Sino-Capitalism: China's Reemergence and the International Political Economy

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SINO-CAPITALISM
China’s Reemergence and the International Political Economy

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INTRODUCTION

There is little doubt that China’s international reemergence represents one of the most significant geopolitical and geoeconomic events in modern history. As China’s political economy gains in importance, its interactions with other major political economies will shape global values, institutions, and policies, thereby restructuring the international political economy. “Where China goes?” is thus highly likely to define the early twenty-first century.

Scholarly analyses of this question have predominantly relied on explanations tied to systemic properties at the international level, as in international relations and power transition theory. In this literature the future influence of China on the international system is heavily debated, and there is a considerable range of nuance and viewpoints.¹ John J. Mearsheimer and G. John Ikenberry offer two of the most salient representations of the opposing positions in this debate.² Proposing a theory of “offensive realism,” Mearsheimer argues that regardless of China’s domestic political situation and engagement with the global capitalist order, the country will seek regional hegemony in East Asia as it becomes more powerful. He notes that “China and the United States are destined to be adversaries as China’s power grows”³ and, even

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¹ For an in-depth exploration of power transition theory as it applies to China, see, inter alia, Levy 2008.
² For another rendering of this debate, see Brzezinski and Mearsheimer 2005.
more bluntly, that “China cannot rise peacefully.”⁴ China’s international reemergence thus represents a clear and present “threat” to continued US dominance and to the liberal order in general.⁵

Ikenberry, by contrast, sees China as being constrained by the Western-centered liberal order in which it is becoming increasingly embedded: “The rise of China does not have to trigger a wrenching hegemonic transition.”⁶ Rather, “[t]he capitalist democratic world is a powerful constituency for the preservation—and, indeed, extension—of the existing international order.”⁷ While the United States cannot forestall China’s international reemergence, it can strengthen the liberal international order and thereby tie China to the rules and institutions it has created and continues to lead.

Paralleling this debate, a second debate has emerged, one that uses a political economy framework. Although not as well crystallized and academically nuanced as the debate in international relations, this political economy debate stakes out two similarly opposing viewpoints: either China could emerge as a distinct threat to the liberal global economic order or it could become enmeshed in it as a “responsible stakeholder.”⁸

Seeing China as an increasing threat to the free-market globalized system, Ian Bremmer argues that China is generating a form of state capitalism in which the state controls the commanding heights of the economy in the form of state-owned, state-sponsored, or private yet state-loyal corporations and wealth funds.⁹ Bremmer holds that this state capitalism is fundamentally incompatible with the liberal international political economy centered on the United States, and he fears that increasing state intervention in the developing world signals a strategic rejection of free-market doctrine.

Like Bremmer, Pat Choate posits that while the great economic conflict of the twentieth century pitted capitalism against Marxism, the battle of the twenty-first century will be characterized by state versus market capitalism.¹⁰ In contrast to these views, Edward Steinfeld holds that China is not a future threat to the Western-led economic system but rather is a key component of it.¹¹ China has aggressively

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⁴ Mearsheimer 2010, 2.
⁵ Deng 2006 provides an overview of various dimensions of the “China Threat” theory.
⁶ Ikenberry 2008a, 24.
⁷ Ikenberry 2008a, 36; also Ikenberry 2008b.
⁸ Zoellick 2005.
⁹ Bremmer 2010.
¹⁰ Choate 2009.
¹¹ Steinfeld 2010.
embraced networked production, thereby following the contemporary industrial revolution, which favors multifirm, multinational global production networks. To be successful China has had to radically restructure its domestic economy to bring it in accord with more marketlike control systems.

Zachary Karabell similarly argues that “China and the United States have become one intertwined, integrated hypereconomy: Chimerica.” In his view, any attempt by the United States to prevent China from assuming a key position in the international political economy might actually undermine its own global position. Active efforts to destroy the ongoing fusion of the economies of America and China, that is, would be mutually destructive.

While this political economy debate still lacks specific analytical rigor, it does have certain strengths. The debate on the consequences of China’s rise in power transition theory and more broadly international relations focuses on economic factors only insofar as these influence power capabilities. As such, these debates have occurred mainly in the realm of politicosecurity affairs, especially within the realist theoretical framework, which for the most part ignores nonsecurity issues. By contrast, the political economy debate attempts to integrate the political and economic aspects of China’s reemergence. It also projects the domestic political economic arrangements of China’s emergent capitalism onto how the country might act within the international political economy. Or, to put it differently, by adopting a political economy approach, scholars can harness the nature and logic of China’s domestic transformation to gain a better understanding of China’s possible international influence and behavior.

Naturally, approaches using purely domestic causes to explain international effects—“second image”—tend to be insufficient for explaining a country’s policy preferences. Nonetheless, attempts at analytically integrating two levels—China’s institutional arrangements and interest alignments in the domestic political economy with China’s emergent global role—can open up new perspectives. While China might have been a minor player in the international political economy up until ten years ago, the characteristics of its domestic political economy now

12 Karabell 2009, 3.
13 Karabell 2009, 9–11.
14 Gilley 2011.
15 Waltz 1959.
16 The approach taken here thus draws inspiration from the “the logic of two-level games” to analytically incorporate the “black box” of China’s domestic political economy into analyses of its emerging international role. See Putnam 1988.
matter more than ever. After all, it is the emergence of capitalist development within China that has unleashed the productive forces driving China’s growing influence in international trade, finance, diplomacy, and military affairs. Understanding developments in China’s internal political economy should thus form an integral part of studying China’s international ascent.

The objective of this article is to create a nuanced, yet comprehensive perspective of the implications of China’s rise for the global political economy by adopting insights from the study of comparative political economy, especially on comparative capitalisms. To achieve this analytically, I examine the basic elements of China’s domestic political economy by proposing the concept of Sino-capitalism.

What, then, is Sino-capitalism?

It is a capitalist system that is already global in reach but one that differs from Anglo-American capitalism in important respects. Sino-capitalism relies on informal business networks rather than on legal codes and transparent rules. It also assigns the Chinese state a leading role in fostering and guiding capitalist accumulation. China, ultimately, is a large developing economy with a distinct socialist and imperial legacy.

Central to Sino-capitalism’s institutional structure is a unique duality that combines top-down state-led development with bottom-up entrepreneurial private capital accumulation. For the most part private capital accumulation in China has exhibited highly networked formal and informal institutional characteristics that have enabled entrepreneurs to overcome initial hostility from the state and forge cooperative relations at the local level, where the two processes of state-led development from above and network-based development from below tend to meet. As a consequence of this dynamic, state-capital relations have been localized and have engendered considerable variation within China. The highly networked character of private capital accumulation in China has also integrated Chinese firms into local, national, and often globally linked production and knowledge networks. Additionally, therefore, considerable influences emanating from the global capitalist system have shaped Sino-capitalism from the outside in.

What emerges is a unique form of capitalism that is characterized not so much by internal institutional arrangements that reinforce each

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17 Anglo-American capitalism constitutes a generic form of capitalism based on liberal market economies with minimal state involvement in the allocation of goods and services. See Hall and Soskice 2001; for a historically applied elaboration of this form of capitalism, see Frieden 2006.

other as by institutional forces that are often juxtaposed in compensatory, even seemingly contradictory fashion. Most notably, the ascent of Sino-capitalism represents the first time since 1850 that the global capitalist system is experiencing the rapid rise of a continent-sized capitalist power that espouses values, international viewpoints, and domestic institutional arrangements and power relations that are fundamentally different from those characterizing the dominant Anglo-American system of capitalism. To reiterate, although continental European and Japanese models of capitalism have historically challenged the Anglo-American model, this is the first time the world has encountered a capitalist power with the potential to rival Anglo-American global preponderance.

I begin by integrating the study of Sino-capitalism with analytical frameworks in the study of comparative capitalism. I then look in some detail at the domestic elements and dynamics of Sino-capitalism. The origins of Sino-capitalism outside of Mainland China are briefly elaborated, followed by a focus on China’s emergent political economy, including network capitalism, state-led development, and influences emanating from the global capitalist system. Using the domestic political economy of Sino-capitalism as a conceptual starting point, I move from the domestic level to the global level, analyzing the possible implications for the global capitalist system as Sino-capitalism gains in international prominence. The example of China’s internationalization of the yuan is used to systematically illustrate the multifarious manner in which the domestic logic of Sino-capitalism is expressed at the international level. The article ends by suggesting the implications for the further study of Sino-capitalism’s international influences and preferences as China continues its economic ascent in the twenty-first century.

Comparative Capitalism and Sino-Capitalism

Contemporary capitalism appears anything but cast in stone. From the domestic to the global level, almost every element of political economic organization and governance faces constant uncertainty and volatility. Since the dominant approaches to comparative institutional analysis—from rationalist and economic institutional to sociological and historical approaches—assume the stability of institutional arrange-

19 For the history of global capitalism, see Frieden 2006.
20 For a conceptualization of a clash between European and American capitalisms, see Albert 1993.
ments, these confront difficulty in capturing the dynamic institutional transformations and feedback loops shaping contemporary capitalism. Nonetheless, pertinent insights for the study of China’s emergent political economy can be drawn from frameworks in the comparative capitalism literature, including the varieties of capitalism (VoC) approach.\(^21\) The origins of this literature date to pioneers such as Andrew Shonfield\(^22\) and Alexander Gerschenkron,\(^23\) whose works lay out how capitalist systems can differ in fundamental institutional terms. Despite the convergent force of developments on the global level, therefore, marked differences have emerged among national capitalist institutions.\(^24\) This has become even more apparent with the demise of communism and central planning. As capitalism’s ideological competitor faltered, a hitherto largely neglected problem came to the fore: the differences between capitalist political economies themselves.

The key contribution of the comparative capitalism literature is that it focuses squarely on how modern capitalism represents a heterogeneous force.\(^25\) Capitalism is in this sense not a monolithic, impermeable bloc that is ideologically coherent but rather is a complex socioeconomic system that adjusts to the various ways of different nations, cultures, and times.\(^26\) In particular, the VoC approach has distinguished two generic varieties: liberal market economies, chiefly the capitalist systems derived from Anglo-American traditions; and coordinated market economies, represented by Germany, Japan, and several North European and Alpine political economies.\(^27\) Each of these varieties is characterized by its own complementary set of institutional arrangements. These complementarities shape unique varieties of capitalism and, equally important, influence their innovative performance and economic competitiveness. It is not that one set of institutional arrangements is intrinsically better than any other, but rather that different sets of institutions create dissimilar competitive advantages that nonetheless can be equal in terms of economic performance. Complementarity is thus vital for understanding why capitalist institutions

\(^{21}\) Hall and Soskice 2001. A number of approaches have either preceded or paralleled the VoC approach in comparative capitalism. All aim to classify existing types of capitalism and to probe the causal relationships between the institutional features of a given type of capitalism and its economic performance. See Jackson and Deeg 2006.

\(^{22}\) Shonfield 1965.

\(^{23}\) Gerschenkron 1962.

\(^{24}\) Goldthorpe 1985; Kitschelt et al. 1999.

\(^{25}\) Jackson and Deeg 2006.

\(^{26}\) Albert 1993.

\(^{27}\) Hall and Soskice 2001.
vary; that is, institutional isomorphism creates different trajectories of path-dependent institutional development over time.

The VoC approach has met with several criticisms. First is that it focuses exclusively on the nature and sources of variation in the institutionally more stable political economies of advanced industrial nations. It thus fails to capture the rich and dynamic variety of new forms of capitalism in emerging market economies, including political economies shaped by state capitalist and transnational influences. Philippe Schmitter, for instance, suggests that the dichotomy between liberal and coordinated market economies is too primitive in its attempt to capture all VoC and that greater attention needs to be paid to the degree of stateness permeating a given form of capitalism. Certainly, a system as a whole can be capitalist while guided by state influences, such as indicative state planning, public ownership of the commanding heights of the economy, and the strategic use of state fiscal incentives.

Another major issue concerns the nature of complementarity. Conceptions in the VoC framework initially saw complementarity as different institutions aligning to reinforce each other’s incentives, thus creating institutional coherence with few contradictory incentives. Economic competitiveness emerged from an institutional fit in which institutions shaped clear sets of linearly aligned incentives. In this view, purer VoC of both the liberal and the coordinated market economy varieties performed better than mixed systems such as those found in France or Spain.

This emphasis on institutional fit or coherence becomes especially problematic when applied to China because of the complexity of its emergent capitalism. The nature of the country’s economic development has been characterized by the adaptation and hybridization of a variety of strategies of economic organization, technological innovation, and industrial policy. As the following analysis details, the major characteristic of Sino-capitalism is the juxtaposition of state-led developmental institutions top-down and private entrepreneurial networks bottom-up, often resulting in contradictory incentives and friction. In Sino-capitalism, institutional complementarity is based on a basic compensatory mechanism whereby institutional arrangements com-

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28 See the excellent analysis by Pontusson 2005.
29 Streeck and Yamamura 2001.
30 Nölke and Vliegenthart 2009.
31 Schmitter and Todor 2010.
33 Hall and Soskice 2001.
pensate for each other’s weak points rather than pushing incentives in the same direction.

Several analyses highlight the importance of compensatory institutional complementarity, stressing that institutions can balance certain incentives, such as extreme self-interested behavior, and make up for each other’s deficiencies. Thus, Lane Kenworthy argues that VoC with mixed institutional arrangements can perform just as well as purer, more coherent cases. And John Campbell uses the US financial crisis to demonstrate that highly coherent sets of institutional arrangements that reinforce each other’s incentives can precipitate a crisis, since they can reinforce the wrong sets of incentives. Compensatory institutions are therefore perhaps just as important as coherent reinforcing sets of institutions, if not more so.

Institutional complementarities obviously come in different forms, and counterbalancing, hybrid, and even contradictory sets of institutions can coexist with reinforcing institutions. There is perhaps no perfect way of organizing capitalism. Rather, institutional innovation via learning, political struggle, and competition can over time build institutional infrastructures sustaining politicoeconomic stability and capitalist development.

The conceptualization of Sino-capitalism proposed here is broader and more fluid than the precise yet static models put forward in the VoC analytical framework. It also contradicts some of the major findings of this framework by proposing that hybrid compensatory institutional arrangements can work just as well as coherent reinforcing institutions. Nonetheless, an understanding of Sino-capitalism can derive intellectual guidance from the comparative capitalism literature. First, comparative capitalism approaches highlight the heterogeneous nature of contemporary capitalism. A number of historical, geographic, political, geopolitical, and socioeconomic factors create different trajectories of institutional development that result in fundamentally different institutional, ideational, and political arrangements across the globe. China’s reemergence is thus generating a new form of capitalism that draws on Western, Asian, socialist, and historical and modern Chinese elements.

34 Crouch 2005a; Crouch 2005b; Campbell 2011.
35 Kenworthy 2006.
36 Campbell 2011.
39 Jackson and Deeg 2006.
Second, comparative capitalism approaches elucidate different possibilities for how institutional complementarities can work. In Sino-capitalism, two sets of institutions are central, each with its own inner logic and internally reinforcing incentives—the state-guided realm and the entrepreneurial private realm. While these two sets of institutions compensate for each other’s weaknesses and meld, especially at the local level, they also stand in contradistinction to each other. Added to this are substantial influences emanating from the global capitalist system that have led to the adaptation of both liberal Anglo-American and Asian developmental institutions.

Finally, the study of comparative capitalism draws attention to both the timing and the massive heft of China’s capitalist development. Sino-capitalism is emerging in a highly globalized system, more deeply integrated into global production and knowledge networks than were earlier developers in Asia. Most significantly, Sino-capitalism is based on what could potentially become the globe’s largest political economy. China is not just Germany or Japan. With 1.3 billion people, its population is four times the size of the United States, creating enormous economic potential on a continental, even global scale. China’s rise thus represents the first time historically that the Anglo-American model of capitalism has been challenged to this extent, perhaps finding an equal rival within coming decades.

SINO-CAPITALISM

The term Sino-capitalism was first used with respect to overseas Chinese political economies, especially in Southeast Asia.40 One application of the term links it to Thaksinism, the populist neoauthoritarian, hard-line economism for export employed by the former Thai prime minister.41 Sino-capitalism in this context implies networked corporate empires (based partially on Chinese ethnicity) and authoritarian market policies of no-holds-barred economic development.

The conception of Sino-capitalism employed here takes these antecedents into account but also attempts to provide a more specific institutionally based definition that builds on the comparative capitalism literature. Most fundamentally, Sino-capitalism is a hybrid consisting of several interrelated codependent compensatory institutional arrangements. Hybridization emerged because China took a gradual,
experimental approach to economic reform that made use of market-oriented rules-based, inter-personal networked, and statist strategies. By practicing “upgraded authoritarianism,” China has found highly innovative policies and institutions to master complex challenges; that is, an “intriguing interplay between development planning and policy experimentation” contributed to China’s economic success.

Three institutional spheres are particularly significant in Sino-capitalism. First, rather than relying purely on well-defined and enforced legal codes, Sino-capitalism makes heavy use of interpersonal relationships utilizing common Chinese cultural norms that cultivate long-term reciprocal personal relationships, known as guanxi in Chinese. The result is the proliferation of informal business networks that create production and knowledge clusters, often with global reach.

Second, as China is a late developer, the role of the state has been magnified. Sino-capitalism represents a “Gerschenkron Squared” form of late capitalist development that assigns the Chinese state a leading role in fostering and guiding capitalist accumulation. Sino-capitalism thus encompasses a new application of state-led, state-coordinated, or state-guided capitalism.

Finally, China’s rapid economic growth has occurred in a highly globalized era. Enormous international competition for trade and investment has conditioned Chinese policies to some extent, especially as these pertain to China’s entry into the World Trade Organization (WTO). Clearly, China absorbed a host of institutional arrangements as it entered the global capitalist system during a period of heightened globalization. This hybridization has allowed some of the dominant Anglo-American institutions and values to enter China, creating a “market-liberal form of state capitalism.”

**Network or Guanxi Capitalism**

Sino-capitalism incorporates aspects of the ideal–typical form of “Chinese capitalism” found in overseas Chinese business communities. Based on a patriarchic structure of family ownership and control, intricate networks of reciprocity (guanxi), and a close interplay between political and economic entrepreneurship, it has become prominent throughout Southeast Asia, Hong Kong, and Taiwan. As China em-

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42 Pang 2009.
43 Heilmann 2010, 110.
44 McNally 2008.
45 Gerschenkron 1962.
46 ten Brink 2010; ten Brink 2011; also Chu and So 2010.
47 On the ideal–typical form of overseas Chinese capitalism, see Redding 1990; on Asian business networks, see Hamilton 1996.
barked on its reform policies after 1978, overseas Chinese business interests were the first to invest. In this process, overseas and Mainland Chinese business networks melded, generating part of China’s export-manufacturing juggernaut. Within Mainland China, however, the role of the traditional paternalistic family business diminished, while the importance of more non-family-based networks increased.\(^{48}\)

Sino-capitalism clearly does not resemble a purely state capitalist system. There are certain twists, since institutionally Sino-capitalism encompasses production clusters based on highly entrepreneurial and flexibly networked systems of small and medium-size firms. Guanxi and other Chinese cultural norms support these networks, though these norms are not the only ones. More rules-based scientific and knowledge networks can take on central roles as well.\(^{49}\)

Guanxi or network capitalism has created deep structural changes in China’s political economy.\(^{50}\) Private business interests have gradually gained political leverage as marketization and capital accumulation progressed. And rather than engaging in confrontation, holders of private capital have become increasingly embedded in the Chinese party-state, creating an alliance of political and economic elites.\(^{51}\) While this system has given rise to widespread corruption and rent seeking, the combination of Leninist control and relentless private capital accumulation has engendered continuous institutional adaptation.\(^{52}\) The result has been a dynamic efficiency that is strengthening both state and capital in mutually reinforcing cycles.\(^{53}\)

Due to bottom-up entrepreneurial networks, the Chinese political economy contains a distinct duality or dialectic: the state controls finance and the commanding heights of industry, while most competitive sectors in retail and manufacturing are populated by private (both foreign and domestic) or hybrid ownership firms. The Chinese state’s continued dominance over crucial aspects of the economy is therefore tempered by the entrepreneurship and dynamism of China’s network capitalism. Successful institutional hybridization in the Chinese system has allowed these two dissimilar types of capital accumulation to coexist and become codependent.

China’s capitalist development therefore relies to a considerable

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\(^{48}\) This is in part due to the one-child policy and the wrenching social dislocations of the Maoist period. See Lin 2010.

\(^{49}\) Hsu and Saxenian 2000.

\(^{50}\) McNally 2011.

\(^{51}\) Dickson 2008; McNally and Wright 2010.

\(^{52}\) Tsai 2007.

\(^{53}\) The process of “mutual empowerment” that ultimately underlies capitalist development has been conceptualized by Kohli and Shue 1994.
extent on a myriad of small- and medium-scale entrepreneurial ventures. Sociocultural institutions such as *guanxi* practices have allowed Chinese entrepreneurs to link up with state officials, access finance, overcome government indifference, build trust, and compensate for institutional uncertainty.\(^{54}\) Common cultural norms and language also aided overseas Chinese entrepreneurs to penetrate China’s initially difficult investment environment, thereby integrating coastal areas with international production and marketing networks.\(^{55}\)

**State-Led Development**

State intervention has undoubtedly played a crucial role in China’s capitalist transition. At the outset of reforms in 1979, the Chinese Communist Party (CCP) faced economic stagnation at home.\(^{56}\) It also realized how other East Asian economies had managed great spurts of industrialization.\(^{57}\) Under the leadership of Deng Xiaoping the CCP thus mustered the political will to sustain disruptive developmental dynamics. Reforms strengthened and legitimized already existing autonomies at the local level, giving local cadres political space for a variety of ever bolder economic trials. Reforms in the CCP’s nomenklatura system—the system that is responsible for party personnel appointments—also created new incentives for cadres to improve local economic performance.\(^{58}\)

The combination of these measures created the political autonomy for local cadres to circumvent central rules restricting market transactions, foreign investment, and local capital accumulation. Cycles of induced reforms unfolded, where each small step at liberalization created pressures for further liberalization.\(^{59}\) Seen from a somewhat different perspective, top-down Leninist incentives focused on economic performance encouraged local governments to compete vigorously for investment capital. This interjurisdictional competition created a form of “de facto federalism” that led to the gradual liberalization of China’s economy and triggered substantial improvements in China’s investment climate for both domestic and foreign investors.\(^{60}\)

Besides utilizing top-down Leninist incentives, the Chinese party-state was able to retain control over the commanding heights of the

\(^{54}\) Wank 1999.


\(^{56}\) Naughton 1995.

\(^{57}\) Cumings 1989.

\(^{58}\) Huang 1996; Edin 2003.


