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Change, Continuity and Power in the Russian Political Economy in Comparative BRICs Perspective

Alexandra Vasileva



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**Change, Continuity and Power in the Russian Political Economy
in Comparative BRICs Perspective**

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aan de Universiteit van Amsterdam

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Dedicated to Uwe Becker

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Uwe generously involved me in his research and teaching on the BRICs when I was still completing my master's degree in Berlin and slowly but surely got me interested in political economy - the field of social sciences that still excites me most. Uwe encouraged me to do a PhD despite my cheekiness and stubbornness, perhaps recognising in me some of his own traits. I sometimes wondered why he talked so much and liked to jump from varieties of capitalism to some obscure sports results from the 1970s and back. However, I got to appreciate his endless curiosity about the social world, his deep concern about the topics he chose to study and his common sense approach to complicated matters, reinforced by a humble attitude to his own research and a healthy critical stance towards academia in general. He would always question conventional wisdom and challenge the mainstream. This was often great, sometimes annoying and never made life simple. Uwe was an uneasy yet in a way ideal mentor: the one who not only taught, pushed and challenged me but also eagerly tapped into my knowledge, permitting disagreements and sometimes even full-fledged fights. I think these intellectual battles sharpened many of the arguments in our joint work.

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Having tragically lost my mentor, I was extremely lucky to gain a new one who helped to make the second half of my PhD a journey more

intellectually stimulating and gratifying than I ever expected or hoped it to be. I always felt that Uwe's mentorship gave me wings. I guess Brian taught me how to fly.

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Abstract

This article-based dissertation explores the development of the Russian political economy over the past 25 years in comparative BRICs perspective. The first half of the thesis describes (article 1) and compares (article 2) the evolution of the macro-configuration of Russia's political economy (state-business and capital-labour relations) in the framework of Comparative Capitalism approach. The main finding is that Russia de-liberalised in the 2000s and increased its patrimonialism, understood as a form of socio-economic organisation strongly based on clientelism and patronage. All other BRIC countries developed in the opposite direction.

The second half of the dissertation examines the functioning (article 3) and origins (article 4) of Russia's current type of capitalism, characterised by insecure property rights and dubbed 'statist-patrimonial'. The focus of analysis is placed on small firms and their daily interactions with state officials. Based on in-depth interviews, the articles examine the drivers of widespread informal - and sometimes corrupt - business strategies and reveal the mechanism of 'informality trap': small firms that behave informally get locked in the vicious circle of informality, thus inadvertently undermining the security of their property. As a result, small businesses are not only victims of state predation but also have actively contributed to the functioning and emergence of Russia's form of capitalism.

In summary, by examining patrimonialism and the mechanism of 'informality trap' the dissertation provides a better understanding of the Russian case and enables the refinement of social science tools to analyse political economies beyond the industrialised countries.

Abbreviations

BRICs	Brazil, Russia, India, China
CEO	Chief Executive Officer
GDP	Gross domestic product
SMEs	Small and medium-sized enterprises
OECD	Organisation for Economic Co-Operation and Development
R&D	Research and Development
VoC	Varieties of Capitalism
WTO	World Trade Organisation

Tables and figures

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Summary

This PhD dissertation explores the development of the Russian political economy over the past 25 years in comparative BRICs (Brazil, Russia, India and China) perspective. It focuses on the central feature of Russian capitalism dubbed 'patrimonialism', examining the relationship between the state and (primarily small) companies, in particular its informal aspects. The dissertation is article-based and aims at:

- describing the distinct variety of Russian capitalism (chapter 1);
- comparing the evolution of Russia's variety of capitalism to that of other BRIC countries (chapter 2);
- understanding how Russia's capitalist variety functions and is sustained (chapter 3);
- exploring why Russia's capitalism developed this particular way (chapter 4).

In short, the chapters focus on the description, comparison, functioning and origins of Russia's type of capitalism. Thereby they address four fundamental questions of social science: 'what?'; 'and compared to others?'; 'how?'; and 'why?'.

Conceptually, the dissertation moves from a macro perspective on a political economy as a whole (chapters 1 and 2) to a micro study of its functioning on the level of small and medium-sized enterprises (SMEs) (chapter 3) and then back to the macro level, focusing on broader implications of companies' activity for the origins of the system (chapter 4). This three-step analysis requires a conceptual 'gear shift'. Theoretical tools of the 'Varieties of Capitalism' (VoC) scholarship are used in the first half of the dissertation to discern the specificity of Russia's politico-economic form and describe how it developed over time in a comparative BRICs perspective. The remaining half of the dissertation looks at Russia's highly patrimonial capitalism on its own terms, focusing on the behaviour of SMEs and their interaction with local state officials based on insights obtained through in-depth interviews.

In terms of the method, the dissertation combines a historical study with statistical assessment; a case study with a comparative study; a macro analysis of major institutions of a political economy with a micro treatment of behaviour of business actors; descriptive and explanatory

approaches, as well as desk research and data obtained from personal fieldwork. The timeframe of the analysis commences with the collapse of communism at the end of 1991 and ends in 2014 - the year of the latest available data.

Qualitative data obtained from in-depth interviews build the empirical centrepiece and offer a methodological contribution of this dissertation. The interviews were conducted during fieldwork in Russia in the spring of 2014. The total of 34 respondents included entrepreneurs, business association executives, corporate lawyers, academics and journalists. In addition, cross-sectoral and cross-national quantitative data were used in this study, as well as secondary literature, newspaper articles and historical analyses by other scholars.

Here is the overview of the main findings of the four articles (chapters) of the dissertation:

Chapter 1, entitled '**Continuity and Change in Russian Capitalism**' (published as a chapter in an edited volume), is a historical study of the evolution of Russian state-business relations and capital-labour relations since the collapse of the Soviet Union along three dimensions. The political dimension comprises state capacity and the composition of the dominant political elites; the legal dimension deals with the rule of law and the security of property rights; the economic dimension includes the economic policy of the state towards business. Viewed against the backdrop of the statist, liberal and patrimonial ideal types of capitalism, the chapter finds that the main direction of change in the Russian political economy is expressed in the shift in the proportion of the liberal and statist elements. While between 1992 and 2002 the Russian capitalism can be characterised as largely liberal, after 2003 the trend towards increased statism became clearly pronounced. Etatisation of the Russian capitalism is expressed in the partial increase of the state capacity, in the shift from the liberal to conservative political elites and in the partial nationalisation of the strategic economic assets, coupled with an overall increase in the state's involvement in the economy and labour relations.

The major continuity of the Russian capitalist development was found in the persistence of patrimonialism, expressed in the pervasive weakness of the rule of law; in the endurance of corruption, partial fusion of the state

and business and in the spread of the informal state-business and capital-labour relations, which were at odds with the formal regulations governing these relations. Another notable feature of Russia's patrimonialism is found in the informal bureaucratic control of property (dubbed 'power-ownership') and the extraction of administrative rents from it, examined in the following chapters of the dissertation. The chapter leaves open the questions of the scope of the Russian patrimonialism, eventual differences between the 1990s and the 2000s and mechanisms of its working as it is taken up in the later chapters of the dissertation.

Chapter 2, entitled '**Russia's political economy re-conceptualised: a changing hybrid of liberalism, statism and patrimonialism**' (published in co-authorship with Uwe Becker in *Journal of Eurasian Studies*), is a study of the evolution of Russia's capitalism in a comparative BRICs context. It is based on the analysis of both historical and statistical data and takes up some of the questions left open in chapter one. In particular, it gives an approximation of the scope of Russian patrimonialism and how it developed between the 1990s and the 2000s.

The chapter proposes a conceptual framework for assessing the impact of patrimonialism on the country's trajectory of change by systematically adding patrimonialism as a third dimension to the better-known liberalism and statism. The chapter conceptualises Russia's trajectory as changing with respect to ideal-typical liberalism, statism and patrimonialism. The main finding of the first, historical part of the chapter is that Russian patrimonialism hindered the rise of the economically facilitating state capacity and undermined both liberalisation in the 1990s and re-etatisation in the 2000s. The second part of the chapter provides a quantitative assessment of these developments based on statistical data and adds a comparative BRICs perspective that clarifies the peculiarity of Russia's development. The data confirm the de-liberalisation of Russia and show an increase of patrimonialism in the 2000s compared to the 1990s. Another finding is that Russia was the only BRIC country that de-liberalised and increased its level of patrimonialism in the period under consideration.

The remaining two chapters of the dissertation focus on the Russian case and its statist-patrimonial variety of capitalism, aiming to illuminate its

working and understand its origins by focusing on the activity of small firms. **Chapter 3**, entitled '**Trapped in informality: The big role of small firms in Russia's statist-patrimonial capitalism**' (published in the journal *New Political Economy*), is a study of the functioning of Russia's capitalism and the mechanisms of its stability. It takes up a question left open in chapter one, namely the mechanisms behind Russian patrimonialism and the factors and circumstances that give bureaucrats the power to extract administrative rent from property under their indirect control.

