

# **The political Economy of Russia's Economic Transition Problems since 1991 and their implications for Russia's Relations with the West**

Alan Jones and Grahame Fallon  
Faculty of Management and Business,  
University College Northampton,  
United Kingdom.

## **Introduction**

In our paper we seek address the problem of Russia's recent economic failure in terms that seek to identify obstructions within the existing order, but from the premise that the concept of transition may be inappropriate. We argue that the concept of transition in relations to Russia is largely a construct that has been framed by western perspectives and that economic and other behaviour that might seem irrational in the context of a transition perspective reflects responses to deep seated rejection of those perspectives that may be traced in part at least to the persistence of Communist forms. Examining recent evaluations of the Russian economic scene one is struck by the extent to which 'reform' of the system, that has been promised or foreseen since the early days of the end of the soviet state, is consistently postponed or deferred. We argue that the features which most reflect that apparent resistance are also a reflection of a path dependence within which such reforms are seen with some unease and that there is an underlying conventional wisdom that sees the development of Russia out of Communism as necessarily as a very gradual process. We would also argue that from a western perspective this apparent reluctance to engage fully in the process of transition may seem unreasonable, but from a Russian perspective it may be seen as both pragmatic and in keeping with Russia's traditional "Weltanschauung" establish since the 1917 revolution but having roots that derive from earlier Russian thinking. The Russian worldview has traditionally embodied an element sceptical of the values of the West and has historically been divided between those that seek to embrace the west and its materialism those that see Russia as a uniquely separate society. Indeed, in the 19th century Lenin had to define his party and his position against the "Narodnik" tradition that saw the village commune as a natural

basis for Russian socialism and the possibility of bypassing capitalism as a 'stage' altogether. (Wolf 1964, Service 2000). In the context of the end of the Soviet Union, the presumption in favour of 'transition' made by reformists in Russia and western theorists from outside have tended to assume as axiomatic that the objectives of Russian economic development would be a western style democratic capitalist state. In practice, we would argue that the now well known features, that have typified post soviet Russia, the failure of the tax system to accommodate the needs of modern capitalism, the growth of organised crime, the problems of state arrears and the growth of the barter economy as well as the growth of the oligarchy and the emergence of faux capitalist formations like the Financial-Industrial Groups (FIGs) and nomenklatura capitalism; the resistance to change in the political and institutional sphere; all these reflect the persistence of soviet thinking and socio-political structures but also possibly a more complex agenda than transition.

### **The Changing View of the Russian experience since 1990**

Western evaluations of the current position of Russia in economic and political terms are invariably abashed at the extent of the failure of economic development since 1990. After some premature exaltation at the initial progress of the Russian economy and its potential, (Aslund 1994, OECD 1995) the reality of El'tsin's economy of postponed reform and growing economic anarchy has received a more sober evaluation in recent years. Dyker (2000) has proposed "deep seated structural factors"<sup>12</sup> as the grounds for economic failure. With an agriculture that has scarcely changed from its soviet structure, and a pattern of investment in industry that remains the same as that under the soviet regime but with an overall decline in investment of 75%<sup>3</sup> since 1990; with banks that are re-structured but which exist from processing the budget deficit or looting it, rather than as channels for investment; Russia cannot be seen to be in any sense in transition to capitalism but seems to be stalled in a structure that reflects its origins. Nor has Foreign

---

<sup>2</sup> Dyker, D.A. 'The Structural origins of the Russian Economic Crisis' *Post Communist Economies* 12 1 2000 p.5

<sup>3</sup> *ibid.* p.9.

Direct Investment played the role in development that it has elsewhere, FDI has been much lower per capita than most other of the former communist states, has been regionally focused upon Moscow and a high proportion has been absorbed in the budget deficit rather than in the productive economy (Jones and Fallon 1999).

Ellman (2000) reflecting upon the failure of the El'tsin regime, sees Russia finally as a 'mutant economic system' where the role of the state is subverted to private purposes and failed to establish the legal framework for effective reform, control of economic resources was more important than ownership. Echoing Shlapentokh's (1996) conception of Russia that it had become a series of feudal fiefdoms where individuals exploited their control over access to the services of state, Ellman lists the disastrous outcomes and features of the El'stin period, including the well known rise of the virtual economy through the growth of barter and arrears, the decline in production and the primitivisation of agriculture, the growth of criminal activity, the failure of the development of a private banking system. He also cites the importance of soviet style 'reciprocity' as the core economic relationship, it is this that cements economic relations and enables the cooperation between firms, individuals and occasionally the state, that is implied by barter and arrears in supply payments and wage arrears. The survival of these relationships may be important in the failure of market capitalism to find roots in Russia.

An important basis for the discussion of failure has been a critique of the appropriateness of a rapid reform of the economic system for Russia. Doubts of the appropriateness of 'shock therapy' in the institutional and economic context of Russia had been advanced at a relatively early stage, but largely in the context of the creation of transitional arrangements to global market participation. (Nuti 1992, Steffens 1993) The basis for a critique of 'shock therapy' has emerged more recently out of the experience of the El'tsin regime and the current situation of the Russian economy.

