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The Northeast Asian Economic Review

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Low-income Settlement Reconstruction and Subjective Well-being —Based on Six Cities' Sample Survey in Liaoning Province

Chao Li & Shangchao Liu*

Abstract

Low-income settlement is a common problem existing in many countries. By using 2012 survey data of UN-HABITAT and CASS, this paper focuses on the change of original residents' subjective happiness during the process of low-income settlement reconstruction in six cities of Liaoning province. Several conclusions are obtained: (1) Low-income settlement reconstruction had significant effects on original residents' happiness, the relation between income level and happiness exhibits an inverted-U shape after reconstruction; (2) Quantile regression estimation shows that the community life quality improvement affected positively on different happiness levels of original residents, while new communication methods and the change of neighbor relationship after reconstruction cannot improve subjective well-being; (3) According to the low-income class, the influencing factors of happiness is so different with other groups and also government's indirect pro-poor policies received slightly less positive effect. Therefore, authorities should pay more attention to both explicit and implicit effects of low-income settlement reconstruction.

Keywords: low-income settlement, social effect, subjective well-being, Liaoning province

1. Raising issue

Low-income settlement is a universal issue existing in many countries with different income levels. "2010-2011 State of the World's Cities" shows that by carrying out of low-income settlement, 227 million people moved out from slums in last ten years, meanwhile, the population of slum residents increased from 776.7 million in 2007 to 827.6 million in 2010 with a net increase of 55 million. Since the Chinese reform and opening up, the largest scale of accelerating urbanization process in human history has happened in China, simultaneously the low-income settlements has been spreading out in many large cities. Shanty town is a typical representative of Chinese low-income settlements. Until the end of 2008, 11.48 million households lived in various kinds of shanty towns, including 7.44 million households with middle or low-income lived in city shanty towns. In Liaoning province, an old industry base in north-east China, the problem of shanty towns was particularly serious that 29 million square meters centralized shanty towns held more than 700,000 households and 2.1 million residents. Since 2005, when State Council approved the project of shanty town reconstruction in north-east China, Liaoning provincial government started the comprehensive integrated shanty town reconstruction. Official statistics shows that 29.1 million square meters shanty towns were rebuilt and houses for 706,000 households and 2.11 million residents were provided from 2005 to the end of 2011. The final goal of shanty town reconstruction in Liaoning is to pay more attention on original resident's housing condition and welfare level, thus the final reconstruction performance depends on both improvement of living space, environment and subjective well-being growth. However, does the affordable housing engineering reach its expected social effect after seven years? Does low-income settlement have significant influence on individual subjective well-being? This paper will

comprehensively discuss the above topics in depth.

Concerning the overall condition of sampling survey this time, most of the original residents participating in shanty town reconstruction are vulnerable group. Comparing with general city residents, their basic features are low income, low education, including the old, the sick and the disabled. More than fifty percent shanty town residents are staffs who working in low profit manufacturing enterprises and industrial mining enterprises. Their family annual incomes are about RMB 30,000 while Engel's Coefficient is 66.2%, belonging to typical low-income class. People of such class have made great contributions to north eastern old industrial base construction, but they stuck in survival and development difficulties because of system obstacle. They cannot improve living condition through their own efforts with the absence of bottom-up self-renewal capacity. As a result we consider that sustained attention to low-income settlement reconstruction and residents' welfare is not only assessment towards engineering efficiency but also value orientation concerning about social equity policy.

2. Literature review

Improving resident welfare is the final purpose of government public policy (Huang Youguang, 2005). Of course, a number of local governments are committed to win the politic championship on seeking partly the growth of total GDP in recent years, but housing problem which is concerned with resident welfare has not been emphasized enough from government. Driven by land financing, some local governments turn a deaf ear to soaring house price. At the same time, accompanying with economic accumulation and space aggregation since the Chinese reform and opening up, house price has rocketed in some first-tier cities due to the effect of supply and demand. In large cities such as Beijing, Shanghai and Shenzhen etc., house price is even 21 times of citizen's yearly income, which is far beyond citizen's affordability (Lu Jianglin, 2010). In fact, soaring house price has become a visible threshold for which common people can hardly achieve well-being. With the help of CGSS database, Lin Jiang (2012) conducted a practical analysis of the relation among city house price, house property and citizen well-being. Four conclusions are discovered as following: first, the degree of raising city house price has a negative effect on resident well-being; the higher house price is, the lower resident well-being will be. Second, resident's house property is notably related to their well-being. For example, well-being of residents owning a unit house and more unit houses is remarkably higher than that of tenants; similarly well-being of residents owning more unit houses is remarkably higher than that of residents owning a unit house. Third, the increase of house price has negative effect on tenant's well-being and has positive effect on well-being of residents owning one unit house or more unit houses. Well-being of residents owning more unit houses is remarkably higher than that of residents owning one unit house while house price goes up quickly. Fourth, house quality also affects resident's well-being.

If living condition plays an important role in residents' subjective well-being, then the government's public policy should certainly concentrate on improving residential condition for low-income class. Peer Group Effect shows that the existence of low-income settlement is largely due to the city governments' unequal public financial distribution among communities (Wan Guanghua, Cai Fang, 2012). Murray (1998), Hussar and Sonnenberg (2000) studied that there is a notable difference in expenditure per capita among pupils living in different communities while such difference could easily transmit to future labor market so that the inequality would be more

serious. Furthermore, if the city communities were originally consisted of low-income residents, then the neighbor effect would bring interaction among communities. Such effect will be intertemporal and transmittable between generations. Learning from global experience, existence of low-income settlement relate to a series of economic and social factors. Although in some countries and areas this problem was already die hard, but it should be effectively controlled via policy adjustment, and this opinion has reached broad consensus (Wan Guanghua, Cai Fang, 2012).

The role and function of government on low-income settlement reconstruction is where the academia has dispute (Glaeser & Saiz, 2003). Turner (1972) considered that the government can only reconstruct the living environment around low-income settlement areas but does not need to pull down the old houses. That is residents-oriented bottom-up reconstruction mode. This participative mode has been accepted by many experts (Korten, 1989) who think that the government has complex levels and low efficiency comparing with market-led reconstruction mode. During 1990s, World Bank used a top-to-down mode to carry out the low-income settlement reconstruction in three cities of Calcutta, Jakarta and Manila. Looking from short term assessment, it appeared quick return and low cost, however, from long term observation, those projects did not thoroughly improve living condition for the low-income residents, and they got much of the blame as the surrounding environment was even worse (World Bank, 1994; Thomas, 1997).

Experience studies tell that completed market-led or only government-led modes, or focusing on only improving of housing but neglect social effect will lead to a huge loss of the reconstruction efficiency. A kind of investment mode that can reach balance between equality and efficiency is in exploration. Bugg-Levine and Emerson (2011) criticized the dichotomy idea of public welfare and business by analyzing a precedent in which Quaker Presbyterians had mixed faith, business and community together in the 17th century. They proposed a concept of “blended value”, that is to say it is not necessary to make one’s choice between social benefit and economic interest and yet aim to make the maximum of blended value. Investment performance should be evaluated by “Social Return on Investment”, a standard of comprehensive consideration of economic, social and environmental benefits, regardless of government and NGO or profit and nonprofit, so that the desire of doing public welfare can be satisfied and expect return can also be obtained. British government’s “Bootstrap” policy in late 1960s, and also the municipal government of Sao Paulo’s “Poor settlements in urban renewal plan” in 1989, even Obama administration’s “Featured residential plan” contain the same ideal to a certain extent.

At the technical level, the change of assessment systems will be implemented if social effect is measured scientifically. So far, a generally recognized method measuring social effect has not been formed because of different perspectives, ideas and complex subjective or objective factors. Happiness is not only a standard to evaluate social development, but also a goal and base of government performance (Zheng Fanghui, 2011). In 1972, Jigme Singye Wangchuck, king of Kingdom of Bhutan, firstly proposed the concept of citizen happiness index, resulting in gross national happiness (GNH) which consists of economic growth, environment protection, culture development and government administration, and blended social effect and happiness together. The World Values Survey, directed by Ronald Inglehart, Professor of University of Michigan, announced a generally recognized index system in which interviewees had made direct answer to the two dimensions question of personal happiness and satisfactions. From the demand perspective, academic field has proposed three kinds of index system: an index system relates to

the degree of life satisfaction in the field of cognitive categorization, including the degree of living satisfaction (such as job, income and social security), the degree of life quality satisfaction (such as housing, healthcare and education). B index system is composed of emotional status and pleasure level. C index system is aimed at interpersonal relationship as well as harmonious degree of individuals and society. Therefore, well-being is a key variable connecting closely with social effect in literatures mentioned above.

Besides the key influencing variable such as housing condition, community environment and social effect etc., the relation between income and happiness is also a hot issue. More and more studies show that subjective well-being has negative relation with GDP growth after income reaches a certain level, called Easterlin paradox (Easterlin, 1974; 2001). With research goes further, a number of effective factors are also taken into account, including: first, relative income and income gap will affect personal well-being, in other words, a phenomenon of 'keeping up with the Joneses will affect personal well-being. Thus some researchers often think that well-being has no relation with absolute income and relative income will affect well-being (Luis & Becker, 2007). Second, history and expectation is also called time comparison, the change of human physiological indices will affect well-being (Chen Huixiong, 2008). Third, hidden factors related to personal life, such as health, family love and personal relationship play a great role in well-being improvement. Fourth, other macro factors such as inflation, jobless, government expenditure and environment etc. also influence well-being (Lu Yuanping and Wang Tao, 2010). In addition, some researchers think that well-being has to be excited by pulsatile variation, even though high income people have no satisfaction well-being without pulsatile variation. The less a rare enjoy is, the higher well-being is. In general, diversity of affective factors is helpful for human being to gain insights of well-being, but it is clear that these factors do not exist independently but rather connect with one another. That is to say, these factors are largely collinear and endogenic.

Based on former research, this paper mainly probes into the influence of key variable on subjective well-being before and after low-income settlement reconstruction through family, community and social levels. Because well-being values come from the individual's subjective feeling, so we adopt the approach of Bruni, etc. (2007), specifically, this paper controls age, educational status, relationships and other individual characteristics. The structure of paper is as following: Section 3 contains the modeling and the utility function used to set up research framework. Section 4 is concerned with data processing, statistic description and empirical test. Section 5 provides robustness test and Section 6 is conclusions and relative policy suggestions.

3. Theoretical model and research setting

3.1. Modeling

According to the study of Glaeser et al (2001), the paper first analyzes a consumer whose utility function could be properly estimated by Cobb-Douglas function. The consumer's utility function is defined as $U = \theta H^\alpha X^{1-\alpha}$, where U is the consumer utility function, θ is the quality of life in community, H is the housing consumption, X is the consumption of other commodities, which satisfies the following budget constraint $W = P_H H + P_X X$, where P_H is the housing price, P_X is the price of other commodities and is normalized to 1. According to the utility function and budget constraint equation, the first order condition is derived as follows:

$$H(P_H, W) = \alpha W / P_H, \quad (1)$$

where α is the proportion of housing consumption in the household income, $0 < \alpha < 1$. The indirect utility function is defined as:

$$U = \frac{k \theta W}{P_H^\alpha} \quad (2)$$

$$\text{where } k = \alpha^\alpha (1 - \alpha)^{1 - \alpha} \quad (3)$$

The first order Taylor series expansion of Eq.(3) derives $k = \omega \alpha$, where ω is a constant. We take the natural logarithm of both sides of Eq.(2) and derive:

$$\ln U = \ln \omega \alpha + \ln W + \ln \theta - \alpha \ln P_H \quad (4)$$

As mentioned above, since utility is a vague concept, economists have difficulties in its accurate measurement. According to Huang Youguang's study (2005), we can use the subjective well-being as an alternative indicator to evaluate the utility. And in order to evaluate the change in subjective well-being before and after the shanty town reconstruction and relative factors, we can classify the explanatory variables into four categories according to the variable and indicator system by Zheng Fanghui (2011) and Zheng Siqu et al. (2011).

The first category is residents' profiles, including age *age*, education *edu*, interpersonal relationship *int*, which is measured by the proportion of expenditure on interpersonal relationship in total expenditure, and etc. The second category is households' profiles, including household size *size*, household income *inco*, the quadratic term of household income *inco*², the increase in housing area after shanty town reconstruction *Δarea*, the cost of housing reconstruction P_h^{-1} , and the change in household consumption pattern *Δeng* (represented by Engel coefficient). The third category of variables measures the quality of life in community, including the improvement of drinking water quality *wat*, green area augment *gre*, functionality and convenience of telecommunication network *comm*, public transportation accessibility *tras*, and neighborhood friendship *neig*. The fourth category is concerned with social impact, including security improvement after the reconstruction *sec*, political participation increase *pol*, satisfaction with government efforts in low-income settlement reconstruction *gov*, and recognition of poverty alleviation policies *help*.

With the above four categories of variables cover progressive from individuals, households, communities to society, the overlap and interplay between variables are minimized. And we choose different indicators in each type of variables to decrease the colinearity between variables. According to the above classifications, the basic regression equation is defined as follows:

$$\ln \text{Happiness}_i = \Phi(\lambda' \ln \text{Individual}_i + \eta' \ln \text{Family}_i + \zeta' \ln \text{Community}_i + x' \ln \text{Society}_i) + \varepsilon_i \quad (5)$$

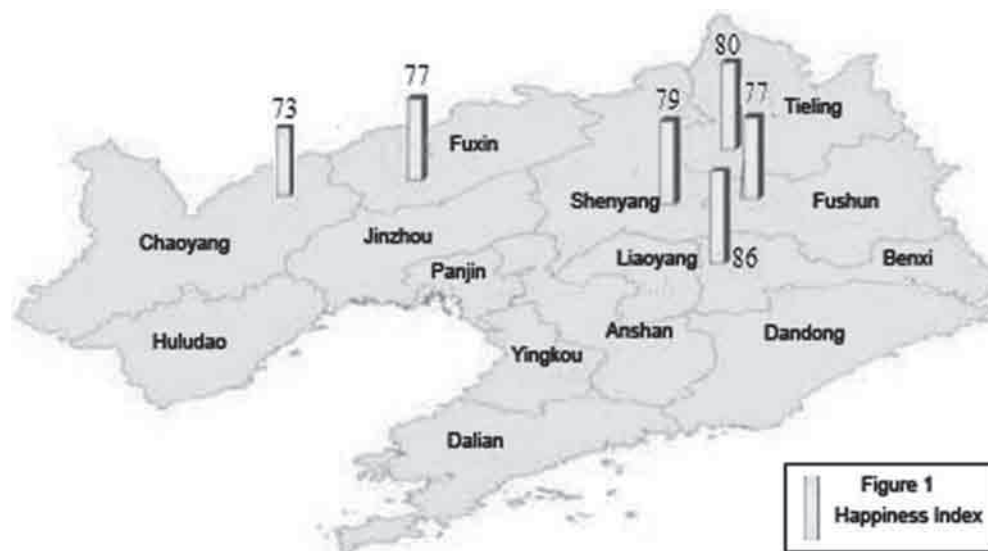
3.2. Sample data and variables

The data in the paper is collected from the representative sample surveys conducted by the joint research group of UNHUBITAT and CASS in Liaoning Province in 2012. We obtain the

samples in Shenyang, Fushun, Benxi, Beipiao of Chaoyang, Tieling and Fuxin in which the low-income settlements are the most concentrated². The shanty towns in the six cities take over 80% of all the shanty towns in Liaoning. We control the sampling errors in the following ways: first, we obtain samples by including the representative areas and the representative shanty town reconstructions in the six cities. Most samples are obtained in Beipiao where the shanty towns are concentrated. Second, the survey sites are diversified with at least 3 sites in each city and different residential sub-districts in each site as the samples. Third, in case the respondents are of the same gender or household, only one data is chosen to keep the surveys individual. Fourth, to keep the encounter surveys random and the interviewees' occupations diverse, snowball sampling is avoided. Fifth, the data quality is strictly controlled in the following ways: we have a summary upon the completion of the trial surveys and standardize the measurement requirements for all the problems; each sample, once completed, is immediately checked by interviewers and double checked by supervisors. Personal errors are controlled effectively before, during and after the surveys accordingly. There are 1,311 copies collected in the representative sample surveys with a confidence of 95% and an error of $\pm 3.5\%$. Our test on the internal consistency reliability of the questionnaire completed shows a coefficient of 0.936 (Cronbach α).

The descriptive statistics of all variables are shown in Table 1 in which the dependent variable is happiness index (*hap*). The respondents are asked in the questionnaire to score their happiness from 0 to 100. Higher scores stand for higher degrees of happiness. The happiness index of Benxi and Tieling are 86 and 80 while the rest are roughly over 70 (see Figure 1)

Figure 1: Happiness Index of the Post-Reconstructed Shanty Towns in the Six Cities in Liaoning



Among the explanatory variables, we control the individual variables such as age and education and use the proportion of social relations expenses in total expenses to measure social relations. The household size, household income and the quadratic term, the increase in the house area, the price of house reconstruction and the change in consumption structure are all included in the questionnaire. The variables at the community and social level chosen in the paper are two types. The first are dummy variables with the values of 0 and 1. For instance, for the variable *wat*

which measures the improvement of drinking water, the question in the questionnaire is “is the quality of the drinking water improved after reconstruction?” The value of Yes is 1 and the value of No or As same as before is 0. The second are perception of the community and society which are divided into the levels from 1-5 and 1-7 respectively in terms of satisfaction. According to the correlation matrix among variables³, there is a big correlation coefficient and a high degree of significance between the explained variable *hap* and the other explanatory variables (see appendix 2). Meanwhile, since most explanatory variables are independent data in the questionnaire, their correlation coefficient and degree of significance are low, which eliminates the multicollinearity. So we can reach an objective analytical result using a linear regression model for the variables.