\(^{60}\) Zheng 2007.
economy throughout the reform period. State firms and state research institutes continue to shape most direct developmental interventions, undertaking projects fraught with risks or long repayment horizons.\(^{61}\)

In addition, an ambitious effort at state enterprise reform starting in the mid-1990s created a much more profitable state sector. Most small and medium-size state firms were privatized, while large state enterprises were corporatized under the “Modern Enterprise System.”\(^ {62}\) This involved the clearer exercise of property rights under newly corporatized firm structures, which opened the door to corporate restructuring, listings on stock markets, and more profit-driven incentive structures.\(^ {63}\)

The large, centrally controlled state enterprises were then subsumed under the control of the State-owned Assets Supervision and Administration Commission (SASAC) in 2003. This commission exercises quasi-trustee control over state-owned assets. It oversees government holdings, appoints boards of directors in conjunction with the party’s central Organization Department, and directs large mergers, combinations, acquisitions, and divestments. SASAC’s remit not only suggests state control but also contains elements of state corporate steering and transformation. Consequently, the Chinese state sector is populated by very large state-owned enterprises that in 2006 constituted only 8 percent of all industrial firms but produced 36 percent of industrial value added and 44 percent of recorded industrial profits.\(^ {64}\) Currently, most significant state firms are profit oriented and their major operations are in units listed on stock markets. Large state firms also continue to have preferential access to loans, land, and subsidies.\(^ {65}\)

Obviously, the state sector continues to loom large over the Chinese political economy. While state firms retreated from the most competitive and least profitable sectors, they have kept a tight grip on a wide range of critical industries. These include oil, gas, and mining; the production of basic producer goods such as nonferrous metals, steel, and petrochemicals; essential network industries in telecommunications, transportation, and utilities; and all major banking and financial institutions in China.

This direct control over economic matters via state-owned or state-sponsored ventures continues to enable central and local authorities to allocate financial resources and guide economic activities. In addition,
the Chinese state has undertaken several phases of bureaucratic reforms. The Chinese state bureaucracy has now become much better suited to the demands of a developing and globalizing market economy. The state, though, has retained institutions to implement industrial policy. Of note is the National Development and Reform Commission, which emerged after the 2003 central bureaucratic reforms as a hub for steering industrial development and upgrading.

These features raise some comparisons with East Asia’s “developmental states,” but China’s state apparatus is not as institutionally coherent and has not perfected market-conforming methods of state intervention in the economy. Rather, detailed industrial policy implementation has often been frustrated by the complex and multifaceted nature of China’s state apparatus. Intense rivalries among Chinese state agencies and local governments put considerable implementation constraints on indicative planning and market-conforming state interventions. In fact, overlapping and incongruous features have created glaring local government interventions that run counter to central policies.

Nonetheless, the Chinese state has retained enormous leeway in its ability to intervene in the economy via the Leninist party-state, control over the commanding heights of industry and finance, and the substantial regulatory purview of local and central state formations. In the final analysis, China must be seen as a late developer undertaking a form of state-led development. Gerschenkron’s insights provide some comparative political economy pointers in this regard. In his view, the timing of a political economy’s entry into the global capitalist system directly influences the shape of its capitalism. Earlier and later capitalist developers differ fundamentally in terms of the institutional arrangements supporting capital accumulation. Generally, in later developers the role of the state is magnified and state coordination is much more closely linked to high finance and industry. New institutional solutions are adapted to enhance the capacity of states to coordinate or even directly manage great spurts of industrialization.

China entered the global capitalist system after large-scale industrial and financial competitors were already well established. Like other late developers, China invariably modeled itself on already developed

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68 Johnson 1982; Wade 1990.
69 Howell 2006.
70 Gerschenkron 1962.
economies, often copying institutional arrangements and technologies to give itself an “advantage of backwardness” by adopting best practices rapidly throughout the economy. Therefore, from a Gerschenkronian perspective, China emerges as a third-generation late developer. Top-down Leninist party-state incentives, state control over the largest firms, and a wide array of regulatory tools have all been crucial factors in China’s capitalist transformation. Nonetheless, this is a form of capitalism that relies on a uniquely compensatory institutional structure whereby state capitalist features are balanced by vibrant entrepreneurial private capital accumulation and, as the next section elaborates, the development of a relatively internationalized and globally enmeshed economy.

Adaptation of Global Influences

China’s entry into the global capitalist system during an era of intense globalization stands in contrast to the experiences of the economies of Japan, South Korea, Taiwan, Hong Kong, and Singapore. These late developers faced global capitalist competition under the postwar (1945–80) “embedded liberalism,” which espoused a fairly tightly managed system of economic exchanges. They also benefited from being frontline states in the Cold War, obtaining privileged access to US markets and technology. China, by contrast, belongs to a more contemporary wave of industrialization in East Asia, a wave that roughly began in the 1980s alongside the acceleration of neoliberal globalization.

The strengthening forces of globalization presented China with both opportunities and challenges and to a considerable extent shaped policy. Compared with earlier developers in East Asia, China adopted more free-market principles. These principles include substantial access by foreign capital to China’s manufacturing and retail sectors; the relatively rapid development of stock markets and intensive use of Hong Kong’s internationalized capital markets; and the fact that Chinese banks do not practice share ownership in industrial firms. Especially noteworthy is China’s opening to foreign direct investment. While overseas Chinese capital played a crucial role at the beginning, later on more globalized players used China’s coastal areas as manufacturing platforms, servicing customers in North America, Europe, and Japan.

71 The original formulation of this insight with regard to Imperial Germany is in Veblen 1915.
72 Ruggie 1982.
73 Stubbs 1999.
74 Lee, Hahn, and Lin 2002; Chu and So 2010.
75 Hsing 1998.
Finally, despite China’s socialist legacy, concerted efforts have been made to increase labor-market flexibility, especially regarding the hiring and dismissal of employees. This was aided by the timing and sequencing of foreign direct investment that weakened labor’s role even in the more regulated state sector.\textsuperscript{76} China has thus been able to establish one of the most flexible labor markets in the world.

Faced with strong international pressures to open China’s domestic economy to foreign trade and financial flows, China entered the WTO in 2001. China’s accession protocol included stringent commitments to reduce import barriers and to end discrimination against foreign companies that go well beyond those agreed to by other emerging market economies, such as India and Brazil.\textsuperscript{77} Neoliberal globalization thus prodded the Chinese government to develop one of the highest “absorption capacities” for the forces of globalization among developing economies.

Clearly, some of China’s developmental policies, especially in terms of openness to foreign investment and trade, stand in marked contrast to East Asia’s earlier developers. However, in other respects Chinese policies have followed Japan, Taiwan, and South Korea quite closely. China, too, has used programs of subsidized investment in “strategic industries,” pursued an export-led growth strategy, and suppressed domestic consumption while encouraging high savings and investment rates. Most prominently, China is following its Asian predecessors by employing exchange rate controls to maintain an undervalued currency that fosters export performance. Despite some liberal impulses, therefore, China’s development policies feature a substantial role for the state and have emphasized the development of domestic industry and technology.\textsuperscript{78}

In sum, the growth of Sino-capitalism implies that the global system will be faced with a developing economy that, while exhibiting low degrees of institutional certainty and predictability, contains considerable industrial, technological, and financial capacities. How Sino-capitalism will influence the shape globalization takes in future years is still open to question. However, it is highly likely that Sino-capitalism will become the second most important player globally, soon to rival the still dominant Anglo-American form of capitalism.

\textsuperscript{76} Gallagher 2005.
\textsuperscript{77} Edmonds, La Croix, and Li 2008.
\textsuperscript{78} Edmonds, La Croix, and Li 2008.
SINO-CAPITALISM IN THE GLOBAL SYSTEM: THE CASE OF INTERNATIONALIZING THE YUAN

China’s historical legacy, size, and exposure to the forces of globalization have given rise to institutional arrangements that combine Western, Asian, socialist, and Chinese elements, both historical and modern. Sino-capitalism thus emerges as a unique hybrid, a model of late development formed under intense globalization and built on China’s distinct historical legacies.⁷⁹ Evidently, Sino-capitalism contrasts sharply with liberal-democratic forms of capitalism, especially Anglo-American capitalism. China has seen the evolution of a distinct network-based mode of informally dealing with contradictions between capitalist accumulation and continued party-state hegemony.⁸⁰ Market, legal, and regulatory regimes are only partially formalized, while state officials retain considerable leeway to intervene in private firms and markets. Consequently, Sino-capitalism relies less on legal codes and transparent rules than on informal business networks and interpersonal trust. Vibrant interpersonal networks also act as local intermediaries to the global economy.⁸¹

Perhaps most importantly, Sino-capitalism puts less trust in free markets and more trust in unitary state rule and social norms of reciprocity, stability, and hierarchy. Economic development has to be carefully managed, rather than being left to unpredictable and fickle market forces. Sino-capitalism’s hybrid institutional arrangements—top-down state guidance; bottom-up networks of entrepreneurs; global integration—thus do not conform to general notions of how capitalist institutional complementarity is structured, though they have proved to be quite impressive in fostering capitalist accumulation. The ascent of Sino-capitalism ultimately implies that the global economy will be faced with a systemically important late developer that espouses a very different form of capitalism.

Although we cannot predict the future of Sino-capitalism’s global influence, analyses of China’s emergent role in the international political economy nonetheless point to how China has adopted largely non-disruptive policies supportive of the rules-based multilateral order.⁸² China’s economy has been integrated globally by relying on multilateral institutional frameworks, especially the WTO. And so far China has

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⁷⁹ For the deep historical institutional reservoir that has shaped Sino-capitalism, see Faure 2006; and Gates 1996.
⁸₀ McNally 2011; Tsai 2007.
⁸² Kahler 2010; Gilley 2011; Steinfeld 2010; Lawrence 2008.
mostly complied with its WTO commitments and avoided any aggressive role in trying to change the nature or rules of the organization. A strategic willingness on the part of China’s leaders to embrace the existing multilateralism is thus apparent, though it is not quite clear whether their motives have been purely utilitarian or reflect a fundamental ideational adjustment.

Certainly, the emergence of Sino-capitalism reflects both multilateralist rules-based behavior—“playing our game”—and a strong inclination to use state policies and actors to shift the “playing field.” The employment of creative and comprehensive industrial policies to foster new leading sectors and technologies has already triggered several WTO cases against China. Certainly, the effects of these policies have not been lost on American firms. As Conrad Burke, chief executive of Innovalight, a solar innovator, puts it: “How do you fight against enormous subsidies, low-interest loans, cheap labor and scale and a government strategy to make you No. 1 in solar?”

Sino-capitalism emerges as a complex new global capitalist force, incorporating statist, flexible network-driven, and liberal rules-based multilateralist orientations. China’s stance and strategy in the international political economy therefore hew quite closely to Sino-capitalism’s hybrid compensatory institutional complementarities on the domestic level: state guidance; flexible and entrepreneurial networks; and global integration. One salient area that elucidates Sino-capitalism’s emergent international role concerns China’s policies toward the international monetary system, especially recent attempts to internationalize the yuan. The currency issue is perhaps the most fundamental point of contention in the economic relationship between China and the United States. Hence it opens an analytical window on to the international political economic logic of Sino-capitalism.

Like other late developers that have raised themselves from poverty to wealth in the industrial era, China uses an export-led growth strategy to accumulate capital and incorporate foreign technology. In contrast to the view advocated by the United States and other advanced industrial economies, Chinese leaders view the exchange rate not as a price to be determined by the market but rather as a tool in China’s economy.
broader development strategy. An undervalued currency promotes exports and aids China in its quest to develop internationally competitive industries. There is thus little regard for the distortions in both international and domestic markets that this exchange rate policy creates. Prices and market mechanisms are merely tools to an end: to develop China and make it wealthy and powerful. China’s currency policy reflects the developmentalist and statist elements of Sino-capitalism. As Barry Eichengreen notes, the Chinese yuan “is a currency with too much state.”

Despite their statist origins, Chinese currency policies have created a host of consequences that have entrenched China in the international monetary system. They have, indeed, created something of a headache for Chinese policymakers: the accumulation of vast foreign exchange reserves, totaling about $3.2 trillion in early 2012, most of which must be invested in low-yielding US Treasury securities. While China’s dollar holdings are a potential source of structural power and leverage over the US, the dangers of China’s dependence on the US dollar and US financial markets became clear after the financial crisis of 2008. Trade financing in dollars froze, hurting China’s export sector directly. China’s vast stockpile of dollars also seemed at increasing risk, since a deterioration of the US economy could trigger a sharp devaluation of the dollar and a massive loss of capital for China. However, besides US markets there are no other markets large, liquid, and safe enough to absorb China’s foreign exchange accumulations. With nowhere else to move its reserves while retaining the ability to redeem them on short notice, China remains dependent on US financial markets.

This dependence and the increasing risks to its holdings have prod- ded China to begin a gradual process of internationalizing its own currency, the yuan. If the yuan could play a more important international role, it would reduce both exchange rate risks and transaction costs for China’s international trade. Greater use of the yuan internationally is also seen by Chinese elites as a way to enhance policy independence.

The policy measures and institutional arrangements China has employed in this regard reflect certain elements of Sino-capitalism. Policy

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88 Kroeber 2011.
89 Eichengreen 2011, 7.
90 Kroeber 2011.
91 For an analysis of China’s potential financial power in the international system, see Drezner 2009.
92 The concerns of China thus parallel those of European powers dependent on the US dollar in the run-up to the collapse of the Bretton Woods system in 1971. See Kahler 2010.
93 Miller 2010.
94 Blanchard 2011, 48.
initiatives under Sino-capitalism have been cautious and experimental, combining “neoetatist” planning with explorative and innovative policy experimentation. As its approach to reforms in the domestic political economy, therefore, China has taken cautious and pragmatic measures in addressing its dependence on the US dollar. Chinese policy has experimented with innovative bilateral, networked, and multilateral institutional solutions.

Basically, three key mechanisms have been employed to foster the internationalization of the yuan: a networked approach involving China’s sprawling entrepreneurial networks in combination with state coordination that has fostered mostly bilateral international accords to internationalize the yuan; the active use of global finance, including international financial centers and institutions, to create and absorb offshore pools of yuan; and the continued dominance of state control over yuan capital flows into and out of China.

After pegging the yuan to the dollar from 1997 to 2005, China gradually, in fits and starts, allowed the yuan to appreciate. By utilizing a pragmatic, experimental, and step-by-step approach, China opted not for full-scale liberalization but rather for a gradual, state-controlled appreciation of the yuan. This policy has had several advantages: it created a further mechanism—the exchange rate—to control domestic inflation; over time it made the manufacturing of ultracheap low-value-added goods less attractive, thus generating incentives for exporters to move up the technology ladder; and it deflected to some extent international criticism of China’s currency policies while retaining a measure of stability and predictability in the exchange rate.

The drawback has been to make the yuan a “one-way bet,” since it only seems to appreciate over time vis-à-vis the US dollar. Hot money flows to take advantage of this have, in part, contributed to the vast accumulation of foreign exchange reserves in China. To free China from its reliance on accumulating US dollars, rather comprehensive policy measures to internationalize the yuan are now being taken, especially since 2009. These policies are not intended to topple the dollar but rather should be seen as hedging against the inherent risks in an international monetary system dominated by the dollar. Overall, China’s policy initiatives have been sophisticated, cautious, and responsible.

In the wake of the financial crisis of 2008, Zhou Xiachuan, the

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95 Heilmann 2010.
96 Kroeber 2011.
97 Drezner 2010; Grimes 2009.
98 Miller 2010.
governor of the People’s Bank of China, called for the creation of a suprasovereign reserve currency based on the International Monetary Fund’s (IMF) special drawing rights (SDRs). Zhou advocated expanding the role of SDRs as a settlement currency, and China did subsequently subscribe to an expansion of IMF capital by buying SDRs. The issue of multilateralizing the international monetary system via SDRs was raised by China several more times throughout 2009, exposing at least a rhetorical multilateralist bent. Nonetheless, due to a host of political, technical, and institutional factors, SDRs are unlikely to become serious competitors to the US dollar. Certainly, China has not taken the necessary practical steps, such as creating a liquid market in SDRs, that could further this goal.

Rather, China since 2009 has moved more forcefully to broaden the international use of its own currency—moving in the direction of making the yuan into a potential reserve currency that could one day rival the US dollar. The policies taken by China combine the use of international financial networks and state control to internationalize the yuan. To begin, authorities have encouraged the use of yuan in China’s international trade, announcing in August 2011 that cross-border trade settlements in yuan will expand from twenty provinces to the whole country. Starting from zero in early 2009, about 7 percent of the value of China’s international trade was being settled in yuan by mid-2011.

At the same time, China has taken a networked approach, albeit mainly top-down and state coordinated, to foster the international availability and use of the yuan. Bilateral currency swap agreements with central banks worth billions of dollars have been signed to authorize the use of yuan to settle payments for commercial transactions. This gives other central banks the capacity to borrow yuan, especially during financial market disruptions, and it allows them to diversify their reserves. China already has signed multiple-year currency swap agreements with economies in Southeast Asia and beyond, including Argentina, Iceland, South Korea, Belarus, and Russia. In 2011 China signed currency swap agreements with Uzbekistan, Mongolia, and Kazakhstan, as well as with New Zealand. And on Septem-

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100 Tadokoro 2010; Eichengreen 2011; Drezner 2010, 402–3.
101 Eichengreen 2011, 140.
102 Wang 2011.
103 Grant and Goff 2011, 1; Economist 2011.
104 Kung 2011.
105 Wang 2011.
106 Reuters 2011.
ber 6, 2011, Nigeria announced it would turn 5 to 10 percent of its foreign exchange reserves into yuan assets to diversify its reserves and strengthen cooperation with China. As in other cases, Nigeria plans to sign a swap arrangement with the People’s Bank of China and may apply to purchase yuan-denominated bonds directly on the Chinese interbank market or buy yuan assets in Hong Kong.\textsuperscript{107}

Internationalizing the yuan has directly benefited from China’s sprawling networks of private entrepreneurs, who initially introduced the yuan as a medium of exchange in Southeast Asia and Central Asia. More recently, large amounts of yuan have flowed into Africa via private trading networks centered on China and the migration of Chinese entrepreneurs. As Lamido Sanusi, governor of the Nigerian central bank, noted, “Renminbi are already being traded on the streets of Nigeria, so this shows the market is ahead of us and we are just catching up.”\textsuperscript{108}

Besides top-down state-coordinated networks and bottom-up entrepreneurial networks, the use of international financial centers to establish offshore yuan trading platforms constitutes a key mechanism. Most important has been Hong Kong’s emergence as a yuan offshore trading center, while Taipei, Singapore, and London are vying for this business as well. Hong Kong now offers yuan currency deposits, foreign exchange, and various investment vehicles.\textsuperscript{109} A considerable pool of yuan deposits has formed in Hong Kong as a result of settling trade in the Chinese currency, while yuan-denominated bonds—dim sum bonds—and a few equities are now available as offshore investment vehicles.\textsuperscript{110}

Major international banks, such as HSBC and Standard Chartered, are also participating in the yuan offshore business, providing deposit taking, trade settlement, and corporate account services in various countries. Additionally, Chinese-funded banks are expanding their overseas presence, establishing offshore yuan trading locations.\textsuperscript{111} In August 2011, for example, the Lusaka branch of the Bank of China in Zambia became the first in Africa to offer yuan cash banking services, including deposits and remittances.\textsuperscript{112}

Nonetheless, saving and investing offshore in yuan remain problem-

\textsuperscript{107} Wang 2011.
\textsuperscript{108} Wang 2011.
\textsuperscript{109} Want China Times 2011.
\textsuperscript{110} Dim-sum bonds include Chinese treasury bonds, state bank bonds, and bonds issued by both Chinese and foreign enterprises in Hong Kong denominated in yuan.
\textsuperscript{111} Han 2011.
\textsuperscript{112} Wall Street Journal 2011.
atic. For example, by the end of June 2011 there were 4.7 yuan in Hong Kong deposits for every 1 yuan of dim-sum debt.\textsuperscript{113} Simply put, because of illiquid and limited markets there are insufficient ways to profitably park yuan offshore. The Chinese government is trying to address this shortcoming by creating designated institutional “pipelines” to funnel yuan into and out of China. Although this constitutes some modest relaxing of strict capital controls, the Chinese state retains ultimate control over the flows. Mechanisms include the swap agreements with central banks and allowing large foreign financial institutions, such as HSBC, to increase the amount of investments they can make in Chinese bond and interbank markets. A recent proposal builds on expanding the Qualified Foreign Institutional Investor program already in place since 2002 to allow foreign investors to use yuan acquired overseas via cross-border trade settlements, offshore yuan bond issuance, and share sales to make direct investments in China.\textsuperscript{114}

All of the above elements—state-coordinated and entrepreneurial networks that spread the use of the yuan overseas; the strategic utilization of international financial centers and institutions to establish offshore yuan markets; and continued state control over “pipelines” by which yuan can enter and exit China—bear the hallmarks of Sino-capitalism’s domestic political economic arrangements. Fundamentally, the strategy attempts to benefit from the internationalization of the yuan, while not upsetting China’s development model. China’s capital account remains firmly regulated, but gradually “pipelines” allowing offshore yuan funds to flow back into China are being widened, a precondition for China to eventually transform the yuan into a reserve currency.

Most analysts, though, see the yuan in the near to medium term as far from ready to achieve reserve currency status and replace the US dollar.\textsuperscript{115} A reserve currency requires safe, liquid, and low-risk assets traded on transparent and open markets that foreign investors can easily buy and sell. China’s closed capital account flies in the face of this. Basically, China’s development model relies on a distrust of markets to freely set prices, including for the exchange rate and domestic interest rates.\textsuperscript{116} A closed capital account underpins state control of domestic finance to channel savings into state banks that can then support state-coordinated investment projects with low-cost capital. “China’s

\textsuperscript{113} Debt valued at issue price; see \textit{Economist} 2011.
\textsuperscript{114} Hong and Zhang 2011.
\textsuperscript{115} Drezner 2010; Bowles and Wang 2008; Setser 2008; Kroeber 2011; Roubini 2009.
\textsuperscript{116} Kroeber 2011.
philosophy of monetary management and financial development has been based on a closed-economy system. This philosophy makes it almost impossible to create an effective reserve currency, since there could be substantial costs and risks were China to open its capital account to foreign portfolio flows.

While it is beyond the scope of this article to argue for or against the potential of the yuan to become a reserve currency, the policies and institutional strategy employed by China to internationalize the yuan do suggest the possible international impacts of Sino-capitalism. Unquestionably, a direct translation of Sino-capitalism’s domestic institutional arrangements and ideational precepts onto the international arena is problematic. Nonetheless, the above exploration shows that Sino-capitalism’s international reverberations build on domestic institutions and precepts. Sino-capitalism is a system that strategically employs markets, though not in an essentialist or fundamentalist manner. When necessary, the system is willing to constrain, manipulate, and control markets with statist measures.

The yuan is clearly a state-controlled currency, yet one that is spreading in international use via both state-linked networks and more purely private ones. It could gain in international prominence not by the full liberalization of China’s capital markets but rather by measured and controlled liberalizations involving offshore trading centers and designated pipelines to control capital flows into and out of China. Indeed, the yuan has certain advantages that doubters of its future status as a reserve currency tend to disregard: China will soon be the biggest trader in the international system and a large capital exporter; the yuan is seen as increasingly safe by many risk-averse foreign investors; and, perhaps most important, its gradual but relentless appreciation has so far made it an attractive investment option.

**Implications: Sino-Capitalism versus Anglo-American Capitalism?**

Sino-capitalism’s challenge to the liberal international political economy has been limited so far. Historically, late developers have had very little influence over how the international political economy functions and thus have had to adjust to its rules, institutions, and power relations. Institutions are by nature slow to change, and there is thus a considerable lag between economic ascendance and actual influence over

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117 Anderson 2011.
118 Subramanian 2011, for instance, takes a sanguine view of the yuan’s future global influence.
the global political economy.\footnote{Kahler 2010.} China is no exception, and neither was the United States. For instance, the US dollar gained an international role only after 1907, long after the United States overtook the United Kingdom in aggregate economic size.\footnote{Eichengreen 2011.}

Comparatively speaking, therefore, the internationalization of the yuan is occurring at a rather early stage in China’s development.\footnote{The yen also started to be internationalized only in the 1980s as Japan already had reached advanced industrial status. See Eichengreen 2011, 45.} It expresses how China’s sheer size is indicative of its considerable impact on the global political economy even as Sino-capitalism remains in its high-growth developmental phase. Ultimately, the global capitalist system is experiencing for the first time since 1850 the rapid rise of a continent-sized capitalist power that espouses ideas, institutions, and interests fundamentally different from those of Anglo-American capitalism.