The problem for those reformists who espoused the application of 'shock therapy' has been characterised by Hedlund (2000) as a failure to understand the importance of institutional theory; their mistake was that they sought to apply the formal rules of the western market economy to the Russian economy; but in doing so assumed away the

importance of the informal norms that support the market institutions of the west. Hedlund emphasises the importance of the history of the development of market capitalism in the West; modern capitalism is the product of the evolution of western society over a long period of history in which the social norms that support capitalism evolved. His point is that such 'market conforming' social norms were entirely absent in Russia, but more than this, Russia is characterised by 'path dependence' that derives from soviet experience. In the west, 'path dependence' is established positively through the interaction of formal rules and informal norms such that over the long evolution of the modern market economy but equally importantly, democracy and the rule of law. Thus the formal rules have favoured behaviour that adapts to rules and within which, informal norms, which are mental models that rationalise behaviour, promote compliance with the rule of law. For Hedlund Russian path dependence is rooted in the soviet system, firstly this was not based in the market system, but equally importantly it was based in 'rule aversion'. This latter being the product of the experience of the citizen of a state that could not be trusted to enforce rules impartially. Rule evasion becomes the rational strategy for the soviet citizen, in the West acceptance of rules derives from the successful experience of rule compliance, in the soviet system social norms derive from the success of rule evasion. This 'path dependence' is further reinforced by the fact that the state has not evolved in a contractual relationship to the citizen in Russia. In the West the relationship between the individual and the state depends upon the ability of the state to regulate relationships within society, this is particularly true of economic relationships where the state can guarantee contractual compliance through the legal system. In Russia, the state has, under the Tsars and under the Communist Party, been paternalistic and autocratic, it has not offered rights. Simon (1998) has noted this difference as well and also a contradiction at its heart, Russians have expected everything of the state but always deeply mistrusted it.

“What is missing is a concept of the priority of the individual and the contractual relationship between the state and the citizen with mutual rights and duties. The absence of a contractual culture constitutes one of the most fundamental differences in the Russian tradition compared with the rest of Europe. The Russians did not conclude mutual contracts with his subjects; instead he accepted their

subjugation to him and rewarded it with benefits and privileges.”  
Simon 1998 p.72-74

It is this tradition that the renewed communist party and its nationalist coalition, seeks to fit into in its appeal to nationalist sentiment;

“The concept of strong state centralisation is a process the Russian people themselves have initiated by voluntary submission to state control over the apolitical and anarchic character of the Russian popular spirit.” Alexei Podberezkin<sup>1</sup> cited in Flikke 1999

But in Hedlund’s critique and that of Olsen (1995), the presumption is in favour of a failure of Russian reform, which implies that had El’tsin grasped the nettle of reform, then the market economy would have prevailed. As a corollary of this, the implication is often that the Russians have failed to understand the nature of the problem; for Hedlund the mechanism is path dependence in which ‘rule evasion’ became the nature of the game under the soviet system and carries through into the post-soviet era; this is a valuable notion because it emphasises the problem of neglecting established social norms in the formulation of economic policy solutions. For Olsen the Communist party of the soviet era was a monopolist of an essentially illegitimate power, which becomes fragmented after 1990 in to a host of smaller illegitimate powers. Here the difficulty is that legitimacy is derived from those who can confer it, i.e. the soviet people, Olsen presumes illegitimacy because it would be illegitimate from a western viewpoint.

It is appropriate to consider the issue of reform in the context of the ‘path dependence’ of Russia, and the natural expectation may be that in these circumstances the reform of political and legal conditions for economic development have important contribution to make to the overall transformation of the Russian economy. But equally importantly, the will to embrace such change has to be developed, this requires the positive reinforcement of rapid success, ‘shock therapy’ isn’t therapy if the consequences are long and drawn out.

The nature of the regime presided over by El’tsin has been important in defining the character of the economy and society that Putin will now need to change. El’tsin’s

---

<sup>1</sup> Alexei Podberezkin is a political adviser to Gennadii Zyuganov leader of the CPRF

vacillations which were largely designed to maintain himself in power and enrich the “family”<sup>1</sup> consisted largely of playing off various power sectors against each other. He managed to stall the IMF and other international agencies on the matter of reform on the one hand, and managed to persuade the electorate that the ability to acquire financial assistance depended upon his ability to derive funds from the IMF on the other. In practice the left dominated Duma and the federal representatives of the upper house proved very able in stalling legislation in a number of areas that might have been beneficial, particularly with regard to taxation and FDI in oil exploration (Jones & Fallon 1999).

Although it may be taken for granted that much has changed since the first privatisations little progress was made on reform until very recently, tax reforms covering personal income taxes, turnover taxes and a number of other taxes that had been recommended through the whole period of El’tsin’s regime were passed into law in July 2000 and will take effect from January 2001 for example. (IMF 2000.)

The failure of El’tsin, particularly, in the corruption of the process of privatisation process in favour of the oligarchs who had supported him in the 1996 election has had its impact upon the mental processes that are seen by Hedlund to inform the informal norms of Russian society. As Urban (1999) has indicated the problem for the ideologists of reform has been the impact of those aspects of reform that have been implemented, or implemented inappropriately, that have tended to reinforce the perception of a failure of western political ideology and economics.

