption opportunities, purchasing power and terms of trade will be inefficiently turned against them. Consumption won't occur at point E on the contract curve where purchasing power is misallocated, and will lie off the curve if Paretian negotiations

FIGURE 6
Income and Retail Distribution

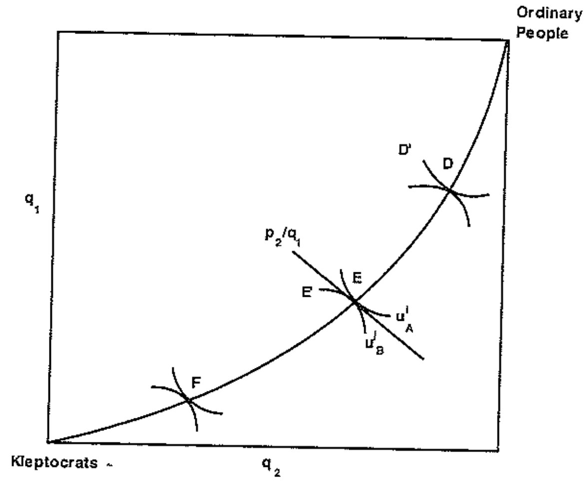
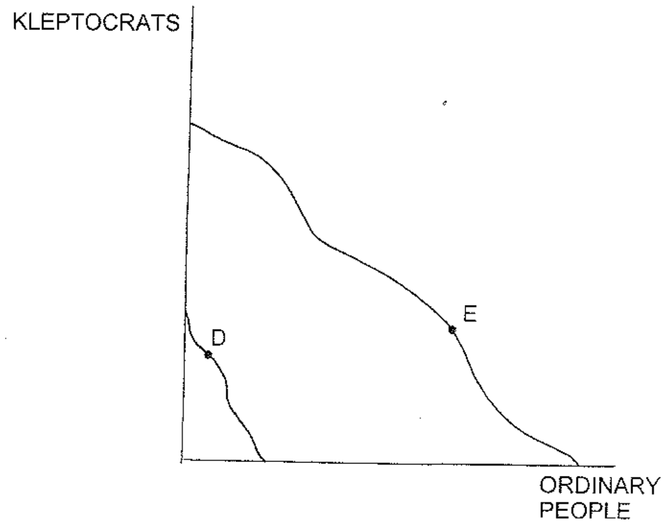


FIGURE 7
Optimal Utility Possibilities



are incomplete. Also, by analogy with the isoquants in the Edgeworth-Bowley production box, indifference curve levels may be renumbered downward if consumers' appreciative faculties are dulled by systemic traumas. A delicious meal may be tasteless to a distracted gourmet. And of course, the phenomenon of waste interpreted as a shrunken Edgeworth-Bowley consumption box should not be ignored. When goods spoil, or people spend their money on things they later find they didn't want, actual well-being will be less than potential.

These demand-side failures arising from irrationality and laxness are compounded by supply-side lapses in distributional efficiency and abuses of public and private coercive power. Retailing inefficiencies prevent goods from reaching consumers in the optimal assortments, and excess profits, rents and other unearned incomes (seizures) resulting from anti-competitive practices and subjugation skew the distribution of income in favor of offenders, diminishing the well-being of victims, and spawning inequity and injustice. This phenomenon is illustrated in Figure 6 by forced movements away from point E toward D' (where the kleptocratic elite receives an unjustly large share of GDP) along the contract curve. If the movement is to D off the contract curve, it further diminishes social welfare by sub-optimally distributing goods and services with insufficient regard for productivity, need or merit.

Russia's record in all these regards is lamentable. The collapse of the Soviet Union disordered retail distribution and unleashed a spate of asset-grabbing, asset-stripping, rent-seeking and financial malfeasance, which concentrated control of wealth and income in relatively few hands, while impoverishing large segments of the population. These transfers never would have been tolerated in a classical régime, or in the coercive economies of the mature West, and stand as a monument to the colossal failure of Yeltsin's criminally empowering free enterprise, even though some interpret gross inequity as a sign of Russia's success in its struggle to transition from communism to market capitalism. The disorganization of the retail market exemplified by the widespread persistence of barter, the Mafia's control over small vendors, and restraints in the provision of retail services through private and governmental collusion all testify to the exorbitant inefficiency of Russia's consumer sector. Despite a patina of ostentatious display by the nouveau riche, the standard of living for most of the population is poor not just because supplies are inadequate, but because the retail sector is disorganized and unjust. Figure 7 which arrays kleptocrats on the ordinate and ordinary people on the abscissa illustrates this outcome by comparing the achieved Russian social utility frontier (which takes account of all aspects of national compulsion and coercion) with the competitive ideal. It suggests that the average quality of Russian life is much lower than its potential, with the klepto-elite faring exceptionally well compared with the plight of ordinary people [Brainerd, 1998].