While predominant accounts focus on the lack of institutional constraints on state predation, the chapter explains the resilience and maintenance of Russia's statist-patrimonial capitalism by exploring the often-overlooked contribution of small- and medium-sized companies. Drawing on statistical data, the chapter finds a steady rise of SMEs in the 2000s despite increasing state predation, concluding that SMEs are not simply subjugated by the state. In-depth interviews with Russian entrepreneurs reveal that business contributes to the maintenance and functioning of the statist-patrimonial system through the mechanism of the 'informality trap': companies that choose the informal strategy find it difficult to return to the legal sphere and become trapped in the informal economy.

The chapter finds that the drivers of informality comprise institutional constraints such as overregulation and bureaucratic extortion, which represent a power resource on the side of the state and compel companies to opt for informal behaviour. However, informality is also driven by some company-specific factors that offer a degree of choice and thus agency. Firstly, depending on the characteristics of a company (such as size and sector), a small enterprise may face incentives to choose informal behaviour. Secondly, socio-cultural factors dubbed 'normality of informality' matter in this regard too: viewing the formal costs of doing business and informal expenditures such as bribes as comparable expenses, for subjective reasons, some SMEs may prefer cutting corners to legal compliance. Though this power to subvert the system may sometimes help companies to get things done or protect their interests, it often has an unintended adverse long-term effect on the security of property rights as the companies may get locked into informality. In sum,

the mechanism of the 'informality trap' highlights the agency of SMEs in Russia's political economy and their contribution to its functioning.

Finally, **chapter 4** provides a historical analysis of the origins of Russia's variety of capitalism, entitled '**Digging their own graves: how small companies contributed to the emergence of Russia's statist-patrimonial capitalism**' (in preparation for submission). The chapter traces in historical perspective how for a variety of reasons Russian companies embarked on informal practices back in the 1990s and, by falling into the informality trap in the following decade, co-created the foundation of insecure property rights and informal particularistic state-business relations that define patrimonial capitalism today.

The main finding of this chapter is that statist-patrimonial capitalism is not only the result of a top-down activity of the state sovereign, its corrupt agents or cronies in big business, as is commonly perceived, but that it is also a system that rests on the bottom-up activity of the bulk of economic actors - the SMEs. They are not simply passive victims of state threats to property rights, rather in many cases they also contributed to the emergence of these practices. This resulting contribution - often inadvertently made - was linked to some of the informal business practices undertaken by the SMEs that locked them in the long run in the informality trap. Back in the 1990s some of those informal practices were not the only choice available to companies, but were taken up by SMEs out of expediency. In the 2000s, when the state grew more powerful, the informal behaviour of these companies backfired as the corrupt state took advantage of the informality of some companies and exploited it to violate the property rights of virtually any business actor at will. Thus the advent of statist-patrimonial capitalism in the 2000s, marked by state threats to property rights, was made possible and in fact facilitated, among other factors, by the informal choices and practices of business actors in the previous decade.

The main contribution of this dissertation is two-fold. Empirically, it allows us to better understand how Russia works, and where its political economy stands compared to the other members of BRICs. It also suggests why Russian statist-patrimonial capitalism functions the way it does, and how it came to be this way. Another empirical contribution is the suggestion of a tool for quantifying and comparatively mapping the

trajectories of change in emerging economies, applicable beyond the BRICs to other emerging economies and time periods.

Conceptually, the dissertation refines the Varieties of Capitalism debate by a systematic incorporation and a detailed study of patrimonialism. The findings of the dissertation corroborate that patrimonialism is more significant than an incidental feature like corruption or a blemish on a particular type of capitalism. Instead, patrimonialism should be viewed as a competing logic of economic and social organisation, without which political economies beyond the OECD world cannot be adequately understood. By studying the reproduction of patrimonialism on the example of Russia the dissertation adds knowledge about reproduction of institutions more generally. By giving attention to bottom-up forces generating and sustaining patrimonialism, the findings of this dissertation also speak to a broader state-society debate in social sciences.

Introduction

The disintegration of the Soviet Union 25 years ago was a seminal moment in recent history. It marked the end of the Cold War and saw the largely peaceful dissolution of the former totalitarian empire that had spanned almost an entire continent and reigned over some 300 million people for seven decades. The dramatic changes Russia has undergone since then can be viewed as a major politico-economic experiment. The country first radically liberalised its former planned economy in the early 1990s under the first President Boris Yeltsin and conducted the largest single privatisation in history. This process made a few individuals immensely rich but left the greater part of the citizenry coping with the economic hardship of the shock transition. In this context many became disenchanted with the nascent democratic institutions that were introduced concurrent with the economic reforms. A decade later, under the leadership of its second President Vladimir Putin, Russia reverted to an increasingly authoritarian political regime with a state-influenced economy, which was governed not only by formal state intervention, but also driven by a myriad of informal practices. Understanding this immense political-economic change, some of its processes, origins and implications by focusing in particular on the role of business actors and their informal practices is the primary intent of this dissertation.

After 1991 Russia's development upset the expectations of both scholars and practitioners: it fitted neither the standard predictions of the modernisation theory nor the transformation paradigm, made popular in social sciences by Fukuyama, who famously proclaimed the 'end of history' (1992); nor did Russia fulfil the hopes of liberals who expected it to join the club of Western capitalist democracies, like the formerly-communist states of the Visegrad group (Poland, the Czech Republic, Slovakia and Hungary). The fact that things developed differently in Russia requires us to rethink our understanding of societal change. It should also make us question the validity of some of our conceptual tools as they may be not up to the task of capturing what happened in Russia after the collapse of the Soviet Union (cf. Bodin et al. 2013). Western models and paradigms are often used as a yardstick, against which Russia's democracy is described as 'derailed', its economy as 'crony' and the system as a whole a 'kleptocracy' (e.g., Fish 2005, Dawisha 2014).

Thus Russia's political economy is often seen as a failure, a deviation or a blemish on the 'pure' Western-style variety of capitalism.

This dissertation circumvents a normative judgement on the quality of Russia's system of governance or the economy and aims to examine Russia's political economy as a distinct though not exceptional mode of socio-economic organisation. To this end, I systematically integrate the Russian case into the comparative capitalism debate by re-considering it from the perspective of the Varieties of Capitalism framework. Emerging economies, and also Eastern European economies including Russia, have recently become part of the comparative capitalism agenda (King 2007, Myant and Drahokoupil 2011, Nölke and Vliegenthart 2009, Schneider 2009; McNally 2012, Nölke et al. 2015). However, in this debate Russia is mostly examined as a case *sui generis*, variously labelled as 'Kremlin capitalism' (Blasi et al. 1997), 'political capitalism' (Robinson 2013a), 'bureaucratic capitalism' (Petrov 2011), 'state-managed, network capitalism' (Puffer and McCarthy 2007), 'oligarchic capitalism' (Myant and Drahokoupil 2011) or even 'chaotic capitalism' (Lane 2005). This approach tends to be static (it does not capture the enormous changes that have been under way in Russia) and is ill-suited for comparisons. To close this gap, I propose a typology as an analytical tool that allows to trace change and to draw comparison with other countries and that at the same time accounts for the informal (I call them 'patrimonial') elements of a political economy. Patrimonialism is central for understanding Russia and other emerging economies, however it is not a complete story.

Within this theoretical framework, the dissertation attempts to describe the Russian economy in a comparative BRICs (Brazil, Russia, India and China) context, to understand its working and shed new light on its origins. This approach may help us better understand the Russian case proper and give us a hunch about the development of other emerging political economies such as the BRICs, and as a result help refine our analytical tools and conceptual frameworks. In this context, the overarching question guiding this dissertation reads: *How can we grasp the changing political economies of emerging countries using the example of Russia, and what are the drivers of continuity and change?* To answer this question, I will focus on the central feature of Russian capitalism dubbed 'patrimonialism', examining the relationship between

the state and (primarily small) companies, in particular its informal aspects.

This dissertation is centred on questions about the nature of Russian capitalism and, more broadly, the sources of political-economic change. It aims at better understanding the Russian case and refining social science tools to analyse political economies beyond the industrialised countries. The dissertation is article-based and specifically aims at:

- describing the distinct variety of Russian capitalism (chapter 1);
- comparing the evolution of Russia's variety of capitalism to that of other BRIC countries (chapter 2);
- understanding how Russia's capitalist variety functions and is sustained (chapter 3);
- exploring why Russia's capitalism developed this particular way (chapter 4).

In short, the dissertation focuses on the description, comparison, functioning and origins of Russia's type of capitalism. Thereby it addresses four fundamental questions of social science: 'what?'; 'and compared to others?'; 'how?'; and 'why?'. The first three questions deal with the nature of Russian capitalism, whereas the latter question is broader and points to the sources of social change and continuity.