### **The Challenge for Putin; the economic implications of El’tin’s regime**

The extent of the problem now facing Putin defies the market mechanism, and the process that has created the current Russian situation has eroded hope in market reforms. The irony of the advocacy of ‘shock therapy’ is that it set an example of the effects of capitalism that could only reinforce distrust in those that were adversely affected by the

---

<sup>1</sup> In this case referring to El’tsin’s daughter and her ramified business operations and the then leader of the presidential administration Valentin Yumashev

experiment. Putin has to address the unfinished process of reform in a terrain that has changed little except to retrench some of the negative aspects of the El'tsin period.

That notwithstanding, Putin has come to power with some advantages, not least a Duma that has a reduced presence of the culturally nationalistic parties that in the past have obstructed reform and passed budgets that cannot be met by available revenues. Not that the left is now powerless, the CPRF still holds 21% of the power against Yedinstvo<sup>1</sup> 18%, in addition the grouping that competed with Putin for the Presidency the All Russia party which includes presidential candidate Primakov, holds around 10% of the vote (NUPI 2001).

He also comes to power with the advantage of an economy that has picked up since the 1998 crisis, output has increased to above pre-1998 levels supported by import substitution derived from the lower value of the Rouble, similarly the world increase in energy prices has made a contribution. Additional effects have been the growth of non-energy exports (+6%), the benefits from energy exports have been largely seen in higher prices for existing levels of exports, exports of oil and gas have been constrained by continued infra structural problems (IMF 2000). In addition, Putin has been favoured by the Russian predilection for strong leadership, he is seen as a heroic military man an image that he does much to cultivate, though his background as a KGB officer in East Germany may seem in the west to be less than heroic, for some (Piontovsky 2001) he is seen as another romantic Russian myth who will turn out as unreliable as previous incumbents.

“And now people dying in Chechnya, freezing in the Far East and drinking themselves to death in Central Russia will defend to the last Putin’s myth and popularity rating, going against every scrap of common sense, it would seem. In this sense, Putin is our everything. This is the last Russian myth – a senseless and merciless myth.”  
Alexei Piontov director of the Moscow Centre for Strategic research (2001)

---

<sup>1</sup> Yedinstvo Medved (Unity Bear) is the party that supports Putin though he claims to have no formal connection to it.

Whatever his qualities he will still have to deal with the failures of his predecessor and from this point of view the review of the situation will need to embrace the issues raised above.

### **The Structural problems of Russia**

Sufficient time has elapsed since the end of the Soviet regime for theorists to have examined the nature and causes of the structural and institutional problems that have beset Russia's efforts to effect transition (Berglöf & Vaitilingam 1999, Dyker 2000). The question of whether it is appropriate to speak of 'transition' in the case of Russia has not been answered by the election of Vladimir Putin. The issues concern the outstanding problems of reform in the area of taxation and 'fiscal federalism' (Berglöf & Vaitilingam 1999), the problems of crime and corruption, the problems that arise in the industrial sector including those of arrears and barter, faux capitalism and oligarchy remain as El'tsin's legacy.

### **Taxation and Fiscal Federalism**

The current tax system dates from early reforms of 1992 where a not very effective attempt was made to emulate the tax systems of the EU member states. The system created was complex and contradictory with over 150 different taxes and a spread of authorities that were empowered to impose taxation. (Popova & Tekoimi 1998) The confusion was compounded by 900 stipulations, which were often contradictory, and regulations that could change on a monthly basis. This tax system brought specific difficulties with it, firstly, the regional authorities were not always willing to pass on the share of taxation owing to the central authorities, secondly, VAT and profit became the most important source of income for the state, and here collection become more difficult because of avoidance by new private businesses, but revenue also fell as the state enterprises and newly privatised enterprises were unable or unwilling to pay increased their VAT and profit tax arrears. These matters were compounded by the approach to tax liability, which did not match the approach in Europe and the USA, so that no allowance could be made for legitimate business expenses. While the IMF and other agencies were urging the Russian authorities to collect their revenues more effectively and making loans



dependent upon this, the incentive in the business community to evade taxation was very significant. In addition, the issue of non-payment, the build up of arrears between enterprises and between the state and enterprises as well as the build up wage arrears is symptomatic of a negative feedback relationship between enterprises and the state. The state is still a major consumer of the output of enterprises and the failure of the state to make payments for goods and services has resulted in a reciprocal failure to pay taxes (Ivanova & Wyplosz 1998). Adaptations from the soviet system may be reflected in attitudes to profit on both sides of the revenue issue; in the soviet system businesses were valued and given status based on their size and their perceived importance to state strategy rather than their economic effectiveness (Mc Faul 1996). This was reflected in attitudes to profit, organisations in the soviet period were funded according to the needs of soviet planning if they made surpluses these were acquired by the central government, if they didn't then insofar as their activity was necessary to the realisation of the planning structure they would have their losses written off.