Table 1: Descriptive data of main variables

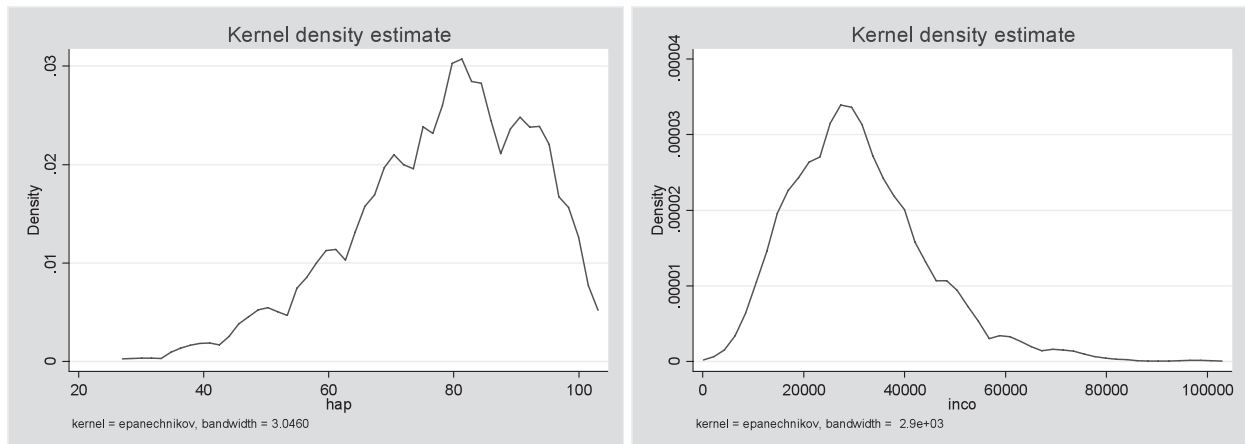
| Variables | Name | Abbr | Questionnaire design | Sample | Average | Standard error |
|---------------------------|---|--------------------------|--|--------|----------------------|----------------------|
| Dependent variable | Happiness index | <i>hap</i> | Self evaluation | 1311 | 78.316 | 14.224 |
| Individual level | Age span | <i>age</i> | Five age spans from 20 to 60 | 1311 | 3.599 | 1.082 |
| | Education | <i>edu</i> | Five levels from pupils to graduates | 1311 | 2.240 | 0.725 |
| | Interpersonal relationship | <i>int</i> | Proportion of expenditure on interpersonal relationship to total expenditure | 1311 | 0.077 | 0.057 |
| Household level | Household size | <i>size</i> | Five levels of household size from 1 to above 6 | 1311 | 2.963 | 1.005 |
| | Household income | <i>inco</i> | Total household income | 1311 | 31035.030 | 13436.490 |
| | Quadratic term of household income | <i>inco</i> ² | Quadratic term of total household income | 1311 | 1.14×10 ⁹ | 1.04×10 ⁹ |
| | Increase of housing area | $\Delta area$ | Increase in housing area after shanty town reconstruction | 1311 | 15.674 | 24.339 |
| | Cost of housing reconstruction | P_h | Cost per m^2 in the shanty town reconstruction | 1311 | 416.004 | 378.483 |
| | Change in household consumption pattern | Δeng | Change of Engel coefficient after shanty town reconstruction | 1302 | 0.003 | 0.141 |
| Community level | Water quality | <i>wat</i> | Where increase is 1, or it is 0 | 1311 | 0.695 | 0.461 |
| | Green area | <i>gre</i> | Where increase is 1, or it is 0 | 1312 | 0.784 | 0.411 |
| | Telecommunication network | <i>comm</i> | Seven levels from 1 to 7 | 1311 | 5.679 | 0.900 |
| | Transport | <i>tras</i> | Seven levels from 1 to 7 | 1311 | 5.566 | 0.977 |
| | Neighborhood | <i>neig</i> | Seven levels from 1 to 7 | 1311 | 5.273 | 1.082 |
| Social level | Security | <i>sec</i> | Seven levels from 1 to 7 | 1311 | 5.407 | 0.964 |
| | Political participation | <i>pol</i> | Seven levels from 1 to 7 | 1311 | 5.230 | 1.048 |
| | Satisfaction with government work | <i>gov</i> | Five levels from 1 to 5 | 1311 | 2.576 | 0.866 |
| | Recognition of poverty alleviation policies | <i>help</i> | Seven levels from 1 to 7 | 1311 | 4.943 | 1.220 |

Source: The data is from the representative sample surveys conducted by the joint research group of UNHABITAT and Chinese Academy of Social Sciences in Liaoning Province in 2012.

4. Empirical results and analysis

Along with the ideas mentioned previously, we analyze the results of the sample surveys comprehensively. Model 1 and Model 2 are OLS estimations before and after the control variable for social impact is added. The model's goodness of fit is improved substantially after the variable is added. It shows that the social impact created before and after the reconstruction has a significant impact on the subjective well-being with a highly positive correlation ($p < 0.01$) between the satisfaction with government work *gov*, recognition of poverty alleviation policies *help* and well-being. It is noticeable that besides regular reconstructions of houses, community and urban structure etc., there are also some indirect poverty alleviation policies such as free training programs to avoid the local residents' returning to poverty. It is empirically proved that such an approach of *blood-generation* as the indirect policies is more effective than *blood transfusion* as the direct policies. Interpersonal relationship has a more significant positive correlation with subject well-being than age and education, no matter social impact is controlled or not. As for the variables about households after social impact is controlled, the variable of housing reconstruction cost P_h has a stronger impact on well-being than housing area increment $\Delta area$. The fitting of the models from 1 to 5 shows that the coefficients of household income *inco* and its quadratic term $inco^2$ after low-income settlement reconstruction are positive and negative respectively, in an inverted U shape. Therefore, there is a threshold value between income and well-being index in the special group of original residents in low-income settlements. More income results in higher well-being below the threshold value, and vice versa, which is supported by Seligman et al (2006). However, the inverted U shape, which is common in academic researches, exists in the residents in low-income settlements, indicating that the original middle-income residents have higher well-being than low-and high-income ones during reconstruction. Hence, more attention should be paid to the well-being of low-and high-income residents in the future. The change in household consumption pattern (Engel coefficient), nevertheless, has little impacts on well-being.

Similarly, at different well-being levels, the factors for subjective well-being may be different, and people of different income levels may perceive well-being very differently. As shown in Figure 2, the subjective well-being and household income are scattered widespread in some sections and concentrated in other sections. Therefore, it is necessary to analyze the samples at different stages and levels. In contrast to OLS estimation for the whole sample of Model (1) and Model (2), the estimation for Model (3), (4), (5) shows a quantile regression estimation result of 25%, 50% and 75% of the whole sample respectively. And the estimation for Model (6) produces a regression estimation result of a low-income group (namely, the household whose income is below 20, 000 RMB per year).

Figure 2: Kernel density estimation of subjective well-being and household income

The results of the whole sample and the quantile regression estimation show that the community level variables such as improvement of drinking water quality *wat*, green area increase *gre* and high transport accessibility *tras* have a positive correlation with happiness index *hap*. So we think that the improvement of quality of life in community has positive effects on original residents with different well-being levels during the reconstruction. It is worth mentioning that good telecommunication network *comm* has a negative correlation with happiness index, unexpectedly different from our projection. The field investigation conducted by the research group shows that it still takes some time for many residents to get used to the new things such as network and instead they prefer a face-to-face communication method. This can be explained by the variable of friendly neighborhoods *neig*. For the whole sample and quantile regression analysis, the regression coefficient and significance level of *neig* are low, which indicates that there is no expected increase in the well-being from friendly neighborhoods. There is a question in the questionnaire survey: “from whom will you ask for help when you have troubles in job?” 11.4% of the respondents choose to go to their neighbors for help before relocation, but this ratio goes down to 9% after relocation. The larger the cities are, the lower the ratio is. For example, the ratio is less than 7% in Shenyang and Fushun. Attention should be paid to the change in communication and interpersonal alienation after relocation.

The regression estimation of low-income groups shows that the improvement of drinking water quality *wat* and satisfaction with government work *gov* during the reconstruction are closely related with subjective well-being with the regression coefficients up to 6.2151 and 5.2993, much larger than the marginal effect of other coefficients with higher significance levels. Although the poverty alleviation policies have remarkable impacts on the subjective well-being of low-income groups, the regression coefficient is less than the whole sample and the regression estimation under the quantile of 25%, 50% and 75%. It indicates that the indirect policies work on low-income groups less effectively than on other groups. Moreover, compared with other models, the regression coefficients of the interpersonal relationship, household income and household consumption pattern of low-income groups are remarkably different from other model estimations and the significance level is lower. Therefore, it is suggested that some different policies should be proposed for the low-income groups in the future reconstruction.

Table 2: Estimation of the subjective well-being factors for the original residents in low-income settlements

| <i>hap</i> | Model (1) | Model (2) | Model (3) | Model (4) | Model (5) | Model (6) |
|--------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| <i>age</i> | -0.2518 (0.369) | -0.2081 (0.341) | -0.2397 (0.464) | -0.2477 (0.418) | -0.3616 (0.447) | 0.9051 (0.979) |
| <i>edu</i> | 0.9767* (0.561) | 0.1812 (0.521) | 0.7292 (0.694) | -0.1750 (0.635) | 0.3163 (0.685) | -0.2471(1.332) |
| <i>int</i> | 24.3717*** (6.360) | 25.4318*** (5.914) | 26.0138*** (8.663) | 24.4977*** (7.208) | 42.7550*** (6.561) | 7.8113 (12.832) |
| <i>size</i> | -0.2607 (0.402) | 0.1240 (0.372) | 0.5647 (0.513) | 0.4307 (0.454) | 0.2284 (0.471) | -1.7008* (1.015) |
| <i>inco</i> | 0.5417*** (0.100) | 0.4330*** (0.093) | 0.4488*** (0.129) | 0.5558*** (0.113) | 0.5045*** (0.114) | 2.8157* (1.601) |
| <i>inco</i> ² | -0.0058*** (0.001) | -0.0046*** (0.001) | -0.0051*** (0.002) | -0.0061*** (0.001) | -0.0060*** (0.001) | -0.1068* (0.059) |
| <i>Δarea</i> | -0.0056 (0.016) | 0.0062 (0.015) | 0.0054 (0.020) | 0.0118 (0.019) | 0.0062 (0.019) | -0.0044 (0.035) |
| <i>Ph</i> | -0.0021* (0.001) | -0.0023** (0.001) | -0.0047*** (0.001) | -0.0024* (0.001) | -0.0006 (0.001) | -0.0033 (0.003) |
| <i>Δeng</i> | -0.9154 (2.545) | -1.8461 (2.354) | -1.6546 (3.458) | 0.9686 (2.877) | -0.0366 (2.830) | -6.7451 (5.003) |
| <i>wat</i> | 4.5236*** (0.909) | 1.8979** (0.858) | 2.2049* (1.126) | 1.3923 (1.051) | 2.5739** (1.104) | 6.4151*** (1.944) |
| <i>gre</i> | 7.5281*** (1.063) | 3.9634*** (1.014) | 5.1545*** (1.335) | 5.2774*** (1.243) | 1.9536 (1.317) | 4.9209 (3.056) |
| <i>comm</i> | -1.3345*** (0.481) | -2.2483*** (0.456) | -1.3069** (0.624) | -2.1415*** (0.557) | -3.0316*** (0.573) | -1.2455 (1.262) |
| <i>tras</i> | 1.2170*** (0.437) | 1.2387*** (0.411) | 0.9677* (0.555) | 0.9597* (0.504) | 0.4877 (0.555) | -1.3742 (1.023) |
| <i>neig</i> | 2.3894*** (0.357) | 0.1953 (0.390) | 0.2891 (0.533) | 0.3839 (0.476) | 0.0408 (0.492) | 0.0435 (0.944) |
| <i>sec</i> | | -0.2909 (0.414) | 0.9569* (0.539) | -0.3736 (0.505) | -0.9411* (0.543) | 1.3430 (1.024) |
| <i>pol</i> | | 0.2596 (0.419) | 0.3911 (0.579) | 0.2388 (0.514) | -0.1071 (0.552) | 0.6758 (0.990) |
| <i>gov</i> | | 3.8639*** (0.453) | 5.6239*** (0.625) | 4.3794*** (0.553) | 2.5096*** (0.553) | 5.2993*** (1.160) |
| <i>help</i> | | 3.4470*** (0.359) | 2.9830*** (0.478) | 3.1907*** (0.439) | 3.7527*** (0.427) | 2.5188*** (0.947) |
| <i>constant</i> | 44.0912*** (3.932) | 60.6653*** (4.286) | 44.0661*** (6.055) | 61.5644*** (5.231) | 78.8583*** (5.155) | 52.5549*** (15.69) |
| <i>N</i> | 1302 | 1302 | 1302 | 1302 | 1302 | 231 |
| <i>R</i> ² | 0.201 | 0.322 | — | — | — | 0.409 |
| <i>F</i> | 23.12 | 33.85 | — | — | — | 8.14 |

Notes: Those in the brackets are standard errors, "*" represents the significance level, where "*" is $p < 0.1$, "***" is $p < 0.05$, "****" is $p < 0.01$. As the variable *inco* is bigger than other variables in value, we divide it by 1000 in all regression models, the same for Table 3.

Source: The data is from the representative sample surveys conducted by the joint research group of UNHABITAT and Chinese Academy of Social Sciences in Liaoning province in 2012.

5. Robustness test

In the previous section we take well-being index as a continuous dependent variable (range from 30 to 100) in the regression with several results achieved. However, there is still plenty of room for improvement, which is mainly concerned with the truncation issue for the dependent variable. Individual's well-being index is designed to be in the range from 0 to 100 in the questionnaire, nevertheless, according to empirical statistics, we have not found any individual whose well-being index is less than 30. In other words, those individuals with well-being index

under 30 have been truncated. This seems to be a common problem in social surveys, since in surveying process, if a surveyor enquires about respondent's well-being degree, the respondent tends to give over-evaluated answers after taking account of personal privacy, face saving, etc. Particularly for groups with low well-being index, they are more likely to evade or quit from the survey. Hence, we could only observe samples with well-being index greater than 30. This could be seen from Figure 2 obviously that the well-being index curve in kernel density estimation inclines to right sharply, namely has the relatively significant right tailing phenomenon; however, on the left of the curve, points with well-being index less than 30 are truncated, this left truncation problem of samples seems to be caused by the survey quit of individuals with less than 30 well-being index.

According to modern micro-econometrics theories, simple OLS prediction would be biased if independent variable is truncated or censored. Generally, in this case of limited dependent variable prediction, we need to adopt the maximum likelihood estimate using the Limited Dependent Variable Regression model, in specification:

Table 3: Truncated Regression Analysis Results

| Variable | Coefficient, Standard Error | Variable | Coefficient, Standard Error |
|--------------------------|--------------------------------|-----------------|--------------------------------|
| <i>age</i> | -0.2068 (0.340) | <i>wat</i> | 1.8977** (0.855) |
| <i>edu</i> | 0.1790 (0.519) | <i>gre</i> | 3.9825*** (1.011) |
| <i>int</i> | 25.3757*** (5.889) | <i>comm</i> | -2.2654*** (0.455) |
| <i>size</i> | 0.1203 (0.371) | <i>tras</i> | 1.2414*** (0.410) |
| <i>inco</i> | 0.4343*** (0.093) | <i>neig</i> | 0.1960 (0.389) |
| <i>inco</i> ² | -0.0046*** (0.001) | <i>sec</i> | -0.2919 (0.413) |
| <i>Δarea</i> | 0.0061 (0.015) | <i>pol</i> | 0.2683 (0.419) |
| <i>P_h</i> | -0.0023** (0.001) | <i>gov</i> | 3.8758*** (0.451) |
| <i>Δeng</i> | -1.8397 (2.344) | <i>help</i> | 3.4679*** (0.359) |
| | | <i>constant</i> | 60.5903*** (4.273) |

Note: Standard error in brackets; *** p<0.01, ** p<0.05, * p<0.1.

Source: Typical sampling survey in Liaoning Province done by the joint project team of United Nations Human Settlements Program and Chinese Academy of Social Sciences.

From the above table we can see that truncated regression model results are similar to OLS results, significance level for each coefficient is almost completely consistent in spite of the slightly different coefficient values. In the truncated regression model, regression coefficients for the four variables *sec*, *pol*, *gov*, *help* at social level are higher than those estimated in OLS model (refer to Table 2 Model 2), which indicates that simple OLS model has under estimated the social effects' impacts on subjective well-being in low-income settlement reconstruction process. Therefore, in low-income settlement reconstruction, the key factors to improve subjective well-being are the social effects caused by reconstruction project itself, such as satisfaction improvement on government efforts, democratic participation level increase, approval of government's poverty relief policy, and etc.

6. Conclusions and discussions

By analyzing the results of typical sampling survey conducted in six cities in Liaoning province, this article demonstrates that the "government leading and market participating" low-income settlement reconstruction engineering is significantly effective. One of the main achievements is residents' well-being improvement. Based on the idea of "blended value", the reconstruction engineering not only meets the requirement of supporting public welfare to a certain extent, but also brings expected social return. The conclusions of empirical study can be summarized as following: first, social effects brought by low-income settlement reconstruction, particularly increased satisfaction level on government and approved poverty relief policy of government, have significantly positive effects on residents' subjective well-being. Compared with traditional direct blood-transfusing poverty relief approach, indirect blood-generating approaches organized by government such as employment training programs are more effective. Second, at individual level, interpersonal relationship is highly significant with relatively large coefficient at each quantile level for all the samples except for the low-income groups. With respect to low-income groups, their well-being is closely related to quality improvement of drinking water and their satisfaction on government's efforts in reconstruction engineering. In addition, government's indirect poverty relief policy is less effective for low-income group compared with others. Third, at family level, original resident's family income and well-being index exhibit the "inversed-U" shape curve, which is a common relationship for normal groups, indicating that through the low-income settlement reconstruction engineering in Liaoning province, middle-income original residents have obtained relatively higher well-being; hence well-being for both low-income and high-income groups should be more intensively addressed by government in the future. Fourth, whole sample and quantile regression results show that living quality improvement in communities has positive influence on original residents of each different well-being level, while some variables that emerge before and/or after the construction like new communication pattern and change of neighborhood relationship cannot promote resident's well-being effectively. Therefore, these issues should be highly stressed by relevant departments as well.