The measures taken to internationalize the yuan are a good reflection of Sino-capitalism’s institutional arrangements on the domestic level, such as top-down state coordination, bottom-up entrepreneurial networks, and focused global integration. The domestic political economy of Sino-capitalism thus can serve as a starting point for understanding China’s present and possible future preferences in the international political economy.

First and foremost, Sino-capitalism is a hybrid. China’s model of development has adopted liberal tenets, such as openness to foreign investment and flexible labor markets, while also generating a form of capitalism fundamentally different from the variants that have become globally dominant. A reliance on interpersonal networks rather than on clear and transparent rules, as well as the prominent role of the state, places Sino-capitalism outside the varieties of capitalism that the rules-based international order has so far accommodated.\footnote{Kahler 2010.}

Undoubtedly, China’s currency policies signify a very different attitude toward the role of markets, both domestic and international. The Chinese government has put off opening its financial sector to international capital flows. This has served China well, since a relatively closed capital account has provided China with considerable insulation from speculative attacks and the vagaries of the international financial system. Sino-capitalism therefore perceives that markets have to be carefully managed rather than left to their own devices. They are merely tools in a broader state-guided strategy of creating an internationally
competitive political economy. It is particularly in this respect that the basic precepts of Sino-capitalism and Anglo-American capitalism are likely to compete in the governance of the international political economy.

While Sino-capitalism remains clearly subordinate to Anglo-American capitalism in globally systemic terms, China’s aggregate economic heft means that Sino-capitalism is already having a massive impact. The concept of Sino-capitalism and its possible challenges to Anglo-American capitalism can thus inform political economy debates on China’s future influence. As Michel Albert argued with respect to Anglo-American capitalism and the “Rhine” capitalism of Northern Europe, there are different models of capitalism in the international system that are unlikely to converge or meld; they are instead poised to challenge each other for global influence. Correspondingly, political economy debates imply a stark dichotomy regarding Sino-capitalism’s possible preferences vis-à-vis the international system: China could emerge as a distinct threat to the liberal global economic order or meld with it, even reinforce it.

Authors such as Bremmer see Sino-capitalism as a form of state capitalism in which “the state acts as the dominant economic player and uses markets primarily for political gain.” Sino-capitalism and other forms of state capitalism are therefore fundamentally incompatible with a free-market globalized system, since increasing state intervention represents a strategic rejection of free-market doctrine.

Bremmer sees China as the world’s leading practitioner of state capitalism, but the picture is insufficiently nuanced. Sino-capitalism is much more complex than pure conceptions of state capitalism. It incorporates various liberal economic tenets and the creative use of market forces, while encompassing vibrant, highly networked, and globally integrated entrepreneurial firms often with hybrid or purely private ownership. Many state firms are also frequently profit driven, seeking markets or resources for commercial reasons rather than purely to fulfill political goals.

Steinfeld represents the other side of the debate in emphasizing the networked production that China has aggressively embraced under Sino-capitalism. For him, China has successfully restructured its economy to accord with more marketlike control systems, and it has become a “capitalist facilitator that opened up its domestic industry to

123 Albert 1993.
125 Steinfeld 2010.
global firms and allowed them . . . to fit China into a new structure of
global production.”126 China is therefore not a threat to the Western-
led economic system but rather is a key component of it. And the deep
global enmeshment of Sino-capitalism could even see China’s authori-
tarian way of governing become increasingly obsolete.

Again, the concept of Sino-capitalism shows the need to move be-
yond dichotomous debates on China’s possible future influences. The
rise of Sino-capitalism is unlikely to be one-dimensional, as it is rid-
dled with complexities and contradictions. This model of capitalism is
based on a distinct compensatory institutional complementarity, a du-
ality that enables state-guided capitalist accumulation to coexist with
bottom-up entrepreneurial forces and considerable global influences.

Likewise, the study of Sino-capitalism can inform debates in inter-
national relations. Although systemic properties, especially the anarchic
structure of the international system, are important factors influencing
state behavior, they are not the only ones that do so.127 In contrast to
the views presented by Mearsheimer and by structural realists in gen-
eral, it is quite arguable that the properties of the international system
are undergoing a process of constant change, especially with the advent
of nuclear weapons.128 Moreover, any system-level analysis must take
into account the nature of global capitalist competition and the incen-
tives it creates for nations to attract the best human, organizational,
and innovative capital.129

In this regard, the study of Sino-capitalism agrees with Ikenberry
that “[t]he U.S.-China power transition can be very different from
those of the past because China faces an international order that is fun-
damentally different from those that past rising states confronted.”130
Yet it is questionable to what extent a liberal order that is “harder to
overturn and easier to join”131 than ever before can withstand the rise
of Sino-capitalism. Even with reinvigorated US leadership and concerted
efforts to sink the roots of the global liberal order as deep as possible,
the impact of Sino-capitalism is likely to be disruptive.

The Western system, especially in its neoliberal Anglo-American
form, is built on specific principles for how capitalism should function.
Sino-capitalism does not fully share these principles. For sure, all forms

126 Steinfeld 2010, 226.
127 Indeed, for endless capitalist accumulation to proceed, the anarchic features of the interstate
system must be balanced by coherent and orderly features. See Wallerstein 2004, 56–57.
128 See Brzezinski’s arguments in Brzezinski and Mearsheimer 2005, 48–49.
129 Weede 2010.
130 Ikenberry 2008a, 24.
131 Ikenberry 2008b, 91.
of capitalism have benefited from the openness and expansiveness of the Western liberal postwar order. But with the liberalization of international finance in the 1980s, the system has developed yet again (as before 1914) deep contradictions that undermine its stability. The financial crisis of 2008 thus has not only provided China’s leadership with new evidence that enlightened state management will offer protection from the natural excesses of free markets but has also convinced other emerging market economies to move away from the precepts of Anglo-American capitalism. One might interpret this to mean that state capitalism is the logical institutional means by which weaker players in the global system can withstand the sheer power of international financial flows and successfully compete for scarce resources in the global race to capture shares of the next leading sector.

**Conclusion**

As China reemerges, the international political economy will be faced with a massive capitalist power that is unlikely to feel fully comfortable with the precepts of Anglo-American liberal market capitalism. Can the liberal order adjust to this and incorporate Sino-capitalism (and other forms of emerging capitalisms, such as Brazil’s and India’s)? Since Sino-capitalism remains relatively weak and is both in symbiosis and rivalry with established economic powers, this question cannot yet be answered. Certainly, large doses of cooperation and shared authority over the global system exist among the major powers.

Analytically, employing the conceptual lens of comparative political economy to explore China’s international ascent opens up new approaches that add a novel dimension to established theories in international relations and power transition theory. The perspective of Sino-capitalism can provide more integrative and encompassing pointers to the possible global influences that could emanate from China. While not a “100 percent solution,” to use Bruce Gilley’s terminology, it goes beyond the “four percent solution” of realist theories which for the most part ignore nonsecurity, ideational, and domestic issues.

To be clear, the study of Sino-capitalism does not attempt to derive a deterministic argument for a given outcome from the structure of China’s emergent political economy. Rather, it attempts to capture

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132 Frieden 2006.
133 Bremmer 2010.
134 Modelski and Thompson 1996.
135 Gilley 2011, 810.
in comprehensive fashion the domestic dynamics of China’s emergent political economy and thereby generate critical insights concerning China’s likely preferences for the future of the international political economy. In addition, the study of Sino-capitalism consciously views power as multidimensional, opening up manifold arenas in which China can emerge as a globally systemic influence. Though salient, geopolitical rivalry based on military power is not the only arena. Other arenas might emerge as more significant, possibly opening up new opportunities for Sino-capitalism to rise. For instance, the internationalization of the yuan might gradually enhance China’s financial power and independence, allowing it to chip away at US financial hegemony.

The study of Sino-capitalism therefore hopes to encourage more expansive perspectives concerning the likely consequences of China’s rise. While Sino-capitalism might wither away under the weight of a dominant and authoritarian state, it is more likely to continue to be highly adaptive and resilient. In fact, the unique compensatory institutional complementarities provided by Sino-capitalism—top-down state guidance; bottom-up networks of entrepreneurs and innovators; global integration—should not be underestimated. ¹³⁶ Sino-capitalism therefore represents an emerging system of global capitalism centered on China that is producing a dynamic mix of mutual dependence, symbiosis, competition, and friction with the still dominant Anglo-American model of capitalism.

Over time, as Sino-capitalism gains in global importance, its precepts are certain to widen the challenge to the Anglo-American model, causing greater friction and altering the global capitalist status quo. Already the international policy consensus has started moving away from the pure neoliberal Anglo-American stance of the 1990s to embrace more state-managed solutions.¹³⁷ In this sense, the study of Sino-capitalism may not only inspire new perspectives on the consequences of China’s rise, but it may also prompt a rethinking of the nature and logic of contemporary capitalism itself.¹³⁸

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¹³⁷ Kahler 2010.

¹³⁸ One starting point for such an undertaking would be Heilbroner 1985.


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Can China Lead?

MARK BEESON

ABSTRACT The ‘rise of China’ is proving to be one of the most consequential developments of the early 21 century. One of the key questions it raises is about the impact this historically unprecedented process will have on the East Asian region in particular and the world more generally. Will Chinese policy makers be able to translate the country’s growing material importance into other forms of political power and influence? Equally importantly, will Chinese elites be ‘socialised’ into the practices and norms of extant institutions, or will they attempt to redefine them to further Chinese foreign policy goals? This paper explores these questions by initially looking at the overall historical context in which East Asian regionalisation has occurred, before considering the operation of some of the more important regional institutions. It is suggested that China’s ability to offer regional leadership is constrained both by its own security policies—which are seen as increasingly threatening by many of its neighbours—and by the actions of the USA, which is trying to reassert its own claims to regional leadership. While the outcome of this process is inconclusive, it helps us to understand the more general dynamics reshaping the international system as a result of the emergence of new centres of international power.

The ‘rise of China’ has clearly been one of the most significant events of recent years. Although that phrase does not capture all the complexity and contradiction associated with China’s remarkable economic development, it does provide a useful shorthand for what is likely to prove one of the most consequential set of processes in the 21st century. Indeed, it is not too fanciful to suggest that the transformation that has occurred in China in little more than three decades may prove to be the most important set of interconnected economic, political, social and strategic processes in the history of the planet. Even if it all goes badly wrong—which is not at all impossible—whatever happens in China will, as Napoleon famously predicted, have truly world-shaking ramifications.

But while the hyperbole may be justified for once, the question is: what will ‘China’ do with all this newly acquired power and influence? Do China’s political elites have a vision for China and its place in the world? Will they inevitably seek to challenge or even usurp the USA’s position as the dominant power of the era, as some of the most influential international relations analysts...
would have us believe? More realistically, perhaps, will the East Asian region provide an important arena in which China’s growing foreign policy ambitions and objectives may be tested and perhaps even realised? These questions form the basis of the following discussion, but at the outset it is important to concede that the answers to such questions will necessarily be tentative and incomplete. The unprecedented nature of China’s recent transformation, the fluid nature of the international system and the unpredictable nature of the response to China’s growing assertiveness all make prediction difficult, if not foolhardy. What we can try to do is to identify the factors that are likely to constrain or facilitate China’s capacity to self-consciously shape the international system of which it is an increasingly consequential part.

The central argument that I develop in what follows is that—at this stage, at least—China’s ability to provide ‘international leadership’ is limited. This is, I suggest, partly because of the nature of the existing international system, partly because of domestic constraints, and partly because any attempt to do so is likely to be met with limited enthusiasm at best, outright hostility at worst. To develop this argument I initially provide some theoretical and historical context with which to explain the particular constraints and possibilities that confront China. Following this I give more specific consideration to the particular circumstances that obtain in East Asia, where any Chinese leadership ambitions are likely to be tested first. Finally, I offer some observations about the prospects for ‘hegemonic transition’.

Leadership or hegemony?

To suggest that the international system is in flux is hardly controversial. Both the apparent decline of the USA and the emergence of the so-called ‘BRIC’ economies are indicative of major changes in the established order and raise questions about the future direction, purpose and structure of the international order. Most fundamentally does the international order actually need ‘leadership’ of the sort we have become used to associating with the USA? Before we can answer that question and decide whether China, or anyone else for that matter, may be capable of providing it, we need to remember what US leadership or hegemony actually looked like.

For a generation of American scholars in particular there was something about the USA, its norms and values, the attractiveness of its culture and society that meant it was ‘bound to lead’. It is no coincidence, of course, that such views reflect an American sensibility, but they are influential primarily because of the USA’s position in the world. Since the Second World War the USA has enjoyed an unparalleled dominance in the international system that even sympathetic observers recognised allowed American policy makers to shape the international system in ways that reflected and furthered their interests. For all the attention that has understandably been paid to the USA’s ideational influence and ‘soft power’, the original foundation of its dominance was crudely material: in the aftermath of the Second World War, with Europe, Japan and China in ruins, the US economy accounted for nearly 30% of global GDP.
The reason we are all currently preoccupied with China is precisely the same: most observers think that, all other things being equal, China is on track to overtake the USA as the world’s largest economy sometime in the next decade or two. The question is what, if anything, China’s leaders might want or be able to do with this material potential. In the case of the USA the answer was—rather a lot. But this raises a further comparative question: was the emergence of US hegemony or leadership a product of unique, unrepeateable historical and geopolitical circumstances? To begin to answer this question and to consider its implications for China, it is useful to make an initial distinction between leadership and hegemony. Although the differences are often subtle, the USA has exercised both at times and it is helpful to say how.

The American way of hegemony

One of the most influential contributions to our understanding of the nature and possible importance of international leadership was provided by Charles Kindleberger. In Kindleberger’s seminal analysis of the Great Depression he argued that one of its principal causes was an absence of leadership, because:

The international economic and monetary system needs leadership, a country that is prepared, consciously or unconsciously, under some system of rules that it has internalized, to set standards of conduct for other countries and to seek to get others to follow them.

Because the UK was incapable and the USA was unwilling, no country provided the sort of leadership Kindleberger argued was necessary to prevent the international economy breaking down as a consequence of protectionism, competitive currency devaluations and beggar-thy-neighbour policies. The big lessons that the USA’s postwar policy makers took from the economic catastrophe of the inter-war period were, first, that it must never happen again and, second, that there were potentially ways of ensuring that it didn’t. In this context leadership can usefully be distinguished as ‘the use of power to orchestrate the actions of a group toward a collective end’.

The consequences of these conclusions are well known but merit brief restatement because they give a possible measure of the task confronting China if it is ever to replace the USA at the centre of a more or less regulated international economic order. The principal institutional manifestation of the USA’s new power and willingness to use it internationally was the creation of the so-called Bretton Woods institutions, created with the intention of providing collective goods and resolving the collective action problems that had plagued the inter-war system. Whatever one may think about the subsequent operation of the World Bank, the IMF and the General Agreement on Tariffs and Trade (later replaced by the World Trade Organization—WTO), they provided an institutionalised foundation for a particular vision of economic and political order. Not only were these institutions imbued with a particular set of liberal values and operating principles, but they offered a stark alternative to the model followed by the USSR and its allies.
The ideological contest that so distinguished the Cold War gives an important clue to the difference between leadership and hegemony. The USA undoubtedly exercised leadership when it decided to prod the Western Europeans into greater cooperation in the postwar period: not only were the war-weary, weakened Europeans receptive to a little prodding, but in the Marshall Plan the USA had a powerful set of incentives that actually made cooperation immediately worthwhile. This is, I think, a rather different process from the one that subsequently drew other countries into the American orbit. True, the Cold War and the implacable logic of geopolitical confrontation may have focused the minds of friend and foe alike but, as even radical critics have noted, institutionalised US hegemony offered long-term incentives and payoffs that made it attractive in its own right, even to states that might not have been traditional allies. Hegemony may, as Robert Cox argues, ultimately be about securing the dominance of a particular state, but it can do so because it creates an order based ideologically on a broad measure of consent, functioning according to general principles that in fact ensure the continuing supremacy of the leading state or states and leading social classes but at the same time offer some measure or prospect of satisfaction to the less powerful.

Some of these principles would need to be universal if the idea of hegemony is to have analytical purchase: the counter-intuitive idea of domination through consent would seem to be central among them. And yet what is distinctive about the US experience is that, as Ruggie pointed out, ‘it was the fact of an American hegemony that was decisive after World War II, not merely American hegemony’. In other words, while there may be common characteristics about hegemonic rule, the particular style or content may vary by country and period. This potential for difference would seem likely to characterise any future Chinese hegemony; it certainly distinguishes its earlier periods of dominance.

Hegemony with Chinese characteristics?

Whether we describe it as hegemony, dominance, civilisational influence or some other term, China has exerted a powerful influence over what we now think of as ‘East Asia’. There are several problems in attempting to compare China’s historical role in East Asia with the USA’s position in the contemporary system, not the least being differences in scale, operational style and constituent parts. US hegemony is the first truly global system of domination, although it is important to recognise that China dominated its ‘world’ until the intrusion of European powers made it painfully apparent that, not only were there other worlds out there, as it were, but they had achieved markedly superior levels of development—at least when measured in terms of the deeply interconnected realms of military and political innovation. Ironically enough, given that Western technological progress borrowed so heavily from China, it was largely the assumed superiority of Chinese civilisation that left its dynastic rulers so ill-prepared to meet the challenge of European imperialism.
Before the Europeans arrived, however, things were rather different. Chinese culture, especially ideas drawn from Confucian philosophy, has exerted a powerful influence on Japan, Korea and Vietnam in particular. More importantly and tangibly China’s influence and its relationship with other ‘states’ of the region were formalised in the ‘tribute system’. Although the political structures of pre-modern Asia were a good deal looser, less precisely delimited geographically, and more personalised than their Westphalian equivalents in Europe, China presided over a regional hierarchy that recognised its own dominance in the tribute missions dispatched by the likes of Japan, Korea, Vietnam, Thailand, Burma and Cambodia.

As far back as the Tang dynasty (618–907AD) China’s neighbours acknowledged its status as the leading power in the region by sending diplomatic delegations to pay homage. At one level this was ritualistic performance that had a limited impact on the subordinate powers which acknowledged China’s superior status. But while the tribute system may have been largely symbolic, it has been argued that it provided an important stabilising influence in a region with no formal mechanisms to manage intra-regional relations. David Kang suggests that ‘far more than a thin veneer of meaningless social lubricants, the tribute system and its ideas and institutions formed the basis of relations between states’. Kang has also claimed that, when China has been strong, the historical record suggests that what we now think of as East Asia has generally been stable and relatively peaceful.

Kang’s depiction of Chinese stability has been challenged, both from an historical perspective, and especially as a consequence of China’s recent, increasingly assertive behaviour in various regional territorial disputes. While there is plainly some merit in these criticisms, the general point to make about China’s prominent historical role in the region is that, first, it is not unprecedented and, second, China was instrumental in creating some of the region’s most distinctive institutions. As Zhang and Buzan point out, ‘Fundamental institutions defined and shaped by these [historical and social] processes do not just reflect the hegemonic institutional preferences, but also represent a collective solution invented by, and consented to among, East Asian states to the perennial problem of inter-state conflict, co-existence and cooperation’.

Perhaps the most striking difference between this Chinese form of dominance and the contemporary period is that, whereas the tribute system was marked by formal inequality but informal equality in practice, in the ideal-typical Westphalian system the picture is reversed: formal equality but a markedly hierarchical and unequal state system. Whether this system of tributary relations is ever likely to be reconstituted is only a slight possibility, but one that is not discounted by some observers. But whether it reappears in this precise form or not, the significance of the tribute system for the purposes of this discussion is twofold: first, there is a (significantly longer) precedent for effective Chinese dominance, one that differed in important ways from the contemporary system; second, there is no reason to suppose that any future hegemonic order will necessarily replicate the one established under the auspices of US power. Having said that, the enduring nature of American power continues to place limits on China’s global and regional ambitions.
Despite China’s unprecedented economic expansion and the fact that it has rapidly become the most important trading partner for nearly every country in East Asia, it is still something of a surprise to be talking about its potential to lead the region, its historical role notwithstanding. After all, as recently as the 1980s China was still an impoverished ‘Third World’ nation on the fringes of the international system. As recently as the 1970s the People’s Republic was primarily seen by many of its neighbours in Southeast Asia in particular as a dangerous source of revolutionary ideology—fears that were reinforced by the existence of a large diaspora of ‘overseas Chinese’ throughout the region. There was little reason to suppose that such a disparate group of people—often with few direct links to the mainland, whose main claim to fame was as disproportionately successful capitalists—could constitute a coherent force of any sort, much less one that might obediently follow the injunctions of communist China.

Nevertheless, it is testimony to the divisive, paranoia-inducing impact of the Cold War that fears about both China and ethnically Chinese people in the region were rampant. Even more importantly the geopolitics of the region throughout the cold war period made region-wide leadership of any sort, let alone by China, an impossibility. The overwhelming strategic reality of cold war Asia was that it was divided along ideological lines, a situation that was reinforced by a strategic architecture that revolved around the series of ‘hub-and-spokes’ alliances established by the USA in the aftermath of the Second World War. Unlike Europe, where US hegemony underpinned European integration, in East Asia it had precisely the opposite effect. Unsurprisingly this had the result of isolating China from many of its neighbours and reinforcing fears about the negative impact of ‘American hegemonism’.

China’s re-emergence

China’s re-emergence as a regional and world power was the result of a series of internal reforms driven primarily by Deng Xiaoping. The process of ‘opening up’ the Chinese economy has been extensively detailed, as have its remarkable consequences. One of the most important symbolic and consequential initiatives undertaken by China’s leaders as the process of liberalisation and integration gathered pace, however, was the decision to join the WTO. Susan Shirk describes China’s decision to join the WTO as ‘the best thing that ever happened to China’s regional relations’, and it is not hard to see why: not only did this have the effect of further accelerating the process of economic expansion and integration, but it did so in a way that indicated Chinese leaders were going to play by the rules established under the auspices of US hegemony.

The extent of the reforms undertaken by China in order to join the WTO ‘far surpass’ any that have been required of previous applicants, and involved actually rewriting parts of the Chinese constitution. At first blush this would seem to be an unambiguous expression of US dominance: after all, China has been forced to adjust to a regulatory and even normative framework that has
been largely created directly or indirectly in the USA. The pursuit of ‘socialism’ in China has been reduced to a rhetorical flourish, the primary purpose of which would seem to be giving some ideological continuity to a communist party largely legitimated by its ability to deliver growth in a global capitalist economy.

Edward Steinfeld persuasively argues that the transformation of China has a more fundamental material basis: as Chinese industries, companies and workers are integrated more deeply into global production networks and the organisational logics that underpin them, they are inexorably transformed by the processes of which they are a part. For Steinfeld,

China today is growing not by writing its own rules, but instead by internalizing the rules of the advanced industrial West. It has grown not by conjuring up its own unique political-economic institutions but instead by increasingly harmonizing with our own.42

If these claims about the impact of regulatory compliance and even the very nature of production processes themselves are correct, then the implications are profound: even if China does become the largest economy in the world, and even if it does see a steady increase in its international influence as a consequence, it will do so as a successful capitalist economy, not as the standard bearer for a radically different set of ideas or practices.