The attitudes to profit may in many circumstances still mirror the nature of soviet approaches and attitudes adapted to new times. Although attention has been focused upon the oligarchic FIGs, it must be remembered that many privatisations took place in ways that maintained a dimension of the status quo, the first wave privatisations that reserved 51% of ownership to the workforce creating "nomenklatura management" or associations of existing management and workers for whom the survival of the enterprise represented the only possible future, and or a necessary link to social support in housing, medical and other services. (Kuznetsov & Kuznetsova 1998, McFaul 1996, Balgione & Clarke 1996) Even if it could be claimed that the state enterprises and newly privatised businesses have a clear vision and corporate purpose, the attitude of the state to profit may retain some of its soviet flavour. Indeed, the failure of successive amnesties to clear up tax arrears (Berglöf & Vaitilingam 1999), and on some occasions to make them worse, is suggestive of a system that does not fully acknowledge the change from the soviet to the market system. It may, moreover, point to a system in which soviet 'reciprocity' still operates as an economic framework for the state and for enterprises at least at some level of the system. This is supported to some extent by MacFarquhar (1999 cited in Berglöf & Vaitilingam 1999) who has claimed that, despite the position of the IMF on this matter,

the Russian state collects tax at a level that, given its size, income and economic structure is comparable to other states internationally but that: ‘ tax evasion and arrears should be understood as a result of the state’s attempt to extract more form the private sector than is feasible for a country in Russia’s position.’ (Berglöf & Vaitilingam 1999 p.15)

The mechanism that generates this range of problems derives from the institutional arrangements at the centre of Russian government and the failure to set a budget that reflects the real ability of the state to support it. The executive has been characterised as dominant in the Russian state, with considerable emphasis given to the decrees of the President and the activities of the prime minister and his deputies, but the Duma has powers that are not insignificant, particularly in relation to the budget<sup>1</sup>. Von Steinshof (1999) speaks of the relationship between the executive and the Duma as ‘inszenierte Konflikte’<sup>2</sup> and ‘begrenzte Kooperation’<sup>3</sup>, a relationship that is full of ‘sound and fury’ but which thrives on brinkmanship and compromise. She also has identified the common ground of what was El’tsin’s relationship to his left dominated Duma:

“both sides lacked the will to present this bothersome but necessary policy of proceeding by small steps appropriately to the general population,. In the face of the enormous and manifold pressure of problems in the Russian society under transformation, most decision-makers have been accustomed to making their current opponents solely responsible for all the difficulties. This scapegoating policy must, in the end, lead to the general population regarding all decision makers as either incapable of, or unwilling to cooperate and to be irresponsible.” Von Steinshof 1999 p.19-20

The budget formed a nexus of the relationship between the Duma and the executive and the outcome tended to favour the slow change, or even maintenance of the status quo, rather than the rapid reform favoured by the indigenous and foreign ‘shock therapists’.

One outcome of this relationship has been the failure to pass budgets that were appropriate, the deficit was at first financed from inflationary expansion of the money supply, and then by the issue of the GKO’s a third of which ended up in the hands of

---

<sup>1</sup> Under article 114 paragraph 1a of the Russian constitution the proposed budget must be presented to the Duma for approval.

<sup>2</sup> Staged conflicts

<sup>3</sup> limited cooperation

foreigners, and by other state borrowing overseas. But if the decision making at the highest level of government wasn't urgent there was also an inability to impose control further downstream in government. Ministries and regional governments spent on projects by running up arrears on wages and supplier payments even in the context of reductions of cash payments by the Ministry of Finance under pressure from the IMF. (Berglöf & Vaitilingam 1999)

The use of tax powers by the federal states and the bilateral negotiation between the central government and individual states was also a meant that revenue to central government declined in favour of the regions, individual states withheld tax from central government. Re-distribution also takes place between regions through non-transparent arrangements based on bi-lateral agreements operating between the central government and some regions. The basis of these arrangements is often a reflection of the political relationship between the executive and the regions so that those that are inclined to use their position in the upper house to threaten executive policy are appeased. Nor does this practice reflect equity of needs so that often the regions most inefficient in expenditure and least effective in tax collection are rewarded by re-distribution in their favour (Treisman 1996). Most federal revenue comes from 10 of the 89 administrative regions, 25% of the contribution comes from the city of Moscow (Popova & Tekoniemi 1998). Here too the relationship reflects the soviet arrangements, where central government controlled and distributed revenues, and 'tax sharing' based on bargaining between the levels of the union determined that distribution. (Popova & Tekoniemi 1998). Though the power relationships between the regions and the centre may have changed the mechanisms from the soviet times persist and pervert the rationale of tax policy.

### **Barter, Inter-Organisation Arrears and FIGs**

Barter has come to prominence as an issue in the failure of the reform process as an important element of the behaviour of large and small enterprise in Russia, Russian Economic Barometer (cited in Yakovlev 2000) estimates the share of intra industry sales as consisting of up to 50% in barter transactions in 1998 and in large organizations it was up to 75% (Yakovlev 2000). Barter arose rapidly between 1992 and 1998, the systems for

supporting barter developed very rapidly and were not confined to unofficial activity since the state at regional and central level accepted 'offsets' as payment of tax arrears, indeed, according to Berglöf & Vaitilingam (1999) these amount to 50% of regional taxes and 35% of federal government taxes in 1997. Aukutsionek's (1998) study put the main reason for the growth of barter as a desire to facilitate the acceleration of turnover of working capital and the desire to maintain production, tax evasion was another reason but not a dominant one. Most barter takes place between buyer and supplier companies which are linked together in longstanding supply chain arrangements; this makes sense because barter arrangements tend to operate on the basis of a double coincidence of wants and a mutual desire for survival. A more recent study Maurel and Brana (1999) using the same data, endorses Aukutsionek's view that, for some organisations the central problem is access to liquidity but for others it may be a mechanism for avoiding or delaying bankruptcy.