The answers provided in this dissertation aim at as much precision as possible; at the same time we need to acknowledge that they are bound to include interpretation, estimation and a degree of speculation as a result of the complexity and interdependent character of the social phenomenon at hand – the changing political economy. Overall the dissertation is explorative: it neither tests theoretically derived hypotheses nor reduces the analysis to a few discrete variables, but rather seeks to understand the phenomenon from a holistic perspective by trying to tackle its complexity and scrutinise the mechanisms of its working. The dissertation also contains deductive elements, drawing on a typology of capitalist variety.

Figure 1: Overview of the article-based dissertation 'Change, Continuity and Power in Russia's Political Economy in Comparative BRICs perspective'



In this introduction, I will discuss the major knowledge gaps that motivated the central questions and arguments of the dissertation, introduce the main theoretical concepts that underlie the study and explore why patrimonialism matters - beyond the Russian case - and how it enriches our understanding of the working of political economies in general. I will then present the main empirical findings on the development, functioning and origins of Russia's statist-patrimonial capitalism. A brief discussion of the major empirical and theoretical contributions follows. Implications of the findings, as well as policy recommendations will be dealt with in the concluding chapter of the dissertation.

Knowledge gaps and the main arguments of the dissertation

Russia's politico-economic system has been the subject of numerous scholarly studies. However, at least four major knowledge gaps or incomplete interpretations exist, which drive this dissertation and which I address in each of the chapters.

Firstly, the trajectory of Russia's political economy is most often described as one of initial liberalisation, followed subsequently by re-tatisation a decade later (cf. Aslund 2007, Goldman 2010, Hanson 2007, Rutland 2008, Yakovlev 2006). I argue that this view is incomplete and that two dimensions are inadequate to capture the development of Russia's political economy. Moreover, I argue that attention should be given to the continuity of what I call 'patrimonialism' in Russian capitalism. Patrimonialism is a distinct structural mode of political-economic organisation based on clientelism, patronage and informal bureaucratic control of property. I make a case for supplementing the statist and liberal dimensions of Russia's trajectory with the systematic incorporation of patrimonialism. Even those studies that recognise that Russia combines both legal-rational and patrimonial features (e.g., Sakwa 2011, Whitmore 2010, Solomon 2008, Robinson 2011, Robinson 2012) do not spell out the relationship between the two spheres. This dissertation aims at illuminating more precisely the ways in which patrimonialism interacts with other dimensions of Russia's development and suggests both a qualitative and a quantitative assessment of this interaction. Patrimonialism which is one of the central concepts of the study is discussed in more detail in the next section.

Secondly, to the best of my knowledge no quantitative assessment of the Russian variety of capitalism and its change over time has been carried out thus far. To address this gap, I propose a methodology to measure change in Russia and in other political economies based on existing comparative statistical data. With the help of the suggested tool the dissertation provides a quantification of Russia's development compared to other BRICs countries and empirically assesses the impact of patrimonialism on politico-economic development.

Thirdly, conventional wisdom sees the Russian state as the primary actor in Russia's capitalism (e.g., Easter 2008, Gans-Morse 2012, Petrov

2011a, Rochlitz 2013, Nazrullaeva et al. 2013). Challenging and complementing this interpretation, the dissertation makes the case that business, and small and medium sized enterprises (SMEs) in particular, are also an important part of the system. Rather than simply being victims of state predation or fighters against it, these companies actually often inadvertently facilitate state predation. The dissertation explores how the activity of SMEs becomes a bottom-up force that provides energy, reinforcement and sustenance for the Russian politico-economic form.

A fourth knowledge gap regards the bottom-up dynamic of the emergence of Russia's politico-economic form. Existing accounts of the origins of Russia's capitalism primarily focus on the defining role of the state and a corrupt bureaucracy viewed together with the Soviet legacies of command economy and authoritarianism (e.g., Yakovlev 2006, Hellman et al 2000, Gelman 2012, Yakovlev et al. 2014). Business is viewed as merely adapting to imperfect institutions. By contrast, this dissertation shows that the actions of part of the business community itself contributed to the emergence of the system. I argue that by embarking on informal strategies, business inadvertently facilitated the advent of a predatory state offensive against property rights that defines Russian statist-patrimonial capitalism, as we know it today.

Methods and data

To develop these arguments empirically, I use a combination of methods and a variety of data. Such combination is necessary for understanding complex social phenomena such as changing varieties of capitalism and is one of the contributions of this dissertation. The dissertation combines a historical study with statistical assessment; a case study with a comparative study; a macro analysis of major institutions of a political economy with a micro treatment of behaviour of business actors; qualitative and quantitative data; descriptive and explanatory approaches, as well as desk research and data obtained from personal fieldwork. The timeframe of the analysis commences with the collapse of communism at the end of 1991 and ends in 2014 - the year of the latest available data. Most chapters include historical digressions to both Tsarist times and the

communist era as their legacies continue to shape Russia's present-day political economy and patrimonialism in particular.

This dissertation draws upon a combination of qualitative and quantitative data, obtained both from existing sources and gathered by myself. Drawing on different types of data allows triangulation: insights obtained with the help of quantitative data complement insights from qualitative assessment and compensate for each other's weaknesses. For example, statistical assessment allows a quantification and comparison of developments examined in this dissertation (limits of precision notwithstanding), while qualitative data illuminate processes and mechanisms behind general statistical trends.

Quantitative cross-national data used in this dissertation and obtained from existing sources comprise comparative data on the BRICs from the World Bank (Worldwide Governance Indicators), the Organisation for Economic Co-operation and Development (OECD) (indices of Product Market Regulation and Employment Protection Legislation) and Heritage Foundation (Index of Economic Freedom). Drawing on Becker (2013), the data are combined in an index designed to measure the relative share of liberalism, statism and patrimonialism in political economies. However, it should be noted that there are limits to how far statistical data are able to reflect the relevant social reality and therefore measurement precision is compromised to some degree. This is particularly so with regards to the BRICs data where data availability and reliability are found to be an issue.

I further combined various cross-sectoral quantitative data myself, drawing on a number of databases from the Russian statistical service Rosstat to compile a comprehensive overview of the development of the Russian SMEs sector since the 1990s. The difficulty found with using Rosstat data is that they are sometimes calculated in a non-comprehensible way or the data are based on different methodologies over different years, making over-time comparisons difficult. My approach to such data problems was to make them explicit and integrate their discussion into my interpretation. Whenever possible, I double-checked, re-calculated or included alternative measures that were comparable over time. For example, I contrast official Rosstat figures for the share of SMEs employment with my own calculations. This yielded

lower figures based on Rosstat data on the number of workers and on total employment.

Qualitative data obtained from in-depth interviews build the empirical centrepiece and offer a methodological contribution of this dissertation. I conducted the interviews during fieldwork in Russia in the spring of 2014. The total of 34 respondents included entrepreneurs, business association executives, corporate lawyers, academics and journalists. Respondents who were not entrepreneurs were reached through internet based search and contacted via email. Recruiting entrepreneurs was more problematic. The most effective way was to rely on the personal recommendations of my acquaintances and other respondents. This 'multiple snowballing' had two advantages. Firstly it allowed me to reach companies whom I would not have been able to identify otherwise as many of them did not have websites. Secondly, contact made through personal recommendations helped to create trust, which was probably the reason why most entrepreneurs were surprisingly open when talking about sensitive issues such as interactions with the authorities. Indeed many of my respondents shared details of informal and in some cases outright corrupt transactions (cf. Vinogradova 2006, Ledeneva 2006).

In addition to the interviews, during my fieldwork I attended four pertinent conferences in Moscow: a presentation of the annual report by the federal Business Ombudsman Boris Titov; a roundtable at the Civic Chamber on violations of SME rights with representatives of the local administration and business; a conference at the Higher School of Economics on the challenges of state-business relations with invited entrepreneurs and lawyers discussing cases of property rights violations by the authorities; and a roundtable with business association executives and experts on new risk assessment for government bodies authorised to control business. I complemented insights obtained from fieldwork by minor archival work, having researched policy documents, speeches by policy makers as well as texts of laws and regulations pertaining to SMEs.

Finally, the dissertation draws on qualitative data obtained from existing sources. I used data from in-depth interviews with entrepreneurs conducted in the late 1990s by Igor Kliamkin and Lev Timofeev, which was published in full transcript in the appendix to their book (2000).

Having access to the interviewees' original statements was hugely advantageous in my examination of the origins of Russia's variety of capitalism. In addition, I used data from secondary literature, newspaper articles and historical analyses by other scholars.

Theoretical angles: bringing patrimonialism into the Varieties of Capitalism debate

Conceptually, the dissertation moves from a macro perspective on a political economy as a whole (chapters 1 and 2) to a micro study of its functioning on the level of SMEs (chapter 3) and then back to the macro level, focusing on broader implications of companies' activity for the origins of the system (chapter 4). This three-step analysis requires a conceptual 'gear shift'. Theoretical tools of the 'Varieties of Capitalism' (VoC) scholarship are used in the first half of the dissertation to discern the specificity of Russia's politico-economic form and describe how it developed over time in a comparative BRICs perspective, ultimately becoming statist-patrimonial capitalism. The remaining half of the dissertation looks at statist-patrimonial capitalism on its own terms, separate from the VoC debate. It focuses on the Russian experience and provides a detailed analysis of Russian patrimonialism by examining the behaviour of SMEs and their interaction with local state officials. The mechanism of the 'informality trap' is central to this account. Chapter 3 investigates the informal activity of SMEs as a feature of Russian capitalism and as a part of its operation and maintenance. Chapter 4 explores causal implications that the informality trap may have had on the rise of the system.