Low-income settlement reconstruction is not only an economic but also a social issue. Long-lasting social care for low-income groups is the unavoidable responsibility and obligation for government. Government's objectives are not merely to guarantee low-income residents "have places to live in", but also to make them "live stably" and "live well", which are consistent with our concept of "inclined and smooth city development". "Inclination means that policies

and institutions incline to or favored certain cities or areas in terms of space planning and urban development; “smoothness” means that basic systems and public service supply, particularly for the public service at individual level, should be smooth and equal. This is a bottom line in achieving “harmonious society” and “happy city” Finally, well-being is a subjective concept, but the fundamental facts that lead to or support well-being are objective. Well-being is composed by various factors, as citizens, we can do little with congenital factors, but we expect that government could lay the foundation of our well-being, namely a fair and equal public service system.

*Chao Li and Shangchao Liu are both assistant professor of Chinese Academy of Social Sciences. This paper is a joint research of UN-HABIT and Chinese Academy of Social Sciences. Thanks to the help of Professor Pengfei Ni and Banji Oyelaran-Oyeyinka.

¹ The cost of housing reconstruction here refers to the cost per m² in the shanty town reconstruction, generally lower than market price.

² The introduction of Sample cities will be presented in Appendix 1.

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Appendix 1: Introduction of Sample cities

Shenyang is the capital and largest city of Liaoning Province, as well as the largest city in Northeast China. Currently holding sub-provincial administrative status, the city was once known as Shengjing or Fengtian Prefecture. In the 17th century, Shenyang was conquered by the Manchu people and briefly used as the capital of the Qing Dynasty. Along with its nearby cities, Shenyang is an important industrial center in China, and serves as the transportation and commercial hub of China's northeast—particularly with Japan, Russia, and Korea. A titan of heavy industry since the 1930s, and the spearhead of the Chinese central government's Northeast Area Revitalization Plan, the city has been diversifying its industry and now has a solid industrial foundation, a good land and air transport network, abundant natural resources, and a skilled workforce. Shenyang has a population of 7.2 million and its total GDP is 660 billion yuan in year 2012.

Fushun is about 45 km east of Shenyang, with a population of 2,138,090 inhabitants (2010 census) and a total area of 11,271 km², 713 km² of which is the city proper. Fushun is one of the industrial and economic development hubs in Liaoning. It has developed as a thriving center for fuel, power and raw materials and is also offering more and more opportunities in textiles and electronics. The world's largest open-pit coal mine, known as the Magnificent West Pit, is located not far from downtown. It has been in operation since about the 12th century. Fushun has a major aluminum-reduction plant and factories producing automobiles, machinery, chemicals, cement, and rubber. Fushun has a population of 2.2 million and its total GDP is 124 billion yuan in year 2012.

Benxi is located in the eastern mountainous region of Liaoning Province. It covers an area of 9,348 sq km. The population of the city amounted to 1.53 million and its total GDP is 111.2 billion yuan by the end of 2012. Famous for its geology, Benxi is rich in mineral resources including coal, iron, and copper. Reserves of coal total approximately 200 million tons, top ranking among all prefecture-level cities in the province. Forests cover 74.0% of the city's lands and contain timber reserves of 48.6 million steres, contributing 26% to Liaoning's total. In addition, Benxi is replete with water resources. There are approximately 200 rivers running through the city, producing annual surface runoff of 3.5 billion cubic meters. During the past decades, Benxi has undergone drastic economic, social, and urban development, becoming one of the largest cities in Liaoning. Benxi Iron and Steel Company is the largest employer in the city, and used to be the fourth-largest steel company in China.

Beipiao is a city in Chaoyang prefecture, Liaoning province. It has a population of 582,282 and its total GDP is 26.2 billion yuan in year 2012. The main industry in the area is coal mining. With vertical shafts of almost 1000m, these are some of the deepest coal mines in China. The coal produced is used for coking. Daheishan National Forest Park is located in the northwestern part of Beipiao city. The dinosaur Beipiaosaurus was named after the city where its fossils were found nearby.

Tieling is one of 14 municipalities of Liaoning Province. It lies in the middle section of Songliao Plain. Tieling is composed of 45 percent of water, 45 percent of fields, 10 percent of

roads and manors as well. The mountain area on the east of Tieling is located in the branch-range of Changbai mountain. The total grain output being more than 3 billion kg, Tieling has the reputation of “Northern Liaoning Barn”. There are also four large-scale reservoirs in the city. The gross amount of water resources reaches 5 billion cubic meters. Having the oversized coal base with industrial reserves of coal of 2.259 billion tons and the annual production capacity of 21 million tons , as well as two oversized steam power plants in our country with installed capacity of over one million kilowatts. Tieling has a population of 3.02 million and its total GDP is 97.5 billion yuan in year 2012.

Fuxin is a prefecture-level city in northwestern Liaoning Province. The total population of the prefecture is 1.91 million and the total GDP is 56 billion yuan in 2012. Fuxin is a mining center in an agricultural region, producing mostly coal and agate. Fuxin is known as China’s ‘Agate City’, with 50% of the nation’s known deposits of the mineral being located there. The city also accounts for more than 90% of the country’s agate products. The city suffers from the over-mining of coal, which is low in supply while fundamental to Fuxin’s economy. As the coal mines run dry, Fuxin is trying to find other industries to keep its economy going. Measures taken have included the development of a part of the city as a ‘Special Economic Zone’, by which the city hopes to attract international investment.

Appendix 2: Correlation Matrix between Explained Variable and Other Explanatory Variables

| | <i>hap</i> | <i>age</i> | <i>edu</i> | <i>int</i> | <i>size</i> | <i>inco</i> | Δ <i>area</i> | <i>ph</i> | Δ <i>eng</i> | <i>wat</i> | <i>gre</i> | <i>comm</i> | <i>tras</i> | <i>neig</i> | <i>sec</i> | <i>pol</i> | <i>gov</i> | <i>help</i> |
|----------------------|------------|------------|------------|------------|-------------|-------------|----------------------|-----------|---------------------|------------|------------|-------------|-------------|-------------|------------|------------|------------|-------------|
| <i>hap</i> | 1.000 | | | | | | | | | | | | | | | | | |
| <i>age</i> | -0.026* | 1.000 | | | | | | | | | | | | | | | | |
| <i>edu</i> | 0.052* | -0.402* | 1.000 | | | | | | | | | | | | | | | |
| <i>int</i> | 0.122*** | 0.053* | -0.098* | 1.000 | | | | | | | | | | | | | | |
| <i>size</i> | 0.012* | -0.122 | 0.022 | -0.018 | 1.000 | | | | | | | | | | | | | |
| <i>inco</i> | 0.097*** | -0.079* | 0.201 | 0.051* | 0.415 | 1.000 | | | | | | | | | | | | |
| Δ <i>area</i> | -0.124*** | 0.151* | -0.108*** | 0.149* | -0.543** | -0.248* | 1.000 | | | | | | | | | | | |
| <i>ph</i> | -0.118*** | -0.019 | 0.116*** | -0.101* | 0.099** | 0.153*** | 0.157* | 1.000 | | | | | | | | | | |
| Δ <i>eng</i> | -0.015* | 0.031 | 0.034 | -0.006 | -0.045 | -0.054* | 0.071** | -0.015 | 1.000 | | | | | | | | | |
| <i>wat</i> | 0.295*** | -0.056** | -0.004 | 0.082** | -0.009 | -0.005 | -0.123*** | -0.285* | 0.044 | 1.000 | | | | | | | | |
| <i>gre</i> | 0.301*** | 0.133* | -0.110*** | 0.058** | -0.110* | -0.108* | -0.017 | -0.361* | 0.015 | 0.482 | 1.000 | | | | | | | |
| <i>comm</i> | 0.015 | 0.048* | 0.123** | -0.055** | -0.102** | 0.101 | 0.023 | -0.137 | -0.030 | -0.025 | 0.029 | 1.000 | | | | | | |
| <i>tras</i> | 0.120*** | -0.030 | 0.091* | 0.032 | -0.038 | 0.085* | -0.021 | -0.157 | -0.024 | 0.097* | 0.038 | 0.521*** | 1.000 | | | | | |
| <i>neig</i> | 0.267*** | 0.054* | 0.013 | -0.004 | -0.066* | 0.023 | -0.055** | -0.204 | -0.051* | 0.193* | 0.275 | 0.259 | 0.254 | 1.000 | | | | |
| <i>sec</i> | 0.171*** | 0.075* | -0.007 | 0.035 | -0.096*** | 0.016 | -0.020 | -0.304 | -0.043 | 0.158* | 0.229* | 0.370* | 0.356* | 0.391* | 1.000 | | | |
| <i>pol</i> | 0.283*** | 0.054* | 0.016 | 0.026 | -0.069* | 0.057* | -0.055 | -0.212 | -0.002 | 0.226* | 0.302* | 0.307 | 0.305 | 0.559 | 0.437 | 1.000 | | |
| <i>gov</i> | -0.414*** | 0.043 | -0.073* | -0.090* | 0.079* | 0.028 | 0.092* | 0.277 | -0.045 | -0.367 | -0.383 | -0.136* | -0.132* | -0.303 | -0.250 | -0.328 | 1.000 | |
| <i>help</i> | 0.431*** | 0.044 | 0.075 | -0.055* | -0.090* | 0.057* | -0.153* | -0.240* | -0.013 | 0.273* | 0.334 | 0.272 | 0.206 | 0.523 | 0.392 | 0.535 | -0.414 | 1.000 |

Infrastructure Development and Financing in the Russian Far East

Tadashi Maeda*

Abstract

The importance of the Asia-Pacific region has increased significantly for the Russian economy. The Russian government's Far East Development Program has shown the way towards infrastructure development in the Far East. Given the regional characteristics of the Far East, it is important to take a flexible approach when selecting priority projects of vital importance and of high utility value, and when utilizing government-led investment to develop transportation infrastructure, while at the same time, proactively inviting private investors when bankable infrastructure projects arise. From such a perspective, JBIC intends to contribute to the "Win-Win" Far East development through the Japan-Russia Investment Platform with RDIF and through partnership with FEDF under the business cooperation. Considering the further deepening relations among North East Asian countries, we see huge potential for growth when viewing the Japan Sea Rim Economic Subregion as a single economic bloc. In order to promote such regional economic development, a bold and flexible way of thinking is needed to take a view of Northeast Asia, including the Russian Far East, as a "plane" from the perspective of international logistics.

Keywords: Russian Far East, Infrastructure, Far East Development Program, Japan-Russia Investment Platform, Japan Sea Rim Economic Subregion

Introduction

A member of Asia with a wide expanse of national land, Russia has been boosting exports, mainly that of oil, natural gas, and other energy resources, to the Asia-Pacific region. Also, the importance of the Asia-Pacific region including China, which has now become Russia's largest trading partner, as well as Japan and South Korea, has increased significantly for the Russian economy.

While the Russian Far East region¹ (hereinafter referred to as the "Far East") is located in a corner of the Asia-Pacific region and accounts for over a third (36.4%) of Russia's land area, its share in the country's gross domestic product (GDP) stands just around 5-6% and its population only at 4.5%, having been left out of Russia's social and economic development for a long time.

Since the inauguration of the government of President Vladimir Putin, the phrase "Leave Europe, Enter Asia" has been heard among Russian intellectuals. "Leave Europe, Enter Asia" is the phrase wording emblematic of the Putin administration's shift in the emphasis of policy emphasis from Europe to the Asia-Pacific region. The Russian government took the opportunity of hosting the Asia-Pacific Economic Cooperation (APEC) summit in Vladivostok in September 2012 to put more effort than before into the development of the Far East. Behind this is nothing less than Russia's political and economic intention to benefit from take in the "dynamism" of the Asia-Pacific region, with remarkable development for Russia's economic growth with the Far East serving as a gateway. With the economies of Europe, hitherto the cornerstone of its external economic relations, remaining sluggish in the wake of the Eurozone crisis, Russia wants to find a way out by searching for new opportunities in the Asia-Pacific region. In the Presidential Address to the Federal Assembly of the Russian Federation in December 2013, President Putin referred to

the importance of developing relations with the Asia-Pacific region.

Against this backdrop, Prime Minister Shinzo Abe made an official visit to Russia in April 2013 for a summit meeting with President Putin, the first time in 10 years a Japanese prime minister had visited the country. At the summit, the two leaders agreed to promote cooperation for the development of the Far East, including the establishment of an investment platform by the Japan Bank for International Cooperation (hereinafter referred to as “JBIC”) and the Russian Direct Investment Fund (RDIF) /Vnesheconombank (VEB). Despite the lingering territorial issue, if Japan and Russia, strengthening ties under the strong leadership of both leaders, cooperate to push forward with the development of energy resources and infrastructure and the fostering of industries in the Russian Far East, it can be expected that the Russian Far East will be incorporated into the economic growth of the Asia-Pacific region, as well as that progress will be made toward the Japan Sea Rim Economic Subregion comprising of Japan’s Sea area of Japan, northeastern China, the Korean Peninsula, and the Russian Far East.

This article discusses the rise of Russia, a major power in the Asia-Pacific region, as well as progress in the development of the Far East. In Chapter 1, an overview of the latest political and economic developments in Russia and the importance of the Far East are presented. Chapter 2 focuses on infrastructure development in the Far East and discusses the current status and future outlook of infrastructure development. Japanese cooperation and efforts for the promotion of investment in the Russian Far East are addressed in Chapters 3 and 4, and the future outlook for the “Win-Win” Far East development for both Japan and Russia is presented in the Conclusion.

1. The Current State of Russia’s Government and Economy and the Importance of Development of the Far East

1.1. The Current State of Russia’s Government and Economy

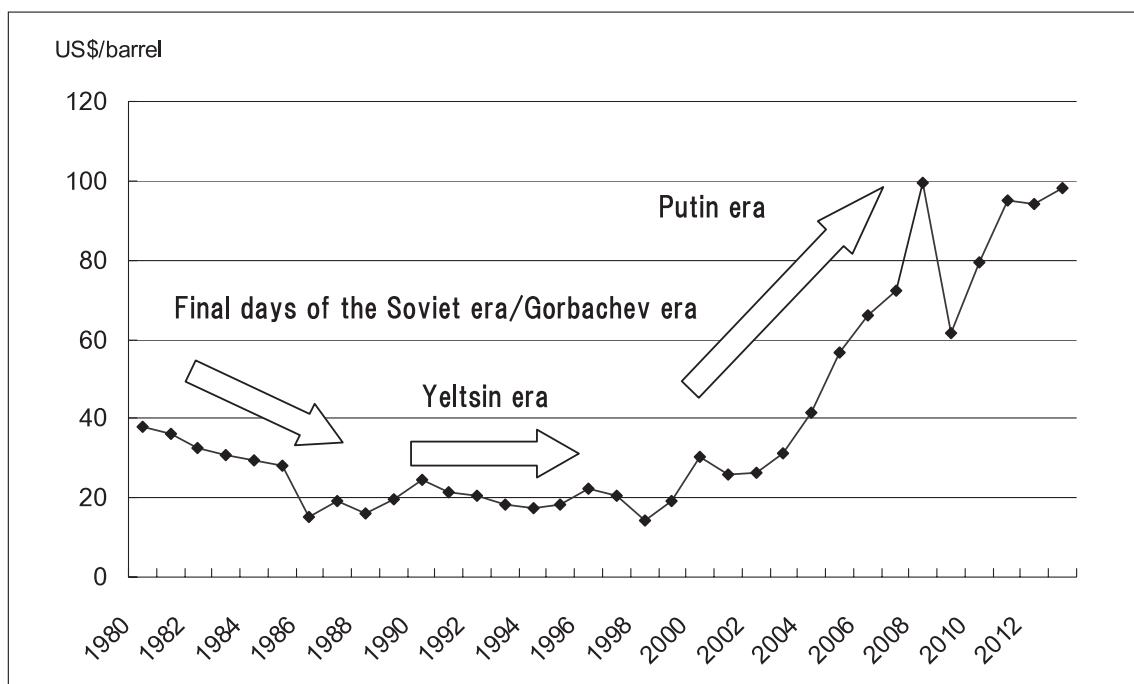
1.1.1. The Strong Putin Government

The first Putin government launched in 2000 came up with the “Great Power policy” to seek the revival of Russia. For this reason, the first thing Putin did was oppress the influence-peddling new conglomerates (oligarch), and he then created the “federal district presidential representative system”, to place regional powers across Russia under his control. The “federal district presidential representative system” was a political mechanism aimed to realize a pyramidal grip of power in order to receive and carry out orders from the central government carried through, and represented a major shift from the decentralization of power advocated by former President Boris Yeltsin. Chechen, Tatarstan, and some other ethnic republics in the Russian Federation fiercely rebelled against President Putin’s initiative. However, in the face of overwhelming military force, the turmoil eventually calmed down, and many Russians supported the restoration of order after the resulting confusion from the aftermath of the collapse of the Soviet Union, and also supported social stability under Putin.