"At the micro-economic level, barter lowers the ability of money to harden firms' budgets. It consolidates existing inter-firm relationships, reduces market competition, and tends to create artificial demand. Moreover relative prices changes become less meaningful. Consequently, the pace of economic transition is slowed down, and economic and financial valuation of firms becomes groundless." Maurel and Brana 1999 p.18

But they identify the central difficulty that barter both reflects the failure of reform and represents a major obstacle to industrial restructuring.

The EBRD estimated total arrears of the enterprise to be 43% of GDP in 1998 and that non-monetary payments represented 60% of sales in the sector. This had led Gaddy and Ickes (1998) to doubt the validity of Russian GDP figures, they claimed that this vast array of firms making no monetary profit are essentially engaged in 'subtracting value' and that the outcome of state estimates grossly overstate GDP as a result, giving rise to the concept of a 'virtual economy'. Since then Guriev and Ickes (1999) have determined that rather than a clear distinction between those organisations that use barter and those that use money in transactions, Russian organisations use a mixture of barter and money.

They also refute the claim that liquidity problems are the main motive for barter, since empirically there is (in their data) no significant correlation between barter and the availability of assets. They prefer the explanation that barter represents a rational choice for businessmen because of the high relative costs of monetary transactions, this because of high taxes, problems with property rights, poor credit markets characterised by rent seeking banks. Similarly they argue that though conventionally the complexity of wants makes multilateral barter prohibitively costly, this is not apparently the case in Russia where organisations with complex inputs engage in barter. Interesting for us, is that along with the fact that they cite technology and the growth of specialist intermediaries as a reason for this, they also cite networks from the Soviet era as a possible support system for barter on this scale. Views of this problem at the micro- and the macro economic level imply significant blockages to re-structuring. In the Guriev and Ickes case, however, the fact that historical relationships form the structure of networks, may make it more difficult for the process of re-structuring because they imply a rupture of long standing interdependent relationships. This gives them reason to raise the possibility that there are strong factors that may lock Russian organisations into barter and actively work against industrial re-structuring. There would seem to be in this a strong presence of behaviour that evokes soviet structures in production and in behaviour between organisations.

### **Restructuring and Industrial Sclerosis**

Industrial restructuring of has proved to be a chimaera in the Russian context and unless one can speak of reverse transition, transition too is also a problematic term. Dyker (1999) has shown that the industrial structure of Russia has changed little from its Soviet past, except that the overall level of output has declined by 54% (Ellman 2000) and the level of investment by more than 75% (Dyker 1999). What is more Dyker speaks of investment in 'structurally reactionary sectors' and notes the decline in investment in the potentially productive area of engineering, a fact that is mirrored by its catastrophic decline in production in 1999 to 48% of its level in 1991 (Goskomstat). Dyker reflects also on the decline of science and technology based activity reflected in the decline in science and technology personnel (-45% between 1991 &1997) and R&D expenditure (-50% between 1991 &1997). The picture is one in which practice oriented activity has

declined in the context of a proliferation of R&D organisations in which basic research has increased at the expense of client focused research, the strength of the organisations being in their political connections.

“What is left of the Russian S&T system is more heavily concentrated in the ‘ivory towers’ of the Russian Academy of Sciences than ever before. Institutional sclerosis has been mirrored and reinforced by attitudinal rigidities.” Dyker 1999 p.13

Although some authors put an optimistic gloss on the prospects for re-structuring and the benefits of privatisation and emphasise the growing heterogeneity of ownership of enterprises (Aukutsionek, Filatochev et al. 1998), a recent large scale survey (Moers 2000) has again provided some evidence of industrial sclerosis. The survey confirmed the decline in production at the enterprise level indicating an average cumulative decrease in sales of 54% between 1992 and September 1999. Interesting, however, was the persistence of labour hoarding among enterprises, where employment fell by only 42% implying a decrease in productivity of 11.4% (Moers 2000). Echoing the national industrial production figures, the engineering and light industry sectors were hardest hit by declining sales. Larger industries tended to be hit harder than small industries by declining sales but were also much more prone to labour hoarding and suffered the largest decline in productivity.