Varieties of Capitalism

The Varieties of Capitalism approach gained prominence in the comparative capitalism scholarship from the early 2000s. In its initial formulation, based on the example of Western industrialised countries, VoC suggested that there were two ideal types of organisation of the economy that were internally coherent and internationally competitive - a liberal type and a coordinated type (Hall and Soskice 2001). Although it drew on previous studies such as Regulation Theory (Boyer 1986), the approach was novel in at least two respects. Firstly, it drew attention to

the fundamental differences between the main forms of socio-economic organisation in (parts of) the industrialised world. Secondly, it implied that there were different roads to international competitiveness and that global competition did not necessarily push all political economies in a liberal direction. In sum, somewhat countering the prevailing *zeitgeist*, liberal convergence was not viewed as given.

Many scholars worked with this framework and developed it further, suggesting additional types with the aim of permitting the analyses of a greater number of economies that did not fit the initially proposed dichotomous typology. For example, Nölke and Vliegthart (2009) introduce the type of 'dependent market economies' to capture the importance of foreign capital in the socioeconomic configurations of post-socialist Central European countries; Schneider (2009) proposes the type of 'hierarchical market economies' to analyse countries of Latin America; Nölke and collaborators (2015) unite China, India and Brazil under the label 'state-permeated market economies'; for the case of China, McNally even introduces a separate type dubbed 'Sino-capitalism' (McNally 2012); Bohle and Greskovits (2007) as well as Myant and Drahekoupil (2011) propose several types to classify political economies of Eastern Europe and the former Soviet Union.

Ideal types of capitalism can be very useful heuristic tools that help to analyse and compare political economies. However, a typology needs to strike a balance between parsimony and an attempt to capture relevant aspects of empirical reality (indeed this debate has preoccupied the comparative capitalism scholarship, see, for example, Allen 2004). If a new type is developed for every 'unique' case, the typology loses its usefulness. Types become labels and systematic comparisons over time and among cases become impossible.

To overcome this problem, in this dissertation I opt for the 'Open Varieties of Capitalism' approach advocated by Uwe Becker (2007; 2009). It broadens the scope of the analysis and conceives of political economies as open systems, that is, systems open to change. Becker suggests a limited number of ideal types as theoretical models that capture relevant aspects of empirical reality and represent alternative modes of socio-economic organisation. Ideal types do not circumscribe normative ideals (and are not conceived as the best performing

configurations) but rather represent a tool to ease comparative analysis. Becker distinguishes ideal types from real-life political economies, which only approximate types and can exhibit features of several of them. In this way Open Varieties of Capitalism approach allows to systematically integrate emerging economies and in particular Russia into the comparative capitalism debate rather than treating them as cases *sui generis*, and is thus better suitable for capturing change.

The view of political economies as dynamic mixes containing elements of several ideal types is the main difference between the open approach to the VoC mainstream, which traditionally classifies countries as representatives of one or another type and has difficulties grasping and explaining social change. Establishing the proportion of ideal types in the empirical mix, and the change of the mix over time is a way to tackle the long-standing problem of measuring change in political economies. Among the sources of change, covered in the chapters of the dissertation, the open VoC approach names structural forces, the agency of relatively autonomous actors, in particular individual companies, the unintended consequences of action as well as power relations (Becker 2007, Becker 2014). The notion of power, though not explicitly a central concept in the chapters, intersperses the present analysis of the Russian politico-economic form and state-business relations in particular. Power refers both to the capacity of the state to limit the scope of choice of business actors and, in some cases, to subjugate and dominate them, as instances of state predation and informal bureaucratic control over property illustrate; but it also refers to the – arguably underestimated – power of individual business actors to subvert the system through informal practices and in this way to get things done in a hostile business environment and, as an unintended consequence, ultimately to shape and consolidate the variety of capitalism in which they operate.

In this dissertation I use three of the ideal types of capitalism proposed in the open Varieties of Capitalism framework. Two of them are widely used in comparative capitalism scholarship. With slight variations in titling, they are referred to as 'liberal' and 'statist' and can be defined as follows:

- In the *liberal type of capitalism* the market governs the economy, state interventionism is limited, industrial relations are

individualised and workers as well as companies are highly commodified. The USA and other Anglo-Saxon political economies approximate the liberal type.

- In the *statist type of capitalism* the market is restricted by political regulation, which intends to determine the course of the economy and facilitate economic development. State-owned companies may be prominent and industrial relations are organised hierarchically. France, as well as many emerging political economies, features a considerable degree of statism.

The third ideal type of capitalism, *patrimonialism*, is not part of the traditional account but appears central for making sense of the developments of emerging economies such as Russia and the other BRIC countries and needs to be incorporated into the analysis.

Patrimonialism

Patrimonialism as a type of capitalism is based not on the market mechanism (as in the liberal type) or state regulation (as in the statist type), but rather on informal clientelist relations between the state and business actors, as well as between employers and employees, and is based on patronage of the society. Patrimonialism is indicated by state agents who deploy the power of their position for personal gain, and in particular for informal control over private property,

The notion of patrimonialism goes back to Max Weber (1978). He conceived of it as a state-society nexus consisting of personal hierarchical relationships based on loyalty and mutual services between the rulers and the ruled, as he observed in the examples of Imperial China, the late Roman Empire and Tsarist Russia. The patrimonial set-up derives from a household administration by a chief (*pater*) who grants his clients tax-farming opportunities in form of prebends, fiefs and the like. According to Weber, patrimonial domination 'regards all governing powers and the corresponding economic rights as privately appropriated economic advantages' (Weber 1978: 236). Thus the main feature of patrimonialism is the private appropriation of a governmental sphere by those who hold political power. No strict distinction between public and private exists. Weber described patrimonial state administration as based on the interpersonal rather than the impersonal relations of authority and thus

distinguished it from the universalist rational bureaucratic state (ibid.: 217-241).

The concept of patrimonial rule has gained prominence in the social sciences since the 1960s in the study of Latin America, Asia and more recently Africa (Bach 2011). Eisenstadt (1973) coined the concept of neo-patrimonialism, resolving the ambivalence related to the application of a concept associated with traditional rule to modern states. Neo-patrimonialism is defined by the co-existence of legal-rational and patrimonial elements within a political system. At the same time, (neo-)patrimonialism attained a negative connotation as it increasingly came to be associated with predatory and corrupt forms of politics and, more broadly, political economy (e.g., Sakwa 2011, Robinson 2013).

The central proposition of the conceptual framework of this dissertation is that patrimonialism should to be seen as an alternative mode of politico-economic organisation instead of an aberration or a blemish on an otherwise well-functioning economy. I argue that it is not simply an incidental feature of certain social arrangements, but rather a distinct structural principle of economic and social organisation that affects the relationship between the state, business and labour.

I attach no specific normative connotation to the notion of patrimonialism as its aspects can be both facilitating and detrimental. Consider the example of informal practices, widespread in interactions between citizens and state officials in emerging economies. Such practices may compensate for the deficiencies of the formal system, helping to cut red tape or get things done, and may thereby foster reciprocity, trust and even social cohesion. The Soviet practice of *blat* - the use of personal connections to obtain goods in short supply - and the similar Chinese practice of *guanxi* are cases in point (Ledeneva 2008). However, informal practices can also be subversive of the formal system as they may undermine formal institutions and the common good, promote particularism at the expense of universalism and entail exploitation of state resources for personal gain.

The main advantage of incorporating the patrimonial type of capitalism into the analysis, along with the better known liberal and statist types, is that it helps to better capture the empirical reality since its features are

widespread in the politico-economic organisation of most emerging economies, and in fact it is found in many industrialised countries as well. These cases cannot be adequately understood without systematic attention to this informal, particularistic dimension of their politico-economic organisation. At the same time, emerging economies cannot be simply reduced to patrimonialism, even though it is a prominent feature, and we need to grant attention to the liberal and statist dimensions of their political economies, too.

In sum, the conceptual gear shift that the dissertation makes allows us to combine a macro theoretical framework and holistic analysis (Varieties of Capitalism) with empirical work and the study of concrete mechanisms (patrimonialism and 'informality trap'). This adds value to both the theoretical framework and the empirical account. The theoretical framework helps to systematise Russia's development, to examine how its different dimensions interact and to compare it with the economic development of the other BRIC countries. Conversely, the Russian case is a concrete illustration of how a pattern of interaction that is central to the organisation of the economy does not fit either of the patterns of the classic VoC approach. Findings from the Russian case help to refine the conceptual framework by incorporating patrimonialism as a distinct type of socio-economic organisation and permit a better understanding of its nature, functioning, sustenance and origins.