This is a potentially very significant point, as many observers have cast doubt on China’s ability to lead.43 Because China does not have a coherent vision or alternative model to offer would-be followers, its capacity to offer leadership is circumscribed, the argument goes. Whatever one may think about the impact and underpinning logic of the so-called ‘Washington Consensus’, it did represent a fairly coherent set of policy proposals and implicit normative values.44 Few people are making similar arguments about the ‘Beijing Consensus’,45 and there are consequently questions about whether the ‘China model’ exists, much less offers an alternative to the dominant political and economic paradigm of the postwar era.

The China model

Even though China has arguably re-emerged into the international system as a highly successful capitalist economy and increasingly influential participant in the institutions of international governance, it is sufficiently different to represent a practical and theoretical challenge. In analytical terms the key question is how far the supposed ‘socialisation’ process has actually influenced the thinking and world-views in China.46 I say more about this later in the context of China’s foreign policy, but it is important to remember that change in ‘ruling ideas’ happens at a number of levels: in analyses of the sort I am undertaking here the focus is invariably on elite-level actors who are often unrepresentative of broader social opinion. While it is difficult to generalise about public opinion in non-democratic China, views about economic, foreign and social policy are clearly becoming more varied and critical. Having said that, it is also striking that such surveys of public opinion as do exist invariably suggest that China’s
government enjoys high levels of public support—and generally much higher than do their democratic equivalents in the West.

This is potentially important because, for all the alarmist predictions that have been made about China’s future, thus far at least the Chinese Communist Party has remained firmly in control. Moreover, there are few signs at this stage that China’s growing domestic bourgeoisie is clamouring for the sort of political transformation that characterised politics in the West at a similar stage of development—if it is possible to make those sorts of comparisons given all that has happened in between. What we can say is that China’s capitalists seem—like their counterparts in the West—intent on making money and are quite happy to work with China’s authoritarian, undemocratic government if this is the price for guaranteeing social stability and private profitability. Although much can change in a country that is prone to the occasional revolutionary upheaval, the foundations of the Chinese model of capitalism look reasonably secure. This may be one of its attractions to other countries seeking to replicate China’s broad-ranging economic and social development.

Plainly any attractions the China model may have are likely to be limited primarily to countries that are rather closer to the beginning of the developmental continuum than to the end. For this reason many have pointed to China’s growing economic and diplomatic influence in Africa as evidence of the attractiveness of the China model. Given the ‘pragmatic’ basis of the Beijing Consensus—do whatever seems to work, even if that means having an authoritarian state and cavalier attitude to human rights—and the significant developmental challenges in much of Africa, such views are understandable perhaps. And yet it is striking that China stands accused of ‘neo-colonialism’ and ‘neo-mercantilism’, and the impact of its policies has drawn growing criticism—not just in the West. Nevertheless, there are aspects of China’s approach to development that are not only arguably attractive in themselves—to the economic and political elites who are most likely to benefit from them, at least—but which may compel a degree of emulation for precisely the same reasons the Westphalian state was adopted throughout the world in the 19th century: because these aspects confer competitive advantages that leave rivals little option but to follow suit.

The emergence of ‘state capitalism’ has attracted growing attention as the rise of the BRIC economies has become synonymous with the emergence of a very different style of political and economic organisation to that associated with the Washington Consensus. As Ian Bremmer points out:

State capitalism is not the reemergence of socialist central planning in a twenty-first century package. It is a form of bureaucratically engineered capitalism particular to each government that practices it. It’s a system in which the state dominates markets primarily for political gain.

Such a formulation not only helps to explain the durability and perhaps the success of capitalist development in China, but it also explains why it is such a challenge to the extant order that has been dominated by the West generally and more recently by the USA in particular for the past 150 years or so. In an East
Asian context what is especially significant about China’s style of development and state–government relations is that it is entirely in keeping with a tradition of developmental success that has distinguished East Asia in the postwar period. While there may not be a ‘China model’ that other countries would either want or be able to adopt, there may be sufficient commonalities of history and experience to make China’s potential influence more significant than many in the West would like to think.

Can China lead East Asia?

Before European imperialism overturned the old order in Asia, China was its undisputed leader, even if the nature of its leadership was rather passive and customary. But Asia before the 19th century was a very different place: we cannot simply assume that just because China has led the region in the past it could do so again, or that the factors that underpinned its dominance and the stability of the region then are relevant now. In trying to decide whether China can lead, a number of interconnected questions seems relevant: does China have the capacity to lead? How are its leadership ambitions likely to be received in Asia and elsewhere? Is the sort of leadership, or even hegemony, associated with the USA either possible, necessary or desirable in the 21st century?

China’s grand strategy

While China clearly has one of the most important qualities for becoming a major actor in regional and even world affairs—the second largest economy in the world—translating material weight into influence is not a straightforward process. China’s great regional rival, Japan, is a reminder of just how difficult it can be to make the transition from developmental superstar to aspiring great power. True, there were (and still are) particular domestic and external impediments that inhibited Japan’s foreign policy ambitions, not the least of which is its continuing strategic dependence on the USA. While China plainly doesn’t have the same problem with the USA—quite the contrary, in fact—it has suffered from Japanese-style inhibitions about assuming too prominent a place in world affairs. Deng Xiaoping’s famous dictum that Chinese foreign policy should ‘adopt a low profile and never take the lead’ is remarkably like Japan’s ‘Yoshida doctrine’, which also placed an emphasis on domestic development and national strengthening. The question in China’s case is whether the period of domestic development has been effectively accomplished and its foreign policy ought to reflect its new status.

China’s foreign policy-making process is notoriously opaque and difficult to decipher. Ultimate responsibility for foreign policy decisions, like so much else, resides with the Politburo Standing Committee (PSC). Although the Ministry of Foreign Affairs (MFA) has notional responsibility for constructing China’s foreign policy, in reality, as Jakobson and Knox point out in one of the few detailed analyses of China’s decision-making processes, the MFA ‘is today merely one actor in the realm of foreign policy and not necessarily the most important one.’ Significantly, no single member of the PSC has sole responsibility for
foreign affairs, a situation that inevitably makes policy making more contested and less focused. Adding to the uncertainty is the fact that there is a growing number of actors both inside and outside government attempting to influence the construction and content of policy. Not only do other government departments or actors such as the Ministry of Commerce or the People’s Liberation Army seek to influence policy, but so too do a growing number of non-state actors in universities, think-tanks and even the blogosphere. The result, argues David Shambaugh, is a ‘conflicted’ China with no single sense of national identity.61

This is not to say that the Chinese government does not have broadly consistent long-term goals or even a ‘grand strategy’, however. Like Japan before it China’s leaders have adopted a form of ‘comprehensive security’,62 consciously linking political, economic and military issues to achieve security and great power status. Avery Goldstein argues that China’s grand strategy has three core components:

Politically, China pursues multilateral and bilateral diplomacy to mute threat perceptions and to convince others of the benefits of engagement and the counterproductive consequences of containment. Economically, China nurtures relations with diverse trading partners and sources of foreign investment, weaving a network of economic relations to limit the leverage of any single partner in setting the terms of China’s international economic involvement. Militarily, China seeks to create some breathing space for modernization of its armed forces.63

Whether China should now be considered a ‘great’ or merely a ‘regional’ power is debatable,64 but, as Zhang and Tang point out, at an empirical level China’s influence is still likely to be manifest mainly at the regional level, so its policy in East Asia can be considered ‘the core of its grand strategy’.65 Its principal features, they argue, are an abiding consciousness of US hegemony, a desire to cultivate good regional relations, and an embrace of multilateralism and good international citizenship.66 Whether these goals are reconcilable with each other or with the rapidly evolving context within which regional relations are being played out is a moot point. Nowhere illustrates these tensions more clearly than China’s relations with Southeast Asia.

Is China’s policy charming...

For those observers who emphasise the importance of ‘socialising’ China into good behaviour its relations with Southeast Asia offer grounds for optimism. There plainly has been a dramatic change from China’s position as a destabilising exporter of revolutionary ideology little more than 30 years ago, to its current role as an important part of the East Asian region’s burgeoning institutional architecture. China’s regular participation in organisations such as the Association of South East Asian Nations (ASEAN) Regional Forum—the principal security grouping in the broader ‘Asia-Pacific region’67—has clearly had an impact on the diplomatic elites who participate. Undoubtedly such events have
contributed to ‘confidence building’ and must be given some credit for the overall peace and stability that distinguishes the region.

It is also important to recognise that China has actively reinforced this appearance of being what Robert Zoellick famously described as a ‘responsible stakeholder’ by unleashing a ‘charm offensive’ on the Southeast Asian region in particular. A number of points merit emphasis about this overall attempt by China to improve relations within the region generally and with Southeast Asia in particular. First, it implicitly recognises the potential value of participation in regional institutions and the possibility that this is not necessarily incompatible with the pursuit of ‘national interests’. On the contrary, long-term objectives may be achieved more effectively by cultivating good relations with other states and minimising potential points of resistance to a Chinese agenda.

Second, it has become increasingly common to talk about China’s ‘soft power’, a concept that was until recently almost exclusively associated with the USA. Not only did the USA’s own ideational influence and standing go into steep decline during the administration of George W Bush, but China’s also rose independently. Although there have been important discursive efforts on China’s part to reassure perennially nervous Southeast Asian states about the implications of what China insists is its ‘peaceful rise’, these rhetorical innovations have been reinforced by more tangible gestures. China’s decision not to devalue its currency at the height of the Asian crisis in 1998 was not only well received by the region, it signalled China’s (re)emergence as a decisive economic and political force in regional affairs. This policy of using its economic leverage to pursue long-term diplomatic goals in Southeast Asia was taken to new heights when China suggested establishing a free trade area with ASEAN. Although this was entirely in keeping with broader developments in the region, the fact that Chinese policy makers were willing to give ASEAN an ‘early harvest’ of unilateral trade liberalisation and access to China’s rapidly expanding domestic market highlighted the costs China was willing to bear to cultivate good relations.

We might be forgiven for thinking that China’s soft power is growing and that its charm offensive has been a success. But not only is it important to remember that the charm offensive was partly designed to offset the earlier ‘China threat’ theory that emerged primarily from the USA, we should also note that China’s own recent actions have undermined its efforts at regional rehabilitation.

...or alarming?

Over the past one or two years there has been a noteworthy shift in China’s foreign policy, one that casts doubt on its ability to provide regional leadership. Two issues in particular have sparked renewed regional anxiety. First, there is a growing concern about increases in Chinese defence spending. Although there has been a noteworthy increase in spending as China attempts to modernise its military, it remains small compared with the USA, which still outspends all of the other great powers combined. However, what has caused particular alarm is China’s acquisition of an aircraft carrier and a new generation of anti-ship
missiles, which some observers think may change the strategic balance in the region.81 Defence spending across the region has increased as a consequence, reinforcing the views of those who see the region as inherently unstable.82

The second development that has caused alarm has been China’s increasingly assertive, even confrontational, approach to territorial disputes around the region generally, and in the South China Sea in particular. By some estimates oil reserves in the South China Sea may amount to over 200 billion barrels, second only to those in Saudi Arabia if proven.83 Since it became an oil importer as recently as the mid-1990s, questions of energy security have begun to assume an increasingly prominent place in China’s foreign policy priorities and calculations.84 It is not hard to see why: the principal source of legitimacy for the ‘communist’ elites that still govern China is their ability to continue delivering economic growth and social stability.85 Both of these would be threatened by any deterioration or transformation in China’s external sources of supply. The South China Sea could play a crucial role in insuring against such an eventuality, which helps to explain both China’s confrontational stance and its interest in developing the capacity to protect the vital sea lanes through which resources must travel.86

The other significant aspect of China’s approach to its territorial disputes in the South China Sea is its reluctance to multilateralise them. Despite the existence of the Asian Regional Forum (ARF), an organisation that ought to be uniquely well placed to play a mediating role,87 China prefers to exercise its greater power and leverage through bilateral channels in this particular issue area.88 While China has demonstrated a willingness to play an active role in regional and even global institutions, this has not been at the expense of national sovereignty, which remains paramount in Chinese strategic thinking.89 In this respect, at least, for all the unhappiness China’s behaviour may cause among Southeast Asian political elites, China’s preference for sovereignty-enhancing regional institutions is entirely in keeping with ASEAN’s own fundamental principles. The question is whether such an approach can provide the basis of a leadership role for China at the regional level, let alone on the global stage.

The constraints on Chinese leadership

It has been widely noted that Japan and China are rivals when it comes to regional leadership.90 This helps to account for the relative feebleness and growing number of regional institutions: China, Japan, Indonesia and Australia have all proposed, or are associated with, different regional institutions and/or visions, which often have roles that potentially overlap and even compete.91 In the case of China’s preferred regional option—ASEAN plus 3 (APT), which includes the ASEAN states along with China, Japan and South Korea—there is no doubt that alternative proposals from the likes of Japan and Australia are actually designed to compete with, and diminish the influence of, the APT grouping. Many of China’s neighbours are concerned about the development of an organisation that is exclusively East Asian and that is likely to be dominated by China. A more encompassing definition of the region that includes the USA, by
contrast, is seen as a way of limiting China’s influence and keeping the USA strategically engaged in the region.92

This marks an important change of direction in the region, and needs to be seen as part of a long-running contest to define the region itself and its constituent membership.93 In the aftermath of the Asian financial crisis, and with the enthusiastic support of Malaysia, it seemed that institution building in the region would not only take-off, but would do so with an exclusively Asian membership.94 Now, however, things look rather different. China’s growing material importance, its military modernisation and its increasingly assertive behaviour have caused growing alarm in Washington. Long preoccupied with the Middle East, many strategic analysts in the USA have suddenly become concerned about the possible challenge China poses to America’s assumed leadership in the ‘Asia-Pacific’ region. The recent ‘pivot’ in US foreign policy and the reprioritisation of strategic ties with traditional allies such as Australia and Japan, and even former foes like Vietnam, is evidence of this new policy focus.95 The reassertion of US strategic influence in the Asia-Pacific is one more manifestation of a number of factors that suggest China’s capacity to supply regional, much less global, leadership as conventionally understood is likely to be constrained for the foreseeable future.

Concluding remarks

There has been a direct response to China’s rise that is increasingly focused on the possible strategic implications of its growing power and apparent willingness to use it in the context of areas such as the South China Sea. While Chinese authorities continue to accumulate material weight and leverage in international affairs—as its symbiotic economic relationship with the USA vividly reminds us96—it is not easy to translate this latent power into influence, much less leadership of the sort we have traditionally associated with a single country such as the USA. But this may not be a failing of Chinese leadership so much, perhaps, as a more general indication of a profound change in the nature of the international system more generally. It is a striking feature of the contemporary system that no individual state or collective actor—not even the formerly ‘hegemonic’ USA, and certainly not the increasingly ineffectual EU—seems able to provide the sort of leadership that Kindleberger once thought was pivotal. This may, however, be more cause for celebration than consternation. True, there may be formidable regulatory and collective action problems in the increasingly integrated international economy, but this may be a small price to pay if we collectively avoid the strategic excesses that were unleashed at the height of the Bush administration’s period of ‘unipolarity’. Whether George W Bush provided ‘leadership’, or simply demonstrated the dangers of unfettered unilateralism, is debatable but, as Barry Buzan persuasively argues, moving towards a world without superpowers and the sort of ‘leadership’ they have traditionally supplied ‘may be no bad thing’.97

At a theoretical level this may mean that some of the assumptions and concomitant fears about ‘hegemonic transition’ are misplaced.98 Although it is not possible to address this issue in any detail here,99 the key point to emphasise is
that it may be inappropriate to infer any inevitable consequences as a result of China’s rise—should it continue. We have only two real examples of modern hegemonic orders (if we discount China’s), and the circumstances in which Britain and perhaps even the USA dominated the system are already becoming anachronisms. Even if China does eventually assume the sort of dominant position its growing material weight implies it might, the historical circumstances that underpinned Britain’s and America’s dominance look unique and unrepeatable. Even in East Asia, where we might expect China’s influence to be most readily felt, at this stage there is little evidence of any ‘bandwagoning’, much less identification with Chinese goals. This is hardly surprising: not only are the geopolitical circumstances that might encourage such ideological isomorphism absent, but so, too, is any Chinese ‘vision’ around which followers might coalesce—over-excited discussions of the self-serving, essentially nationalistic Beijing Consensus notwithstanding.

And yet, despite East Asia’s chequered history, in which China has played a large and often tragic part, there are perhaps some grounds for cautious optimism. Despite the relentlessly gloomy predictions made by historical analogy about East Asia’s prospects and the inevitability of conflict and hegemonic competition, thus far at least the region remains remarkably stable. It is also, of course, the centre of the greatest economic development story the world has ever seen. There is much to lose by undermining this essentially benign state of affairs. If there are lessons to be drawn from European history, perhaps they are about the desirability of some sort of ‘concert of powers’ in which regional states—and perhaps a post-hegemonic USA too—reach some sort of mutual accommodation. This may not be the sort of leadership to which we’ve become accustomed, but it may prove more durable than some historical alternatives.

Notes

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1 This is an unsatisfactory, but conventional, shorthand for the complex array of processes and influences that ultimately produce foreign (and domestic) policies. Some of these influences are considered in more detail in what follows.


15 Japan is undoubtedly the most important example of this possibility, and not just in Asia. While there were particular aspects of the relationship between Japan and the USA that are unique and which explain the degree of Japan’s reliance on the latter, the general point stands. See W LaFeber, The Clash: US–Japanese Relations throughout History, New York: Norton, 1997.


50 As one of two referees perceptively noted, the need to maintain social stability through full employment increases the pressure to ‘manipulate’ the yuan and limits China’s ability to provide internationalisation strategy. See BJ Cohen, ‘The yuan tomorrow? Evaluating China’s currency internationalisation strategy’, *New Political Economy*, 17(3), 2012, pp 361–71.


59 T Branigan, ‘China’s foreign policy is playing catch-up with its new status’, *Guardian*, 22 March 2012.


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66 Other influential Chinese scholars also emphasise the possible importance of multilateralism and ‘soft power’ as part of its grand strategy, which makes China’s recent more assertive behavior all the more surprising. See J Wang, ‘China’s search for a grand strategy’, Foreign Affairs, 90(2), 2011, pp 68–79.
78 For an overview of the policy debate in China, see M Beeson & F Li, ‘Charmed or alarmed? Reading China’s regional relations’, Journal of Contemporary China, 21(73), 2012, pp 35–51.
79 K Hille, ‘China’s defence spending to rise 11.2%’, Financial Times, 4 March 2012.
90 B Emmott, Rivals: How the Power Struggle between China, India and Japan will Shape our Next Decade, London: Allen Lane, 2008.

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99 Beeson, ‘Hegemonic transition in East Asia?’.


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Neoliberalism and the Russian transition

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Neoliberalism and the Russian transition

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ABSTRACT

This article aims to assess the role of neoliberal ideas in shaping Russia’s transition to a market economy. Prevailing ideas of the Washington Consensus undoubtedly encouraged Russia’s leaders to embrace radical reforms, but Russia’s reformers were not blindly following an ideological agenda set for them in Washington, DC. The actual policies that were implemented diverged considerably from the prevailing neoliberal orthodoxy and were heavily shaped by the self-interest of the elites who were making the policy decisions. While prices were freed and international trade and currency flows opened up, an insider-dominated privatization process left the Russian economy in the hands of a narrow circle of oligarchs. Russia’s corrupt, oil-dependent and state-centered economy is far removed from the decentralized, competitive market system that the reformers had envisaged. Democracy, which was initially seen as integral to the transition process, also fell by the wayside. While critics argue that Russia suffered from an overdose of ‘market fundamentalism’, neoliberals themselves still insist that Russia did not go far enough in unleashing genuine market forces. Either way, Russia has now joined the global market economy, while at the same time preserving many of the institutional features that are the product of its unique geography and historical heritage.

KEYWORDS

Russia; neoliberalism; privatization; transition; shock therapy.

1. INTRODUCTION

This article examines the extent to which a specific body of ideas, which we call ‘neoliberalism’, played an independent causal role in Russia’s post-Soviet transition. The article begins with a discussion of the rise of neoliberal ideas and their role in economic development. The framework of analysis. The third section describes the reforms introduced in Russia in the 1990s, while the following section assesses lacunae in the neoliberal
approach. The final section examines developments since Vladimir Putin took over the Presidency in 2000.

The conclusion is that certain general assumptions about how the market economy works did enable and encourage radical economic reforms in Russia at a critical juncture. But it is very difficult to separate the causal role of ideas from the host of practical concerns that were pushing leaders to act in a certain direction. Leftist critics of globalization portray neoliberalism as a package of inflexible policies that was imposed on governments around the world – Russia included – through the sticks and carrots of International Monetary Fund (IMF) loan conditionality (Harvey, 2007; Klein, 2007). However, examination of the historical record shows that the Russian leadership took a selective approach to the neoliberal policy package, adopting some proposals and spurning others. And even the policies that they did embrace were often radically altered in the course of implementation.

One possible way of trying to judge the influence of neoliberal ideas would be to assess the final results of the reform process. If Russia emerged from the tunnel of transition as a prosperous, competitive market economy, then that could be construed as *ex post facto* support for the importance of neoliberal ideas. But the evidence is mixed and observers are divided over how to evaluate Russia’s subsequent economic trajectory. Russia is now a market economy in which most assets are owned by private corporations and most transactions take place at market-clearing prices. However, Russia’s markets are highly oligopolistic and prone to capricious state intervention. Anders Aslund (1995, 2003) and Daniel Treisman (2011) portray the Russian transition as a qualified success, while Joseph Stiglitz (2002) argues that an alternative, gradual approach with more state regulation could have worked better. Marxists such as Gareth Dale (2011) concede that the reformers succeeded in integrating Russia into the global capitalist economy, but they argue that this was to the detriment of the Russian people. For example, in the course of the 1990s, Russia saw a radical contraction of employment in agriculture and manufacturing and a growing dependence on the extractive sector – oil, gas and metals (Tabata, 2012). To market advocates, this is to be welcomed as evidence of comparative advantage in action. To market critics, it is a sign of a failure to preserve a balanced, diversified economy, capable of sustained growth and social equality.

Whether one adopts an optimistic or pessimistic stance on Russia’s performance as a market economy, it is very difficult to isolate the specific causal impact of neoliberal policies (to the extent that they were implemented by the Russian authorities) on Russia’s economic transition.
2. THE ROLE OF IDEAS IN ECONOMIC DEVELOPMENT

2.1. The global transition and the rise of neoliberalism

In politics, timing is everything. If the Soviet Union had collapsed in the 1950s, post-Soviet leaders might well have adopted the social market economy that was then delivering rapid growth in West Germany. But the Soviet collapse came in 1991, by which point many policy makers in the developed capitalist countries had lost faith in the Keynesian model that had been in place since 1945. The global economy was experiencing a wrenching set of transformations that cast doubt on the prevailing economic paradigms.