Moers sees this as an indication that the larger organisations have sought to avoid the social consequences of making their workforce unemployed consistent with the traditional paternalism of the soviet enterprise (Moers 2000 but also Baglione & Clarke 1997, McFaul 1996). The regional dimension is important here as well, the largest decline in sales and the highest levels of labour hoarding are to be found in Volga Vyatka and in the East of Russia, in East and West Siberia, and the Far East. In the east decline has also been accompanied by the highest levels of labour hoarding mirroring that other soviet feature of industrial life, the one company town. What Moers’ survey also indicated was that privatisation and hard budget constraints do not of themselves make for re-structuring and other factors that might have driven the re-structuring process forward are not present, not least competition, from either domestic or foreign competitors, or an institutional framework that might favour it. Finally, the importance of

nomenklatura networks was acknowledged by all of Moers' respondents, leading him to comment:

“Nevertheless, the response on enterprise restructuring indicates that, whatever else may have changed Russian industry is still largely ruled by ‘red directors’. Moers p.324

What is peculiar about Russia's ‘red directors’ is that, in contrast to their counterparts in the CEEC countries, they are not contributing to the re-structuring process (Aghion & Blanchard cited in Dyker 1999), because they are ideologically connected to their soviet roots. Still dominated by insiders, Russian enterprises are run by ‘Nomenklatura capitalists’ who maintain their paternalist relationship to their employees and are tied in reciprocity to their suppliers and customers and linked to their regional government through old soviet networks. Although as Aukutsionek, Filatochev et al. (1998) may maintain that outsiders are increasingly important, in large areas of Russia it is the insiders that determine the future of restructuring.

Thus El'tsin's legacy is an economy where soviet structures persist and the market mechanisms that might serve to open up the economy are atrophied or assimilated into the system to create hybrid forms like the Financial Industrial Groups. FIGs combine a number of features of post soviet capitalism, they do not depend for their existence upon conventional banking or industrial activity, they were born out of shadowy organisations with criminal connections in the process of privatisation, their subsequent behaviour was characterised by unconventional or criminal activities like tax evasion and capital flight operations. Though some have highlighted the possibilities of these organisations as positive economic forces, comparing them to Keiretsu or to the German Interessengemeinschaften that historically formed the basis of industrial growth in Japan and Germany, their background is not the same. In Russia the growth of the power of the Oligarchs is linked to the abuse of power, that grew out of the decline in law and order in the years after the end of Communism, which then converted itself in quasi legitimate business through its ability to command finances unavailable to anyone else. These finances being derived from criminal activities like extortion.

Corruption and criminality are ubiquitous in modern Russia, its roots are in the Soviet era gangs who, among other things ran the black market which flourished in the 1970's in the context of the failure of the economy to produce sufficient consumer goods. This was accompanied by the growth of a shadow economy of extortion and blackmail of the participants in the black market (Frisby 1998). The criminal fraternity has historically been well organised, even meeting in the 70's to agree common rates of extortion. Perestroika provided the first opportunity for growth and opportunities for the legitimisation of criminal business and the infiltration of mafia like organisations into legitimate areas of business. Now crime syndicates are claimed to control about 55% of the national capital of Russia and are largely responsible for the illegal flight of capital from the economy estimated at more than \$60 billion over the 5 years to 1997. As much as 80% of shares in Russian companies are held by criminal clans; 400 banks are claimed to have mafia like structures controlling them; 41,000 companies and 80% of joint ventures are claimed to have criminal connections. (Finansovye Izvestiya 1997 cited in Frisby 1998).

The importance of the Oligarchy in Russia today is reflected in its ability to exercise state power on its own behalf. The oligarchs' relationship to the state and influence over the dispositions of state property, as well as their power over the media and individual economic power places them in a strong position to decide the conditions in which the processes of change will take place. In the presidential election in June 1996, E'ltsin relied heavily upon the financial backing and media power of a group of seven businessmen who claimed to control about 50% of the Russian economy. They were regarded as oligarchs by both the communist and the reformist opposition, and though claiming to be reformers, were seen to be hostile to de-regulation and to foreign access to Russian opportunities. As major beneficiaries of the privatisation process, they were perceived to have benefited from special arrangements to acquire important Russian assets at knock down prices (Naudet, 1996 Buiten 2000). In return for their support in 1996, E'ltsin rewarded two of the oligarchs with government posts, although both were later dismissed as part of a belated attempt on the part of the President to restart reforms from a more conventionally liberal base.



Some reformist Russian politicians (for example, Chubais) have defended the oligarchs on the grounds that they offer the best prospects for the future of Russian capitalism as they will inevitably seek to secure legitimacy as the best source of security for their gains (Freeland *et al*, 1997). But Buiten (2000) has illustrated the problem this presents for Russia, the difficulties that have arisen from the privatisation process are that they have not put a sufficient distance between the old regime and the new, on the contrary they have delivered it largely to its former controllers or else to co-conspirators in a process Buiten calls the 'theft of the state'. Dyker (1999) agrees, describing the process as one in which the objective of the participants, nomenklatura or 'mafia' is essentially about looting not capitalism. Linking to the ideas of a fragmented feudalism put forward by Shlapentokh (1996) he says:

“The Russian nomenklatura do not generally maintain private armies in the manner of the great landowning aristocrats of the past. Rather they do deals with organised criminals, conniving at mafia looting in exchange for such ‘security’ services as they require, thus ensuring that a large part of the economy will remain imprisoned within a subsystem in which there can be no accumulation and innovation, because there can be no trust.” Dyker p.20

In identifying the essentially parasitic nature of the activities of FIGs and of nomenklatura capitalism, we are linked back to the problems of the failure of restructuring. A serious question that arises from the evidence surrounding the issues of barter and industrial sclerosis is, that given the decline of the Russian economy and the failure of reform, is Russia 'locked in' to a failing structure or can it be released for a new trajectory of transformation?