Moreover, the empirical focus on SMEs incorporates an important segment of the economy - in fact the large majority of companies in any economy - into the theoretical framework. The traditional VoC approach focuses only on one segment of the business world - big industrial companies that define the countries' comparative advantage - and does not give due attention to SMEs whose activity, in particular in the services sector, is typically driven by logic other than international competition (cf. Becker 2007: 276). By contrast, this dissertation suggests that the activity of SMEs may shape the national variety of capitalism to a considerable degree and we need to take mechanisms such as the 'informality trap' into account if we are to better understand how varieties of capitalism emerge and reproduce themselves.

Overview of the main findings

The evolution of Russian capitalism in comparative perspective

Chapter 1, entitled 'Continuity and Change in Russian Capitalism', is a historical study of the evolution of Russian state-business relations and capital-labour relations since the collapse of the Soviet Union along three dimensions. The political dimension comprises state capacity and the composition of the dominant political elites; the legal dimension deals with the rule of law and the security of property rights; the economic dimension includes the economic policy of the state towards business. Viewed against the backdrop of the statist, liberal and patrimonial ideal types of capitalism, the chapter finds that the main direction of change in the Russian political economy is expressed in the shift in the proportion of the liberal and statist elements. While between 1992 and 2002 the Russian capitalism can be characterised as largely liberal, after 2003 the trend towards increased statism became clearly pronounced. Etatisation of the Russian capitalism is expressed in the partial increase of the state capacity, in the shift from the liberal to conservative political elites and in the partial nationalisation of the strategic economic assets, coupled with an overall increase in the state's involvement in the economy and labour relations.

The major continuity of the Russian capitalist development was found in the persistence of patrimonialism, expressed in the pervasive weakness of the rule of law; in the endurance of corruption, partial fusion of the state and business and in the spread of the informal state-business and capital-labour relations, which were at odds with the formal regulations governing these relations. Another notable feature of Russia's patrimonialism is found in the informal bureaucratic control of property (dubbed 'power-ownership') and the extraction of administrative rents from it, examined in the following chapters of the dissertation. The chapter leaves open the questions of the scope of the Russian patrimonialism, eventual differences between the 1990s and the 2000s and mechanisms of its working as it is taken up in the later chapters of the dissertation.

Chapter 2, entitled 'Russia's political economy re-conceptualised: a changing hybrid of liberalism, statism and patrimonialism', co-authored

with Uwe Becker, is a study of the evolution of Russia's capitalism in a comparative BRICs context. It is based on the analysis of both historical and statistical data and takes up some of the questions left open in chapter one. In particular, it gives an approximation of the scope of Russian patrimonialism and how it developed between the 1990s and the 2000s.

The chapter proposes a conceptual framework for assessing the impact of patrimonialism on the country's trajectory of change by systematically adding patrimonialism as a third dimension to the better-known liberalism and statism. The chapter conceptualises Russia's trajectory as changing with respect to ideal-typical liberalism, statism and patrimonialism. The main finding of the first, historical part of the chapter is that Russian patrimonialism hindered the rise of the economically facilitating state capacity and undermined both liberalisation in the 1990s and re-etatisation in the 2000s. The second part of the chapter provides a quantitative assessment of these developments based on statistical data and adds a comparative BRICs perspective that clarifies the peculiarity of Russia's development. The data confirm the de-liberalisation of Russia and show an increase of patrimonialism in the 2000s compared to the 1990s. Another finding is that Russia was the only BRIC country that de-liberalised and increased its level of patrimonialism in the period under consideration.

The functioning and origins of Russian capitalism

The remaining two chapters of the dissertation focus on the Russian case and its statist-patrimonial variety of capitalism, aiming to illuminate its working and understand its origins by focusing on the activity of small firms. Chapter 3, entitled 'Trapped in informality: The big role of small firms in Russia's statist-patrimonial capitalism', is a study of the functioning of Russia's capitalism and the mechanisms of its stability. It takes up a question left open in chapter one, namely the mechanisms behind Russian patrimonialism and the factors and circumstances that give bureaucrats the power to extract administrative rent from property under their indirect control.

While predominant accounts focus on the lack of institutional constraints on state predation, the chapter explains the resilience and maintenance of Russia's statist-patrimonial capitalism by exploring the often-overlooked

contribution of small- and medium-sized companies. Drawing on statistical data, the chapter finds a steady rise of SMEs in the 2000s despite increasing state predation, concluding that SMEs are not simply subjugated by the state. In-depth interviews with Russian entrepreneurs reveal that business contributes to the maintenance and functioning of the statist-patrimonial system through the mechanism of the 'informality trap': companies that choose the informal strategy find it difficult to return to the legal sphere and become trapped in the informal economy.

The chapter finds that the drivers of informality comprise institutional constraints such as overregulation and bureaucratic extortion, which represent a power resource on the side of the state and compel companies to opt for informal behaviour. However, informality is also driven by some company-specific factors that offer a degree of choice and thus agency. Firstly, depending on the characteristics of a company (such as size and sector), a small enterprise may face incentives to choose informal behaviour. Secondly, socio-cultural factors dubbed 'normality of informality' matter in this regard too: viewing the formal costs of doing business and informal expenditures such as bribes as comparable expenses, for subjective reasons, some SMEs may prefer cutting corners to legal compliance. Though this power to subvert the system may sometimes help companies to get things done or protect their interests, it often has an unintended adverse long-term effect on the security of property rights as the companies may get locked into informality. In sum, the mechanism of the 'informality trap' highlights the agency of SMEs in Russia's political economy and their contribution to its functioning.

Finally, chapter 4 provides a historical analysis of the origins of Russia's variety of capitalism, entitled 'Digging their own graves: how small companies contributed to the emergence of Russia's statist-patrimonial capitalism'. The chapter traces in historical perspective how for a variety of reasons Russian companies embarked on informal practices back in the 1990s and, by falling into the informality trap in the following decade, co-created the foundation of insecure property rights and informal particularistic state-business relations that define patrimonial capitalism today.

The main finding of this chapter is that statist-patrimonial capitalism is not only the result of a top-down activity of the state sovereign, its

corrupt agents or cronies in big business, as is commonly perceived, but that it is also a system that rests on the bottom-up activity of the bulk of economic actors - the SMEs. They are not simply passive victims of state threats to property rights, rather in many cases they also contributed to the emergence of these practices. This resulting contribution - often inadvertently made - was linked to some of the informal business practices undertaken by the SMEs that locked them in the long run in the informality trap. Back in the 1990s some of those informal practices were not the only choice available to companies, but were taken up by SMEs out of expediency. In the 2000s, when the state grew more powerful, the informal behaviour of these companies backfired as the corrupt state took advantage of the informality of some companies and exploited it to violate the property rights of virtually any business actor at will. Thus the advent of statist-patrimonial capitalism in the 2000s, marked by state threats to property rights, was made possible and in fact facilitated, among other factors, by the informal choices and practices of business actors in the previous decade.

As the dissertation is article-based, its chapters are intended for publication as stand-alone pieces. The first chapter is published as a chapter in an edited volume by Uwe Becker entitled 'The BRICs and Emerging Economies in Comparative Perspective' (Vasileva 2014). The second chapter is co-authored with Uwe Becker. I wrote the first, historical part of the chapter analysing Russia's trajectory, while Uwe Becker contributed the second comparative BRICs part. Here I contributed to data interpretation and drew the figures. The introduction and the theoretical background were written jointly. After Uwe's passing I heavily revised the whole manuscript and published it in *Journal of Eurasian Studies* (Becker and Vasileva 2017). The third chapter is published in *New Political Economy* (Vasileva 2017). The fourth chapter is being prepared for submission to *Post-Soviet Affairs*.

In conclusion, this dissertation investigates facets of Russia's political economy dubbed 'statist-patrimonial capitalism': its evolution from the early 1990s in the wake of the collapse of the Soviet Union up to the present; the quantification and specificity of this development compared to other BRICs countries; the mechanisms of sustenance and reproduction

of Russia's particular variety of capitalism; and finally, the origins of the system and in particular the role that business played in the creation of statist-patrimonial capitalism.

The main contribution of this dissertation is two-fold. Empirically, it allows us to better understand how Russia works, and where its political economy stands compared to the other members of BRICs. It also suggests why Russian statist-patrimonial capitalism functions the way it does, and how it came to be this way. Another empirical contribution is the suggestion of a tool for quantifying and comparatively mapping the trajectories of change in emerging economies, applicable beyond the BRICs to other emerging economies and time periods.

Conceptually, the dissertation refines the Varieties of Capitalism debate by a systematic incorporation and a detailed study of patrimonialism. The findings of the dissertation corroborate that patrimonialism is more significant than an incidental feature like corruption or a blemish on a particular type of capitalism. Instead, patrimonialism should be viewed as a competing logic of economic and social organisation, without which political economies beyond the OECD world cannot be adequately understood. By studying the reproduction of patrimonialism on the example of Russia the dissertation adds knowledge about reproduction of institutions more generally. By giving attention to bottom-up forces generating and sustaining patrimonialism, the findings of this dissertation also speak to a broader state-society debate in the literature, to be addressed in the concluding chapter.