Another important factor behind the popular support for the first Putin government was that higher crude oil prices benefited the Russian economy and result in dramatically raising the standard of living of Russian people (Figure 1). Crude oil prices began falling in the final days of the Soviet era, breaking below US\$20 per barrel. Crude oil prices remained low during the Yeltsin era, but started its sharp ascent around 2000 when Putin came to power. Russia took

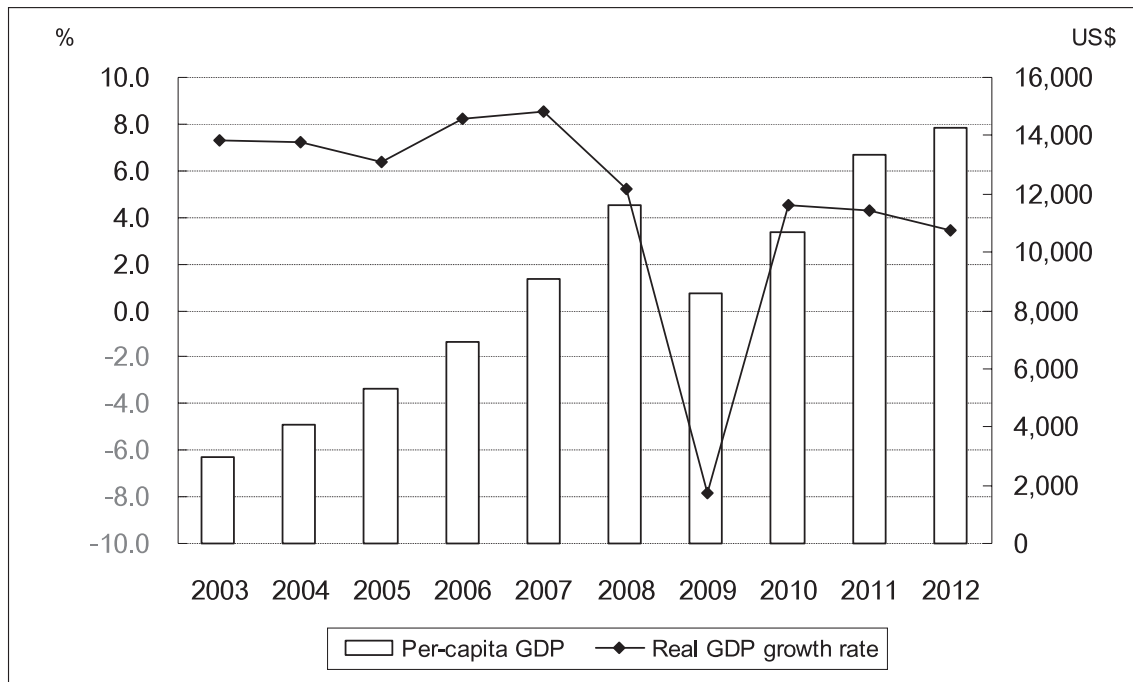
advantage of a massive inflow of oil money to accumulate foreign currencies, becoming the world's third largest holder of foreign exchange reserves after China and Japan. As the reins of government was handed over to Dmitry Medvedev when crude oil prices fell sharply in the wake of the Lehman Shock of 2008, Putin was not held responsible for Russia's dismal economic performance following the economic crisis, and crude oil prices was again on an upward trend by the time of the inauguration of the second Putin government in May 2012. While allegations of election fraud by the ruling party United Russia emerged in the December 2011 State Duma election, the share of the vote stood at 63.6% at the time of the inauguration of the second Putin government, an indication of the continued popular support for the strong leadership of the Putin government.

Figure 1: Changes in Crude Oil Prices and the Governments in Russia



Source: IMF Statistics

The Russian economy, heavily dependent on exports of oil, natural gas, and other energy resources, was dealt a heavy blow by the global financial crisis triggered by the Lehman Shock, with its GDP growth rate in 2009 slumping to negative 7.8%. However, the economy subsequently recovered, and Russia's real GDP showed a stable 3.4% growth in 2012, helped by, among others, crude oil prices remaining high during the first half of that year (Figure 2). The real GDP growth rate in 2013 is expected to slow down from 2012, with the Ministry of Economic Development and Trade estimating growth at 1.4% (as of December 2013). An international organization estimates that Russia's per-capita GDP in 2012 was a steady US\$14,247.

Figure 2: Per-Capita GDP and Real GDP Growth Rate

Source: JETRO

1.1.2. Slack Resources Trade with the “West,” Expectations on the “East”

While Russia has achieved its economic growth so far by exporting resources to the “West,” including Europe, the shale gas revolution in the United States and other parts of the world is recently giving Russia a new headache, and the European Union (EU), former republics of the Soviet Union, and Eastern European countries that relied on Russia for the supply of energy have heightened their bargaining power and started playing tough with Russia. It is still fresh in our minds that Ukrainian President Viktor Yanukovich surprised Russia by canceling a visit to Moscow in December 2012 for negotiations on import prices of Russian natural gas. Ukraine’s international balance of payments has deteriorated rapidly because of sharp natural gas price hikes by Russia, and declines in spot prices of natural gas that gave rise to the likelihood of Ukraine being able to import natural gas from other sources were believed to have prompted Yanukovich’s cancellation of the planned trip to Russia. Historically, the largest export markets for Russia are Germany and other European countries, which take about half of exports from Russia. Following the shale gas revolution, however, Russia is expected to face even tougher price negotiations for its Europe-bound exports of resources, and Russia was also forced to suspend its plans to export liquefied natural gas (LNG) (Shtokman LNG, etc.) to North America. For these reasons, President Putin has expressly put forward the “Look East policy,” planning to boost exports of resources to China and other Asian countries with growth potential on top of Japan and South Korea, by laying pipelines going through Khabarovsk and Vladivostok in the Far East, and also expecting an expanded inflow of technologies and funds from Asian countries.

1.2. Russia's Asia-Pacific Strategy

1.2.1. Growing Asia

At a time when the U.S.-dominated “single polar system” has taken a step backward, and the framework of the Group of Eight major industrial countries (G8) is no longer functioning effectively, multilateral organizations and regional organizations in the economic field have newly come forward, with G20 (summit meetings of 20 major countries and areas) and BRICS (summit meetings of the five countries of Brazil, Russia, India, China, and South Africa). Nothing can be decided by G8 (summit meetings of eight major industrial countries), and in particular it has been often pointed out that the framework of G8, which excludes China with the world's second-largest GDP, is now behind the times. Looking at the GDP of the G20 members by region, North America accounts for about US\$16.8 trillion (2011), Asia about US\$16.7 trillion (2011), and Europe about US\$11.2 trillion (2011). When the GDP of Russia, Turkey, and Saudi Arabia is added to the above figures as Asian countries in a broad sense, the combined GDP for Asia comes to US\$19.9 trillion, far larger than the North American GDP, giving the Asian economic bloc a nonnegligible presence.

According to a survey by Goldman Sachs Group Inc., the GDP of the four BRICS countries other than South Africa is expected to overtake that of G6 (the United States, Britain, France, Germany, Italy, and Japan) by 2039, and China's GDP is likely to surpass that of the United States by 2041. The same survey results predict that the world's six largest economic blocs in 2050 will be (1) China, (2) the United States, (3) India, (4) Japan, (5) Brazil, and (6) Russia, with European countries disappearing from the six largest economic blocs. The geographical classification of the anticipated six largest economic blocs in 2050 shows that China, India, Japan, and Russia are all located in Asia or Eurasia, making Asia or Eurasia the center of the world economy around the mid-21st century.

1.2.2. Moves for the Far East Development and the Foray into the Asia-Pacific region

Russia's diplomacy has thus far revolved around the “West,” and even through Moscow regards the Asia-Pacific region as important, the West has remained the cornerstone of its foreign policy. Amid the sluggish growth of European countries in the wake of the global financial crisis, however, the Putin government has made a strategic shift to the “East” in search of the engine of Russia's future growth in Asia, making clear its stance of accelerating the Far East development in order to take in the economic growth of the Asia-Pacific region.

Since former Soviet Communist Party General Secretary Mikhail Gorbachev's “Vladivostok Speech” in 1986, in which he unveiled plans to turn Vladivostok, then the closed city, into a “window” for exchanges with the Asia-Pacific region, the momentum begun for economic cooperation with the Asia-Pacific region through the Far East, and following the inauguration of the first Putin government in 2000, Russia made a full-fledged shift to the East and joined multilateral organizations in Asia one after another. Particularly in 2000, the year when the first Putin government was launched, President Putin chose the East Asia as the destination for his first diplomatic tour and visited China, North Korea, and Japan. The Shanghai Cooperation Organization (SCO), which later developed into a security mechanism for the Central Asian region, was also created in 2000. In 2003, Russia also joined the Six-Party Talks on the Korean

Peninsula to discuss North Korea's nuclear development, and at the Economic Leaders' Meeting of the Asia-Pacific Economic Cooperation (APEC) held in Sydney in 2007, Russia expressed its intention to host the APEC summit in Vladivostok. With its accession to the Asia-Europe Meeting in 2010 and participation in the East Asia Summit in 2011, Russia has now been numbered among the members of all of Asia's key forums, leading to its hosting of the APEC summit in Vladivostok in 2012. Under the leadership of President Putin, Russia is finally shifting into high gear with its development strategy for long-term development of the Far East while strengthening economic relations with fast-growing Asia-Pacific countries.

1.2.3. The Geopolitical Importance of the Japan Sea Rim Economic Subregion

The Russia Far East is located adjacent to China, but the Primorsky Region, Khabarovsk Region, Amur Oblast, and Jewish Autonomous Oblast are the only areas that actually border with China. Given that Amur Oblast and Jewish Autonomous Oblast have no access to the sea, their dependence on China inevitably increase. Looking at the situation from China as well, of the three northeastern provinces (Liaoning Province, Jilin Province, and Heilongjiang Province), only Liaoning Province has access to the sea, and the three provinces' increased exchanges with the Russian Far East appear to be only a natural development geographically.

Furthermore, the Russian Far East is connected to North Korea by a railway extending from Khasan station in the southernmost part of the Primorsky Region to Rajin port in North Korea across the Tumen River, which is positioned as part of a plan to link the Trans-Siberian Railway to the Trans-Korean Railroad. Russia changed the rail gauge to Rajin port into a mixed gauge of standard gauge and broad gauge, and conducted a test run in October 2011. The mutual railway extension into Busan, South Korea, is on the drawing board for the future.

In a similar manner with the railway, a project is under way to construct a natural gas pipeline that runs through the Korean Peninsula, which is supposed to be mainly used to carry natural gas from Russia to South Korea.

In addition, there is a plan to construct a power transmission line to supply electricity generated in Russia to North Korea, which is plagued with power shortages.

Against these backgrounds, plans have been under discussion for many years for cross-border infrastructure projects (Tumen River development, distribution systems, construction of a pipeline to carry natural gas from Russia to North and South Korea, etc.) and the establishment of regional development banks by the Japanese, Chinese, and South Korean governments, or a Northeast Asia Bank for Cooperation and Development to support infrastructure projects that utilize private-sector resources involving Japanese, Chinese, and South Korean companies. While there should be no objections towards initiatives for the development of the Japan Sea Rim Economic Subregion from an economic point of view, the recent heightening of political tensions between Japan and China and between Japan and South Korea is presently keeping the momentum from rising for the establishment of such a new regional financial institution any time soon. Therefore, it is important to select quality projects first. If the coordination among countries involved requires time, it may be a good idea to make use of a framework of dialogue like the Japan-Russia investment platform described in Chapter 4.

1.3. The Significance of the Far East Development

1.3.1. Population Outflows from the Far East

For Russia, while the advance into the Asia-Pacific region and the development of the Japan Sea Rim Economic Subregion are important elements of the Far East development, controlling population outflows from the Far East is also an important objective and means for the Far East development.

With natural resources buried in abundance under a broad stretch of land from East Siberia (east of Lake Baikal) to the Primorsky Region, the Russian Far East has developed itself as an export base for resources. In the wake of the economic turmoil after the breakup of the former Soviet Union, and the abolition of various preferential measures accorded to residents in the Far East, people have been moving out of the Far East to the western part of Russia, where the climate is mild and infrastructure has been relatively developed, or to overseas. Over the past 20 years (1990-2009), the population of the Far Eastern Federal District declined roughly 20% from some 8 million to 6.5 million, and the population outflow does not appear to be abating even after the commencement of the Far East development.

In inverse proportion to the population outflow, foreign workers have been on the increase. While not many Russians support the acceptance of foreign workers, Chinese workers are moving into the Russian Far East across the China-Russia borders, advancing into a variety of fields, including house building and road construction.

The population of China's Heilongjiang Province neighboring the Russian Far East across Amur River and other borders is some 38 million (2010), about six times as large as the 6.5 million people in the Russian Far East. The situation where the entry of Chinese workers into the Russian Far East may outnumber Russian residents with their expanding living quarters, has been the cause of alarm for Russia, spawning a sense of crisis not only from political and economic aspects, but also from the standpoint of national security. For Russia, the Far East development is no longer just a policy challenge based solely on the positive motivation to take in the vitality of the Asia-Pacific region, but rather a compelling policy challenge against the backdrop of the declining population and an overwhelming demographic pressure from neighboring China as well as the political, economic and security threats arising from them.

1.3.2. The Strategic Vision for the Far East Development

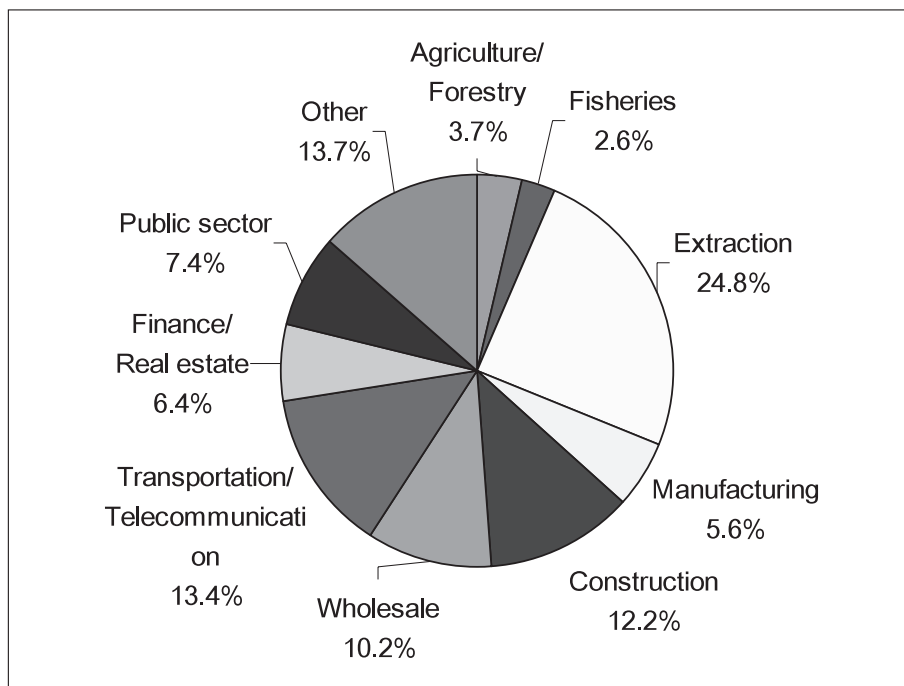
The Putin government's intention is to leverage the Far East development to redress the gaps with the central parts of Russia, raise the quality of life of residents, and promote the settlement of Russians without succumbing to the demographic pressure from China, in order to put the brakes on the outflow of population from the Far East. The government has a sense of crisis that unless the population outflow is stemmed, the Far East's economic growth would slow down and the economic disparity with the central parts of Russia would further widen.

Under these circumstances, the Putin government aims for the revival and fostering of manufacturing, not limited to infrastructure development, and seeks to turn the Far East into the point d'appui as the gateway to the Asia-Pacific region as the core part of the strategic vision for the Far East development.

As shown in Figure 3, the extraction of resources accounts for a quarter of the Far East's

gross regional production (GRP), with the manufacturing industry having only a meager 5.6% share (2010). But the Putin government is focusing on the manufacturing industry, as represented by automakers, by introducing tax breaks such as the exemption of import duties on certain parts for manufacturers setting up local production operations, developing an idea to turn Vladivostok into the “auto production base of the East.” The government also finds it necessary to tackle the development of distribution infrastructure, such as roads, railways and ports, collectively being the keys to transportation to the Asia-Pacific region, which will be the main market for the Russian Far East.

Figure 3: Composition of the Russian Far East’s Gross Regional Product



Source: Federal State Statistics Service

The development of the Far East, not only as a supply center of resources but also as a regional economy of growing importance as a manufacturing base, brings huge advantages to Japan as well as leading to stronger Japan-Russia relations through a successful development of the Far East. Also, the stability of the region through the Far East’s enhanced economic strength is deemed desirable from the perspectives of politics and security. Ongoing discussions on further Russo-Japanese cooperation in the Far East and Siberia following the Japan-Russia summit in April 2013 represent efforts in the right direction, which are expected to contribute to further strengthening relations between the two countries. From the standpoint of the Japan Sea Rim Economic Subregion, an idea to view the Subregion as a “plane” or a single economic bloc, is also of importance. For the Japan Sea Rim Economic Subregion, it is hoped that the Far East economy, which hitherto has not had much of a presence other than the supply of resources, will become revitalized and strengthen ties with the economies of Japan, China, and South Korea with trade and investment, with its enhanced presence raising the overall level of the Japan Sea Rim Economic Subregion, and leading to the optimization of international division of labor.