### **New Opportunities, Old Difficulties**

The question of the possibility of transition is to some extent a western one, the Russians, in choosing Putin as their president have given an indication of a wish for change. There was never any evidence that the Russian electorate in general wished to return to communism, on the contrary, the evidence was to some extent in the opposite direction, though never unambiguously so. In a survey of 1991, redone in 1996, in anticipation the presidential elections a question asking whether voters approved of the market system

only 36.1 indicated they were unequivocally in favour in 1991 but a further 34.5% were 'somewhat in favour', indicating a majority in favour (71.2%) (VTsIOM<sup>2</sup> survey cited in Byung-Yeon Kim 1999). By 1996 this had declined to 21% for those unambiguously in favour, but the figure for 'somewhat in favour' had risen by 4.8%, whilst not a ringing endorsement, in the circumstances of the time it does seem to indicate a reluctant acceptance. But it may be the reluctance of the acceptance that is important, an acceptance of a need for change but qualified and framed in Russian perceptions, otherwise the nationalist agenda that the communist party embraces would not find as much favour as it does. (Flikke 1999)

Whatever the failings of the economic elements of the ideology brought from the West, the democratic process has served the Russians reasonably well, and in their own terms has enabled them to choose a Russian 'myth' – the strong leader (Piontsov 2001). Putin is a good Russian choice because he does not represent a total break from the past; his credentials as a head of the FSB and as a former KGB man link him firmly to a Russian cultural nationalist position. His election also brings with it a degree of risk, the Russian wish for strong leadership can be taken too far, and a slide into dictatorship under the weight of Russia's contradictions, has already been seen by one commentator as a serious possibility. (Shlapentokh 1998)

But Putin's rise is interesting in its smooth transition, by allowing El'tsin his immunity he enabled him to slip away without unseemly and dangerous resistance, a peaceful transition in a democratic context is quite a striking thing in a country of such apparent anarchy. El'tsin after his initial heroic beginning fell prey to the pervading corruption, in doing so he locked himself into to an undignified and unholy relationship with his opposition in the Duma. El'tsin's corruption reduced his power and standing and rendered his whole regime morally bankrupt and incapable of making a serious process of reform.

---

<sup>1</sup> The question put was: How much do you agree or disagree with the following statement? A free market economy is essential to our economic development.

<sup>2</sup> VtiOM is The Russian Centre for Public Opinion Research

Putin's position is a contrast to El'tsin, apparently untainted by corruption, he cannot be held to ransom by any grouping in the Duma and has chosen a strong man image that ties into some of the traditional aspects of Russian nationalism as well as a more contemporary desire for order after so long a period of anarchy. Yedinstvo the party which supports him has tended to define itself against other groupings rather in favour of particular policy. In particular it has defined itself against the Moscow elite represented by Lyushkov (mayor of Moscow) and Primakov the former prime minister under El'tsin, and more explicitly against the criminal elements. Its leader is an engineer Sergei Shoygu a former minister for civil defence under three El'tsin prime ministers, now a deputy prime minister in the Putin government. One of its spokesman is the former minister of the interior who was strongly involved in activities against organised crime, indicating its anti-corruption position, an indication on its economic position may be seen in the fact that the faction leader is the St Petersburg deputy Boris Gryshkov who is associated with regional development activities in his home region.

It is early days yet and Putin has a reputation for slow deliberation, but some indication of moves in the direction of reform and re-structuring as well as some evidence of institutional concerns are already appearing. On the institutional front he has already moved to re-assert the authority of the presidency and the federal government against the power of recalcitrant regional leaders. In the context of a catastrophic energy crisis in Primorsky Krai, Putin has used his presidential right to dismiss the notorious governor of the region, Evgeni Nazdratenko. More importantly for the wider institutional problem of the relationship between the federal and regional government he has appointed seven 'prefects' to oversee the work of the regional governors (Financial Times 2001). He has also removed governors from the upper house of the Duma and to address the crisis in the legal system he has promised to improve the funding of the judicial system. (Jack 2001). In relation to the Oligarchs he has used the courts to pursue Boris Berezovsky and Vladimir Gusinski both of whom have fled Russia.

The direction of the new government has not been fully tested, but overtures to the west in foreign policy terms and efforts to improve the institutional system may be the first slow and deliberate steps in the direction of a change in the mindset that has locked

Russia into its soviet past. The doubts that remain relate to the 'strong man' provenance of Putin's government and supporting party, the pursuit of Gusinski for example can be interpreted as a new line on the freedom of the press, since his broadcasting and media company was seen as a potential source of criticism for the new regime. Russian democracy has proved itself remarkably robust, thus far, it remains to be seen whether it can withstand the weight of events and the Russian tradition of autocratic leadership.

## **Conclusion**

Russia's process of transition has not really been transition at all, in some respects it appears to be a retrenchment into soviet forms under new and unfavourable conditions. The first attempts at the creation of a transformation process underestimated the power of the past and the particular path dependence of Russian society.