Chapter 1: Continuity and Change in Russian Capitalism¹

Abstract

The paper analyses change and continuity in Russian capitalism after the dissolution of the Soviet Union against the backdrop of the statist, liberal and patrimonial ideal types of capitalism. It focuses on the development of the state-economy relations and the capital-labour relations. One finding is that after a decade of liberalisation in the 1990s and early 2000s Russian capitalism moved towards increased statism. This trend was expressed in the increase of coercive state capacity, in the shift from liberal to conservative political elites and in the partial nationalisation of strategic economic assets, coupled with an overall increase of the state's involvement in the economy and the labour relations. Despite some strengthening the state remained weak in several crucial aspects of state capacity. The second finding regards the continuity of patrimonialism, which is identified in the pervasive weakness of the rule of law, in the endurance of corruption, in the partial fusion of the state and business and in the spread of informal state-business and capital-labour relations. A notable feature of Russia's patrimonialism is found in the informal bureaucratic control of property (dubbed 'power-ownership') and the extraction of administrative rents from it. The paper draws mainly on qualitative but also some quantitative data.

¹ The chapter is published as a chapter in an edited volume (Vasileva 2014).

Introduction

The development of the Russian political economy presents observers with an intriguing combination: on the one hand, in the wake of the collapse of the Soviet Union Russia has introduced basic institutions of a market economy. At the same time, the Russian political economy has maintained many features of the old system, in particular clientelism, patrimonialism and a pronounced role of the government and the bureaucracy. The Russian politico-economic system is often referred to as 'Kremlin capitalism' (Blasi et al. 1997), 'patrimonial capitalism' (King 2007: 314), 'state capitalism' (Zudin 2006) or 'bureaucratic capitalism' (Petrov 2011: 61).

The objective of this chapter is to analyse change and continuity in the Russian political economy since 1992, focusing on the state-economy relations but leaving some space for the capital-labour relations. I grant special attention to the elements of continuity in the process of change – an aspect that has not yet received the consideration that it deserves. The main finding is that, after the initial liberalisation in the 1990s and the early 2000s, change in Russian capitalism manifests itself in etatisation, expressed foremost in the increased role of the state in the political economy since approximately 2003. Continuity manifests itself in the persistence of patrimonialism, expressed in the enduring corruption, in the partial fusion of the state and the economy and in the spread of the informal state-business and capital-labour relations. In the last part of the chapter I take a look at the endurance of patrimonialism and its influence on the changes in the Russian political economy through the lens of the mechanism of 'power-ownership'. This mechanism describes how Russian bureaucrats use their positions in the state apparatus in order to control the cash flow from property (e.g. local business) as if it belonged to them.

I follow the critical mainstream of both Russian and international scholars of Russian capitalism (for example, Aslund, Gudkov and Zaslavsky, Kapelushnikov, Kryshtanovskaya, Pappe and Galukhina, Rutland, and Shevtsova, to name a few) but also develop my own distinct argument. Unlike the mainstream, I do not divide the timeframe into the 'Yeltsin period' and 'Putin period' but rather distinguish the periods of 'liberalisation' and 'etatisation' which only partly coincide with the

respective presidencies; neither do I treat president Medvedev as a liberaliser but argue that he was an integral part of Putin's team and continued Putin's statist policies. Furthermore, I argue that the often cited interpretation, according to which Russian capitalism underwent a change from 'state capture' in the 1990s to 'business capture' in the 2000s (Hellman et al. 2000, Fries et al. 2003, Yakovlev 2006), falls short of providing a comprehensive account of the processes that were under way in Russian capitalism in the past two decades. Instead, I emphasise that behind the superficial change from 'state capture' to 'business capture' lies the continuity of a partial fusion of the state and the economy.

My argument draws on the theory of comparative capitalism, where the state of the art is largely defined by the mainstream and the critical accounts of the Varieties of Capitalism approach (Hall and Soskice 2001, Streeck and Thelen 2005, Crouch 2005a, Becker 2009). This framework is best suited for the analysis of the macro level and provides useful analytical tools for capturing change in political economies. Adopting the typology of capitalist varieties by Becker, I deploy three ideal types of capitalism - the liberal, the statist and the patrimonial type - and emphasise the strict distinction between the ideal types and empirical cases. In this context my case - Russian capitalism - is understood as a certain mixture of elements of the ideal types of capitalism at any given point in time. The identification of the shift in the proportion of the statist, liberal and patrimonial elements in Russian capitalism in the last two decades is the central endeavour of my account.

The method of analysis is explorative, meaning that it explores an open question - how did the Russian political economy evolve over time? - rather than testing theoretically derived hypotheses. Focusing on one case, the analysis adopts a holistic perspective that seeks to understand the phenomenon as a whole by tackling its complexity, rather than reducing the analysis to a few discrete variables (Vromen 2010: 257). I start the analysis of the Russian capitalist development in 1992, when the first round of privatisation was initiated, and track it to the present day or at least as late as data are available. The analysis draws both on quantitative and qualitative data - their combination helps 'unpack' the complex Russian political economy, in which formal rules are often at odds with the actual practice.

Compared to other BRIC countries, Russia is somewhat an outlier: its heavy dependence on hydrocarbons and minerals, the underdeveloped manufacturing as well as some signs of economic decline are not typical of most emerging economies. In this context a brief note on Russia's general economic situation seems relevant. The continuous oil boom helped to sustain a spectacular GDP growth between 1999 and 2008 and secured windfall export revenues. The downside of the reliance on petrodollars has been the lack of diversification of the economy and the neglect of manufacturing. Apart from some promising companies in the defence, aircraft, automobile and metallurgy sectors, many industries remain uncompetitive and desperately need investment. The perils of oil dependency have become particularly clear after the 2008 financial crisis: the Russian economy shrank by almost 8% in 2009, plunging into a much deeper recession and recovering slower than other emerging economies. The natural resource bonanza has also served as a source of corruption and cronyism.

These imbalances, exacerbated by the heavy and often predatory interference of the state in the economy, have produced an unsound business climate. It leads to a short planning horizon, underinvestment and capital flight and may have a negative impact on Russia's economic development. Some signs of the economic decline are already visible and include an increased occurrence of technical catastrophes and the deterioration of the notoriously old industrial equipment and infrastructure, including oil and gas pipelines on which Russia relies for its exports. Additionally, mismanagement and endemic corruption have lead to a degradation of public services such as policing, education and science. The shrinking and ageing population, coupled with the brain drain to western countries, contribute to a fairly grim economic prospect (The Economist 2012, Petrov 2011: 61).

In the following sections I will turn to the major changes in the Russian state-business relations, distinguishing the stages of liberalisation (1992-2002) and etatisation (since 2003). The next sections will address the continuities in the Russian state-business relations and then review the development of the capital-labour relations. A conclusion and several open questions close the chapter.

For the sake of systematisation I will analyse the state-business relations along three dimensions. The political dimension comprises state capacity (the state's capability to design and implement policies) and the composition of the dominant political elites; the legal dimension deals with the rule of law and the security of property rights; the economic dimension comprises the economic policy of the state towards business. It has to be noted that the choice of the year 2003 as a dividing line between the 'liberal' and the 'etatist' periods concerns primarily the change in the state policy towards business and thus should not be viewed as a sharp dividing line that denotes changes in every aspect of the state-business relations.

Change in the Russian State-Business Relations (1992-2002): Liberalisation

The Political Dimension

Along with the general collapse of statehood in the course of the break-up of the Soviet Union, the Russian state was weak in every aspect of state capacity. The 'strategic' state capacity can be characterised as feeble throughout the 1990s since many institutions were dysfunctional or had to be built from scratch, the state apparatus was notoriously under-financed and a new legal framework had to be developed. Yeltsin, who was elected president in 1991, faced a constant blockade from the communist-dominated Supreme Soviet (parliament) so that regular policy formulation was hardly possible. The new constitution, adopted in 1993, endowed the president with much power and helped to overcome the stalemate, allowing Yeltsin to rule by decree and to push through the liberal reforms against the conservative, pro-communist mindset of the deputies in the parliament. As a consequence, many key government decisions, including much of the privatisation programme, were introduced by presidential decrees (Zaznaev 2008: 33).

The 'administrative' state capacity was also low in the 1990s as the federal state was losing control over the increasingly autonomous regions. The 89 provincial executives were making use of president Yeltsin's initial proposal 'to take as much sovereignty as they could swallow' and increasingly resisted Moscow's policy, refusing to pay taxes to the federal government and issuing their own laws and even currencies.

The fact that the policy-making authority quickly devolved from the centre to the regions arguably brought Russia on the brink of disintegration and led in the case of the Republic of Chechnya to a civil war. Furthermore, the Russian state could not effectively collect taxes due to rampant corruption, the spread of barter and the sprawling shadow economy (Stoner-Weiss 2006: 109).