It follows directly from the foregoing survey that Russia's collectivist klepto-laissez-faire market system is extraordinarily inefficient, compounding the harm inflicted by non-market coercion, subjugation and bureaucratic abuse in the complements of sets C, D, and E. Is this merely a consequence of the underdevelopment of the Russian market, or are more fundamental forces at work? Persistent depression suggests that Russian inefficiency cannot be adequately explained in terms of the historical underdevelopment of its market institutions. Classical and Schumpeterian theory both teach that economic performance should consistently improve as marketization expands. But this has not been the case. Yeltsin's collectivist klepto-laissez-faire obviously is anti-productive and growth-inhibiting with no signs of improvement.

This doesn't mean that Russia lacks markets, only that its markets are severely compressed and distorted by coercion, subjugation and bureaucratic mis-administration, without the partially offsetting benefits of Soviet command planning. Negotiated exchange is warped by the decriminalized exercise of unjust market power. It is constrained by residual wage and price controls and is often superceded by private and governmental compulsion. Russia's mixed collectivist economy is designed to serve the anti-productive interests of kleptocrats, cronies, tycoons and the Mafia, providing the foundations for a future rentier state where the demand of pre-capitalist cliques will be sovereign.

It is premature to judge whether this anachronistic system, which is light years removed from the transitional concept of self-cleansing and self-developing markets, will endure or is merely a way station on the road to a more productive and socially responsible régime. At the moment the outcome is anybody's guess. Russia, lacking a tradition of civil liberties and property rights, may remain a grotesque caricature of the Czarist servitor system as Lenin feared. It could metamorphose into a butterfly of advanced capitalism as market liberalizationists aver, or veer toward some variant of fascist-communist authoritarianism.

NOTES

1. The "general, perfectly competitive short-run standard" will be applied throughout this paper, and will serve as a conceptual ideal. The convention has many virtues because of its close links to neoclassical theory, but is also subject to some contentious disputes both about its nature and feasibility. To avoid misunderstanding, the following conventions are adopted with respect to the ideal. First, individuals utility maximize in determining their labor-leisure trade-off, their investments and consumption, while firms profit maximize. Second, firms are atomistic, possess continuously differentiable production functions exhibiting diminishing returns, operate competitively with full information, unimpeded by barriers to entry. Third, in accordance with Irving Fisher's theory of interest, managers understand how to trade optimally with the future, maximizing profits in every time period, choosing technologies that maximize present value, pioneering new businesses and innovating whenever Schumpeterian opportunities arise. Fourth, if conflicts emerge between maximizing production potential and equity because economies of scale preclude atomistic competition, income and wealth maximizing take precedence. Fifth, if economies of scale, patent and related infant industry dynamic efficiencies affecting the optimal rate of innovation require some modest limitations on prefect information, and barrier-free entry, then again priority is given to maximizing the wealth of nations. Sixth, problems of inconsistent expectations, and automatic equilibriation associated with the introduction of money and credit, wage and price rigidities and other Keynesian complications are set aside by assuming perfect macroeconomic policymaking. Seventh, following Adam Smith's admonitions about collective charity in his Theory of Moral Sentiment, ideal laissez-faire is taken to presuppose a Lockean social contract which criminalizes "unfair" economic practices like theft, and coercive market power (monopoly), and is compatible with "compassionate," social democratic regulation and transfer (given the preferences of Lockean social contractors). The state is charged with the enforcement of criminal law, including violations of contract, just micro- and macroeconomic regulation, governance and collective charity [Griswold, 1999; Meade, 1978; Rawls, 1971].

   The author does not believe that this ideal faithfully reflects contemporary market realities because efficiency assumptions are routinely violated, states misgovern and mis-regulate, and democratic choice (in practice) misrepresents the fully informed preferences of Lockean social contractors in determining charitable state regulation, governance and transfer [Arrow, 1963]. However, it is assumed as a working hypothesis that there is a strong positive correlation between the wealth of nations, and economic welfare (not necessarily the same things), and the degree to which national economic systems approximate competitive ideals because of the self-disciplining effects of individual utility and corporate profit maximizing are strongly correlated. Russia's performance will be evaluated accordingly and will be found wanting. The competitive ideal thus not only can serve here as an objective criterion in its own right, but as a proxy for a large set of social welfare constructs [Bergson, 1976; Samuelson, 1981].
2. For a critique of the transitionist theories of these scholars see Stiglitz [1999; 1994].
3. Russia's debt can be divided conceptually into four categories: pre- and post-Soviet, and commercial and sovereign. The August 17, 1998 default primarily involved 280 billion rubles of privately owned, post-Soviet Russian treasury bonds valued at the time at 40 billion dollars. Foreigners held one third

of these securities. The government's default also precipitated a chain of defaults on forward contracts, derivatives denominated both in rubles and dollars, and on bank deposits. Officially, businesses will receive 20 kopeks and individual bank depositors 50 kopeks per ruble on their frozen bank assets. Treasury bond and derivatives holders are likely to receive about 5 cents on a dollar, and those with bank deposits may ultimately fare little better. The government additionally is in arrears (and technically in default) on another 20 billion dollars of Soviet era debt, and is offering 13 cents on a dollar as settlement in lieu of interest on a 362 million dollar past due payment. For technical and political reasons, the Kremlin insists that this isn't actually a Russian default because the debt was issued by Vneshekonombank, not the government (which owns and controls the bank). Russia's total foreign debt is approximately 180 billion dollars (excluding the 40 billion dollars of treasury bonds defaulted in August, plus defaulted forward contracts, derivatives and related bank debt), of which $158 billion is the direct obligation of the state as distinct from Russian banks. 91 billion dollars are Soviet-era obligations. About $31.5 billion are estimated to be owed to financial institutions, of which 20 billion is in technical default. Additionally, Russia has 60 billion dollars of derivative obligations, excluding the 6 billion dollars of forward contracts defaulted in August [Ivanov, 1998].