The extent of the significance of Russia's history was poorly understood in the west and thus unaccounted for in the dealings it has had with Russia in the first 10 years of the new relationship. Russia's current problems especially those of 'structural and institutional sclerosis' will require what is essentially a new beginning after the neglect of the El'tsin years. These features reflect the persistence of soviet forms and mindsets that have been seen by some to lock Russia into an economy that cannot be re-structured. Future approaches to the process of transition will need institutional change, that is to say, the slow establishment of new formal rules and then evolution of new informal norms that can inform a change in Russia's existing path dependence.

The task for Russia's new government is still an enormous one requiring him to address the stagnancy that has tied Russia and its people and economy to the past; in some respects it is like starting again in 1992 but with the added baggage of the errors of reform to resolve.

An important issue in this is the need to change the influence of the 'Illich to Illich' years, from a Russian perspective an important issue may be the need for a patience in the West that did not characterise the first relationships between post-Soviet Russia and the West. An important element in the thinking of Russian particularly those that have vote for the

CPRF in recent years has been a suspicion of western intentions with regard to Russia's resources. The 'shock therapy' has given way to de facto gradualism and it may be necessary to acknowledge that the process of transition will be a long one.

## References

1. Aslund, A. 'Russia's Success Story' *Foreign Affairs* 73 5 1994
2. Baglione, L.A. & Clark, C.L. 'A Tale of Two Metallurgical Enterprises,' *Communist and Post Communist Studies*, 30.2, (1997) pp153-180
3. Byung-Yeon Kim 'Economic Experience and Market Commitment in the 1996 Russian Presidential Election.' *Europe-Asia Studies*, May 1999 v51 i3 p467
4. Dyker, D.A. 'The Structural origins of the Russian Economic Crisis' *Post Communist Economies* 12 1 2000
5. Ellman, M. 'The Russian Economy under El'tsin.' *Europe Asia Studies* Dec 2000 v52 i8 p1417
6. Financial Times Editorial 'Putin's Power' February 7<sup>th</sup> 2001
7. Flikke, G. 'Patriotic Left Centrist: The Zigzags of the Communist Party of the Russian Federation' *Europe Asia Studies* March 1999 v51 i2 p275
8. Gaddy, G. & Ickes, B.W 'Russia's Virtual Economy' *Foreign Affairs* 77.5 Sept/Oct
9. Guriev & Ickes 'Barter in Russian Enterprises: Myths versus Empirical Evidence' *Russian Economic Trends* 8. 2 1999
10. Jones, A and Fallon, G.R. 'Obstacles to inbound foreign direct investment into Central and eastern Europe – The case of Russia,' in *UK Academy of International Business, Conference Proceedings of the 26<sup>th</sup> Annual Conference*, University of Stirling, 16-17 April 1999
11. IMF Russian Federation Report September 2000
12. Ivanova, N. & Wyplosz, C. 'Arrears the tide that is drowning Russia' *Russian Economic Trends*
13. Jack, Andrew 'Putin Pledges to Increase income for Judicial System.' *Financial Times* Nov.28 2000
14. Kuznetzov, A.& Kuznetzova, O. 'Corporate Governance under Transition and the Role of the State: the case of Russia' *Conference Proceedings of the 25th Annual conference of the Academy of International Business* (April 1998) pp374-386
15. McFaul, M. 'The Allocation of Property Rights in Russia' *Communist and Post Communist Studies*, 29.3, (1996) pp287-308
16. Naudet J-B. 'Le Kremlin met un Coup d'Arret au Processus de Privatisation,' *Le Monde* (24.01.98) p2
17. NUPI Centre for Russian Studies Database (February 2001) <http://www.nupi.no/russland>

18. Nuti, D. M. (1992), 'Market Socialism: The Model that Might Have Been but Never Was,' in A. Aslund (ed), *Market Socialism or the Restoration of Capitalism?* Cambridge: Cambridge University Press, pp17-31
19. OECD 'The Russian Federation-1995' *OECD Surveys* Paris 1995
20. Olsen, M. 'Why the transition from Communism is so Difficult' *Eastern Economic Journal* 21, 4 1995
21. Moers, L. 'Determinants of Enterprise Re-structuring in Transition' *Post Communist Economies* 12. 3 2000
22. Piontov, A. 'The Merciless Russian Myth' *Russia Business Journal* 27<sup>th</sup> January 2001
23. Shlapentokh, V (1996), 'Early Feudalism the Best Parallel for Contemporary Russia', *Europe-Asia Studies*, 48.3, pp393-411
24. Shlapentokh, V. 'The Truth about Russia- a Liberal society is not to be had in the near Future' *Post Soviet Prospects* VI .4 1998
25. Service, R. 'Lenin – a Biography' Macmillan 2000
26. Simon, G. 'The Historical Prerequisites For Russia's Modernisation' *Aussenpolitik* 1 1998 pp 67-85
27. Treisman, D. 'The politics of Intergovernmental transfers in Post-Soviet Russia' *British Journal of Political Science* July 1996 v26 n3 p299
28. M. Urban 'Re-mythologising the Russian State' *Europe Asia Studies*, 50.6 (1998) pp969-992
29. Wolfe B. 'Three who made a Revolution' Pelican 1964