The 'coercive' state capacity decreased as the Russian government attempted to dispose of the compromised secret service KGB - the embodiment of Soviet coercive practices - in an effort to build a democracy. Having restructured the KGB and dismissed more than 300,000 of its employees, Yeltsin curbed the power of this formidable agency. At the same time, the state was unable to cope with the surging crime rate (not least because the police was underfinanced and corrupt) and was hardly capable of enforcing the rule of law and guaranteeing the protection of the nascent private property. (Kryshtanovskaya 2005: 125f.).

The Russian political elites in the 1990s were fragmented but generally comprised two groups of people. 'The liberals' were young progressive economists and reformers around president Yeltsin, many of whom were newcomers to politics. 'The conservatives' had their background in the communist party *nomenklatura*: these genuinely Soviet elite groups were not confronted by a rising counter-elite in the course of transition and thus managed to retain their positions (Gelman and Tarusina 2000: 320). 'The conservatives' included the so-called *siloviki*, or 'power-agents' – individuals and networks with a background in the armed forces, law enforcement bodies or intelligence agencies. Having been the backbone of the Soviet regime, the *siloviki* continued to constitute a shadow political elite in post-Soviet Russia, not acting on the political surface yet being very influential (Shevtsova 2007: 97).

The balance of power between the liberals and the conservatives changed in the course of Yeltsin's presidency. In the first half of the 1990s the young liberal elites headed by prime minister Gaidar were dominating (Higley et al. 1998: 22f.). By the second half of the 1990s Yeltsin's team began losing popularity due to the painful effects of the radical reforms such as the dramatically declined living standard and the loss of personal savings. The unpopular war in Chechnya and the 1998 financial crisis exacerbated the situation (Gudkov and Zaslavsky 2011: 67, 73).

Confronted with the waning support, Yeltsin was looking for a stable power base and a trustworthy successor, who would guarantee the security of Yeltsin's clan. Having ultimately chosen the former KGB officer Vladimir Putin, Yeltsin shifted the power base from the liberal elites to the *siloviki* (Aslund 2007: 189). Eager to compensate for the missed opportunities during the privatisation, the *siloviki* gradually expanded their influence in politics and the economy in the course of the 2000s, as will be shown later.

The Legal Dimension

Although Yeltsin's liberal government gave high political priority to the establishment of a stable legal environment, the rule of law remained weak throughout the 1990s, which was a manifestation of the low state capacity. The adoption of laws crucial for the establishment of a new politico-economic order was delayed by the confrontation between the parliament and president Yeltsin in the early 1990s and complicated by the resistance of the first Russian businessmen who understood to take advantage of the opaque legal situation. Negotiation of exemptions from rules between the bureaucrats and their crony businessmen often required more time than the drafting of the general rules of the game. Once adopted, laws could not always be enforced in a proper way since the largely dysfunctional state could hardly claim a monopoly over the use of force (Schröder 2008: 5ff., Pappe and Galukhina 2009: 76).

In the early 1990s more than 14,000 criminal groups with about 57,000 members took advantage of the legal vacuum, which led to a surge of crime and violence. Business relied on these gangs and various private 'violence-managing agencies', responsible for racketeering, contract murders, protection and contract enforcement functions. The physical survival of Russian business in the early 1990s often depended on such criminal groups providing protection services – the so-called 'roof'. Criminal 'roofing' virtually substituted the missing rule of law in the 1990s (Volkov 2002, Myant and Drahokoupil 2011: 152f.).

Ownership rights were opaque throughout the 1990s and could not be guaranteed by the state. Ownership did not imply automatic control over business, let alone the entitlement to profit. Moreover, stock owners were supposed to be 'useful' for the company, ensuring good relations with the

bureaucracy, negotiating exemptions from rules or the like. 'Idle' owners could be forced to sell their shares or would be edged out. By the same token, the rights of 'not useful' minority shareholders were virtually ignored (Pappe and Galukhina 2009: 69ff.).

The Economic Dimension

In the wake of the break-up of the Soviet Union Russia faced a deep economic recession, coupled with hyperinflation and the spread of the shadow economy. In this environment the team of young reformers around president Yeltsin endorsed a radical liberal economic policy (the so-called 'shock therapy') that aimed at a rapid transition to a market economy. By mid-1994 the first stage of the liberal reforms had been finished and a market economy had been formally introduced. The reforms included a macroeconomic stabilisation, the liberalisation of most domestic prices and foreign trade and a large-scale privatisation. The first informal round of the privatisation, the so-called 'spontaneous privatisation', occurred already in the last years of the Soviet Union under Gorbachev (1989-1991) and served as a source of early fortunes (Aslund 2007: 57ff.); Yeltsin's team continued with the voucher privatisation programme in 1992.

Every Russian citizen received a voucher that represented a share in the whole national economy and could trade it or use it at voucher auctions to bid for shares in former state enterprises. As a result, approximately half of the formerly state-owned firms had been transferred to private hands. However, the voucher privatisation did not lead, as expected, to the dispersion of ownership throughout the society, but to its concentration since vouchers accumulated in few hands of persons who had benefited from Gorbachev's reforms - foremost the former enterprise managers - and had enough start-up capital at their disposal and bought up the vouchers (McCarthy et al. 2000: 260f.).

Thereafter, between 1995 and 1997, the major trend of the state's policy towards business was further liberalisation and privatisation. For understanding the mode and the result of the reform we need to be aware of the new business actors who had a profound and lasting impact on the Russian political economy - the so-called oligarchs. These billionaires, whose resources typically combined banking, sections of the industry and

the mass media, had both economic power and a considerable political influence.²

The future oligarchs typically originated in the Soviet *nomenklatura* (notably the cadres of the youth communist organisation *Komsomol*) and started accumulating their wealth in the course of Gorbachev's *perestroika* of the late 1980s, profiting from insider information and the access to the financial resources of the communist party, coupled with the waning state control and partial trade liberalisation. Banking was a particularly lucrative source of early fortunes since it allowed to accumulate profits from currency speculation and export arbitrage.³ Furthermore, in the absence of a strong treasury system, banks owned by the oligarchs ensured enormous profits by becoming 'authorised' to manage state funds for a wide variety of government agencies (Aslund 2007: 57f., Hoffman 2007: 345).

In the absence of strong institutions and a firm legal environment, political ties allowed the oligarchs to shape the reform process and the distribution of wealth in the nascent Russian market economy. The channels of influence included participating in agencies such as the Government Committee for Questions of Economic Reform, buying votes of the members of parliament and, most importantly, directly approaching the decision makers and especially Yeltsin's inner circle (Schröder 1999: 972-978). Some of the oligarchs formed an integral part of this circle and exercised informal yet decisive influence on policy making, appearing to have 'captured' the state (Hellman et al. 2000). However, this was rather a relationship of mutual dependency - the

² Among the most influential oligarchs of the 1990s were Alekperov (*Lukoil*, oil), Potanin and Prokhorov (*Interros-Oneksim*, nonferrous metals), Khodorkovsky (*Yukos-Menatep-Rosprom*, banking/oil), Vinogradov (*Inkombank group*, banking), Berezovsky and Abramovich (*SBS-Agro-Sibneft-LogoVaz*, banking/oil/automobile), Fridman (*Alfa group*), Ivanishvili (*Bank Rossijskij Kredit group*, banking), Gusinsky (*Most media group*, TV) and Yevtushenkov (*AFK Systema*, telecommunications) (Pappe and Galukhina 2009: 53f.).

³ The partial trade liberalisation in the late 1980s allowed the '*nomenklatura* capitalists' to make use of the highly varied exchange rates as well as to purchase commodities at government controlled prices and to resale them at great profit on foreign markets. Export arbitrage in metals, oil and gas accounted by 1992 for approximately 30% of Russia's GDP (Aslund 2007: 58, Rutland 2010: 163).

dubious loans-for-shares privatisation and the subsequent Yeltsin's re-election in 1996 are the most striking examples.

The 1995-1997 loans-for-shares privatisation was pivotal for the rise of the oligarchs. It allowed the oligarchs to obtain the country's most valuable assets at favourable conditions set up by themselves. According to the scheme, devised by the oligarch Potanin, the cash-stripped Russian state auctioned off valuable shares of 29 major oil and mineral producers and received loans from the winners in return. The winners would be entitled to keep or to sell the shares if the state failed to repay the loans after one year. Given their political connections the oligarchs organised and controlled the auctions and, by using shell companies, made sure that banks owned by themselves could win. As the government failed to pay back the loans the oligarchs were able to keep the shares. As a result, a favoured group of insiders acquired the shares of the country's leading enterprises - such as *Norilsk Nickel*, *Yukos* and *Sibneft* - at a fraction of their potential market value.