4. "It is tempting to attribute Russia's shattered stabilization to external factors, namely the fall of oil prices and changed attitudes toward emerging markets. But fundamental distortions thwart the Russian economy. The financial crisis in southeast Asia and the drop in energy prices only hastened the failure of stabilization" [Gavrilenkov, 1999].
5. Strobe Talbott, President Clinton's national security advisor appears to be the last authority clinging to the belief that Russia's transition is on track [Talbott, 1998].
6. See also Rosefielde [2000, 1999]. Some see a ray of hope in the reduced stature of Russia's klepto-tycoons(oligarchs) in the aftermath of the August-September financial debacle. Vladimir Potanin's prize asset AO Sidanko oil corporation, part of his Interferros financial and industrial conglomerate, for example, is now being restructured in bankruptcy. But it is premature to write off Russia's kleptocrats. According to a senior Sidanko executive, Potanin's group itself orchestrated the bankruptcy proceedings to "make sure the oil company does not fall to pieces." The move jeopardizes the position of Potanin's partners like BP Amoco PLC with a 10 percent stake in Sidanko acquired in 1997 for $571 million, providing Potanin with an opportunity to leave partners and creditors with the debt baby, while cherry picking for himself [Higgins, 1999; Aslund, 1999].
7. The corporatist market isn't the perfectly competitive textbook mechanism, nor is the state merely the handmaiden of free enterprise. The state, business and labor operate in partnership to suppress grosser forms of economic criminality, and to soften self-seeking inefficiencies by providing various kinds of social protection, including a "safety net" for the disadvantaged.
8. The Ministry of Defense expects to acquire about 30 of these missiles annually [*The Wall Street Journal,* 1998].
9. This attitude reflects a distain for weakness, passivity, submissiveness, risk-aversion, armchair philosophizing, moderation, compassion, sentiment, the rule of law, productive labor, and assiduous wealth building embedded in Russia's despotic Czarist culture, and the romantic conceits of some former Russian aristocrats. The same immoralist ideas are echoed in Nietzsche's concept of the superman, and his condemnation of "effeminate" Judeo-Christian values, and enlightenment social contracts. The link between Russia's cultural flaws and its economic backwardness has been widely observed. For example, Alexander Gerschenkron more than three decades ago in words that resonate strongly in Yeltsin's Russia wrote: "What effectively prevented banks from engaging in industrial investment in Russia of the nineteenth century was *inter alia* the impossibility of building up an effective system of long-term bank credit in a country where the standards of commercial honesty had been so low and where economic, and particularly mercantile, activities and deceit were regarded as inseparably connected. 'He who does not cheat does not sell,' taught the economic wisdom of the folklore" [Gerschenkron, 1996, 47]. See also Hedlund [1999].
10. Market transactions are defined as voluntary exchanges. Any transaction in which one party must "take it" and cannot "leave it," that is where preferred substitution is forcibly prevented, is involuntary, and hence cannot be considered the outcome of a market process. It is compellent, or directive.
11. The term subjugation is interpreted broadly to cover a wide range of compellent actions including edicts, directives, orders, commands, binding obligations in the factor, production, financial, and distribution sectors.

12. Private and bureaucratic coercion (regulation) and subjugation (directives) are conceptually identical, differing only with respect to the degree to which state authority is assumed to be socially legitimate.
13. The average state share of industrial firms is approximately 10 percent, but the figure is much higher in larger firms. Also a significant number of strategic firms remain fully state-owned.
14. These phenomena are described variously in the literature [Aslund, 1996a, 1996b].
15. One of the principal functions of management is preventing avoidable under-exertion.
16. Personal conversation with Valerii Makarov January 4, 1999.
17. In the real world, markets are often segmented in the sense that the same product will be sold at different prices in various locales. Discount stores routinely underprice their full-service competitors. Isofar as such differentials are justified by the cost of delivering different levels of shopping experience, they are compatible with competitive principle, but often the price differential is disproportionate because of "velvet" coercion in the form of deceptive advertising and other mal-practices.
18. Eyewitness reports from Lockheed's satellite rocket joint venture in Moscow confirm that the facility was grossly overstaffed, and under-motivated.
19. During 1997 the state-owned Russian Central Bank(CBR) earned about 3 billion dollars from trade in high yield government securities, but only 250 million dollars was transferred to the budget. The rest was "misappropriated" [Ivanov, 1998; Cullison, 1999]. The Central Bank is now under investigation [Cullison, 1999].
20. This also could be due to supply inefficiencies that render the quantity, quality and assortment of goods and services available for consumption sub-optimal.

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