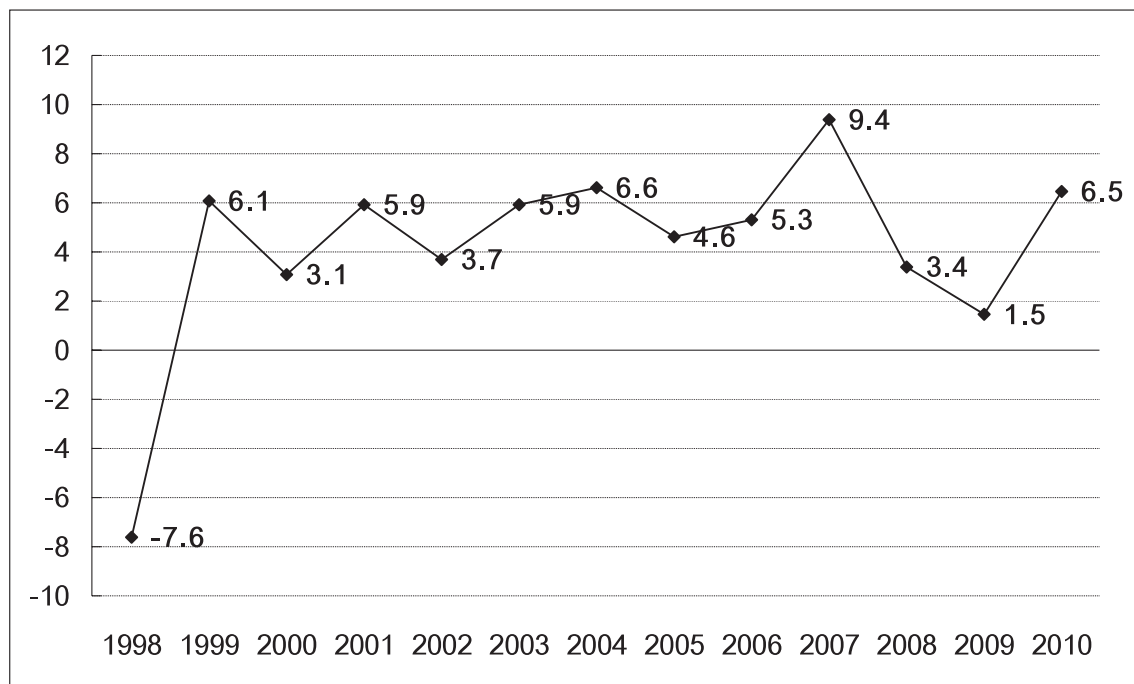
2. The Current State and Future Outlook of Infrastructure Development in the Russian Far East

2.1. The Economic Overview of the Russian Far East and the Current State of Infrastructure Development

2.1.1. The Economic Overview of the Russian Far East

As shown in Figure 4, the Russian Far East's GRP in 2010 stood at 2,103.4 billion rubles (approximately ¥5,679.2 billion), an increase of 6.5% over 2009, with the positive growth exceeding the 4.5% expansion of the overall Russian economy. While Russia slipped into negative growth in 2009 in the aftermath of the global financial crisis, the Far East has marked the positive growth for 12 consecutive years since 1999.

Figure 4: Economic Growth Rate of the Russian Far East



Source: Federal State Statistics Service

In addition to the continued robustness of industries related to the extraction of resources, production of the manufacturing industry shot up 22.1%, due primarily to the commencement of automobile production and increased output of aircraft, making a significant contribution to the GRP growth.

On the other hand, foreign investment remained low. Foreign direct investment in the Russian Far East, which amounted to only hundreds of millions of U.S. dollars until 2002, rose sharply to US\$3.0 billion in 2004 and to US\$4.0 billion in 2006, which were mainly made up of funds invested in oil and natural gas development projects in Sakhalin, but plummeted to US\$1.2 billion in 2010.

Russia, not limited to the Far East, actively introduced foreign capital since the collapse

of the Soviet Union, but Russian companies, supported by public investment by the central government, did not try to take in foreign capital but rather distanced themselves from foreign capital. When the economy is booming, large-scale public investments contribute to the revitalization of regional economies. When the economy sputters, however, the burden of the Far East development, including infrastructure development, is highly likely to weigh heavily.

2.2. The Far East Development Program

2.2.1. Transition in the Far East Development Program

Following the inauguration of the first Putin government in 2000, the “Russian Federation's Special Economic and Social Development Program for the Far East and Zabaikal Region for the period 1996 - 2005 and 2010,” a revised version of the “Special Federal Program for the Economic and Social Development of the Far East and Zabaikal Region Program for the period 1996 - 2005” formulated in 1996, was approved, but the program had little impact on the development of the Far East as expenditures from the federal budget was kept low. Subsequently, with sharp rises in crude oil prices bringing ample funds into the federal coffers, some 75% of the budget for the “Economic and Social Development of the Far East and Trans-Baikal for the Period to 2013,” approved in November 2007 after another revision, was to be funded by the federal government, signaling the federal government’s enthusiasm for the Far East development.

Meanwhile, in December 2009, the federal government approved the “Strategy for the Socio-Economic Development of the Far East and Baikal Region to 2025,” setting out long-term development plans for federal districts. The primary objective of the strategy was to raise the level of socio-economic development in the Far East and Zabaikal region to the average national level, thereby promoting the settlement of residents there. The strategy reflected the Russian government’s strong intent to solve the problem of population outflows from the Far East.

Furthermore, in April 2013, the Russian government approved an ambitious federal state program, “Socio-Economic Development of the Far East and Baikal Region,” designed to boost GRP of the Far East and Baikal region 2.2 times, increase industrial production by 53% and expand exports three times, respectively, from the 2011 levels by 2025. The program is outlined in Table 1.

The program was put together in a short period of three months by the Ministry for Development of Russian Far East under President Putin’s instructions. While inheriting a variety of existing programs described above, it has been developed presumably as a comprehensive development plan for the Far East and Baikal region. The program consists of 12 subprograms put together for such individual themes as transportation infrastructure and electricity infrastructure for the Far East and Baikal region, as well as that of two federal objective programs, “Economic and Social Development of the Far East and Baikal Region for the Period to 2018,” and “Socio-Economic Development of the Kuril Islands (Sakhalin Oblast) for the period 2007-2015” (hereinafter referred to as the “Far East Development Program”). The program includes a list of hundreds of concrete projects, their budgets and the timing of implementation, etc., conveying the Putin government’s strong message that the “Far East development is a top priority for Russia.”

Table 1: Overview of the Far East Development Program

| | |
|----------------------|--|
| Competent authority | Ministry for Development of Russian Far East |
| Aggregate investment | Approximately 10.7 trillion rubles |
| Federal government | Approximately 3.8 trillion rubles |
| Regional governments | Approximately 350 billion rubles |
| Private sector | Approximately 6.5 trillion rubles |
| Period | 2014-2025 |
| Coverage | Federal districts, Irkutsk Oblast, Buryatia Republic, Zabaikal Region |
| Composition | 12 subprograms and 2 federal objective programs |
| Major projects | Development of the Trans-Siberian Railway and the Baikal-Amur Mainline (BAM) Railway, development of regional airports, construction of LNG plants, etc. |

Sources: Mitsui Global Strategic Studies Institute, etc.

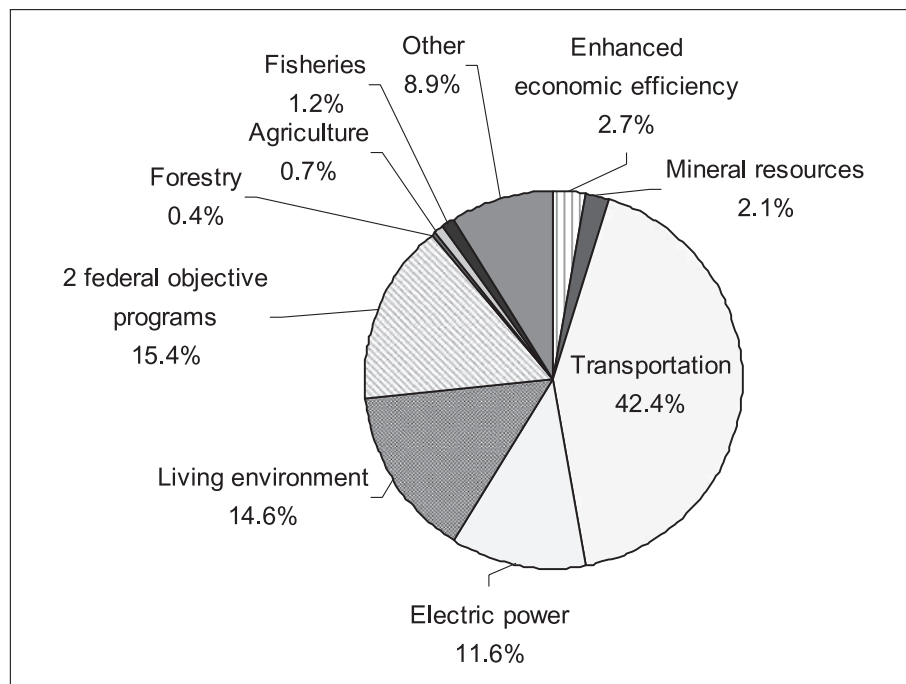
2.2.2. The Current State of Infrastructure Development in the Russian Far East

Judging from the Far East and Baikal Region Socio-Economic Development, the Russian government seems to be placing emphasis on the development of transportation infrastructure (transit and physical distribution), and the development of electrical infrastructure in order to leverage the region's geographically easy access to the Asia-Pacific region and the advantage of having abundant resources, including crude oil, natural gas, and metal resources.

Aggregate investment in the transport infrastructure reaches 1.7 trillion rubles as the sector is considered to be the largest obstacle to the development of the Far East and Baikal region. While some 850 billion rubles are allocated to the overhaul and modernization of the Trans-Siberian Railway and the Baikal-Amur Mainline (BAM) Railway, approximately 1.6 trillion rubles of federal budgets are earmarked for the planned development and expansion of roads to inland regions, including the road connecting Yakutsk and Magadan, ports, and regional airports. An expansion of transport and traffic networks is expected to further enhance the presence of the Far East and Baikal region as a shipping terminal linking Asia and Europe.

In the electricity infrastructure sector, construction and renovation of power plants and an expansion of power transmission lines are under consideration, with over 400 billion rubles of federal budgets allocated.

In addition, Russia is planning to complete a natural gas pipeline, called the SKV Pipeline, from Sakhalin to Vladivostok via Khabarovsk, and a crude oil pipeline, called the Pacific Pipeline, seeking to develop Vladivostok as a collection center of crude oil and natural gas by developing petrochemical and gas chemical industries at the terminals of these pipelines.

Figure 5: Breakdown of Federal Budgets for the Far East Development Program

Source: Prepared by the author based on materials of the Institute for Russian & NIS Economic Studies

2.2.3. Challenges in Implementing the Far East Development Program

While the Far East Development Program should be appreciated for signaling the medium- and long-term direction of the Far East development and the government's resolve to carry through with it, several challenges have been pointed out.

The first concerns the organizational structure for promoting the Far East development. The Ministry for Development of Russian Far East was created in May 2012 and took charge of putting together the above-mentioned "Far East and Baikal Region Socio-Economic Development" program as a command center for the Far East development. However, Minister for Development of Russian Far East, Victor I. Ishaev, was dismissed abruptly in September 2013, and Alexander Galushka was subsequently appointed as his successor. Galushka, an experienced consultant in the private sector, reportedly intends to clarify the areas covered by the federal government and the private sector and their respective roles in order to make the Far East Development Program into a more realistic one. In October 2013, immediately after the appointment of the new minister, a government committee on socio-economic development matters in the Far East, which met in Khabarovsk, made a positive move to consolidate the functions and administrative powers concerning the Far East development with the Ministry for Development of Russian Far East², but whether the Ministry for Development of Russian Far East can perform its function sufficiently going forward remains to be seen. Furthermore, an idea is said to be still contemplated within the Russian government to establish an East Siberia and Far East Development Corporation, as a propulsory machinery for the Far East development reporting directly to the President to implement important regional development projects. At any rate, in order to lead the Far East development, the existence of a powerful organization bestowed with both the authority to decide on business development and the authority to use budgets would

be necessary.

The second challenging task is the prioritization of projects. The list of projects in the Far East Development Program includes the electric power sector, the transportation sector, such as railways, ports, airports, and roads, the resources sector, the production sector, including manufacturing and agriculture, and even a space station. Among projects in the extensive list, which are the most efficient and can be expected to yield large effects to meet such policy objectives as the urgently required enhancement of connectivity within the region and to the Japan Sea Rim Economic Subregion, and the fostering of industries and measures to counter the decline of population? Given that funding for the Far East development is not limitless, the selection of priority projects would be imperative. It is also necessary to decide on the ordering of the priority of projects not only in terms of profitability, but also from a social policy perspective.

The third challenge is in attracting investors and business operators from home and abroad. While the Far East development is being undertaken with the federal government's large-scale investment and political initiative, it is being pointed out that funds currently invested come all but from the federal government's budgets and government-affiliated enterprises, and private-sector investment is going to other regions in Russia or overseas. In addition, as the Far East has not actively tried to introduce foreign capital previously, the investment climate has not improved, with complicated licensing procedures left unattended, requiring the Russian government to take institutional and other measures to invite private-sector investment. Furthermore, on top of measures to improve the investment climate, efforts to discover and organize projects with high feasibility are gaining in importance in order to attract the interest of private-sector investors and business operators (See Chapter 4 for the "Japan-Russia Investment Platform," a framework of cooperation between Japan and Russia for that purpose).

The fourth challenge is financing, which is discussed in the following section.

2.3. Financing for Infrastructure Development in the Far East

An aggregate amount of investment required to implement the Far East Development Program is estimated to reach 10.7 trillion rubles by 2025. The federal government and regional governments together cover a little less than 40% of the total amount, and over 60% is expected to come from private-sector investment.

In the Far East Development Program, the development under the public-private partnership is envisaged, with the infrastructure sector, such as transportation and electric power, designated for the priority allocation of federal funding. In particular, transportation is recognized as the biggest factor hampering the development of the Russian Far East, and 1.6 trillion rubles (or over 40%) of the federal budgets of 3.8 trillion rubles are earmarked for the transportation field, including the renovation of Trans-Siberian Railway and BAM Railway. Since it is difficult for private-sector business operators or private-sector financial institutions to assume commercial risks in the development of transportation infrastructure given the lack of guaranteed usage in depopulated regions like the Far East, the easy reliance on the "private sector" could result in no progress in infrastructure projects. Considering this, it is commendable that the federal government has made clear its policy to take the initiative in the development of transportation infrastructure.

Given Japan's postwar experiences, instead of developing infrastructure with an idea

of gaining profits from projects concerned, infrastructure development should be pushed forward with the use of large-scale investment under the governmental budget and government guarantees, with the idea of economic revitalization through the enhanced convenience of transportation as a result of infrastructure development. This way of undertaking infrastructure projects is recommended not only for Russia, but also for infrastructure projects in other emerging economies. Backed by long years of experience in supporting projects in emerging economies, in recent years JBIC has been holding policy dialogues and providing advice on a continuing basis on measures to promote infrastructure projects under public-private partnerships in Indonesia and Viet Nam. JBIC hopes to provide “software” cooperation depending on Russia’s needs, by making use of such frameworks as the Japan-Russia Investment Platform (described below) for infrastructure development in the Russian Far East as well.

3. Japan’s Cooperation for the Far East Development

3.1. Past Economic Cooperation in the Far East

Japan has so far been involved in the development of resources in the Russian Far East, including such flagship projects as the Sakhalin 1 Project (the project cost is estimated at US\$12 billion. JOGMEC and other entities have acquired some interests in the project) and the Sakhalin 2 Project (the project cost is estimated at US\$20 billion. Mitsui and Co., Mitsubishi Corp. and other entities have acquired some interests in the project). However, investment from Japan is now beginning to flow into fields other than resources. As described in Section 3 of Chapter 1, as the Putin government positions the revival and fostering of the manufacturing industries in the Far East as a high-profile challenge, Japanese and other automakers set up production bases and started operations there. More specifically, in Vladivostok, where used Japanese vehicles command a market share of over 90%, Russian automaker Sollers moved in and started assembling South Korean-brand passenger cars in 2010. Mazda Motor Corp. commenced production in October 2012, and then Sollers-Bussan, a joint venture between Mitsui and Co. and Sollers started producing Toyota vehicles in February 2013. The Russian government is also proactively supporting the invitation of manufacturers there by offering preferential taxation measures, including zero import duties for some parts and components. Sojitz Corp. and Kawasaki Heavy Industries, Ltd. delivered cogeneration equipment, a power generation system to provide both heat and electricity said to be in strong demand in cold regions, to a federal university on Russky Island, the venue of the APEC summit. Such business efforts based on regional characteristics are also worthy of attention.

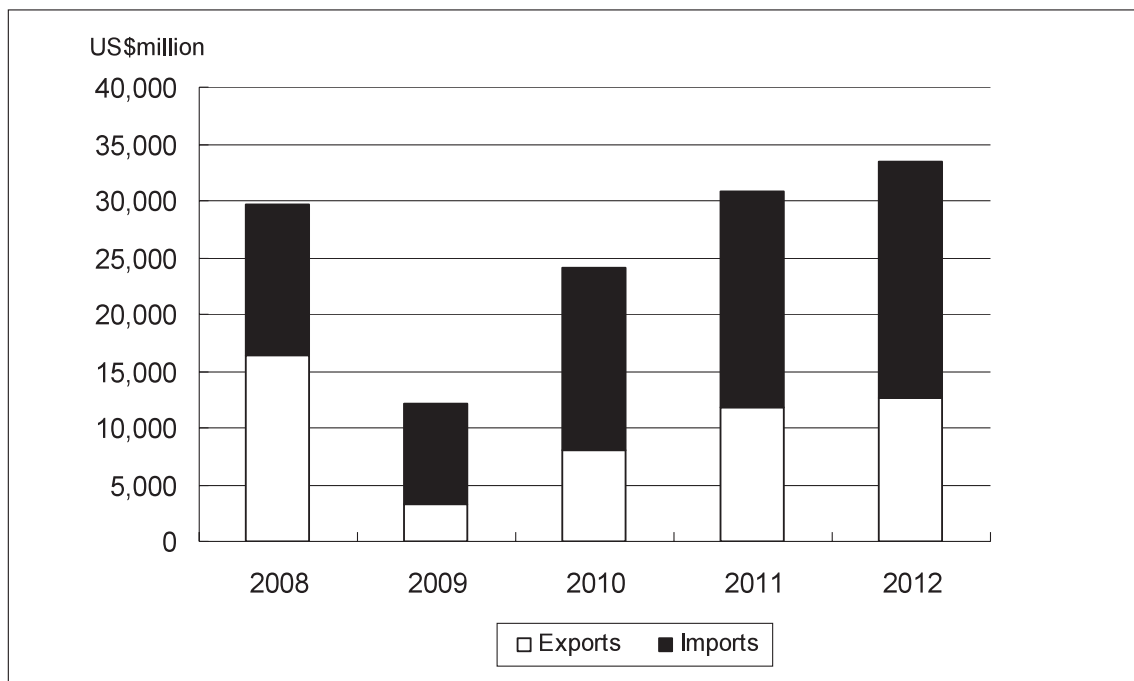
3.2. Progress in Japan-Russia Cooperation in the Far East Development

The visit to Kunashir Island by then President Medvedev in November 2010 threw Japan-Russia relations into a negative state temporarily, but following the Great East Japan Earthquake of March 2011, the dialogue between the two countries resumed after prompt proposals by the Russian government, particularly then Prime Minister Putin, for humanitarian assistance and energy cooperation. Furthermore, the fact that the Russian government has embarked in earnest on the development of the Russian Far East and its Asia-Pacific strategy after the APEC summit held in Vladivostok in September 2012, is having a positive impact on Japan-Russia relations.