By the 1970s, the American and European economies were suffering from slow growth, high unemployment and inflation; social and political unrest; the breakdown of the Bretton Woods currency management system, which had been in place since 1944; and the 1973 oil price hike that introduced new instabilities to the global financial system. Add to this debt crises and political instability in the developing world, which discredited prevailing strategies such as the import-substituting industrialization favored by the Left (under the influence of dependency theory) and the infrastructure lending favored by the World Bank (shaped by traditional growth theory). At the same time, there was a revolution in transport and information technology that led to the globalization of manufacturing processes and the rise of assembly plants in East and Southeast Asia. It was an open question to what extent national governments had the capacity to steer their countries through these turbulent times. Increasingly, economists and decision makers were coming around to the view that it was better for the state to step back and work with, rather than against, market forces – in what Philip Cerny has called the ‘competition state’ (Cerny, 1997).

A group of radical market advocates who came to be known as ‘neoliberals’ urged governments to shed the Keynesian interventionism and welfare state spending of the post-war era and, instead, embrace the logic of deeper market relations, both externally (through greater involvement in the international division of labor and global capital markets) and internally (by removing barriers to market forces and shrinking the role of the state). Neoliberalism is more a broad political philosophy, inspired by the writings of Milton Friedman and Friedrich Hayek, than a specific set of policy proposals (Mirowski and Plehwe, 2009; Shleifer, 2009). For its defenders, it is a philosophy that maximizes human freedom and prosperity; for its opponents on the Left, it is a façade behind which capitalist elites advance their class interests (Dale, 2011; Klein, 2007; Harvey, 2007). Neoliberalism now has a strongly negative connotation amongst international policy elites, and especially in academia (Hartwich, 2009). Proponents of
the policies identified as ‘neoliberal’ almost never use the term about themselves. Rather, they describe themselves as advocates of the free market, or of capitalism.

Neoliberalism did not always have such negative connotations. One early branch was the German economic thinkers of the period from the 1920s to the 1950s known as the Ordoliberals. They were devoted to rescuing and reviving the power of capitalist institutions in a continent that had seen the market crushed by the state under fascist and communist regimes. Unlike contemporary neoliberals, the Ordoliberals viewed the market as socially embedded and stressed the importance of developing political institutions (rule of law, federalism, democracy) that would be congruent with and supportive of market competition (Zweynert, 2006). Classical liberalism had never erected a wall between economic behavior and other forms of social interaction. After all, the same Adam Smith who wrote *The Wealth of Nations* had previously written *The Theory of Moral Sentiments*. It was only after German Ordoliberalism migrated to Latin America in the 1960s, where it was known as ‘neoliberalism’, that the label started to be used primarily by its adversaries and that liberal economic prescriptions became divorced from attention to the political institutions without which they cannot function (Boas and Gans-Morse, 2009). This historical excursus is relevant because it draws attention to the fact that, in the 1990s, neoliberal economics got divorced from its political context, with unpleasant consequences.

The costs of this separation were particularly salient in Russia, a country that was simultaneously attempting to make the transition to both democracy and a market economy (Aslund, 2009). Neoliberalism has a complex relationship with democracy. Neoliberals themselves are firm advocates of the spread of democracy, but critics argue that it was unrealistic to expect countries just starting on the path to democracy to take the kind of tough, controversial decisions that radical market reforms require. Neoliberal reforms bring immediate and substantial short-run costs with the promise of (mostly) long-term benefits. Also, despite promises that market reforms would benefit the majority of citizens, in practice, liberalization tends to increase social inequality. This means that there is going to be substantial political resistance to such a policy innovation both within the ranks of the ruling party and in the electorate at large. However, the record shows that neoliberalism and democracy are not incompatible. It is not the case that neoliberal reforms were only or even primarily introduced by authoritarian rulers. The authoritarian regime of General Augusto Pinochet, which came to power in Chile in 1973, may have been a trailblazer, but it was something of an exception. The next wave of neoliberal reforms were launched by democratic governments: Margaret Thatcher’s Conservative government in the UK and the Labour government in New Zealand,
which came to power in 1979 and 1980, respectively. With strong leadership able to articulate a convincing political vision, neoliberal reforms can be launched by democratically-accountable governments, too.

2.2. Different approaches to the role of ideas in institutional change

How is one to understand the role of neoliberal ideas in the spread of market reform in East Europe in the 1990s? To some extent, it suits both advocates and critics of neoliberalism to exaggerate the importance of that body of ideas in shaping the post-socialist transition. The reality is more complex and nuanced (Ganev, 2005; Bockman and Eyal, 2002).

It is now commonplace to assume that at any given time, one particular set of ideas will tend to exercise hegemony, with all the social actors articulating their identity and pursuing their interests through the language of the ruling paradigm. This notion can be traced back to Karl Marx’s 1845 pamphlet, *The German Ideology* (‘the ideas of the ruling class are in every epoch the ruling ideas’). More narrowly, such an approach was applied to the sphere of science in Thomas Kuhn’s influential work, *The Structure of Scientific Revolutions* (1962). In some domains, there are competing paradigms – as in the field of international relations, for example, where states are pulled between Realist and Liberal Institutionalist frames.

In fields where there is a prevailing orthodoxy, analysts face the challenge of explaining why and how a particular set of ideas was able to establish hegemony and displace the preceding paradigm. It is tempting to adopt a reductionist position and to explain away ideological shifts as mere epiphenomena, reflecting changes in the ‘real’ economy and relations between competing social groups. Hence, for example, the rise of Keynesianism in the 1930s could be seen as a response to pressure from organized labor in the face of the Great Depression, while the weakening of labor in conditions of global competition led to the demise of Keynesianism in the 1970s. In contrast, Mark Blyth (2002) argues that the rise and subsequent fall of Keynesianism required the emergence of a new epistemic community favoring the new approach, which gained access to mass media and political elites. It was not the case, Blyth argues, that one paradigm arose simply because it was a more ‘true’ reflection of social reality than its rival.

In East Europe, the collapse of state socialism led to an ideological vacuum that attracted ideas about the superiority of markets and liberal democracy emanating from the West. While Western labor unions and socialist parties tried to promote social democratic values, sending delegations and opening offices in the region, it was radical pro-market ideas that quickly captured the attention of ruling elites across Eastern Europe – and even in Russia itself. The dissemination of neoliberal ideas occurred very quickly and involved a small number of people – Western economic consultants who travelled to the region; missions from international financial institutions; and conferences attended by a handful of young,
reform-minded economists from the transition countries (Wedel, 2001). (For an example of one of the earliest neoliberal publications in Russian, see Kapelyushnikov (1989).) The vast majority of indigenous economists in the region remained committed to socialist planning principles or, perhaps, favored some kind of social democratic alternative. There is no evidence that neoliberal ideas became ‘hegemonic’ across the majority of political and economic elites in the region, still less amongst the population at large. Rather, there was a more diffuse sense that market reforms were necessary – and the Washington Consensus was there ready and waiting as a prescription for change. There was no epistemic community of ‘market fundamentalists’ in Russia prior to 1989, just a handful of thinkers edging towards market solutions (Sutela and Mau, 1998). Most of the indigenous advocates of neoliberalism in the 1990s were recent converts with little professional training in free market economics. Take, for example, Yegor Gaidar and Vaclav Klaus, both trained as economists in the socialist system, who went on to oversee the introduction of market reforms as Prime Ministers of Russia and Czechoslovakia, respectively (Appel, 2004). They became open advocates of neoliberal ideas only in the late 1980s. In Latvia, neoliberal ideas were promoted by a group of émigré economists known as the ‘Georgetown Gang’, who returned to Latvia in the late 1980s (Sommers and Berzins, 2011: 123). In some cases, neoliberal ideas were picked up and used as rhetorical clubs by politicians such as Estonian Prime Minister Maart Laar, who claimed to have read only one economics book, Milton Friedman’s *Free to Choose* (Aligica and Evans, 2009: 156).

In any event, even within the neoliberal paradigm as it emerged in the West, there was no standard theory about how to convert an entire state-run economy into a competitive market system. Previous neoliberal theory had merely tackled the question of rolling back government within an already established market economy. So, transition economists were operating ‘without a map’ (Shleifer and Treisman, 2001). They had to beg and borrow ideas from whatever experience looked relevant. Many of the theoretical ‘principles’ shaping policy were invented overnight, and actual practice immediately diverted from the model, such as it was.

Critics often associate the market reforms of the 1990s with the libertarian economics of Friedrich Hayek, also known as the ‘Austrian school’. As Aligica and Evans note (p. 23), however, neoliberals invoked the techniques and assumptions of mainstream neoclassical economics, rather than Austrian economics per se. A true Hayekian would object in principle to the very idea that a reform package could be designed in Washington and applied throughout the world by national governments. And if such an effort were undertaken, the results would inevitably be very different from what the reformers intended. Hayek believed that social orders emerge spontaneously as a result of individuals pursuing self-interest and not as a result of some grand design (Petsoulas, 2001).
2.3. The Washington Consensus reaches out to the post-socialist bloc

Pro-market ideas were not just circulating in academia and the press, but also became an instrument of policy for the leading international financial institutions. Throughout the 1990s, the IMF, the World Bank and the newly-created European Bank for Reconstruction and Development (EBRD) made compliance with the standard neoliberal policy package a condition of new lending to governments in the post-socialist countries. Governments were told that they had no choice but to accept the comprehensive package of measures dubbed the ‘Washington Consensus’ (Williamson, 2008). This was in essence ‘a set of policies predicated on a strong faith in unfettered markets and aimed at reducing, or even minimizing, the role of government’ (Stiglitz, 2008: 41). That general philosophy certainly resonated in the Soviet bloc and strongly influenced the decision-making of the reform leaders.

The Washington Consensus primarily reflected the experience in Latin America. Efforts to open up those economies to more market competition had been stymied by class warfare and spendthrift populist governments, leading to cycles of debt crisis and hyper-inflation. The Washington Consensus boiled down to a holy trinity of liberalization, stabilization and privatization. The case for free trade and sound money had been around for some time, but privatization, the newest leg of the triad, had only been introduced at a national level by Margaret Thatcher in the UK in the early 1980s. But it was not clear to what extent the British and Latin American experience was relevant to the task of building a market economy from scratch in countries that lacked basic institutions such as joint stock companies, independent courts, a commercial code and private land ownership (Rodrik, 2006).

The argument was that the policies had to be implemented as a package because failure on one front would undermine progress on other fronts – for example, a fiscal imbalance would cause a run on currency. Also, it was important to signal the leadership’s ‘credible commitment’ to better policies – a signal both for foreign investors and for domestic political and economic actors. Failure to pursue consistent policies across the board would send a mixed message and undermine confidence. Consequently, the package favored rule-based policy over discretionary policy and paid little or no attention to indigenous institutions and culture (Headey, 2009).

In Russia, stabilization (that is, the reduction of inflation and closing the fiscal deficit) took longer than promised and came at the expense of ordinary citizens due to increases in unemployment, cuts in public spending, a slump in gross domestic product (GDP) and an inflationary surge that wiped out savings (Popov, 2007). The neoliberal package made controlling inflation a priority since prices are the key signaling device in a market economy. Critics argued that in their zeal to choke off inflation, the
reformers exacerbated the transition recession (Klein and Pomer, 2002). Also, lifting capital controls and introducing currency and, later, capital account convertibility made these economies vulnerable to speculative capital flows. Reformers tended to treat the exchange rate as the nominal anchor for anti-inflation policy, seducing governments into costly and often unsuccessful efforts to stabilize the exchange rate. The privatization process was pushed through much faster than skeptics believed possible, but, in most countries, it was accompanied by corrupt dealing that saw choice assets steered into the hands of insider elites (Aslund, 2003).

Apart from its economic core, the package approach also had certain political advantages. Its proponents argued that it was important to move quickly while society was in a state of disarray and before representatives of the ancien régime could regroup and turn back the transition. Leading Russian reformers such as Anatolii Chubais and Yegor Gaidar openly stated that the primary motive behind their reforms was political, rather than economic: to shatter the bureaucratic infrastructure, which was the backbone of the power of the nomenklatura, and to make a return to communism impossible (Gaidar, 2007). Speaking in July 1993, Chubais said the reforms were 5 percent economics and 95 percent politics (cited in Nelson and Kuzes, 1995: 158). However, such statements could be seen as an effort to avoid responsibility for the initial failures of the economic program, while trying to claim credit for the progress towards liberty in Russia.

As a result of the market reforms, social inequalities increased and a small number of individuals became incredibly wealthy. It is tempting to argue post hoc ergo propter hoc: that those who benefitted from the market reforms were not only its main defenders, but even its principal instigators. So, market reform is seen to be the result of a deliberate policy by far-sighted communist bureaucrats to convert their collective political authority into private negotiable assets, an interpretation favored by both the Left (Kotz and Weir, 1997) and the Right (Satter, 2004; Hedlund, 2000). The implication is that the Western neoliberals were dupes who failed to realize that their reforms had been introduced to benefit venal elites. There is some truth in this argument, but it tends to exaggerate the degree of influence of the individuals who subsequently became oligarchs. Many of them were young and far removed from the core decision-making process in the late 1980s and early 1990s. Their political influence came after they became wealthy, not before.

The promoters of neoliberal ideas had a variety of levers at their disposal to persuade post-socialist governments to embark on radical market reform. First, they could claim the authority of Western economic science, portrayed as universal truth akin to the laws of physics or as just common sense. Considerable effort went into training and setting up exchange programs to school East European officials in the prevailing ‘best practices’, from corporate accounting to central bank independence (Epstein, 2008).
Second, they could portray themselves as speaking on behalf of the international financial institutions without whose assistance the transition countries faced imminent bankruptcy. Indeed, in return for Poland’s 1990 ‘shock therapy’ reform package, Jeffrey Sachs won Warsaw a 50 percent write-down of its $40 billion foreign debt (Murrell, 1993; Sachs, 1993). This was similar to the deal Sachs had won for Bolivia in 1985 and came in the wake of the 1989 Brady plan, which granted a 35 percent discount on $60 billion of bad third world debts in return for the acceptance of IMF conditionality.\(^2\)

### 3. RUSSIA EMBARKS ON REFORM

*‘In the valley of the blind, the one-eyed man is king’.*

H.G. Wells

#### 3.1. The implementation of Washington Consensus policies in Russia

The Washington Consensus had an important impact on the trajectory of economic reforms in Russia in both the initial, chaotic phase of the early 1990s under President Yeltsin and during the return to economic growth in the 2000s under President Vladimir Putin. However, adoption and implementation of the policy package were halting and uneven (Table 1). During the Yeltsin years, Russia implemented roughly half of the policy package associated with the Washington Consensus. Optimists will say the glass was half full, pessimists, that it was half empty. The most significant progress came in the area of currency convertibility and trade liberalization. There was little forward progress during the Putin years, with the notable exception of taxation and fiscal discipline.

<table>
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<tr>
<th>Policy Area</th>
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<td>Fiscal discipline</td>
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<td>Public spending reform</td>
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<td>Tax reform</td>
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<td>Interest rate liberalization</td>
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<td>Competitive exchange rate</td>
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<td>Trade liberalization</td>
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<td>Liberalization of FDI</td>
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<td>Privatization</td>
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<td>Deregulation</td>
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<td>Property rights</td>
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*Note: For parallel exercises in scoring the Russian transition, see EBRD (2005), World Bank (2002) and Ahrend and Tomson (2005). The policy list is from Williamson (2008).*
The initiative for reform was generated within the upper echelons of the Russian political elite, who realized that the inherited institutional structure was failing to keep the Soviet Union competitive with rival capitalist powers. Under both Mikhail Gorbachev and Boris Yeltsin, the reforms were top-down; they were not driven by pressure from below, nor were they a direct response to pressure from outside the country (Rutland, 1997). The economic reforms introduced by Gorbachev after he became General Secretary in 1985 were enough to disrupt the functioning of the centrally planned economy, but stopped well short of a transition to the market (Mau, 1996; Ellman and Kontorovich, 1998). Gorbachev decentralized decision-making to the enterprise level and allowed the emergence of small cooperatives. But he balked at lifting price controls and allowing private property. Gorbachev’s political reforms were more substantial. The end of censorship and the introduction of semi-free elections quickly eroded the Communist Party’s monopoly of power and led to the collapse of the Soviet Union itself.

As President of the newly-independent Russian Federation, in January 1992, Boris Yeltsin inherited a country whose political institutions were in the throes of transition from one-party rule to some sort of electoral democracy. At the same time, the institutions of the centrally-planned system were disintegrating and the economy was in free fall, with $80 billion of international debts and an empty treasury. Russia saw open worker unrest for the first time in decades, as coal miners struck to protest empty store shelves. Yeltsin’s hastily-assembled team of economic advisers, led by Yegor Gaidar, decided they had no choice but to liberalize domestic prices to get goods flowing and prevent mass starvation (Gaidar, 1999). On 2 January 1992, something like 80 percent of prices was freed. At the same time, restrictions on private entrepreneurs and on foreign trade were lifted and real markets started to appear. The decision to liberalize prices was taken in a great hurry and reflected more a gut understanding of the logic of supply and demand than a considered reflection of the prescriptions of the Washington Consensus.

Unfortunately, prices exploded, with inflation running at 1,600 percent by the end of 1992. This was partly due to the stock of unspent rubles that people had saved over preceding years, and partly because the Central Bank was pumping liquidity into the system in the mistaken belief that this would prevent a fall in living standards (Murrell, 1993; Popov, 2007). This action by the Central Bank undermined the reformers’ pledge that there would be a one-time price adjustment, but no sustained inflation. The problem was that the bank was accountable, not to Yeltsin’s government, but to the Congress of People’s Deputies, the majority of which came out in opposition to Yeltsin’s ‘shock therapy’. This was the very same Congress that had rallied at Yeltsin’s side to face down the hardliner coup in August 1991, just months before. It took three years of political infighting before
Yeltsin’s government was able to bring the money supply and budget deficit under control, with inflation falling to 130 percent in 1995 and 25 percent in 1996 (Rosstat, 2012). The lifting of most controls on foreign trade, the lowering of trade tariffs and the introduction of partial ruble convertibility saw a surge of exports of Russian raw materials and imports of food and consumer goods. Foreign trade went from 17 percent of GDP in 1990 to 48 percent in 2004, so this aspect of liberalization worked more or less as anticipated (Rosstat, 2012).

If the moving spirit of neoliberalism was the retreat of the state from economic life, then Russia certainly exemplified the program. The initial reforms in 1992 saw the rapid emergence of a multitude of independent economic actors – from street traders up to factory directors, now free to manage their still state-owned factories without supervision by central planners. There was also a leakage of power from state to non-state actors, and from the federal center to the regions. Federal government revenue shrank to a low of 10–12 percent of GDP in 1997 and the government had trouble paying pensions and state employee salaries (Rutland, 1997). Federal financing of education and health care virtually ceased, as did state orders for defense plants. This early period also saw the breakdown of respect for the law and a surge in crime and corruption. The retreat of the state was not so much a deliberate policy of the liberal reformers as a result of the collapse of the Soviet state institutions, a process that began in 1987 and accelerated in 1991, before Yeltsin’s administration came into power. In Russia, it was not really the case that ‘[t]he weaknesses in public institutions were caused in part by the Washington institutions’, as Stiglitz argues (2008: 51). At the most, neoliberalism provided a rhetorical shell to explain these developments as the price to be paid for building a new economy.

3.2. The privatization program

Privatization, the shift of economic assets from state ownership into private hands, proceeded in remarkably rapid fashion in Russia. However, the methods used did not conform to neoliberal prescriptions of how it should be done. Western advisers argued for open, competitive auctions that would bring in new owners with capital and expertise. But, in the Russian context, those outside bidders would likely be foreign corporations, and an influx of foreign owners was politically unacceptable. The chaotic economic conditions and the failure of the stabilization program meant that the state assets were, in effect, given away and, ‘[i]n a sense, what took place was more a definition and clarification of existing property rights than a redistribution of ownership’ (Sutela and Mau, 1998: 70).

First, beginning in the late 1980s, there was a process of ‘spontaneous privatization’ as incumbent directors took over de facto control of state enterprises and started running them for their own personal profit (Nelson and Kuzes, 1994). Some firms managed to register themselves
as independent corporations with the approval of their supervising ministry. In this manner, the former Ministry of Natural Gas converted itself into the Gazprom Corporation. Second, there was the mass privatization program launched in 1992 by Anatolii Chubais, the head of the State Property Committee, under which citizens were given vouchers to bid for shares in state enterprises. This was modeled on the successful scheme launched in Czechoslovakia the previous year (Appel, 2004). Unlike the Czech model, however, in Russia, workers and managers were given the option of acquiring a majority of the shares in their own firm (a concession Chubais had to make to win passage of the law through Congress). More than 70 percent of firms chose the insider buyout option and control usually concentrated in the hands of the incumbent directors. Most of Russia’s most profitable firms, particularly those in the oil, gas and metals sectors, were excluded from the mass privatization program. Vitaly Naishul, one of the earliest proponents of the voucher approach for Russia, denounced the Chubais program as a giveaway to insiders (Sutela and Mau, 1998: 68).

A third wave of privatization through cash sales began in 1994. The government did not want to sell to foreign investors, but Russian buyers lacked capital. So, in 1995, Chubais proposed swapping shares in a dozen leading oil and metals companies in return for loans from Russian banks. After one year, if the state did not repay the loans, the bank could keep the shares. The scheme was introduced by Presidential decree: there was no way that the scheme would have been approved by the new State Duma, elected in December 1993 and controlled by the communist and nationalist opposition. The transactions reeked of corruption: firms were sold in rigged auctions, at bargain prices, to bidders chosen in advance (Hedlund, 2000). The loans-for-shares scheme enabled the Moscow-based banks to take control of some of the major revenue-generating assets of the economy, such as the Norilsk nickel mine and the Yukos and Sibneft oil companies. In return, these newly-enriched oligarchs helped Boris Yeltsin get re-elected in June 1996 by putting their financial and organizational resources at the President’s disposal. Overall, the Russian public viewed the privatization process as fundamentally illegitimate. Summarizing survey data from 2000–07, Kapelyushnikov (2008) concludes that ‘about 90% of all Russians and even 72% of “entrepreneurs” are convinced that privatization was carried out dishonestly’. (He also notes that in none of the post-socialist countries are the results of privatization regarded as legitimate by a majority of the population.)

3.3. The role of international financial institutions

What role did the international community play in the launching of Russia’s market reforms? The IMF and the World Bank (together with the
newly created EBRD) enthusiastically embraced the cause of market reforms in the former socialist bloc. The fall of communism provided these organizations with a chance to redeem their reputation after decades of disappointing performance in the developing world. (It also meant they could expand their budgets.)

Russia turned immediately to the IMF for help with its serious debt crisis. Foreign debts had reached $80 billion by the end of 1991 and Moscow had insufficient reserves to cover debt service and necessary imports. Russia was allowed to roll over its debts by the London and Paris clubs of government and private lenders, but was never granted any debt relief — mainly because the lenders were confident that oil-rich Russia would eventually be able to meet its international obligations. The IMF lent $3 billion to Russia in 1993–94 in the form of a Systematic Transformation Facility, followed by a $6.5 billion standby loan in 1995, and a three-year, $18.5 billion Extended Fund Facility in 1996 (Stone, 2002: ch. 6). These IMF loans provided the Russian government with much-needed cash to cover its yawning budget deficit, but the government routinely violated the conditions of the loans, especially with regard to cutting government spending. Political considerations led the IMF and Western governments to turn a blind eye to Russia’s failure to meet reform targets, since Russia was simply ‘too big, and too nuclear’ to be allowed to fail (Rutland, 1999). Randall Stone concludes: ‘The IMF quickly abandoned its attempt in 1992 to enforce rigorous conditionality on Russia and made a series of compromises that culminated in the spectacular violations of conditions during the presidential elections in the spring of 1996. . . . Years were lost in which the foundations of a competitive economy and consolidated democracy could have been built’ (Stone, 2002: 164–5). It was not until the capital markets crashed in 1998 that the Russian government was finally forced to adopt more fiscally responsible policies.