Particularly after the inauguration of the Japanese government of Prime Minister Abe, Japan and Russia have both come to recognize the importance of the Far East development. When Prime Minister Abe visited Russia in April 2013, the two countries issued a joint statement on the Japan-Russia partnership, and the Japan-Russia summit meetings were held multiple times in a single year.

As shown in Figure 6, Russo-Japanese economic relations recovered from the doldrums caused by the economic crisis in 2009. In 2012, Japan's exports to Russia rose 7.1% over the previous year to some US\$12.6 billion, and its imports from Russia also increased 9.9% to some US\$20.8 billion, setting a record high in terms of the dollar-quoted value of bilateral trade.

Figure 6: Trends of Japan-Russia Trade



Source: Ministry of Finance Japan

Prime Minister Medvedev's recent visit to Kunashir Island following his earlier visit in 2010 poured cold water on Japan-Russia relations yet again, but it should be noted that the bilateral dialogue is continuing despite this incident. It is hoped that Japan and Russia will continue to enhance the dimension of cooperation as strategic partners going forward.

Table 2: Recent Developments Related to the Far East Development

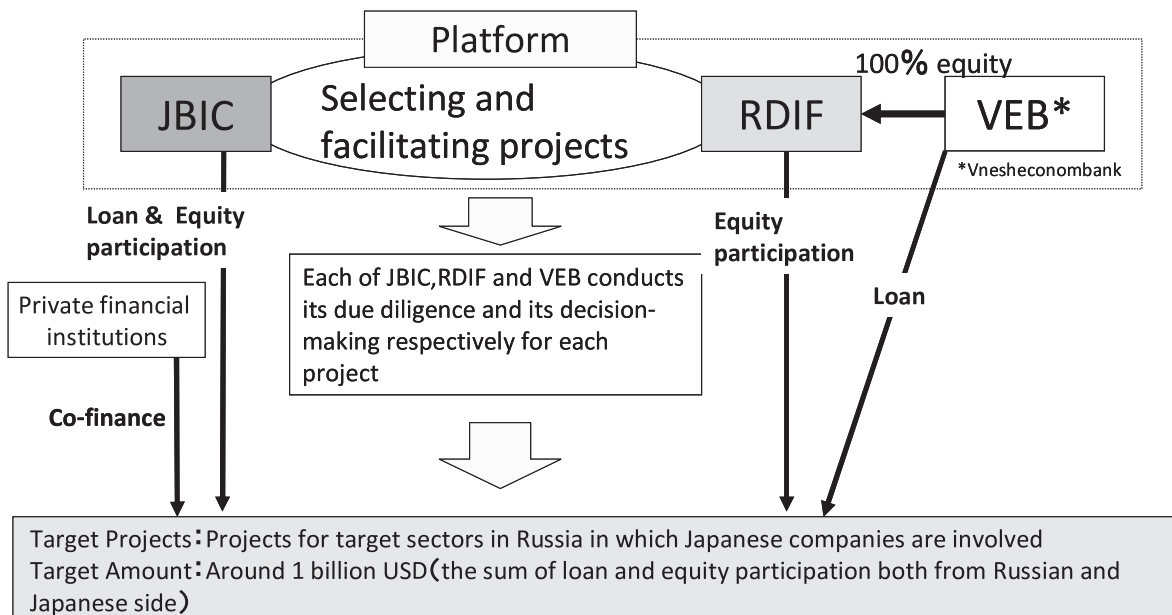
| | |
|-----------|---|
| 2011 | |
| August | The Russia-North Korea summit was held; a natural gas pipeline between Russia and South Korea via North Korea was discussed. |
| October | A test run of the railway between Rajin (North Korea) and Khasan (Russia) started. |
| November | At the Russia-South Korea summit held in Saint Petersburg, the top leaders discussed a natural gas pipeline running through North Korea. |
| 2012 | |
| May | The Ministry for Development of Russian Far East was established. Victor I. Ishaev, Presidential Representative in the Far Eastern Federal District, was appointed as the first minister. |
| July | Prime Minister Medvedev visited Kunashir Island. |
| September | The APEC summit was held in Vladivostok. |
| 2013 | |
| April | The federal state program, "Far East and Baikal Region Socio-Economic Development," was adopted. The Japan-Russia summit was held (in Moscow, Russia). |
| June | The Japan-Russia summit was held in (in Lough Erne, Northern Ireland, UK). |
| September | Victor I. Ishaev, Presidential Representative in the Far Eastern Federal District and Minister for Development of Russian Far East, was dismissed. Yuri Trutnev was appointed as Presidential Representative in the Far Eastern Federal District and Deputy Prime Minister, and Alexander Galushka as Minister for Development of Russian Far East. |
| October | The Japan-Russia summit was held (in Bali, Indonesia). |

Source: JETRO

4. For Promotion of Japan-Russia Joint Investment

4.1. Japan-Russia Investment Platform

On the occasion of the Japan-Russia summit in April 2013, JBIC concluded a memorandum of understanding on the establishment of the Japan-Russia Investment Platform with Vnesheconombank³ (VEB) and the Russian Direct Investment Fund⁴ (RDIF). The Japan-Russia Investment Platform is a framework of joint support by JBIC, RDIF and VEB for projects in which Japanese companies participate in order to expand Japanese companies' business operations and technological presence in Russia, including the Far East. The investment platform is expected to be utilized for infrastructure development and the fostering of industries in the Russian Far East as well.

Figure 7: Basic Concept of the Japan-Russia Investment Platform

Source: JBIC

Unlike funds that directly finance projects, the Japan-Russia Investment Platform is a mechanism whereby JBIC, RDIF and VEB individually invest in or provide loans to an individual project after JBIC and RDIF jointly propose and select projects and, when an agreement is reached, consider an optimal form of financing for each project.

The scale of operation is US\$1.0 billion, the combined total for Japan and Russia. Projects covered by the platform encompass a wide range of business operations, from business operations in the Far East and Siberia, including infrastructure development, new technologies in urban development, such as Smart City, and the introduction of state-of-the-art medical technologies and equipment to alternative energy projects, development of coal and mineral resources, and manufacturing and services industries.

The establishment of the Japan-Russia Investment Platform was conceived after VEB Chairman Vladimir Dmitriyev strongly urged JBIC in 2012 for the launch of a joint investment fund by JBIC and RDIF with a scale equivalent to the US\$2.0 billion Russia-China joint investment fund VEB established jointly with China Investment Corporation (CIC), a Chinese government-affiliated fund. Initially, JBIC had some concerns about the fledgling RDIF becoming an investor with responsibility, and the unimpressive performance of the Russia-China joint investment fund. Without sticking to the form of an investment fund, JBIC proposed that (1) both sides should agree on priority investment areas for enhanced effectiveness; (2) the new entity should be a framework of cooperation to discover feasible projects that can be expected to yield profits; and (3) it should be named the joint investment platform by avoiding the naming of a fund. Agreement was eventually reached after several rounds of negotiations. It is hoped that PPP candidate projects with high feasibility can be brought to a reality by JBIC, RDIF and VEB cooperating in the development of projects from the initial stage.

4.2. Direction of Future Cooperation in the Far East Development

The Japan-Russia Investment Platform is a framework of collaborative support by JBIC, RDIF and VEB for projects in which Japanese companies participate in order to expand Japanese companies' business operations and technological presence in Russia, but JBIC also has the mechanism of cooperation for the Far East development in place other than the investment platform.

In September 2013, JBIC concluded a business cooperation agreement with the Far East and Baikal Region Development Fund (FEDF)⁵, a wholly-owned subsidiary of VEB, on the establishment of the "Far East and Baikal Infrastructure Development Partnership."

Under the partnership, JBIC and FEDF exchange information on infrastructure development projects in the Far East and Baikal region, cooperate for the development of such projects, hold consultations for the development of projects among parties concerned, and share knowledge about the sector of infrastructure utilizing private-sector resources.

As described in Section 2 of Chapter 2, the development of the Far East and Baikal region is positioned as the top priority of the Russian government with the adoption of the federal state program, "Far East and Baikal Region Socio-Economic Development," in April 2013, offering the prospect of accelerated infrastructure development there going forward. Japanese companies are also showing increased interest in participating in infrastructure business in the Far East and Baikal region. Through the "Japan-Russia Investment Platform" and the "Far East and Baikal Infrastructure Development Partnership" described above, JBIC intends to support the further deepening and development of Japan-Russia economic relations through infrastructure development in the Far East and Baikal region, by encouraging the development of feasible and bankable projects.

Conclusion

The development of the Russian Far East is a top priority for Russia and its development is in the interests of Japan (in terms of the secure supply of energy resources and participating in infrastructure development and fostering the growth of manufacturing and other industries) as well, and is also expected to contribute to the development of the Japan Sea Rim Economic Subregion.

On the other hand, the Far East development itself is of extremely low investment efficiency because of the vastness of the Far East and severe natural conditions. Though the Russian government recognizes the importance of Asia as the growth engine of the world economy, whether it can promote the Far East development continuously and effectively going forward requires a close watch.

The Russian government's Far East Development Program has shown the way to infrastructure development in the Far East. Given the regional characteristics of the Far East with a small population and insufficient infrastructure and industrial foundation, however, it is important for the Russian government to take a flexible approach of selecting priority projects of vital importance and high utility value, and utilizing investment under government budgets to develop transportation infrastructure, such as unprofitable railways, ports, and roads, while proactively inviting domestic and foreign companies and investors to join when bankable infrastructure projects suitable for private-sector investment emerge. From this

perspective, JBIC intends to contribute to the “Win-Win” Far East development for both Japan and Russia by supporting, on top of infrastructure development in the Far East, the discovery of projects to introduce Japan’s cutting-edge technology to the Far East, including investment in the manufacturing industry, renewable energy development and medical services, and the development of bankable projects, through the Japan-Russia Investment Platform with RDIF and business cooperation with FEDF.

Some physical distribution routes, including the modernization of railways, are being developed among the Russian Far East, the northeastern part of China and the Korean Peninsula. Going forward, if the grand scheme of the mutual extension of the Trans-Siberian Railway and the Trans-Korean Railway is realized, it would be a major step forward for the realization of a plan for a Trans-Eurasian railway covering some 11,000 kilometers between Busan, South Korea, and Berlin, Germany, via Moscow. Moreover, like a trans-Korean railway, construction of a natural gas pipeline that runs through the Korean Peninsula is reportedly under consideration. These projects that help enhance the regional connectivity will also have an impact on Japan that forms the same economic bloc across the Sea of Japan. For example, if a pipeline is constructed to carry natural gas from the Russian Far East to South Korea, the pipeline may be extended from South Korea to Japan to supply Russian natural gas to Japan. Also, if the railway from Busan Port, to which regular Japanese container vessels are operated, is extended into the continental interior, it would mean the birth of a new physical distribution route.

Under the Putin and Abe governments, Japan and Russia are currently enjoying the closest bilateral relations at both the governmental and industrial levels, and a good cooperative relationship is in place between the two countries for the future, including the Far East development. Amid the further deepening of Russia-China and Russia-South Korea relations over the Russian Far East, we are now presented with a superb opportunity to proactively develop the grand design of the Japan Sea Rim Economic Subregion. When we view Northeast Asia facing the Sea of Japan as a single economic bloc and take a second look at transportation infrastructure, including airports, seaports, and railways from the perspective of “international logistics,” we can find a huge growth potential there. We need a bold and flexible way of thinking to take a view of Northeast Asia, including the Russian Far East, as a “plane.”

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¹ The Russian Far East means the nine component entities of Primorsky Region, Khabarovsk Region, Sakha Republic, Amur Oblast, Sakhalin Oblast, Kamchatka Region, Jewish Autonomous Oblast, Magadan Oblast, and Chukotka Autonomous Okrug.

² At a meeting of a government committee on socio-economic development matters in the Far East, held in Khabarovsk in October 2013, the decision was taken to transfer the following powers to the Ministry for Development of Russian Far East:

1. The Ministry of Regional Development’s rights concerning coordination of the selection and implementation of priority investment projects;
2. Allocation of subsidies by the Ministry of Regional Development and the Ministry of Finance to regional social and infrastructure development;
3. The Ministry of Regional Development’s evaluation of the operational efficiency of regional administrative organizations;
4. The Ministry of Regional Development’s coordination of city construction plans and regional development schemes; and
5. The Ministry of Regional Development’s participation in the management of special economic zones.

³ VEB is a policy-implementing institution, wholly owned by the Russian government, with the purpose of

the development and advancement of the Russian economy. The Supervisory Board of VEB comprises the Prime Minister of the Russian government, the Deputy Prime Minister, and relevant ministers. Its chairman is Prime Minister Medvedev.

⁴ RDIF is a government-affiliated fund established in 2011 for the purpose of fostering Russia's domestic industries and revitalizing investment at the initiatives of then President Medvedev and then Prime Minister Putin. RDIF is wholly owned by the Russian government via VEB and has the asset size of US\$10.0 billion.

⁵ FEDF is a fund established in 2011 as a wholly-owned subsidiary of VEB with the purpose of infrastructure improvements in the Russian Far East and the Baikal Region.

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Cold Peace: “Reset” and Coexistence

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Abstract

American international relations with Russia until recently were governed by the Obama administration’s “reset policy.” Its goal was to work with the Kremlin to construct a harmonious global order based on democracy, free enterprise and universal human rights. This objective wasn’t realized. The policy instead led to contentious engagement, and has been “paused.” The failure was caused by both sides’ overzealous double gaming, and raises the prospect of renewed cold war. The danger can be averted on a second best basis by both camps committing themselves to the principles of “coexistence,” and mutual self-restraint.

Keywords: cold peace, cold war, coexistence, reset

Vladimir Putin has steadfastly refused to comply with Washington’s and Brussels’s reset script.¹ He hasn’t been enticed by American democratic free enterprise, or EU social democratic rhetoric, and he refuses to be swept away by a “Moscow Spring.”² Moreover, Putin can barely hide his contempt for western hypocrisy.³ In the hallowed Soviet tradition, he sees the west as a fading power.⁴ America’s and the EU’s performance since 2008 has reinforced this belief.

The Obama administration, after five years of denial has begun to recognize that something is amiss in its American-Russian partnership campaign. Stung by its inability to prevent Putin from granting Edward Snowden asylum,⁵ Washington has recently decided to “pause and reassess,”⁶ a chill subsequently deepened by Russia’s stout support for Syria during America’s confrontation with Bashar al-Assad over his alleged use of chemical weapons against civilians. There is some speculation that Obama will relent and revert to his reset strategy to enlist Putin’s good offices in implementing Assad’s destruction of his chemical weapons arsenal,⁷ but American policymakers still appear disinclined to consider anything besides a pause or a revived reset because they are reluctant to commit themselves to cold war alternatives: durable “coexistence” or containment.⁸ They remain confident that the west’s economic woes are transitory, continue to believe that Russia will return to its common European home,⁹ and are acting as if giving the Kremlin the cold shoulder is sufficient to push the process forward.

Are they right?

This paper contends that western “reset” advocates have mischaracterized the causation driving east-west relations, and disregarded the counterproductive effects of their engagement policies. American and European Union policymakers portray the reset as a sunshine campaign intended to help the Kremlin appreciate and voluntarily embrace democratic free enterprise or social democracy.¹⁰ They assert that it is in Moscow’s interest to clone itself after the west; insist that any pressure exerted in the process is for Russia’s own good and express confidence that Federation leaders’ will eventually agree. The rub however is that the Kremlin has a very different perception of its interests and rejects the west’s claim that the west is a Good Samaritan. Moscow believes that the west’s “values” campaign is intended to facilitate American and European Union “velvet imperialism,”¹¹ prompting it to redouble efforts to protect Russia’s “rightful” spheres of influence (including Syria).¹² Leaders on both sides frame their assessments in terms of national interests, but are primarily concerned with their own wellbeing.

This suggests that resuscitating the reset with its velvet imperialist hidden agenda will prove counterproductive. A better alternative is needed that realistically takes account of motives and irreconcilable differences on both sides. A policy of self-restrained “cold peace” or durable “coexistence” that avoids feckless conflict and places all relations on a strictly business basis might fill the bill.

1. East-West Divide

The irreconcilable differences that divide Russia and the west today are more ideocratic (alien world views) than institutional (market versus planning).¹³ They are based on deeply embedded informal concepts of the best form of rule rather than the comparative merit of markets and plans. Russia is wedded to Muscovite authoritarianism,¹⁴ whereas the west relies on privileged stakeholder governance masquerading as “true democracy” (the will of the people, subject to constitutional minority rights guarantees).¹⁵ This makes America and Russia inherent rivals committed to maintaining and expanding their domains, rather than acting as strategic partners for enlightenment, peace and prosperity. Both parties find it expedient to idealize their own motives and hold out hope for converting their foes, rather than devising less provocative and combustible forms of “cold peace.” The smoke screen is effective for insiders, but not for restraining needless international strife, and can be easily dispelled by considering the fundamentals.¹⁶

2. The West

The contemporary west operates under the fiction that individuals and governments democratically partner to maximize the people’s notion of social welfare.¹⁷ Elected officials it is claimed are merely the people’s agents, operating selflessly in the national interest. They impartially listen to their constituencies’ pleas, but act scrupulously for the general good.¹⁸

Reality however is grittier. Western domestic and international relations are detached from the democratic free enterprise and social democratic ideals.¹⁹ Privileged stakeholders, particularly big business and big social advocacy rule the roost in collusion with elected officials pressing their special interests at the nation’s expense. Foreign policy strategy under these conditions becomes the blanket promotion of influential stakeholder agendas and refereeing rivalries among them, instead of cost-efficiently maximizing national welfare.

3. Russia Unique, Not Universal

Russian insider rule is similar, but its authoritarian leader (vozhd) is less beholden to stakeholders. The distinction is critical. First and foremost, in Russia both the government and the private sector serve the authoritarian vozhd, not the people (demos). Second, the vozhd is primarily concerned with great national power, military might and strategic opportunism in the Muscovite tradition.²⁰ Third, the vozhd is far more powerful than western presidents, which explains why Putin is capable of operating with a narrower base of stakeholder support. Fourth, the vozhd relies primarily on rent-granting (revocable gifts of assets and usufruct essential for sustaining the rule of men) in building political support and promoting economic production rather than on graft,²¹ state micro and macroeconomic regulation (rule of diverse privileged

stakeholders) or market competition which are the tools used in the west.²² Rent-grants of assets and usufruct are always revocable regardless of the constitution and law, making the leader the de facto freehold owner of the realm. Fifth, the secret police [Federal'naya sluzhba bezopasnosti Rossiyskoy Federatsii (FSB)] is the ultimate political enforcement mechanism. It is more powerful than the legislature, bureaucracy and the military in imposing the *vozhd's* will. Sixth, there is no durable "rule of law" both in business and politics.²³ Seventh, Russian *vozhds* rely more on satisficing than optimizing in pursuing their goals. They don't try to find optimal solutions to all problems.²⁴

Kremlin rulers don't try to construct complete utilitarian objective functions essential for Arrow democratic and Paretian market efficiency.²⁵ Instead, they perpetually maneuver and gather power like masters of "positional chess," so that they can pounce when opportunity knocks. Chasing the rainbow of perfect totalitarian planning and control or perfect market efficiency from the Moscow's perspective is the enemy of the good, even though this was denied in the Soviet era.²⁶ Western leaders also satisfice, but pay more serious attention to Enlightenment and social democratic ideals.

Eighth, Russian *vozhds* and their supporters abroad tenaciously reject the claim that Muscovite authoritarianism is despotic, insisting that everything is done for the sake of the people and the nation. Authoritarianism in their view is superior to democracy. Stalin we are told killed no one unjustly, and should be beatified.²⁷

These distinctive traits which epitomized Russian regimes from Ivan the Great to the Red emperor Stalin and now the "sovereign democratic" (*suveryennaya demokratiya*) president Vladimir Putin,²⁸ constitute Russia's Muscovite "ideocracy."²⁹ They make Russia "unique," not universal (a society based on principles that everyone considers desirable), and set it irreconcilably apart from the west's concept of just governance and broad stakeholder participation.³⁰

4. Russian Ideocracy

Muscovite Russia has a clear ideocratic mission: the preservation and expansion of authoritarian national power, flexibly achieved with rent-granting and guided by strategic opportunism.³¹ The Russian idea is seldom expressed this bluntly, and has been nobly glossed in various ways since Ivan the Great, but the essentials are firmly grasped by rulers, servitors and the *narod*, even if they elude most observers in the west. Russia's ideocracy is the antithesis of Platonic, Aristotelian and humanist governance based on rational order, virtue and justice, and is less scrupulous than corrupt western practice too. It is fundamentally anti-democratic, anti-competitive, anti-egalitarian, anti-humanistic and predatory;³² rhetoric to the contrary notwithstanding.

Russian politics, economics and civil society deviate from contemporary western norms because of its ideocracy. They are impervious to piecemeal reform, although limited efficiency gains are always possible. The Kremlin is an indefatigable tinkerer and has often changed mundane institutional specifics, policy preferences and outward appearances, without transforming the system.³³ Muscovite ideocracy has kept and will continue to keep Russia firmly outside its purported common European home; a rift that cannot be bridged unless one or both sides change in a fundamental fashion.

5. Coexistence

Resettlers, of course, expect Russia to change. Their globalist vision cannot abide Muscovy. Perhaps, they will prevail. But historical precedent suggests that durable coexistence is the more likely option. The Soviet Union and the west saw themselves in an epochal struggle for supremacy 1917-56 (a clash of civilizations), until Nikita Khrushchev threw in the towel at the 20th Communist Party Congress and the west consoled itself with extolling the virtues of democratic free enterprise in lieu of more provocative measures because it couldn't badger or bribe the Kremlin into voluntarily jettisoning communism.

The question today isn't whether coexistence is an acceptable second best, but whether both parties in an era of "cold peace" can discipline themselves sufficiently to avoid relapsing into cold war.

6. Clash of Ideocracies

How are Russia and its erstwhile "strategic western partners" likely to fare this time around in an epoch of "cold peace?"³⁴ Much depends on how ideocracies shape their policies and allow leaders to disregard uncongenial realities.³⁵ Russia can be counted on to remain a rent-granting authoritarian power with a formidable military, comparatively low per capita consumption and repressed political and civil rights.³⁶ Although its rent-granting economic mechanism is inferior, the Russian Federation is no longer destined to be an "impoverished superpower" because it has privatized a substantial portion of the civilian sector (with significant freehold ownership), and decriminalized markets.³⁷ No one today claims that Russia's mounting defense burden will impoverish the nation as Henry Rowen, Charles Wolf and Anders Aslund did just before the USSR self-destructed because the Kremlin's post-Yeltsin "liberalized" autocracy is manifestly superior from the consumer's perspective to the Soviet model of the early 1980s, even though the IMF has suddenly become bearish in the wake of Obama's pause. Politically motivated assessments aside,³⁸ Russia is apt to remain under-efficient in the same way that it was under "liberalizing" tsars from Catherine the Great to Nicholas II.³⁹

This assessment may be overdrawn. There is a chance that Russia's economy could implode due to insider corruption as it did during the early 1990s, but there also is room in Muscovy for living standards to improve while political and civil liberties are repressed, as Dong Xiaoping's successes in the post-Mao era testify.

The west's situation is similarly precarious. Its egalitarian, "worthy stakeholder" ideocracy condemns it to mounting microeconomic sclerosis, macroeconomic imbalance (stagnation, slow growth, and high unemployment) and financial crises,⁴⁰ including the possibility of a black swan debacle,⁴¹ while compelling leaders to aggressively press parochial agendas abroad. The EU's growth rate has been converging asymptotically to zero since 1975 despite "liberalization" and supranationalization with no trend reversal in sight, and the American economy has been anemic since 2008. Likewise, the west's military capabilities (particularly the EU's) have deteriorated at the same time it has relentlessly badgered others to embrace social democratic values (globalization).⁴² The package amounts to a policy of speaking self-righteously and carrying a shrinking stick. It is antagonistic and certain to accomplish little beyond indulging select insider stakeholders, and fostering avoidable hostilities under the veil of strategic partnership.

7. Velvet Empires: Traditional and Supranational

The salad days of imperialism are dim memories in both the west and Russia. The defeat of the axis powers in World War II; postwar British, French, Dutch, Belgian, Portuguese and American decolonization, together with Europe’s pursuit of supranationality put an end to the open quest for empire in the traditional guises of annexation, colonization, tributaries and protectorates.⁴³ The Soviet Union initially bucked the trend, expanding its territorial reach in a secret protocol to the Molotov-Ribbentrop non-aggression Pact (23 August 1939),⁴⁴ and postwar occupations of Bulgaria, Romania, Czechoslovakia, Hungary, Poland, and East Germany. Later it extended its reach to Vietnam, Cuba and other contested areas of the third world.⁴⁵

This expansionary thrust however died with the Soviet Union. The Kremlin relinquished direct control of 14 republics (approximately 50 percent of the Soviet population),⁴⁶ hegemony over Eastern and Central Europe and sphere of influence claims over the Balkans. It continues to assert special interests in all these former dependencies including Transnistria, as well as the Arctic, but re-federation in various guises appears to be off the radar screen.⁴⁷

The new reality for both Russia and the west is “velvet” empire. Neither side openly seeks colonies, tributaries and protectorates, or voices irredentist claims. However they have strong senses of turf, and aren’t shy about establishing, preserving and contesting spheres of influence. The west wants those under its thrall to be social democrats (and supranationalists), or advocates of democratic free enterprise, and to share a common view of stakeholder rights and privileges (“superior values”). This includes the protection of western property rights, foreign market access, politarchic privilege,⁴⁸ “big social advocacy”, a preference for denuclearization and downsized militaries, as well as aspirations for one world government on its own terms. Russia likewise wants those in its orbit to adopt the Kremlin’s agenda, preferring autocracy to democracy, the rule of men to the rule of stakeholders, and large full spectrum militaries.⁴⁹

The west at the current juncture despite diminishing military capabilities is much more aggressive in pursuing its velvet empire under the banners of democracy, partnership, globalization, development, human rights, and free trade than Russia. The diverse appeal of American and European ideals has enabled the west to spread its tentacles broadly in the post-communist age. It has fostered “globalization,” “regime change,” and military intervention in the Balkans, Middle East, North Africa, and Afghanistan.

Muscovite values stripped of their communist overlay however have limited appeal, constraining Russia’s expansionist possibilities. It has many expedient allies, but few admirers.

These fundamentals make the west’s military posture primarily offensive, and Russia’s defensive. The west no longer fears a surprise continental attack from Putin’s tank armies, or even direct military engagement with Russia in contested theaters like Syria. This is why it is prepared to accept substantial “balanced reductions” in nuclear forces and restrict its large scale land war fighting capabilities. The Kremlin doesn’t dispute the west’s offensive strategic assessment, but considers America and the European Union to be formidable threats to its velvet empire. Moscow believes that America encroached on its spheres of influence in Serbia, Iraq, Libya, Central Asia, the Ukraine, the Czech Republic and Poland, and is openly fomenting regime change in Russia, Georgia and the Caucasus.⁵⁰ The west in its view is responsible for the “cold peace” verging toward cold war behind the mask of strategic partnership,⁵¹ despite conciliatory gestures like Russia’s inclusion in various global fora and admission to the World Trade Organization.

8. Strategic Intransigence

Russia and the west are unlikely to blink anytime soon regardless of resets, reboots, pauses, chills and reassessments because the leadership on both sides is driven by incompatible self-interests. The west will continue playing to selected stakeholders by intimidating, cajoling and carrying a shrinking stick, while Russia succumbs to structural remilitarization due to its failed democratization,⁵² even though the games are wasteful and dangerous for the peoples on both sides. The right policy from a “true” democratic perspective requires foreign policymakers to adhere to the people’s wishes by never undertaking missions and programs where costs exceed expected utilitarian benefits as informed majorities perceive them.⁵³ The west under this standard should never adopt foreign policies that advance special interests (Wall Street, gay rights activists, etc.) at the expense of the democratic majority, and the Kremlin should always put the narod’s wellbeing ahead of its Muscovite priorities. If this standard were adopted both sides would be less confrontational and superfluous defense spending would decline. Neither side would be compelled to capitulate to the other, but both would be less testy. Winning from this perspective entails going beyond combative cold peace to conflict averting cold peace by accepting durable coexistence and the promotion of strategic stability as opposed to pressing destabilizing special interest agendas under the pretext of enlightening adversaries.

This means that the principal obstacle to better Russia-west relations is special interest agendas (privileged stakeholders in the west; Muscovite rule in the east) rather than the unwillingness of majorities on both sides to constructively coexist. There are other factors to be considered like China, but they don’t negate this essential. The deep failure in strategic thinking in Washington, Brussels, and Moscow is attributable to anti- “true” democratic hidden agendas more than to flawed threat assessments or strategic analytic incompetence.⁵⁴ This is a message no political establishment wants to hear, but cannot be disregarded by those seriously concerned about efficiency and human welfare. Accepting durable coexistence doesn’t require the west to desist in proselytizing free enterprise and social democratic values. It only needs to prioritize forbearance and self-restraint in the greater interest of peace and prosperity.⁵⁵

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¹ Steven Rosefielde, “Russian Economic Reform 2012: “Déjà vu All Over Again,” US Army War College, Carlisle Barracks, 2012. Rosefielde and Quinn Mills, *Democracy and its Elected Enemies*, Cambridge: Cambridge University Press, 2013. The term reset applied to Russia refers to the Obama administration’s policy of restoring the Bill Clinton era strategy of transforming the Kremlin from an adversary to a trustworthy partner worthy of munificent assistance (Grand Bargain), after the Bush administration shifted to a “containment” strategy 2002-2008 to counter increased Russian geopolitical aggressiveness. American policymakers bent over backward to accommodate the Kremlin, with nothing positive to show for it. See “Our Friends the Russians: The Kremlin picks a fight with America in time for elections. “*The Wall Street Journal*, Review and Outlook, December 2, 2011. “One of the foreign policy priorities of the Obama Administration was to “reset” relations with Russia. How’s that working out? Dmitry Medvedev, the placeholder for Vladimir Putin in the presidency, gave one indication last week. He declared that Russia may deploy “strike forces” and aim mid-range Iskander missiles at Europe. He also threatened to pull out of the 2010 New Start arms accord, which is supposed to be the hallmark achievement of the “reset.” The excuse for Mr. Medvedev’s tantrum is the long-planned missile defense shield for Europe. Once deployed in 2020, it’s designed to stop a limited number of missiles from Iran and doesn’t diminish Russia’s nuclear deterrent. The Obama Administration scaled back the shield to please Russia in 2009, and with Russian agreement in return for the U.S. signing up to New Start, but now apparently that’s not enough. On Tuesday Mr. Medvedev opened a new Russian early-warning radar in the Kaliningrad enclave between Poland and Lithuania and

said: "When they tell us—'It's not against you'—I would like to say the following: 'Dear friends, the radar launched today isn't against you either. But it's for you and for fulfilling the tasks we have set.'" Moscow's ambassador to NATO this week amplified this message by threatening to close the transport route through Russia that the U.S. and its allies use to supply troops in Afghanistan. This so-called northern corridor was another touted achievement of the "reset." Then there's Russia's veto of a Security Council resolution to sanction Syria and its continuing arms sales to the regime of Bashar Assad. Moscow also resists putting any new pressure on Iran's nuclear bomb makers. But the lesson for the U.S. concerns the limits of friendship with an authoritarian government that has no interest in being a strategic partner with the West. Cf. Leon Aron, "A Tormenting in Moscow," AEI, April 12, 2012. "Hence, we now see an anti-American propaganda the likes of which, in crudeness and shamelessness, we have seen since 1985. Witness a "documentary" on a state-controlled national television channel, shortly after McFaul came to Moscow, in which his writings on democracy promotion were used to bolster an accusation that, in essence, he was sent by the CIA to foment a color revolution. Thus the calling out of Secretary of State Hillary Clinton as a "signaler" to anti-Putin opposition. And finally, an utterly base "Anatomy of the Protest" documentary (on the same NTV network) that showed allegedly U.S. officials distributing money and cookies (yes: evil, wanton democracy cookies) to the anti-Putin protesters. Welcome to Moscow, Mr. Ambassador..."

² Alexei Anatolievich Navalny touted as the "man Vladimir Putin fears most," was sentenced to five years in Gulag for embezzlement on trumped up charges on July 18, 2013 without any sign of insurrection. He was released the next day on appeal in what Alexander Podrabinek infers is a ploy to encourage Navalny's emigration. See Matthew Kaminski, "The Man Vladimir Putin Fears the Most," *Wall Street Journal*, March 3, 2012. He was found guilty of misappropriating about 16 million rubles worth of lumber from a state-owned company. "Outspoken Putin Critic Alexei Navalny Hit With Prison Sentence," CNN, July 18, 2013. He ran for mayor of Moscow, but lost with 27 percent of the vote in September 2013. He subsequently filed an electoral fraud suit. Alexander Podrabinek, "Navalny's Choice," *Institute of Modern Russia*, July 19, 2013. http://www.imrussia.org/en/politics/518-navalnys-choice?utm_source=Institute+of+Modern+Russia+news+letter&utm_campaign=0a049b193a-Newsletter+07%2F23%2F2013_English&utm_medium=email&utm_term=0_279627583b-0a049b193a-321633205

Cf. "Russian Prosecutor Seeks Moscow Court to Declare Sergei Magnitsky Guilty and Not Be Rehabilitated in First Posthumous Trial in Russian History," *Heritage Foundation*, July 3, 2013. "Magnitsky is fully incriminated, and there are no grounds for his rehabilitation," said prosecutor according to Interfax news agency, <http://www.interfax.ru/russia/txt.asp?id=316392>

³ He isn't alone. See Peter Morici, "America's Mess in Egypt," July 5, 2013, <http://finance.yahoo.com/blogs/the-exchange/america-mess-egypt-164639195.html>

⁴ Nodari Simonia and Anatoly Torkunov, *Globalization, Structural Crisis, and World Leadership: Myths and Reality*, International Affairs Library, Moscow 2013. Ministry of Foreign Affairs of the Russian Federation, "Russian Foreign Policy Concept Ratified by Russian Federation President V.V. Putin, February 12, 2013, www.mid.ru Stephen Blank notes that this view mimics Vladimir Lenin's treatise "Imperialism the Highest Stage of Capitalism," 1916. See Stephen Blank, "Lt. Kizhe Rides Again: Magical Realism and Russian National Security Perspectives," paper presented at the Annual Strategy Conference of the US Army War College, April 9-11, 2013. Cf. Lilia Shevtsova, *Lonely Power: Why Russia has Failed to Become the West and the West is Weary of Russia*, Carnegie Endowment for International Peace, Washington 2010, p.202. "Putin Triumphant at the G-8," June 29, 2013, <http://imrussia.org/russia-and-the-world/503-putin-triumphant-at-the-g-8> Cf. Vladimir Shlapentokh, "Two targets of a leading Russian liberal's contempt-Putin and the West," June 18, 2012. <http://shlapentokh.wordpress.com/2012/06/18/two-targets-of-a-leading-russian-liberals-contempt-putin-and-the-west/> Shlapentokh insists that Russia's intellectuals are committed to westernization.