The World Bank was also an enthusiastic participant in aiding market reform after Russia joined the Bank in 1992. The World Bank lent $7.8 billion to Russia in the 1990s for 33 projects, focusing on private sector development and infrastructure reform (such as the privatization of the coal industry). However, it encountered stiff political and bureaucratic resistance, a situation that the Bank delicately refers to as ‘lack of country ownership’ of the reforms. Many of their investment projects were derailed by the 1998 financial crash. A 2001 report by the Bank’s own Operations Evaluation Department concluded: ‘Bank advice and lending played a positive but marginal role in the design of policies and in their implementation until 1998’ and that ‘large volumes of adjustment lending in 1996–97 may have delayed rather than accelerated needed reforms’ (Zanini, 2002: ix). In the 2000s, the Bank focused more on technical assistance and reported more satisfactory results.
3.4. Evaluating the reform program

Was there really an alternative to ‘shock therapy’? With the benefit of hindsight, one can go back and say that this or that should have been done differently, but it is hard to make the case that a radically different policy package that would have worked better was available for implementation. First, the data show that countries that liberalized more quickly and decisively experienced a shorter and shallower transition recession (World Bank, 2002). Second, those countries that deviated from this pattern have particular characteristics that are not easily replicable elsewhere. Both Belarus and Uzbekistan rejected neoliberal reforms and they seemed to have experienced a smaller post-Soviet recession. In the case of Belarus, the economic ‘miracle’ was largely due to continued subsidies in the form of cheap Russian oil and gas. In Uzbekistan, the economic stability was the result of a police state keeping farm laborers toiling in the cotton fields to produce ‘white gold’ for export. Contrary to Margaret Thatcher’s famous dictum, there is always an alternative, but those alternatives are often less attractive than the chosen course. Critics are right when they argue that the Washington Consensus downplayed the scope for market failure, but they themselves are guilty of overlooking the pervasiveness of state failure in Russia and the other post-Soviet states.

Much of the criticism of the market reforms is exaggerated. It is simple demagoguery to blame all the ills of the 1990s on the reformers’ policies. The hyper-inflation, goods shortages, falling living standards and GDP collapse that occurred in Russia during 1990–96 were just as much the product of Soviet socialism as of neoliberalism. They were the result of state failure, not market failure. The Soviet central planning system had broken down by 1991, before the launch of real market reforms. The same is true in Poland, where the crash had come even earlier, during 1980–81. That said, it is true that many neoliberals downplayed or simply ignored worrying signs that the reform process was going badly off track.

4. WHAT THE CONVENTIONAL ACCOUNT LEAVES OUT

For heuristic purposes, transition debates tend to portray leaders as facing choices between two alternative models: shock therapy versus gradualism. It is important to remember that politics is a messy business, driven by diverse factors that muddy the waters of alternate economic programs. No expert’s policy agenda can survive an encounter with political reality, especially not a reality as chaotic as the Russia of the 1990s. There are five important dimensions to the political process that the focus on the neoliberal policy package tends to leave out.
4.1. The art of political compromise

On the economic front, it is now widely recognized that none of the post-socialist governments came close to implementing the Washington Consensus package in its entirety. Rather, reformers selected certain dishes from the menu of policies and adapted them to local conditions. For example, contrary to advice to cut public spending, in Poland, the government of Leszek Balcerowicz actually increased pensions to fulfill election pledges to correct some of the inequalities of the socialist pension system (which had excluded farmers) (Orenstein, 2001: ch. 2). In 1992, the Slovenian government rejected the privatization plan proposed by Jeffrey Sachs and went on to become one of the best-performing economies in the region (Ganev, 2005). In Czechoslovakia, the IMF was initially opposed to the voucher privatization program on the grounds that it was unrealistically ambitious, would fail to generate revenue and would delay the influx of foreign investors. Finance Minister Vaclav Klaus pushed ahead with it anyway, correctly calculating that completion of the first round of the mass privatization program would secure victory for his Civic Democratic Party in the June 1992 elections (Appel, 2004).

Anatolii Chubais saw what Klaus was doing in Czechoslovakia and tried to replicate the approach in Russia. As noted above, Chubais watered down the program in order to have it passed into law by the Congress. Yeltsin’s market reforms were narrowly approved by Russian voters in an April 1993 referendum. His forcible dissolution of the Congress in October 1993 was a body blow to Russian democracy and, in the semi-free elections that followed in December 1993, pro-government parties lost to opposition communists and nationalists. These details are important because they show that Russia was a hybrid, transitional regime: it was not a dictatorship ramming through reform in the manner of Pinochet’s Chile.

The actual mechanics of privatization in Czechoslovakia and Russia are often overlooked by critics who portray them as top-down, foreign-imposed programs. The IMF’s most prominent critic was Nobel prize winner Joseph Stiglitz. In Globalization and Its Discontents (2002), Stiglitz argues that privatization in Czechoslovakia and Russia should have been done in a more decentralized way, empowering local managers. But in reality, in both countries, incumbent managers were indeed charged with drawing up the privatization plan and, in the Russian case, they were overwhelmingly successful in keeping control for themselves.

4.2. The importance of historical legacies

Neoliberals tend to treat the world as ‘flat’ and assume that the laws of economics, as interpreted by them, apply uniformly across space and time. The experience of the post-socialist countries showed that initial
conditions and historical legacies played an important role in shaping the reform trajectory. Ideas matter, but culture matters, too.

Although some market reforms took root with bewildering speed, in many areas of Russian society, norms and practices were slow to change. For much of the 1990s, pockets of Soviet society lived on alongside the emerging market economy, as managers struggled to keep loss-making enterprises afloat (Ashwin, 1999). For example, one problem that quickly emerged was the proliferation of non-payments (Woodruff, 2000). As inflation took off and the government tried to restrain the Central Bank from printing money, firms responded to their hardened budget constraints by delaying payments to suppliers, workers and taxation authorities and engaging in barter. By 1995, half of all industrial payments transactions were non-cash, and it was not until 2000 that this parallel economy was shut down. This meant that the government was not able to get inflation under control and it was blamed by some observers for sabotaging the reforms (Gaddy and Ickes, 2002). However, this ‘virtual economy’ did at least allow firms to keep going and pay their workers some sort of wages. The phenomenon signaled the fact that informal practices of the Soviet shadow economy could persist despite changes in the formal rules of the game (Ledeneva, 2006).

Another example of the relevance of legacies is the fact that some of the socialist countries had a vibrant tradition of economic debate, culminating in the ‘market socialism’ movement of the 1960s. These debates continued in Poland and Hungary through the 1970s and 1980s, but they were suppressed in Czechoslovakia after 1968, and never really took place at all in the former Soviet Union. The lack of a cadre of competent economists who could take the Western advice and turn it into a viable policy package customized to the needs of their own country was particularly glaring in Russia.

Equally important was the presence of a political underground during the communist years, which laid the groundwork for the emergence of social consensus post-1989. Poland was the trailblazer, with Czechoslovakia and Hungary some way behind. Again, Russia is an outlier: Yeltsin was a former communist apparatchik and his pro-reform government was drawn overwhelmingly from the ranks of the former nomenklatura. Meanwhile, the former Communist Party lived on as a political opposition that contested market reform at every opportunity.

Neoliberal ideas certainly established a palpable presence in the Russian political spectrum after 1991, but they had to compete with rival schools of thought that had much deeper roots in Russian society. The most prevalent values were those developed during 70 years of Soviet rule: dependence on the state, risk aversion, disrespect for the law, desire for a strong leader, etc. (Ledeneva, 2006). Ideas from deeper in Russian history also surfaced, such as belief in Russia’s great power status, mysticism and Eurasianism.
Neoliberal values cut against the grain of nearly all these ideological legacies. The narrow social basis of support for market reform in Russia made it more dependent for implementation on the authoritarian Presidential branch – an institution that proved particularly vulnerable to capture by a narrow circle of elite interests.

4.3. The rise of the oligarchs

While underestimating the resistance to change of parts of Russian society, paradoxically, the reformers failed to foresee and forestall the rise of a new and powerful set of social actors, the oligarchs, who used corrupt public officials and criminal gangs to seize assets and bar the door to future competitors. Some neoliberals argued that it didn’t matter who was the initial owner of the privatized assets. In a free market, more efficient owners would come along and buy out the first wave of crooks – a version of the Coase theorem (Shleifer and Treisman, 2001).

Worrying signs of ‘state capture’ by the new business interests in the mid-1990s were initially brushed aside. It was assumed that the installation of democracy would ensure the long-term responsiveness of the state to public interests. Given the absence of bureaucratic capacity, self-regulation was seen as the best way to approach supervision of new market institutions such as the stock exchange (Frye, 2000). In the long term, the rising capitalist class would realize that it was in their own self-interest to install a democratic, law-based system of government, as had happened in the classic English case. But even before the August 1998 financial crash, there was a growing consensus that the Russian reform process had gone off track. Joel Hellman neatly captured the sense of dismay with his 1998 article about the politics of ‘partial reform’, whereby the beneficiaries of the first wave of reform were able to ‘capture’ the state and prevent new competitors from entering the arena (Hellman, 1998).

At the same time, within the World Bank itself, there was new attention to the need for institutional reform, following the appointment of James Wolfensohn as head in 1995 (Burki and Perry, 1998). Only after Wolfensohn’s arrival were analysts allowed to use the ‘c’ word – corruption. Manzetti (2003, 2009) persuasively argues that attempts to insulate policy from politics in emerging markets were counter-productive. Radical market reforms without robust political institutions caused economic instability and repeated crises, which, in turn, undermined political accountability, generating a vicious downward spiral. By the 2000s, a new evolutionary institutionalism had arisen to replace the neoliberal paradigm, with an emphasis on second-generation reforms to improve institutional capacity (Roland, 2000).

As it turned out, no rule of law and no free market in economic assets did emerge in Russia. Instead, by the 2000s, under President Vladimir
Putin, the state had established itself as the arbiter of ownership for key assets in the Russian economy. The turning point in this process was the case of Mikhail Khodorkovsky, who was briefly Russia’s richest man with assets of $16 billion. Khodorkovsky acquired control over Yukos in 1995 and turned it into Russia’s largest private oil company. But in 2003, as he was preparing to sell the company to foreign investors, he fell foul of the Kremlin and found himself arrested and jailed on trumped-up fraud charges (Sixsmith, 2010).

4.4. The elusive ‘third way’

A major puzzle of the transition is why we did not see the post-socialist countries follow a social democratic path, a third way between central planning and free markets (Zweynert, 2006). Many accounts of the transition leave out social democracy entirely, portraying a black-and-white world, where there is only central planning or a market economy (Aligica and Evans, 2009).

All the usual preconditions for social democracy seemed to be in place: a large organized industrial working class; an urban, educated workforce with high levels of female participation; low levels of social inequality; full employment; universal welfare state institutions (health, education, pensions, child care); etc. There was an army of bureaucrats and managers accustomed to working within a state-owned economy. There was a broad consensus on the importance of social rights, with polls indicating a preference for Swedish-style social democracy as an ideal form of political regime.

According to the conventional account, the social democratic ‘third way’ was ruled out by the prevailing post-Thatcher intellectual climate – as Vaclav Klaus liked to say, ‘the third way leads to the third world’. The international financial institutions pressed for government spending cuts and showed no interest in including labor unions in the economic policy process (Kubicek, 2004).

But the main obstacle to the spread of social democracy was arguably political. The outgoing communist regimes had claimed to be representing workers’ interests and used labor unions as transmission belts for the ruling party. In that context, it was hard for real social democrats to separate themselves, mentally and politically, from the communist past (which was still, at that time, the communist present).

4.5. Nationalism and political identity

Neoliberals tend to assume that their reforms are self-evidently in the long-term interests of the majority of society, so forming a winning coalition should be within the grasp of any competent political leader. That the
reforms failed in Russia is largely due to the fact that Yeltsin was unable to forge a political coalition behind the creation of an open, competitive market economy. Arguably, the key factor in explaining reform success in East Europe and failure in Russia was the trajectory of nationalist politics – something that was well beyond the scope of the neoliberal world-view.

Political concerns were of course central to the thinking of key decision-makers. These countries were now democracies and governments had to worry about getting themselves re-elected. Leaders had to forge coalitions and create cohesive political parties based on some sort of ideology. In an influential book published in 1991, Adam Przeworski (Przeworski, 1991) noted the contradictions between democracy and capitalism, mainly extrapolating from the Latin American experience. He argued that workers would never vote for capitalism since this would mean the concentration of wealth and power in the hands of a few. The workers would have to be compensated – through the preservation of welfare state institutions, for example. Events in Eastern Europe quickly turned Przeworski’s logic on its head, however, since it was the country with the most active labor movement – Poland – that became the first and most ardent advocate of shock therapy (Orenstein, 2001).

The missing element in most accounts of the market transition is the politics of national identity.3 Workers voted for capitalism partly because their daily experiences with communism had been so negative, but also because national identity trumped class identity. For the Czechs, Hungarians and Poles, their national identity was vested in breaking with Soviet control and tying their national fate to Western Europe – which happened to be democratic and capitalist. In Russia, nationalism worked initially in Yeltsin’s favor – when he was standing up for the Russian Federation and the other republics against the Soviet government headed by Gorbachev (Dunlop, 1995). It was Russian nationalism that enabled Yeltsin to prevail against the August 1991 putsch by appealing to the patriotic feelings of the officers and men of the security forces. However, Yeltsin’s nationalist legitimacy eroded as the economic turmoil deepened – and the reforms he was enacting came to be seen as Western impositions. Some of Yeltsin’s closest lieutenants – such as Vice-President Aleksandr Rutskoi and Congress Speaker Ruslan Khabulatov – broke with him over the market reforms and went over to the nationalists. Given Russia’s history as a great power that defined itself in opposition to the West, it is hard to imagine how market reforms could have been packaged as a re-assertion of Russian identity.

5. NEOLIBERALISM AND PUTIN’S RUSSIA

The Russian economy was hit hard by the 1998 economic crisis, but the incoming Putin administration did not abandon the commitment to a market
economy. The on-and-off market liberalization of the 1990s gave way to the creation of a system of state capitalism under Vladimir Putin. This coincided with a political shift from hybrid semi-democracy to centralized authoritarianism and assertive nationalism. The August 1998 financial crash was caused by the slump in global oil prices after the 1997 Asian financial crisis. That led to a dip in Russia’s export earnings just as the government was desperately borrowing to cover its mounting fiscal deficit. Despite IMF support in the form of a $22 billion rescue package in July 1998, foreign investor confidence collapsed. In one month, the exchange rate fell from six to 22 rubles to the dollar (Rutland, 1999). Russia suspended payments on its foreign debts and many Western banks holding private debt eventually settled for less than 10 cents on the dollar. Inflation hit 75 percent by the end of 1998, again wiping out the savings of Russia’s nascent middle class (the first loss having been the hyperinflation of 1992). Most of Russia’s privately-owned banks collapsed, undermining the wealth and power of many of the oligarchs who were the political foundation of the Yeltsin regime.

Many observers feared that the 1998 crash meant the end of market reform in Russia. But contrary to expectations, the Russian leadership did not try to reintroduce a planned economy and the Russian economy made a surprisingly swift recovery after 1998. The 75 percent devaluation of the ruble made Russian exports more competitive and, fortuitously, there was a rebound in world oil prices, which climbed from $12 in 1997 to a peak of $148 in 2008. By breaking the political power of the oligarchs, the crisis made possible the rise of a new, statist elite under Vladimir Putin (after a bid for power by regional bosses was beaten back in the December 1999 State Duma elections). Putin’s victory in the 2000 Presidential election was due to a combination of factors: the economic recovery; the war in Chechnya; his own personal charisma; and his political formula of a ‘strong Russia’.

During Putin’s eight years as President, the Russian economy grew at around 7 percent per year. Gross National Product (GNP) per capita went from $1,710 in 2000 to $9,660 by 2008 (World Bank, 2011). In current dollar prices, GDP rose from $200 billion in 1999 to $1,680 billion in 2008. Russia went from being the 20th largest economy in the world to the eighth. The global commodity boom generated a large fiscal surplus since the government reintroduced export tariffs on oil, which it had reluctantly abolished at the IMF’s behest in 1996. The government made sure taxes were paid on time and non-cash settlements, which reached 50 percent of all industrial transactions in 1998, fell to 10 percent by 2004. The eight years of Putin’s presidency saw a doubling of living standards; the settling of nearly all of Russia’s foreign sovereign debts; and the accumulation of $400 billion foreign currency reserves by 2008 (Rutland, 2008). During the
Yeltsin era, there had been a major financial crisis every two–three years. This did not happen under Putin.

But what exactly was the model (if any) behind this remarkable and unexpected economic performance and in what ways did it reflect the impact of neoliberal ideas?

5.1. The market economy is here to stay

One might have expected that the rise to power of a 17-year KGB veteran promising the return of a strong state would have meant the end of neoliberalism in Russia. But this was not to be. Putin’s ideas had been shaped by his years reading *The Economist* as a KGB intelligence officer – and by the sobering experience of watching the German Democratic Republic (GDR), the most successful socialist economy, collapse before his very eyes (Putin, 2000).

Putin made substantial changes to Yeltsin’s political regime, centralizing political power in the Kremlin’s hands (Sakwa, 2007). Within months of winning the Presidential election in 2000, he regained control over all the television stations and reined in the regional governors, his strategy culminating in the abolition of direct elections for governors in 2004. At the same time, Putin preserved the pro-market orientation of Yeltsin’s economic strategy. He did not roll back the reliance on private corporations as the foundation of the economic system, nor did he raise tariff barriers to shield Russia from global competition. On the contrary, he maintained a convertible currency and even removed the remaining barriers to cross-border capital flows. Putin clearly understood that Russia’s future as a leading power required its integration into the global economy and the preservation of the core market institutions that had been introduced – at great social cost – in the 1990s.

Few of the original team of liberal economists from the early 1990s were still serving in the Putin administration. Among them were Anatolii Chubais, who was put in charge of reforming the electricity monopoly, United Energy Systems (UES), and Andrei Illarionov, who was appointed Putin’s personal economic adviser in 2000. An avowed libertarian, Illarionov looked increasingly out of place in Putin’s Kremlin. He resigned in 2005 and took up a position at the Cato Institute in Washington, DC. Other notable reformers included Aleksei Kudrin, Finance Minister during 2000–11, and German Gref, head of the Center for Strategic Development, who served as Minister of Economics and Trade from 2000 to 2007. (Interestingly, Gref was a lawyer, with no economics training.) Gref and Kudrin are usually characterized as pragmatic reformers, rather than ideological neoliberals. All four of these men hailed from Putin’s home town of St Petersburg.

There is little evidence that Putin had spent any time thinking seriously about how market economies work. On the contrary, his doctoral thesis,
submitted in 1997, was devoted to the theme of state planning for natural resource development (Balzer, 2005). Putin was simply reacting in pragmatic fashion to his own observations: that central planning had failed and that market economies around the world were surging ahead. For all his commitment to a strong state, Putin was arguably still more of an economic liberal than the average Russian. According to an Ebert Foundation survey in 2000, 70 percent of Russians favored more state planning and 63 percent approved confiscating the property acquired by the ‘New Russians’.4

The 1990s had left the task of building a market economy half-finished. Putin’s first Presidential term saw the passage of some important new reform legislation, although measures that aroused public anxiety, such as utility price increases, were postponed. In 2001, personal income tax was cut from a top rate of 35 percent to a flat rate of 13 percent (Appel, 2011). Revenue rose after the flat rate was introduced, but not as much as the reformers had hoped – in part because there was still a 36 percent social tax on wages, a disincentive to report income from employment.5 These tax cuts were offset by the rise in tax revenues from the booming GDP and energy exports. A cautious pension reform was introduced in 2003, introducing a private contributory pension alongside the state-provided pension. Controversy erupted in 2004 over a government plan to streamline social benefits for 32 million recipients by cutting dozens of benefits in kind (like free public transport) in return for cash compensation. After public protests, a modified version of the reform was pushed through.

Large sections of Russian law were still based on Soviet-era legislation, since Yeltsin had been unable to push new bills through the opposition-dominated parliament. Having forged a working arrangement with the communists in the State Duma in 2000, Putin’s government passed reforms of the judiciary, the tax code and the banking sector. A new labor code made it easier for employers to hire and fire workers. The new land code allowed land to be sold for the first time, but parliament insisted on exempting most farmland, leaving it up to the regions to set their own rules.

Corporate governance throughout Russia’s newly-minted private sector leaves much to be desired. Russia ranked 66th of 142 countries in the World Economic Forum’s 2011 Global Competitiveness Index, down from 57th in 2007 – despite ranking 40th in per capita income.6 Russia scored in the lowest quartile of all countries for quality of public and private institutions and level of competitiveness, but in the upper third for education, infrastructure and market size. The Transparency International 2010 Corruption Perceptions Index rated Russia at 2.4 on a ten-point scale, placing it at 143 among 183 countries.7

A 2004 study of the ownership structure of Russian industry found that the 23 largest private corporations accounted for about 30 percent of industrial sales and 11 percent of employment (Guriev and Rachinsky, 2004).
This is a remarkably high degree of industrial concentration by international standards. Moreover, most of those firms seemed to be controlled by a single individual or group of individuals. The report also noted a vast ‘hidden’ sector of state-owned defense and other plants, which continue to receive subsidies and which account for a quarter of industrial output. Clearly, this highly concentrated and state-oriented economy bears scant resemblance to the kind of open competitive economy that the neoliberal reformers had envisioned. And yet it was the ‘neoliberal’ reforms that allowed and enabled this economy to emerge.

A main challenge was the need to reform the ‘natural monopolies’ that were still under state control – the railways, Gazprom and the electricity giant, UES (Rutland, 2012a). Putin changed the leadership of these giant corporations, but declined to open Gazprom or Russian Railways to market competition. He did push ahead with reform of the UES, which, since 1998, had been headed by the former privatization chief, Anatolii Chubais. In the face of stiff opposition from regional governors and rival oligarchs, Chubais broke up the UES into regional energy companies, while creating a national electricity market. It took Chubais a decade to push through the plan, which was completed in 2008.

As with the natural monopolies, the reform of the bank sector proceeded at a snail’s pace. A long overdue law introducing deposit insurance for private banks was passed in 2003. But there was otherwise no real progress in restructuring or improving the regulation of the commercial banks, which had been devastated by the 1998 crash. Seventy percent of deposits were still lodged at the state-owned Sberbank. Russian banks behaved in an inefficient and irresponsible manner, making few loans to domestic producers, but pouring money into speculative real estate. They borrowed heavily abroad and were thus very vulnerable to the outflow of foreign capital during the 2008 financial crisis (Gaddy and Ickes, 2010).