⁵ Dmitri Trenin, "The Snowden Case as the Mirror of U.S.-Russia Contentions," Carnegie Moscow Center, August 2, 2013. <http://carnegie.ru/eurasiaoutlook/?fa=52572>

⁶ Matt Williams, "Obama Says US Will 'Pause and Reassess' Relations with Putin and Russia," August 9, 2013, <http://www.theguardian.com/world/2013/aug/09/barack-obama-us-putin-russia> Matthew Lee and Deb Riechmann, "Obama Cancels Vladimir Putin Meeting In Moscow After Edward Snowden Granted Asylum," August 7, 2013. http://www.huffingtonpost.com/2013/08/07/obama-putin-meeting_n_3718825.html Emily Heil, "Obama: Putin is slouchin," August 9, 2013, http://www.washingtonpost.com/blogs/in-the-loop/wp/2013/08/09/obama-putins-a-sloucher/_Obama+described+Putin+as+a+sloucher+and+bored+kid+in+the+back+of+the+classroom.+Leon+Aron,+"The+Russian+Pause,"+AEI,+August+14,+2013.+http://www.aei.org/article/foreign-and-defense-policy/regional/europe/the-russian-pause/?utm_source=today&utm_medium=paramount&utm_campaign=081513 Cf. Aron, "Russia's Quest to Rebuild the Soviet State," *Foreign Affairs*, March 8, 2013. <http://www.foreignaffairs.com/articles/139049/leon-aron/the-putin-doctrine>

⁷ Donald Jensen, "Will the Syria Crisis Revive the U.S.-Russia 'Reset?'" *Institute of Modern Russia*, September 13, 2013. http://imrussia.org/en/us-russia/552-will-the-syria-crisis-revive-the-us-russia-reset?utm_source=Ins

titude+of+Modern+Russia+newsletter&utm_campaign=94b3c080. Russia and America signed an agreement September 14, 2013 to have Syria's chemical weapons eliminated by mid-2014. "US, Russia Seal Landmark Deal on Syria Weapons", Yahoo! News, September 14, 2013. <http://news.yahoo.com/us-russia-agree-syria-chemical-weapons-plan-kerry-104641212.html>

⁸ Soviet Leninists and Stalinists contended that capitalism would inevitably be vanquished by communism. This made the east and west implacable enemies until Nikita Khrushchev embraced the possibility of peaceful coexistence at the 20th Soviet Communist Party Congress in 1956. Under this doctrine each side was free to try and persuade the other without recourse to violence. Containment is an American variant of peaceful coexistence that rejected force in rolling back Soviet conquests, but advocated steadfast resistance to further expansion. The concept was elaborated by George F. Kennan in 1946.

⁹ Alexander Yanov, "Putin and the Russian Idea," July 1, 2013, Institute of Modern Russia <http://imrussia.org/society/504>. Yanov views Imperial Russia as a laggard Europe. The Soviet period is interpreted as a reactionary tragedy, and the present moment as "broken Europe," with the possibility of ultimate progressive democratic triumph. Cf. Mikhail Gorbachev, *Perestroika: New Thinking for Our Country and the World*, New York: Harper and Row, 1987.

¹⁰ Samuel Huntington, "The West: Unique, Not Universal," *Foreign Affairs*, Vol.75, No.6 (November/December 1996), pp.28-46.

¹¹ "Kremlin Warns Kiev Over 'Suicidal' Ukraine-EU Trade Deal," August 19, 2013. <http://en.ria.ru/russia/20130819/182849320/Kremlin-Warns-Kiev-Over-Suicidal-Ukraine-EU-Trade-Deal.html>

¹² Kim Jong-un shares the same view of American-North Korean relations. The "rightful" spheres of influence concept echoes the Brezhnev Doctrine. See Matthew Ouimet, *The Rise and Fall of the Brezhnev Doctrine in Soviet Foreign Policy*, Chapel Hill: University of North Carolina Press, 2003.

¹³ Steven Rosefielde and Ralph W. Pfouts, *Inclusive Economic Theory*, Singapore: World Scientific 2014. Steven Rosefielde, "Soviet Economy: An Ideocratic Reassessment," *Ekonomicheskaya Nauka Sovremennoy Rossii*, #3, November 2013. The term ideocratic is connected with Max Weber's concept of legitimation. Authorities usually have a clear idea of how they want to rule, and portray their schemes in the best possible light to consolidate their sovereignty. See Max Weber, *Economy and Society*, Berkeley CA: University of California Press, 1978.

¹⁴ Steven Rosefielde, *Russian Economy from Lenin to Putin*, New York: Wiley, 2007.

¹⁵ Steven Rosefielde and Quinn Mills, *Democracy and Its Elected Enemies*, Cambridge: Cambridge University Press, 2013.

¹⁶ Stephen Blank, "Lt. Kizhe Rides Again: Magical Realism and Russian National Security Perspectives," paper presented at the Annual Strategy Conference of the US Army War College, April 9-11, 2013.

¹⁷ Jean Jacques Rousseau distinguished stages of human development. He thought that good democracy required "civilized" people. Social democrats see themselves as the vanguard of civilization.

¹⁸ Vilfredo Pareto, *Manuel of Political Economy*, 1906. Abram Bergson, "A Reformulation of Certain Aspects of Welfare Economics," *Quarterly Journal of Economics*, 52, 1, pp. 210-34. Kenneth Arrow, *Social Choice and Individual Values*, Wiley, 1951. Bergson, "Social Choice Under Representative Government," *Journal of Public Economics*, 6(3), 1976, pp.171-190.

¹⁹ James Meade, *Liberty, Equality and Efficiency*, New York: New York University Press, 1993.

²⁰ Steven Rosefielde and Stefan Hedlund, *Russia Since 1980: Wrestling with Westernization*, Cambridge: Cambridge University Press, 2007.

²¹ Rent-granting can be construed as an extreme form of gift giving where the size of favors granted far exceed the minimal bribes. Putin has recently moved to strengthen his rent-granting leverage of servitors by requiring them to repatriate their assets. See Donald Jensen, "Putin's Foreign Asset Ban in Action," *Institute of Modern Russia*, September 4, 2013.

²² Rent-granting is a governance technique where authoritarians permit servitors to informally administer assets as they desire without strict accountability in return for a stipulated compensation and fealty. Rent-seekers (recipients) don't profit-maximize. They subcontract and satisfice, each exploiting inferiors at every level. Rent-granting moreover is usually anticompetitive even when it involves market activities.

²³ Russian Prosecutor Seeks Moscow Court to Declare Sergei Magnitsky Guilty and Not Be Rehabilitated in First Posthumous Trial in Russian History 3 July 2013 – Today, the Russian prosecutor has asked the Tverskoi court in Moscow to declare that Sergei Magnitsky was guilty and that he should be refused rehabilitation. The request was made during the last session of the trial of Sergei Magnitsky who has been deceased for three and a half years after being tortured and killed in police custody. The prosecutor asked the court not to apply any punishment to Sergei Magnitsky, and to cease the case with the verdict of guilty and no chance of future rehabilitation. "Magnitsky is fully incriminated, and there are no grounds for his rehabilitation," said prosecutor according to Interfax news agency

- <http://www.interfax.ru/russia/txt.asp?id=316392>
- ²⁴ Steven Rosefielde and Ralph W. Pfouts, *Inclusive Economic Theory*, Singapore: World Scientific 2014. Reinhard Selten, “What is Bounded Rationality?” in Gerd Gigerenzer and Reinhard Selton, eds, *Bounded Rationality: The Adaptive Tool Box*, Cambridge: MIT Press, 2002, pp.13-36. Herbert Simon, “A Behavioral Model of Rational Choice”, in Simon, *Models of Man: Social and Rational- Mathematical Essays on Rational Human Behavior in a Social Setting*. New York: Wiley, 1957. Herbert Simon, “A Mechanism for Social Selection and Successful Altruism,” *Science* 250 (4988), 1990, pp. 1665–8. Herbert Simon, “Bounded Rationality and Organizational Learning,” *Organization Science* 2 (1), 1991, pp. 125–134. Ariel Rubinstein, *Modeling Bounded Rationality*. MIT Press, 1998. Clem Tisdell, Clem (1996). *Bounded Rationality and Economic Evolution: A Contribution to Decision Making, Economics, and Management*, Cheltenham, UK: Brookfield, 1998. Daniel Kahneman, “Maps of Bounded Rationality: Psychology for Behavioral Economics,” *The American Economic Review* 93 (5), 2003, pp. 1449–75.
- ²⁵ Kenneth Arrow, *Social Choice and Individual Values*, Wiley, 1951. Vilfredo Pareto, *Manuel of Political Economy*, 1906.
- ²⁶ Stephen Blank, “Lt. Kizhe Rides Again: Magical Realism and Russian National Security Perspectives,” paper presented at the Annual Strategy Conference of the US Army War College, April 9-11, 2013. Blank makes the same point by claiming that any good historian of Tsarist Russia understands that the system is fundamentally “unsystemic or even anti-systemic.” Andrew Monaghan, “‘Calmly Critical’: Evolving Russian Views of US Hegemony,” *Journal of Strategic Studies*, XXIX, NO. 6, 20-06, pp. 996-999.
- ²⁷ Grover Furr. *Khrushchev Lied. The Evidence That Every “Revelation” of Stalin’s (and Beria’s) Crimes in Nikita Khrushchev’s Infamous “Secret Speech” to the 20th Party Congress of the Communist Party of the Soviet Union on February 25, 1956, is Provably False*. Kettering, OH: Erythros Press & Media. 2011. Furr, *The Murder of Sergei Kirov: History, Scholarship and the Anti-Stalin Paradigm*. Kettering, OH: Erythros Press & Media. 2013.
- ²⁸ According to Vladislav Surkov, sovereign democracy is popular consent to the leader’s programs. See Masha Lipman, “Putin’s Sovereign Democracy,” *Washington Post*, July 15, 2006.
- ²⁹ Ideocratic is a term used by Martin Malia to describe ideologically guided government policy. It should not be confused with idiocratic, meaning idiotic governance as satired in the 2006 cult film “Idiocracy.” See Martin Malia, *The Soviet Tragedy: A History of Socialism in Russia, 1917-1991*, The Free Press, 1994. Steven Rosefielde, “Soviet Economy: An Ideocratic Reassessment,” first draft August 2013.
- ³⁰ Cf. Samuel Huntington, “The West: Unique, Not Universal,” *Foreign Affairs*, Vol.75, No.6, November/December, 1996, pp.28-46. Andrei Shliefer and Daniel Treisman, “Russia: A Normal Country,” *Foreign Affairs*, March/April 2004. Cf. Steven Rosefielde, “Russia: An Abnormal Country,” *European Journal of Comparative Economics*, Vol.2, No.1, 2005, pp.3-16.
- ³¹ The strategy is close to the non-satirical interpretation of Machiavelli’s *Il Principe*, where rulers affect virtue, but don’t scruple to seize the day when opportunity knocks. See Niccolo Machiavelli, *Il Principe*, Antonio Blado D’Asola, Florence, 1532.
- ³² Clifford Gaddy and William Partlett, “Russia’s Financial Police State,” *The National Interest*, July 19, 2013, <http://nationalinterest.org/commentary/russias-financial-police-state-8746?page=1>
- ³³ Gertrude Schroeder, “The Soviet Economy on a Treadmill of Reforms.” in *Soviet Economy in a Time of Change*. Washington DC: Joint Economic Committee of Congress, 1973, 312-66
- ³⁴ Russian signed a strategic partnership agreement with the European Union in 1997. It has been under renegotiation since 2008. The results have not lived up to expectations, prompting calls for a strategic pause. See Jana Kobzova, “Time for a Strategic Pause in EU-Russian Relations?” *EU Council on Foreign Relations*, May 13, 2008. http://ecfr.eu/content/entry/commentary_eu_russia_relations_time_for_a_strategic_pause130 Cf. Garry Kasparaov, “The Myth of a U.S.-Russia Strategic Partnership: Are Russians still supposed to act grateful that we no longer live under Brezhnev or Stalin?” *Wall Street Journal*, May 20, 2012.
- ³⁵ Lilia Shevtsova, “‘The Fall of the West’ and ‘the Russian Matrix’,” Carnegie Center, August 5, 2013, <http://carnegie.ru/2013/08/05/fall-of-west-and-russian-matrix/ghm0>
- ³⁶ “Mr. Putin’s War on Gays,” editorial, *New York Times*, July 27, 2013. http://www.nytimes.com/2013/07/28/opinion/sunday/mr-putins-war-on-gays.html?_r=0
- ³⁷ Henry Rowen and Charles Wolf, Jr., *The Impoverished Superpower: Perestroika and the Soviet Military Burden*, San Francisco: ICS Press, 1990.
- ³⁸ “IMF Says Russian Economic Growth Model Exhausted,” RIA Novosti, October 9, 2013. <http://en.ria.ru/russia/20131009/184030741/IMF-Says-Russian-Economic-Growth-Model-Exhausted.html> “The International Monetary Fund warned in a report published Wednesday that Russia’s economic model has exhausted itself and predicted that future growth will be constrained by negative demographic trends.” The IMF predicts that growth in Russia will be 1.5 percent in 2013, down from the 2.5 percent forecast in

July. Cf. *World Bank, Country Partnership Strategy (CPS) for the Russian Federation*, Report No.65115-RU, November 2011.

- ³⁹ Alexander Gerschenkron, "Russia: Patterns and Problems of Economic Development, 1861-1958," in Gerschenkron, *Economic Backwardness in Historical Perspective*, Harvard University Press, Cambridge, MA, 1962, pp.119-151.
- ⁴⁰ Steven Rosefielde and Quinn Mills, *Democracy and its Elected Enemies*, Cambridge: Cambridge University Press, 2013. Steven Rosefielde and Quinn Mills, *Preventing Another Crisis and Restoring Global Economic Growth*, Singapore: World Scientific Publishers, 2014.
- ⁴¹ Nassim Taleb, *The Black Swan: The Impact of the Highly Improbable*, New York: Random House, 2007.
- ⁴² Christine Leah and Bradley Thayer, "The End of Strategic Stability in the Asia-Pacific?" *RSIS Commentaries*, No.157/2013, August 23, 2013. "The United States' strategy of Extended Nuclear Deterrence (END) is not what it should be. This is, perhaps, not very surprising, given that the degree of threat is the most important driver of such capabilities. As Soviet power waned, there was less need to devote the time and energy to extended nuclear deterrent capabilities. Accordingly, the US was able to reduce its forces and take a "holiday" from the demands of END against a peer competitor."
- ⁴³ Supranationality is a multilevel form of transnational governance where traditional nation states delegate control over some state functions like monetary policy to a collective body, while retaining sovereign control over others like fiscal policy. Its stated purpose is to eradicate national enmities and imperialism, but is susceptible to velvet domination if some states like Germany and France act hegemonically.
- ⁴⁴ The pact divided Romania, Poland, Lithuania, Latvia, Estonia and Finland into Nazi and Soviet "spheres of influence." Stalin invaded Poland on 17 September 1939. Part of the southeastern region of Finland was annexed during the Winter War, followed shortly thereafter by annexations of Estonia, Latvia, Lithuania, Bessarabia, Northern Bukovina and the Hertz region. The only pieces of the USSR's annexation of Poland returned after World War II were the region around Bialystok and a minor part of Galicia. Karelia, Petsamo, the Ingrian and Petseri areas of Estonia, and Abrene region of Latvia were never returned and remain part of the Russian Federation. Northern Bukovina, Southern Bessarabia and Hertz remain part of the Ukraine.
- ⁴⁵ China followed suit annexing Tibet and promoting communism in Vietnam, Cambodia and Laos.
- ⁴⁶ The 14 lost republics are: the Ukraine, Belarus, Uzbekistan, Kazakhstan, Armenia, Georgia, Azerbaijan, Lithuania, Moldova, Latvia, Kyrgyzstan, Tajikistan, Turkmenistan, and Estonia.
- ⁴⁷ Russia forged a customs union with Belarus and Kazakhstan on January 1, 2010, and the Commonwealth of Independent States (CIS) has morphed into the Eurasian Community, but there are no overt efforts being made to transform this economic integration into a new Soviet-type federation or a supranational equivalent of the European Union.
- ⁴⁸ Politarchs refers to government officials primarily in the business of peddling public services, including international relations for personal gain at the expense of the national interest. See Steven Rosefielde and Quinn Mills, *Democracy and its Elected Enemies*, Cambridge: Cambridge University Press, 2013.
- ⁴⁹ Vital Shlykov calls the Kremlin's approach "structural militarization." See Steven Rosefielde, *Russian Economy from Lenin to Putin*, New York: Wiley, 2007
- ⁵⁰ "Russia's Sergei Lavrov: Ukraine Getting 'Out of Control'", *BBC*, January 21, 2014. "He described violent clashes between anti-government protesters and police as "scary" and accused EU politicians of stirring up the situation." <http://www.bbc.co.uk/news/world-europe-25823091>
- ⁵¹ Moscow, ITAR-TASS, in Russian, February 9, 2007, FBIS SOV, February 9, 2007.
- ⁵² Stephen Blank, "Lt. Kizhe Rides Again: Magical Realism and Russian National Security Perspectives," paper presented at the Annual Strategy Conference of the US Army War College, April 9-11, 2013. "This failure to institute democratic controls in this sector of state policy lies at the root of the contemporary Russian security crisis which remains a permanently unstable state whose legislation permits its leaders to wage war abroad with no accountability to anyone on the flimsiest of bases and which actually started the war with Georgia and deliberately planned to dismember Georgia in 2006 not 2008 as Putin has admitted."
- ⁵³ Steven Rosefielde and Quinn Mills, *Democracy and its Elected Enemies*, Cambridge: Cambridge University Press, 2013.
- ⁵⁴ Stephen Blank, "Lt. Kizhe Rides Again: Magical Realism and Russian National Security Perspectives," paper presented at the Annual Strategy Conference of the US Army War College, April 9-11, 2013.
- ⁵⁵ Steven Rosefielde and Quinn Mills, *Democracy and its Elected Enemies*, Cambridge: Cambridge University Press, 2013.

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