Russia’s failure to join the World Trade Organization (WTO) was the most salient blot on its image as a market economy. Russia had first applied for entry to the WTO in 1993 and had brought import tariff barriers down to WTO levels. By 2008, Russia’s average tariff level was 10.7 percent (Rutland, 2012b). The WTO kept moving the goalposts as the years passed, with much stricter requirements being applied to Russia than to, say, China, which joined in 2001. Russia took steps to meet the WTO conditions. A new customs code was signed into law in May 2003, but implementation was weak, and piracy of software and DVDs remained pervasive. In 2004, Putin won European Union (EU) approval for Russian entry in return for Russia supporting the Kyoto Protocol on greenhouse gas emissions. But the US continued to insist on more access for foreign firms to Russia’s finance sector and improved intellectual property protection. The political fallout from the 2008 Georgia war further delayed Russia’s WTO entry, which was finally approved in 2012.
Putin’s continued pursuit of market reforms was based on his own calculation of what was in Russia’s strategic interests – and what would serve the more venal interests of his own political coterie. It did not come as a result of pressure from Western advisers or IMF loan conditionality. There were no Western advisers in the Kremlin and, in 2006, Russia paid off its entire $22 billion debt to the IMF ahead of schedule. Putin wanted Russia to be accepted as part of the global community through entry to organizations such as the Group of Eight (G8) or the WTO, but, at the same time, he portrayed himself to domestic audiences as a strong leader standing up to the West and insisting on Russia’s uniqueness.

5.2. Russia’s dependence on oil and gas exports

‘Our economic foundation, although it has become considerably sounder, is nevertheless unreliable and very weak [because] the monopolists are suffocating the competitive sector of our economy’.

Vladimir Putin, 16 May 2003

Russia’s economic recovery was driven by the surge in global commodity prices during the boom of the 2000s. The Kremlin opened Russia to the global economy and the message from the market was loud and clear: Russia’s clear comparative advantage (both static and dynamic) lay in serving as a source of energy and metals. Oil and gas accounts for about 25 percent of the Russian economy – a high level, though not as high as in Saudi Arabia or even Venezuela, since manufacturing still accounts for about 17 percent of Russian GDP (Rutland, 2008). This was a political challenge for Russian leaders, whose sense of national pride – and strategic security – rested on Russia having an advanced, diversified economy with a high-tech industrial base. Resource dependence was also a problem for market liberals because of the pathologies that usually accompany the ‘resource curse’. These include an overvalued exchange rate leading to the hollowing out of domestic manufacturing (the ‘Dutch disease’) and increased dependence on capital inflows and outflows tied to the volatility of the world oil market. These factors are clearly present in Russia. By 2005, manufactures accounted for only 8 percent of Russia’s exports, and only 3 percent of these were in the medium-high technology category (Rosstat, 2012). On the political front, in the absence of democracy, oil dependence tends to produce a concentration of wealth and power in the hands of a small group of elites. Russia certainly fits the pattern. The Russian government faced two challenges: to minimize the negative features of resource dependency in the short term and to promote diversification of the economy in the long term. It was moderately successful in the first task and is failing in the second. The government lacked a full range of monetary instruments to completely sterilize the inflow of cash from the
trade surplus and struggled to bring inflation down to single digits. (It was stuck at about 10 percent throughout the 2000s.) The ruble continued to strengthen against the dollar and, by 2004, the competitive advantage of the 1998 devaluation had disappeared. Still, at least until the 2008 crisis, Russia’s fiscal policy after 1998 was conservative, closer to that of Norway than Nigeria or Venezuela (Tabata, 2012). In 2004, the government created a Stabilization Fund into which oil exporters pay excess taxes when the price exceeds $20 a barrel. Russia’s state foreign debts were brought down to $53 billion (9 percent of GDP) by 2008, from $150 billion in 1998 (Rutland, 2008). Thus, by embracing integration into global markets, Russia deepened its exposure to the ‘resource curse’. Neoliberal economists don’t have any easy solutions to resource dependency up their sleeve. Given their skepticism about the efficiency of state intervention, they would presumably discourage efforts to tax the energy sector and subsidize other firms in manufacturing or research and development (R&D).

But it is intrinsic to the nature of an oil-dependent economy that one will see a strong role for the state. Oil is simply too important to be left to the private sector. Apart from in the US and the UK, oil production is almost always kept in the hands of state-owned firms.

5.3. A highly political economy

The political regime created by Vladimir Putin is often characterized as a takeover by officials from the security services, or siloviki (‘men of power’) (Sakwa, 2007). A small core of these men was personally known to Putin from his days in the KGB. The rest were recruited from the ranks of the security services and armed forces because they were perceived as sharing Putin’s values of personal loyalty and state patriotism. The siloviki make up roughly one quarter of the upper echelons of the Presidential and governmental apparatus – a significant contingent, but less than a majority. Moreover, the siloviki are divided into competing clans and corporate agencies. They do not have a common identity or political philosophy of their own, independent of the will of Putin – and Putin, as we have argued above, is committed to a market strategy for Russia’s economic development.

Putin’s regime walks on two legs: the siloviki and the oligarchs. The oligarchs have grown in number and in wealth in the course of the 2000s – even as Putin was consolidating the power of the central state. Oligarchs who tried to mount a political challenge to the Kremlin found themselves stripped of their assets, and sometimes their freedom. The 2003 arrest of Mikhail Khodorkovsky and the break-up of Yukos is an exemplary case. Many Western observers took the Yukos affair as signaling that Russia was turning its back on the market economy. However, most of the other Russian oligarchs understood Putin’s rules of the game and avoided jail or
exile. The oligarchs as a class have not disappeared; in fact, they have increased in number and they have seen their wealth multiply under Putin’s rule. *Forbes* magazine reported there were 17 individuals in Russia in 2003 with personal assets above $1 billion. By 2012, their ranks had risen to 96, second only to the US.\(^8\)

Putin did take steps to endure tight state control of the energy sector. As a result of the break-up of Yukos and Gazprom’s purchase of the Sibneft company in 2005, the share of oil output produced by majority state-owned companies rose from 10 percent in 2000 to 42 percent in 2008 (Rutland, 2008). A new law regulating 33 strategic sectors of the economy barred foreign companies from more than 50 percent ownership of any oil field over 70 million tons and required government approval for even a 10 percent stake. Even beyond the energy sector, the Russian state still holds a large stake in a broad range of Russian industries. The overall state share in the economy (measured by share ownership) rose from 30 percent in 2000 to 40 percent by 2008. In the 1990s, the government did not try to exercise any systematic influence over the privatized companies in which it held shares. Putin made a coordinated effort to regain control over these companies by having trusted aides appointed to their boards, in some cases as chief executive. Dozens of government ministers and Presidential staff members now serve on the boards of companies in which the state has a substantial stake (Volkov, 2008). Guriev’s 2004 survey found that 29 percent of the firms in the sample had a government representative on their board. It is an open question whether this hybrid system, in which an intrusive state bureaucracy watches over private oligarchs, can be maintained over time. It is probably *politically* feasible. But is it *economically* feasible? Some argue that the high oil and gas prices will enable the Putin model to continue indefinitely, though the costs of developing Russia’s new petrocarbon deposits in Siberia and the Arctic Ocean are also increasing. The sustainability of the Putin recovery hinges on major investment and structural reforms to increase the competitiveness of Russian industry. But the politically closed nature of the ‘power vertical’ is not conducive to creating the competitive environment needed for sustained economic growth.

### 6. CONCLUSION

While critics argue that Russia suffered from an overdose of ‘market fundamentalism’, neoliberals still insist that Russia did not go far enough in unleashing genuine market forces. The Washington Consensus exerted a strong influence over Russian policy in some specific domains, such as currency convertibility and lowering trade tariffs, but it had scant impact on some of the most important decisions, such as whether and how to privatize, the centrality of oil and gas exports, and the concomitant need for an interventionist state. Neoliberalism, which had been
twisted and selectively deployed to suit the political conditions of Yeltsin’s Russia in the 1990s, went through another metamorphosis and was reborn in Putin’s Russia. The prominent role for the state in Putin’s economic strategy means that Russia has now moved well beyond a ‘neoliberal’ approach to economic development. But both the Russians themselves and Western observers lack a conceptual vocabulary to describe the model they are following. ‘Neoliberalism’ was invoked for tactical reasons by both sides of the political divide. Liberals appealed to the laws of Western economic science to camouflage an asset grab by their friends and allies, while communists pointed to neoliberalism to ‘prove’ that the reformers were merely serving the interests of the West, keen to turn Russia into a ‘raw materials appendage’.

The Russian case shows that in times of tumultuous change, broad and bold theories about how economies work can gain a ready ear amongst harassed politicians desperate for solutions to the challenges they face. However, the political exigencies under which those ideas are taken up and implemented typically carry the resulting policies far beyond the initial conceptions of economic advisers. In addition, the structural characteristics of the economy in question – in Russia’s case, its dependence on energy exports – may override the policy prescriptions of global ‘best practices’ in promoting sustainable economic development. Hence, the Washington Consensus is best understood as a highly conflictual interaction between the dominant transnational policy paradigm (see Babb in this issue) and the specific political challenges facing leaders in individual countries such as Russia. Just as a variety of national Keynesianisms evolved in the developed economies by the 1960s, so too we can see a variety of national neoliberalisms emerging from the reforms of the 1990s.

NOTES

1 Biographies of these and other Russians mentioned here can be found in the Lentapedia database: <http://lenta.ru/lib/>.
2 Somewhat ironically, Jeffrey Sachs is regarded by neoliberals as a Keynesian, as evidenced by his more recent advocacy of large investment programs to cure poverty.
5 The 2001 tax reform cannot be cited as proof of the ‘Laffer curve’ (the idea that tax cuts actually increase total revenue through improved incentives to work), since tax collection procedures were being tightened at the same time as the tax rate was being cut.
REFERENCES


The ‘R’ in BRICs: is Russia an emerging power?

S. NEIL MACFARLANE

The notion of emerging powers presupposes a number of characteristics shared by the states in question.¹ These include regional preponderance, aspiration to a global role, and the contesting of US hegemony. These characteristics arguably make the group as a whole a useful category in analysis and policy formulation. In particular, cooperation among these states, and possibly with more established powers seemingly equally unhappy with the unipolar configuration of international politics (e.g. France), may create a basis for a coalition having the potential to balance American power.² There is ample evidence from all of the emerging powers of unhappiness with the existing structure of international politics. There has also been substantial consideration of the potential for cooperation among them and with certain European states to constrain the hegemon—from the suggestion of entente between France, Germany and Russia to the repeated examination of prospects for a Sino-Russian-Indian triangle, and the growing Chinese and Russian interest in bilateral cooperation over shared security concerns.³

This article assesses the role of Russia as an ‘emerging power’. How do Russians interpret the international system in which they operate? What kind of system would they prefer? What are they trying to do in the current system and why? How do these considerations affect their relations with the hegemon, with other centres of power such as the EU, and with other emerging powers?

The notion of ‘emerging power’ is partly informed by a theoretical assumption that the international behaviour of states is determined by their place in

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¹ A Goldman Sachs report of 2003 identified four states that, it asserted, over the coming half-century ‘could become a much larger force in the world economy’: ‘Brazil, Russia, India and China—the BRICs economies’. See Dominic Wilson and Roopa Purushothaman, Dreaming with the BRICs: the path to 2050, Global Economics Paper no. 99 (New York: Goldman Sachs, Oct. 2003).
³ For example, the growing Chinese and Russian cooperation through the Shanghai Cooperation Organization (SCO) on the terrorist threat in Central Asia and on efforts to limit American presence in that region, as well as in the August 2005 Sino-Russian joint military exercise on and around the Shandong Peninsula.
The international system. They do what they do because, in the structure of power, they are where they are. Small states generally bandwagon with threats, great powers tend to balance against them, ‘middle powers’ float in a post-modern universe that is largely irrelevant, and hegemonic powers seek to control. Emergent powers are distinctive because their identity is dynamic; their position is changing as their power grows and, along with it, their capacity to shape outcomes. They carry some potential for systemic revisionism—a challenge to the hierarchy of the system in which they exist.4

The structural interpretation of state behaviour is widely contested, not least by liberal alternatives stressing the nature of the unit as the factor determining its external behaviour,5 and by mixed models that posit that the foreign policy behaviour of states is a product of both domestic and international considerations.6 Between the structural realist and the liberal perspectives lie regional interpretations that suggest that the external behaviour of states may be powerfully influenced by their immediate geographical contexts.

Moreover, systemic interpretations tend to emphasize hard power. However, many states, including some emerging powers, may seek to enhance their positions in the international system through the exercise of ‘soft power’—the promotion of ideas and values that are attractive to others. In this approach, it is the attractiveness of a state’s identity and values that provides wider influence in international relations.

I argue that—of these three possibilities—the structural/systemic approach implicit in the notion of ‘emerging power’ is the weakest as an explanation of Russian foreign policy behaviour. Russia’s policy is strongly affected by its domestic economic and political context. It is highly responsive to trends in its neighbourhood (the former Soviet Union) and in regions contiguous to what it perceives to be its own space (e.g. EU and NATO Europe and north-east Asia). In the larger international system, Russia seeks not so much to make its mark as to limit the degree to which larger systemic (power-political and ideational) processes obstruct the pursuit of its more limited objectives. The result is a mixed approach of partnership or acquiescence on matters of vital interest to the hegemonic power, and more competitive behaviour on issues deemed central to Russia but peripheral to US interests.

With regard to ‘soft power’, Russia faces significant limitations in any effort to seek influence on the basis of the attractiveness of its identity or its ideational/normative agenda, partly because it has yet to develop a widely shared domestic consensus on values and identity and therefore has little to export, and partly because its internal difficulties and its vulnerability to criticism in terms of

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5 The extensive literature on the democratic peace is illustrative.
6 A well-known example is Robert Putnam’s elaboration of ‘two-level games’ in which leaders seek outcomes that are positive in both the international and domestic contexts. See Robert Putnam, ‘Diplomacy and domestic politics: the logic of euro-level games’, *International Organization* 42: 3, Summer 1988, pp. 427–60.
international human rights and governance norms push it towards a profoundly conservative definition of sovereignty and the rights of states within their domestic jurisdictions. Although this view of international order may resonate in the Third World, and also with certain of the other BRICs (e.g. China), it has little appeal in Europe.

**Is Russia emerging?**

These qualities of Russian foreign policy are in part a reflection of the fact that Russia is not obviously an emerging power in the sense discussed above. The notion of emergence suggests a state that is growing dynamically and undergoing a transformation; a state whose rising power causes it to question its established place in the system and to assert itself more ambitiously in international politics. This image is far from Russian reality. Russia is more properly seen as a state that has recently experienced substantial damage and is attempting to stop the bleeding.

The decline began in the 1980s, ironically at a time when some western scholars conceived the US to be in relative decline and the USSR to be a rising hegemonic challenger. In these years the Soviet decline was evident in faltering economic growth and in the consequent increase in the defence share of GNP as the USSR sought to keep pace with the United States. The Gorbachev leadership recognized the severity of the impending crisis; however, its reforms, designed to reverse the erosion of the Soviet economy, failed, producing the collapse of the USSR.

In the first five years after the collapse, the Russian economy contracted to approximately half its former size. Problems of economic transition were exacerbated by the disruption of trading links to neighbouring newly independent states. As unemployment and underemployment grew, the rouble’s value collapsed, destroying people’s savings. Social safety nets also suffered greatly as real public sector spending contracted dramatically. The economy bottomed out in 1994–5 and began to recover, but was set back again in 1997–8 by the knock-on effects of the Asian financial crisis, leading to a default on the Russian Federation’s international financial obligations. The country returned to fairly steady economic growth in 1998–9, reflecting in part the import-substituting

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7 Gilpin, *War and change*, pp. 235, 239–42. However, both Gilpin (p. 243) and Paul Kennedy (*The rise and fall of the great powers*, New York: Random House, 1987, pp. 430–1, 488–501) did raise doubts about the USSR’s capacity to stay the course in the face of economic rigidity, the draining effect of military spending and the centrifugal pull of the non-Russian peoples.

8 Estimates of the contraction vary and are intrinsically problematic, since most statistics do not fully include activity in the informal and black economies, and estimation of the latter is difficult. There is no doubt, however, that the decline was substantial.

effect of the collapse of the rouble, but also, and more importantly, the beginning of a substantial rise in global energy prices. Putin’s marketizing reforms during his first term helped sustain growth, but if one discounts the GDP effects of rising energy prices, the underlying growth rate has been modest. In any event, by 2004 and after five years of energy-based economic expansion, Russia had a GDP slightly higher than that of the Netherlands and just over a third that of China. Economic difficulties were accompanied by political ones. The early years after the collapse of the USSR were marked by very unstable relations between the executive and the legislature, culminating in the shelling of the Russian parliament by Russia’s own army on orders from President Yeltsin in late 1993. Law and order decayed substantially as individual oligarchs parcelled out state property and as police and military officials essentially hired themselves out to contending entrepreneurs. The capacity of the state to extract revenue to maintain its operations declined sharply, not only because of economic contraction, but also as a result of systematic tax evasion and substantial corruption in tax administration. The various jurisdictions of the Russian Federation sought to usurp the powers of the Russian state in a ‘war of laws’, resulting in a welter of contradictory regional and federal legislation, and the emergence of substantial internal barriers to trade. One member of the Federation (Chechnya) sought to secede, resulting in debilitating civil wars (1994–6 and 1999–2005) that amply demonstrated the increasing incapacity of Russia’s armed forces to maintain internal sovereignty, let alone to act effectively outside Russia’s borders. As one Russian analyst put it in 2005: ‘Russian forces’ actions [in Chechnya] merely reflect the state of the armed services. There is a crying need for strict discipline, better quality personnel, properly functioning equipment, training, tactics and sorely needed specialisation. Chechnya represents a powerful case for fundamental military reform.’

In short, Russia’s experience during the 1990s was not so much one of emergence as one of confusion, retrenchment and decline. Nor was this only a domestic matter. In the mid-1980s, the USSR was seen as one of two global superpowers. In the late 1980s, it lost its sphere of influence in Eastern Europe. In 1991, with the collapse of the USSR, Russia had ‘retreated from Europe, living with borders that had hitherto never existed and surrounded by weak states’. In the late 1990s and the early years of the present century, NATO and the EU expanded into the East European space vacated by the USSR, and then, with the accession of the Baltic republics to these institutions, into the

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10 The growth in energy revenue has a further negative effect, in that the flood of cash reduces incentives to continue with marketizing reform.
11 Russia’s 2004 GDP is also $100 billion less than that of India and roughly $20 billion less than that of Brazil. See World Bank, ‘Total GDP 2004’.
12 In the 1990s and early 2000s Russia’s military shrank from around 2.5 million to approximately 1 million personnel.
The ‘R’ in BRICs: is Russia an emerging power?

territory of the former USSR itself. By 2002, despite Russia’s claim that the former Soviet space was its domaine reservé, the United States had established military bases within the territory of the former USSR in Uzbekistan and Kyrgyzstan. When Russia’s opinion on the international issues of the 1990s diverged from that of the United States, as in respect of Kosovo or on NATO enlargement, Russia’s view was ignored. When Russia sought to block American-led action through the UN Security Council, as in Kosovo in 1999 or in cooperation with France and Germany over Iraq in 2003, the United States acted outside the UN framework. In short, if China is now exiting its period of humiliation, Russia in the 1990s appeared to be entering one.

The combination of chaos in domestic policy and international decline during the Yeltsin years produced a highly incoherent foreign policy. Dominant perspectives on world order ranged from the Gorbachevian liberalism that characterized the early days of Andrei Kozyrev’s tenure as Russian foreign minister, through a long flirtation with ‘Eurasianism’ and multipolarity in the Primakov years, to a pragmatic and issue-specific regional power nationalism. Russia sought partnership with the United States and yet repeatedly advocated multipolar balancing with such candidates as China and India.

In 1993 President Yeltsin signalled in Poland that the Russian Federation would have no objection to the enlargement of NATO, only to reverse course a month later. The Russian Federation resisted the NATO campaign against the Bosnian Serbs in 1995, only to participate in the IFOR/SFOR peace operation that followed the Dayton Accords. Russia also resisted the NATO operation against Serbia over Kosovo in 1999, then provided mediation instrumental in getting the Yugoslav government to accept NATO demands, then unilaterally occupied Pristina airport in defiance of NATO, and then agreed once again to participate in a peace operation in Kosovo under NATO command. Elsewhere, Russia’s definition of militant Islam as a key threat to international order in the post-Cold War period was accompanied by substantial Russian technical assistance in the Iranian nuclear programme.

There was little effective coordination among relevant ministries and agencies, which often pursued inconsistent policies on particular foreign matters. A classic example is the Russian position on western involvement in offshore oil drilling in the Caspian basin. In the mid-1990s, when the Azerbaijan International Operating Consortium’s offshore Chirag–Gunesli project came on stream, the Russian Ministry of Foreign Affairs maintained that it was illegal, because ownership of Caspian seabed resources remained unresolved. The Russian minister of energy meanwhile attended the opening ceremony and congratulated Azerbaijan on its success in bringing the project to fruition. The mercurial quality of President Yeltsin, and his increasingly frequent incapacity exacerbated the mess.

15 In this case, however, Russia took advantage of French and German umbrage to remain in the background. See Sergei Karaganov, ‘Russia and the international order’, in Lynch, ed., What Russia sees, p. 31.
The ideational concomitant of internal deterioration and the collapse of the USSR’s and Russia’s international position was a moral crisis within the Russian Federation itself. Communist millenarianism largely disappeared as the fruits of 70 years of socialist construction evaporated and the world socialist system imploded. For many Russians, the state’s purported commitment to the construction of socialism and to the ‘world revolutionary process’ had rung increasingly hollow as the revolution receded into history. The inability of the system to meet the material aspirations of the Soviet population was increasingly evident. Increasing access to the West and to westerners made clear that the USSR was slipping behind. The elitism of the leadership was manifest, as was the growing role of criminality and corruption in Soviet economic life. However, many took pride in the Soviet position as one of two superpowers in the international system. That pride disappeared with the USSR itself.

While the Soviet system had always provided a basically adequate standard of living for most of its citizens, the post-Soviet economic transition, currency collapse, mass unemployment and disintegration of the social safety net took away the population’s economic security. The consequent hopelessness and frustration were evident in rapidly declining birth rates and life expectancy, particularly among males (see table 1). Overall, Russia’s population declined from 148.3 million in 1990 to 142.3 million in 2003.

In short, Russia was not emerging during the 1990s. It was experiencing a profound crisis in its economy, politics, legal system, society, health, demographics, foreign policy and identity, creating an equally profound demoralization among its citizens.

Picking up the pieces: the domestic dimension of Russian foreign policy

When Vladimir Putin assumed the presidency in 1999, the agenda was reasonably clear: stabilizing and enhancing his own hold on power; regenerating the

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<td>LE (M)</td>
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Abbreviations: GR—annual growth rate of population; CBR—crude birth rate per 1000; LE—life expectancy at birth; LE (M)—male life expectancy at birth.

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economy and balancing the books; consolidating executive control over the state and restoring its capacity to maintain order; restoring the role of the state in the economy and limiting the influence of oligarchical circles that had grown up under the Yeltsin administration; sorting out the relationship between the executive and the legislature at the centre; reasserting central control over Russia’s regional authorities and, in particular, preventing the loss of further territory or the spread of insurgency in Chechnya and the North Caucasus more broadly. As one prominent commentator observed: ‘On 26 March 2000, Vladimir Putin inherited a weak, corrupt and paralysed country on the verge of disintegration … Putin’s strategic goal was to get Russia back on its feet.’

As Putin himself put it early in his first presidential term, Russia’s activity in foreign affairs must ‘enable us to concentrate efforts and resources as far as possible on addressing the social and economic tasks of the state’. This urgency in addressing domestic weakness also featured prominently in Russia’s National Security Doctrine, adopted in early 2000. The focus on domestic consolidation continued, indeed arguably accelerated, during Putin’s second presidential term, one observer noting that: ‘The goal of his second term has been to remove all centers of power but his own.’

In this respect, Russia’s contemporary priorities resemble not so much those of its purported peer group of emerging powers as those of previous Russian and Soviet governments at times of domestic weakness. Defeat in the Crimean War of the 1850s occasioned a similar emphasis on internal reform and on a holding action in foreign policy while necessary internal changes were made. The New Economic Policy after the Russian civil war (1918–21) was accompanied by the temporary abandonment of radicalism in foreign policy, and a quest for peaceful coexistence and mutually beneficial political and economic relationships with the great powers. Mikhail Gorbachev’s accommodating foreign policy was a logical concomitant of the effort, through perestroika and glasnost, to address the mounting crisis in the Soviet economy.

The process of consolidation translated into the concentration of the policy-making process within the presidency. The 1993 constitution of the Russian Federation emphasized the pre-eminence of the executive in the formulation of foreign policy. As discussed above, the Yeltsin era witnessed substantial conflict within the executive, and competition between the executive and the legislature, over foreign affairs, contributing to the marked incoherence in foreign policy characteristic of the period. As early as 2002 Putin had achieved an unprecedented

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19 Anders Aslund, Putin’s decline and America’s response, Policy Brief no. 41 (Washington, DC: Carnegie Endowment for International Peace, Aug. 2005), p. 1. Aslund goes on to stress the dysfunctionality of this ‘overcentralization’, noting that—in terms of Freedom House data—Russia has the distinction of being the only country ‘that has become authoritarian during President George W. Bush’s tenure’. Freedom House is a US-based NGO that monitors transition globally.
degree of autonomy in foreign policy, as a result of his success at the polls, his growing influence over Russian media, his effective subordination of the legislature, and agreement among the economic elite on the fundamentals of his approach. That executive autonomy remains essentially unchallenged.

In other words, the starting-point of contemporary Russian foreign policy was a reasonably clear-headed recognition of Russia’s weakness, both internally and in comparison with the other great powers, notably the United States. In this respect, the Russian case contrasts starkly with the situation of at least two of the other ‘emerging powers’ (China and India), both of which combine dynamic growth with increasing assertiveness in foreign affairs.

The contemporary Russian conception of international order

For much of the Yeltsin period, Russia tinkered with conceptions of multipolar balancing mechanisms as means of dealing with its new position in international relations. This orientation persisted into the first years of the Putin presidency. The first major doctrinal statements of the Putin administration recognized the enhanced possibilities for interstate cooperation in the post-Cold War era, and at the same time evinced significant concern over the global distribution of power. The 2000 Foreign Policy Concept of the Russian Federation identified the systemic tendency towards unipolarity and American unilateralism as significant threats to Russia and declared that ‘Russia shall seek to achieve a multi-polar system of international relations’. These sentiments were echoed in the National Security Concept of the Russian Federation, adopted earlier the same year, which went on to define the eastward enlargement of NATO as a threat to the Russian Federation.

Both documents strongly emphasized the role of the United Nations, and particularly its Security Council, as the bedrock of a legally based multilateral structure, capable of constraining the unilateral exercise of preponderant power, and as an essential protector of the sovereign rights of states. This emphasis reflected the value that Russia placed, and continues to place, on its status as a permanent member of the Security Council, both for symbolic reasons and because membership provides a limited capacity to block initiatives by the United Nations that might complicate achievement of the Russian government’s domestic objectives. In this respect one need only note the absence of any substantial Security Council discussion of the crisis in Chechnya since the beginning of the second war in 1999.

Linked to the continuing Russian focus on the United Nations is an emphasis on the legal status of the UN Charter and a very restrictive interpretation of

20 In the December 2003 parliamentary elections, Putin’s party secured two-thirds of the seats.
those clauses pertaining to sovereignty. Russia has consistently rejected any
dilution of what it sees as the Charter’s defence of domestic jurisdiction. Like
China, therefore, Russia has no time for the notion of humanitarian inter-
vention or the linking of sovereign rights to global standards of human rights.

This highly restrictive interpretation of domestic jurisdiction and sovereign
rights extends also into the Russian posture towards regional organizations. For
much of the post–Cold War period, the OSCE was Russia’s favoured candidate
as an umbrella organization for European security. By 2000–2001, however,
this enthusiasm had paled in the face of increasingly intrusive engagement within
the CIS by offices and field missions of the OSCE. The principle of non-
interference has been a centrepiece of the Russian campaign for reform of the
organization since that time. In July 2004, for example, Russia, in a statement
made jointly with eight other former Soviet states, castigated the OSCE for its
failure to observe ‘fundamental Helsinki principles, such as non-intervention in
internal affairs and respect for the sovereignty of nations’, and for its selectivity
and double standards. The electoral monitoring and assessment activities of the
OSCE’s Office for Democratic Institutions and Human Rights came in for
particularly strong criticism on the grounds that its work had become politi-
cized and that it was inattentive to the ‘specifics of individual nations’. The
OSCE’s field missions were pilloried for unjustified criticism of the domestic
policy of host states. In discussing the statement, the Russian Deputy Foreign
Minister, Vladimir Chizhov, noted that if current trends of ‘degeneration’ in the
OSCE continued, Russia and the other CIS states might ‘lose all interest in it’.

The terrorist attacks on New York and Washington in September 2001
prompted significant adaptation in Russia’s approach to its relations with the
United States. The discourse of multipolarity and balancing largely disappeared,
at least in official circles, to be replaced by a reasonably unambiguous recogni-
tion of US primacy and an acceptance that, for the time being, no really
plausible balancing mechanisms existed. In the absence of such options, the
obvious solution was to bandwagon. As one leading Russian foreign policy
analyst put it recently: ‘A paramount role in Russia’s strategic orientation
toward rapprochement with the West must be assigned to the establishment of
the closest possible partnership with the United States as the leading country in
the contemporary world.’

The embrace of the United States reflected not only acknowledgement of
the unassailability of US preponderance, but also recognition that cooperation
with the United States was necessary in addressing the most significant inter-
national (and transnational) threats facing the Russian Federation—terrorism,
and the proliferation of weapons of mass destruction—and desirable in addressing
lingering Russian economic weakness.

24 ‘Statement by CIS member states on the state of affairs in the OSCE, Moscow, July 3, 2004’, available at
26 Karaganov, ‘Russia and the international order’, p. 41. That Mr Karaganov should take this view is parti-
cularly significant, given his previous support of multipolarity as a priority of Russian foreign policy.
Russia and the hegemon

On major issues where Russia felt compelled to come down on one side or the other in respect of US policy, it has sided with the United States. The obvious example was the Russian response to the attacks on September 11, 2001, when the Putin administration almost instantaneously declared its solidarity with the United States. That this was not mere rhetoric became clear over subsequent weeks, when Russian intelligence forces cooperated closely with the Americans in strengthening the position of the Northern Alliance in Afghanistan. Russia also accepted the creation of American military bases in Uzbekistan (Karshi-Khanabad) and Kyrgyzstan (Manas) in support of combat operations in Afghanistan. The latter decision was not an easy one. The Putin administration had inherited a policy of vociferous resistance to the West’s military penetration of the former Soviet region, and faced significant domestic opposition to this concession. It was, however, probable that the United States would deploy whether or not the Russian Federation opposed it, while Russia lacked sufficient influence over these Central Asian states to persuade them to refuse US requests. So there was little to be gained in attempting to prevent the deployment. Moreover, the effort to do so would have had damaging repercussions in Washington, with which Russia had a much broader agenda. Cooperation in America’s ‘war on terror’, in contrast, carried some potential for gain on other issues on which the Russia–US relationship impinged strongly, such as Chechnya, integration into the world economy, and the maintenance of strategic deterrence and arms control regimes.

To some extent, gains were forthcoming. With regard to Chechnya, the key priority was defusing international criticism of Russia’s conduct of the second war (from 1999), and deflecting international pressure for a negotiated political resolution of the conflict. Since 2001, the US government has not spoken out on Russian military operations in the breakaway republic and on Russia’s treatment of civilians there, accepting Putin’s conflation of the Chechen conflict with the war on terror.

Integration into the world economy has long been seen as an important goal for Russia. In particular, Russia seeks enhanced access to international markets for its exporters, equal treatment on such issues as anti-dumping measures, an end to what is perceived to be discrimination against Russian exports, and a greater role in the management of international economic relations. In this

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27 Putin was the first foreign leader to speak to President Bush after the attacks, and expressed his sympathy and solidarity in unambiguous terms.

28 The 2000 National Security Concept had identified ‘the possible appearance of foreign military bases and large military contingents in direct proximity to the Russian borders’ as one of eight ‘main threats in the international sphere’ (‘The National Security Concept of the Russian Federation’, p. 5).

29 The significance of Russian integration into the global trade and financial system was highlighted in ‘The Foreign Policy Concept of the Russian Federation’, p. 6.

area, too, there was significant (and, from a Russian perspective, positive) change in Russian–American relations after 9/11. In early 2002 the United States recognized Russia’s status as a market economy, and embarked on a dialogue about energy with the Russian leadership. In addition, in May 2002 President Bush acknowledged that Russian accession to the WTO was a matter of national interest for the United States. In the meantime, the Russian Federation completed its accession to full membership of the G8 at Kananaskis in 2002, and Moscow was spoken of as a favoured location for the 2006 G8 Summit. Here too, then, was evidence of significant pay off from the choice of partnership.

However, in the area of arms control Putin was quickly disappointed: in December 2001 the United States withdrew from the ABM Treaty, a cornerstone of Soviet and Russian foreign and security policy for some 30 years. This move carried some potential for degrading the value of Russia’s strategic nuclear deterrent. However, little would have been gained by opposition. Therefore, while the posture adopted was one of regret, Russian policy-makers took care to avoid any spillover from disagreement on this issue into the larger relationship.

This is not to say that partnership is the sole thrust of Russian policy towards the United States on major security issues. The opposition between balancing and bandwagoning ignores intermediate options, one of which is ducking. Russia was, incontrovertibly, opposed to the use of force in Iraq in 2003. Again, however, American resolve was reasonably clear. Russia did what it could to keep the decision-making process within the UN framework. However, when the point of decision actually came, in February–March 2003, Russia turned aside from taking the lead in opposing the American drive, not least because other Security Council members were willing to carry the burden. Thus the resistance in the Security Council to the US quest for a follow-on resolution authorizing the use of force in Iraq was led by Germany and France. The judgement informing the Russian posture was that open opposition would be futile and might carry significant costs.

Furthermore, on issues relevant to the domestic and regional focus of the Russian Federation’s foreign policy, the Putin administration has been more than willing to pursue policies at variance with American preferences. Where the position of the United States is inconsistent with the Russian view of what is necessary to address its domestic objectives, America is ignored. The Yukos affair provides a good example. Here, the Russian government used the courts to wrest control over a substantial portion of Russian energy production out of the hands of Mikhail Khodorkovsky. This effort provoked widely voiced criticism in the US and other western countries concerning the weakness of the rule of law in Russia; western investors and governments alike, moreover, warned that the arbitrary confiscation of private assets would constrict the flow of foreign capital into the Russian Federation. The Russian government proved willing to weather the criticism and to accept the investment risks, because it was committed to strengthening state control over this key sector of Russia’s
economy, as well as to making clear to the remaining oligarchs the danger that they faced if they got ‘off message’ in Russian politics.\(^{31}\)

In addition, and reflecting the priority attached to the state of affairs in contiguous regions, the Russian Federation has been more than willing to resist American policy towards several former Soviet republics. In 2004–2005 Russia forced the departure of the OSCE border-monitoring mission in Georgia, despite wide consensus within the OSCE in favour of its continuation. It has continued its policy of granting citizenship and passports to residents of secessionist regions in Georgia, despite Georgia’s vehement rejection of this policy, and the opposition of the United States and the EU to it. And, finally, although it accepted the establishment of American bases in Central Asia, it is happy to take advantage of circumstances to reverse this intrusion. After the Uzbek government slaughter of protesters in Andijan in May 2005, for example, Russian policy-makers exploited the ambivalence of American perspectives on the human rights situation in Uzbekistan to call into question the status of US bases in the region. Russian spokesmen unequivocally supported Uzbekistan’s rejection of accusations of human rights violations, while stressing that, whatever the case, what happened in Andijan was Uzbekistan’s business.\(^{32}\) They continued by orchestrating a campaign against the US military presence in Central Asia. The approach was consistent with an evolving pattern of Russian behaviour in cases where its perceived interests diverge from those of the United States, but where it nonetheless seeks to avoid direct confrontation. The question of removing US bases was raised principally by regional multi-lateral organizations such as the Shanghai Cooperation Organization,\(^{33}\) and by the states of the region.\(^{34}\) Ultimately, it was Uzbekistan that demanded US withdrawal from its principal base in Central Asia; and it was local specialists who spearheaded the broader campaign to reduce America’s military presence in the region.\(^{35}\) Again, the ‘ducking’ metaphor seems appropriate for the role taken by Russia.\(^{36}\)

\(^{31}\) The campaign against Khodorkovsky seems to have been inspired in considerable measure by Putin’s concern that the oligarch was crossing the line from business into politics. See Aslund, *Putin’s decline and America’s response*, p. 2.


\(^{34}\) For example, the newly elected President of Kyrgyzstan (host to one of two significant US military bases in the region), Kurmanbek Bakiev, noted in summer 2005 that the situation in Afghanistan was stable enough for the United States to re-evaluate its military posture in Central Asia.


\(^{36}\) As Alexei Makarkin pointed out: ‘Russia is playing its own part in the Big Game. It does not want to publicly quarrel with the U.S. by forcing its bases out of the region, as this may provoke accusations of torpedoing the counter-terrorist coalition. Russia’s goal is to ensure that the U.S. bases are pulled out after the Afghan operation.’ ‘What stands behind Uzbekistan’s demand to withdraw US base?’ *RIA-Novosti*, 2 Aug. 2005, available at http://en.rian.ru/analysis/20050802/41076262.html.
Further afield, Russian weapons sales to China and its technology transfers to Iran have conflicted with US policy preferences. From the perspective of the Bush administration, the first contributes to unwelcome change in the East Asian balance of power, while the second arguably undermines the non-proliferation regime to which both Russia and the US are ostensibly committed. Both Russian actions are driven in considerable measure by economic considerations: they bring substantial hard currency revenue into a depressed sector of the Russian economy, and help to fund Russia’s efforts to remain competitive in its areas of traditional comparative technological advantage.

In other words, where Russian preferences directly collide with what the United States perceives to be its vital strategic interests (e.g. NATO enlargement, the war in Iraq and US bases in Central Asia), Russia accepts what it must rather than engaging in a doomed resistance that might provoke significant erosion of the central relationship with the United States. Where the preferences of the two states diverge on issues that are vital from a Russian perspective but peripheral from the perspective of the United States, Russia goes its own way. In the middle ground (as with China and Iran), it tests the limits of its options. This pattern reflects a careful evaluation of America’s threshold of tolerance, above which there is little flexibility and beneath which there is a fair amount of room for manoeuvre.

Russia and the ‘European pole’

The Iraq episode raises the larger question of relations between the Russian Federation and the EU and its major states. Here it is appropriate to begin by noting President Putin’s evident affinity for Europe (and in particular for Germany). This may derive in part from his earlier service as an intelligence officer in East Germany, but his association with St Petersburg, his place of origin and also the city where his political/bureaucratic career blossomed in the 1990s, is also likely to have influenced his outlook. Putin made clear very early on in his presidency his view that Russia’s identity was not in contradistinction to Europe (as Eurasianists would have had it), but that, on the contrary, Russia was part of Europe. As Alexey Pushkov put it: ‘According to the president, partnership with the EU and leading European countries were the *sine qua non* of a successful foreign policy.’

The question arising is what that means in the context of transatlantic (or Euro-Atlantic) relations. Specifically, where does this Europe of which Russia claims to be a part sit with respect to the United States? Here, Russian policymakers have quite consistently stressed the need for Europe to emerge as a concentration of power and influence *within* a Euro-Atlantic community rather than in opposition to America. The emphasis, in other words, is, again, on partnership rather than on balancing.

This conclusion is a product of judgements regarding world order already discussed. It also reflects the disappointment of earlier Russian expectations regarding the Common Foreign and Security Policy and European Security and Defence Policy as harbingers of an effective and powerful EU identity in international affairs. The evident opposition to this outcome within the EU, the slowness of the bureaucratic and diplomatic process, and the current difficulties experienced by the EU in referenda on the European Constitution and in the effort to secure agreement on a budget have dampened Russian enthusiasm considerably. Russia’s interest in Europe as a partner has also been affected by the fact that it has found the construction of cooperative relations with the EU and its member states to be tough going on a wide range of issues. For example, Russia has experienced serious difficulties in negotiating the regime covering access to the Kaliningrad exclave and the visa regime for Russians crossing EU territory between Kaliningrad and the rest of Russia. The EU rejected Russia’s attempts to make renewal of their Partnership and Cooperation Agreement conditional on Europe’s addressing a large number of concerns relating not only to Kaliningrad but also to trade access to new members of the EU.

In addition, the Russians have found the United States to be more accommodating than Europe on the issue of Chechnya. Individual European states, the EU and the Council of Europe have all to varying degrees refused to swallow the conflation of the Chechen conflict with the war on terror. Russia also ran into problems with the EU over the political transitions in Georgia (2003) and Ukraine (2004). Russia viewed these events as threatening both to its domestic arrangements and to its regional influence. In contrast, the EU embraced both as opportunities for democratic development in the former Soviet region. All of these issues reflect an underlying and fundamental dissonance between Russia and the EU: Russia focuses on pragmatically defined interests; the EU has an (annoying from the Russian perspective) preoccupation with liberal values.38

Finally, EU enlargement to include the Baltic states, Poland, Slovakia and Hungary (with the probable inclusion of Romania in the next round) brings the Union much closer to Russia’s regional zone of strategic interest. Despite its stress on cooperation with Russia, the EU’s European Neighbourhood Initiative raises the prospect of increasing tension in Russia’s relations with the Union over issues involving nearby states. Such tension has already emerged not only in divergent responses to political events in Ukraine and Georgia, but over the effort to mediate a settlement of the conflict in Moldova, and over responses to the Lukashenko government in Belarus.

In short, even if Russia were to seek to enlist the EU in an effort to construct a multipolar balance against American power—and it is not clear that it intends to—the EU is a distinctly problematic and unpromising candidate for the role.

38 This tension is well portrayed in Lynch, ‘Struggling with an indispensable partner’, in Lynch, ed., What Russia sees, pp. 121–2.
**Sino-Russian relations**

The other principal regional centre of power attracting significant attention from Russia is China. On the face of it, there is substantial potential for the development of close cooperation between Russia and China on matters of international and regional order as well as in more prosaic economic matters. The two states share considerable unhappiness with the current configuration of power in the international system and, in their bilateral statements, have expressed a preference for a multipolar world order. They both strongly support the United Nations as a means of constraining US unilateralism. They are both unequivocally opposed to the dilution of sovereignty and of the principle of non-intervention. They also jointly opposed American withdrawal from the ABM Treaty. Both are uncomfortable with the US global pursuit of democratization. Neither supported the US attack on Iraq.

They also share substantial concern over stability in Central Asia in the face of what both perceive to be a serious strategic threat from radical Islamism. This concern has been translated into joint regional institution-building (the Shanghai Cooperation Organization) and the development of regional multilateral cooperation in that institutional context to counter terrorism. The two states also share concern about the broadening of American influence in Central Asia, both in terms of military deployments (see the discussion above of the SCO statement on US bases in Central Asia), and in terms of American promotion of democratic political change that threatens authoritarian governments.

Finally, they have a substantial economic agenda of cooperation. Russia sees China as a major customer for its military hardware; and Russia is a major energy exporter, while China is a rapidly growing energy market.

And yet, notwithstanding all this, the prospects for the evolution of the Sino-Russian relationship into anything resembling an alliance are very limited. There are clear limits on the extent to which Russia is willing to take risks in its relations with the United States through further development of its ties to China. Many in Russia see a dynamically growing China as a serious threat to Russian control over Siberia and the Russian Far East, and to Russia’s strategic position in the north-western Pacific. This perception creates a certain ambivalence in Russian policy towards China: is China a friend to be supported and strengthened, or is it a threat to be contained?

Take Russia’s economic interests. China is not the only major potential energy market in East Asia. Consideration of pipeline routes for the eastward export of Russian oil have been dominated by competition between China and Japan for access to Russian supplies. And economic gains produced by military sales must be balanced against the political risks of accelerating China’s rise as a major military power in East Asia. Russia, too, faces the prospect that its

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39 For the latest example, see “‘Full text’ of China–Russia joint statement on 21st century world order’, BBC Media Monitor, 2 July 2005.
40 “‘Full text’ of China–Russia joint statement’, para. 2.
influence in Central Asia could be displaced by a China that is very actively engaging with the region in both economic and politico-strategic terms, seeing it as a significant market for its consumer goods and as a promising source of energy.41

Conclusion

Russia is not an emerging power in the conventional sense of the phrase. Its foreign policy is dominated by the effort to reverse the substantial decline of the 1980s and 1990s and to lay the internal basis for a return to real (as opposed to symbolic) status as a great power. This entails fostering international conditions conducive to allowing this reconsolidation to proceed without external hindrance. Its second major priority in foreign policy is regional: to restore Russian influence over the former Soviet states—or at least to impede the intrusion of external powers into that space, to limit the growth of their influence, and to control tendencies in the region that may produce negative repercussions in Russia itself.

In the larger international system, Russian policy is pragmatic. Conscious of their own weakness and vulnerability, Russian leaders strongly support a traditional understanding of sovereignty and domestic jurisdiction, resisting the dilution of these concepts on human rights or governance grounds. They also seek to maintain or to restore the position of the United Nations as the principal global multilateral security institution, not least because, for historical reasons, Russia enjoys a level of influence and status in the organization that is disproportionate to its current capabilities.

Russia's relations with the hegemonic power are complex, and appear to be based on a realistic understanding of the preponderance of American power and also the hierarchy of American policy interests. The earlier embrace of multipolar balancing has largely disappeared from Russian policy practice, and is now rarely encountered in official discourse. This does not mean that Russians would not prefer a multipolar world. It is clear that Russia is in a profound sense wedded to the Westphalian model of a pluralist system based on sovereign equality. However, current Russian policy focuses not on what is desirable in the far long term, but on what is possible in the current configuration of power in the system. It also reflects numerous specific problems in relations with potential alternative partners such as Europe and China. In this context, Russian policy-makers either cooperate in, or at least avoid substantial confrontation over, matters of American vital interest. In so doing, they seek to draw what advantage they can from issue linkage.

Russia does engage in competitive behaviour over matters that are central to its own priorities while being less essential in American foreign policy and

strategy. And—reflecting again the domestic imperative—Russian policy-makers brook little American interference in domestic policy-making, be it over economic reform, the neo-authoritarian consolidation of the Russian state or the conduct of the war in Chechnya.

In essence, Russian foreign policy is a holding game. It is designed to limit further losses and to sustain or promote conditions that—in the longer term—will permit Russia to re-emerge as a great power in a pluralist international system.