Yeltsin, who was gradually losing support, turned a blind eye to this manipulation since he preferred to foster powerful allies among business instead of achieving the highest price possible. Indeed, the oligarchs provided massive financial and media support to Yeltsin's election campaign and ensured his re-election in 1996 (Hoffman 2007: 353-357). In the same year Yeltsin launched the second wave of the loans-for-shares privatisation, widely perceived as a payback for the election support. Apart from that, dozens of businessmen were appointed to positions in the state apparatus, thus demonstrating the interpenetration of business and government that defines an oligarchy (Aslund 2007: 161-164).

The result of the privatisation programme was an extreme concentration of ownership: by 2001 the countries' 23 largest firms, controlled by mere 37 individuals, were estimated to account for 30% of Russia's GDP, while large parts of the population did not profit from the privatisation (Rutland 2008: 1055). The ownership and management relations in the business empires of the 1990s were often non-transparent, mostly involving offshore affiliates, which gave numerous opportunities for asset stripping and tax evasion (Pappe and Galukhina 2009: 71ff.).

Although the bulk of the state-owned firms (70%) was transferred into private ownership in the course of the privatisation, many of them were essentially operating in the same way like they did in Soviet times, remaining inefficient, overstaffed and heavily reliant on government subsidies - particularly in the energy and defence industries. Some economic sectors were preserved as 'natural monopolies', such as the *Russian Railways* or the gas giant *Gazprom*. The small and medium-sized enterprises (SMEs) developed sluggishly given the weak legal environment and the excessive tax burden. The number of SMEs registered each year declined from 1994 on, so that in 1997 SMEs accounted for barely 12% of the GDP, while in the advanced market economies the number is close to 50% (Gustafson 1999: 110). The state budget was in trouble due to massive tax evasion and the ramifications of the 1998 financial meltdown.

The financial crisis of August 1998, caused by heavy government borrowing and the slump of world oil prices that eroded Russia's account surplus, was a significant blow to the oligarchs. They had been profiteering from high-interest treasury bonds that helped trigger the crisis, but lost much of their fortunes when the state defaulted on its debts and the rouble lost 75% of its value (Aslund 2007: 173-180). In this way the pervasive influence of the oligarchs on policy making decreased, symbolically marked by the denial of admission into the government building. On the whole, in the wake of the crisis the government of prime minister Primakov (1998-1999) pursued a liberal, market-oriented policy and thus the state did not increase its presence in the economy, contrary to some assessments (Pappe and Galukhina 2009: 92).

President Putin's assumption of power in 2000 coincided with an improvement of the economic situation. Backed by the surging world oil prices and a rouble depreciation that boosted exports, the economy had averaged 7% growth since 1999 until 2008, resulting in an increase of wages and real disposable incomes, the reduction of unemployment and the emergence of a nascent middle class. Given this favourable economic situation, Putin enjoyed great popularity and was able to continue the market reforms. He endorsed a liberal economic programme, which put the primary emphasis on deregulation and the improvement of business climate (Gudkov and Zaslavsky 2011: 77).

The programme included a tax reform, which alleviated the overall tax burden and was supposed to boost tax revenues,⁴ a new Land Code that legalised the private ownership of land and liberal reforms targeted primarily at the SMEs. Instead of having to be approved by several government agencies in a lengthy process that could easily take weeks, business could be registered with one agency within only five days. Furthermore, new laws cut the number of mandatory inspections for business and reduced the number of business activities that required licensing (Rutland 2008: 1053ff.).

Since the beginning of his presidency Putin attempted to strengthen the state's authority over business and to formalise the relations. He urged business to join associations such as the Russian Union of Industrialists and Entrepreneurs, which were supposed to channel the consolidated information from business to the government. However, business associations contributed to the institutionalisation of the state-business relations only marginally and gradually lost their significance in the course of the 2000s. Most business lobbying in the 2000s, as in the 1990s, took the form of direct approaches of the government officials by particular businessmen or business groups. Many 'deals' seemed to be concluded in a shadowy way (Pappe and Galukhina 2009: 160).

Contrary to Yeltsin's relations with the oligarchs, Putin created a centralised hierarchical system of relations in which the government assumed the dominant position. This re-alignment was fostered by the weakening of the 'first generation' oligarchs in the wake of the 1998 financial crisis and by the advancement of new, more cautious business players. At the same time, following the unwritten 'deal of equidistance', the state appeared to guarantee the inviolability of the oligarchs' businesses and immunity from prosecution over privatisation as long as they stayed loyal to the Kremlin and did not interfere with politics (Sandschneider 2001: 23). Those magnates who respected the new

⁴ The number of taxes that residents and business faced was reduced from about 200 to 16; a progressive income tax that peaked at 30% was replaced by a flat tax of 13% in 2001; the payroll tax was cut to an average rate of 26% and the corporate profit tax was cut from 35 to 24%; four social taxes were compressed into one; finally, tax collection was centralised into one agency (Cooper 2009: 10).

unwritten rules multiplied their fortunes - by 2008 there were more than 80 oligarchs with combined assets worth 455 billion USD.⁵ Oligarchs who did not comply were forced into exile, like the media tycoons Gusinsky and Berezovsky, or were prosecuted, like the owner of the oil giant *Yukos* Khodorkovsky (Rutland 2008: 1057).

In this context, in the 2000s big business appeared to be 'captured' by the resurgent state (Yakovlev 2006: 1033f.). However, the re-negotiation of the government's relations with business did not imply a dissolution of the partial fusion between the state and business typical of the 1990s. Many of the loyal businessmen were co-opted into politics (Kryshtanovskaya and White 2005: 303ff.) while others continued to rely on clientelist networks and informal modes of interaction with the authorities. At the same time, some politicians became full-blown 'state oligarchs' on boards of state corporations, managing whole swaths of the economy at their discretion and extracting rents (see below).

Change in the Russian State-Business Relations since 2003: Etatisation

The Political Dimension

President Putin saw the strengthening of the state as his political priority. Putin's attempt to improve the capacity of the Russian state was focused on the consolidation of the political power of the president. The creation of the so-called 'vertical of power' implied a centralisation and the co-optation of the regional leaders (Stoner-Weiss 2006: 109f.) but also included the control of the independent sources of power such as the mass media and NGOs as well as the subordination of the parliament and the establishment of the pro-Kremlin 'party of power' *United Russia* (Shevtsova 2007: 174). Although formally committed to democratic

⁵ Among the influential oligarchs of the 2000s were Deripaska (*Base Element-Rusal*, aluminium), Abramovich (*Sibneft*, oil), Alekperov (*Lukoil*, oil), Potanin and Prokhorov (*Interros-Norilsk Nickel*, nonferrous metals) Abramov (*Evrasholding*, steel) and others. While the 1998 crisis weakened the position of the Moscow based oligarchs, many of whom were engaged in banking and finance, it paved the way for the rise of the provincial oligarchs who headed new industrial groups, for example Mordashov (*Severstal*, steel) and Lisin (*Novolipetsk metallurgical combine*, metallurgy) (Gurieva and Rachinsky 2005: 133, Kryshtanovskaya and White 2005: 302ff.).

principles, the government gradually compromised them under the pretext of national security and the danger of terrorism - the war in Chechnya providing an ideal breeding ground for this discourse (Gudkov and Zaslavsky 2011: 182). The 'rise of the state' was bolstered by the surge of the world oil prices and was backed by the Russian public, who associated the economic hardships of the 'wild 1990s' with the failures of the democratic reforms and perceived the new regime as successful in attaining economic growth and restoring order.

Despite the partial strengthening, the Russian state remained weakly institutionalised, with clans and informal networks of patronage being the basic unit of the state apparatus, just as they were in Soviet times. The state also maintained its poor strategic capacity: it was neither successful at promoting a comprehensive modernisation strategy nor at diversifying the economy, and tax collection remained difficult. The implementation of ambitious national projects and programmes for socio-economic development suffered from administrative weakness, bureaucratic inertia and corruption (Bertelsmann Foundation 2010: 18). Furthermore, excessive centralisation has made the state inert, inflexible and less responsive to crisis situations. Instead of routinely addressing arising problems, the state has often resorted to 'manual steering' which requires the involvement of the top political authority (Petrov 2011: 55). All in all, the paradox combination of the increased authority of the central state and of its coercive capacity on the one hand and the persisting weakness of the state's strategic capacity on the other hand can be called 'consolidation of the weak state' (Gudkov and Zaslavsky 2011: 95).

The constellation of the dominant political elites changed dramatically in the course of the 2000s. From the beginning of his presidency, Putin faced a rivalry between different factions and was eager to establish his own reliable team consisting of people who were personally devoted to him. Putin recruited both the liberals and the conservatives, most notably people from the former KGB, who shared with Putin the professional background. The remaining members of Yeltsin's elite left the government in the wake of the *Yukos* affair in 2003-04, marking a shift in the balance between the elite groups in Putin's administration. By Putin's second term the *siloviki*, in particular their ex-KGB-wing, have clearly become Russia's dominant political elite, occupying influential positions

in virtually all political spheres (Sandschneider 2001: 12, Kryshtanovskaya 2005: 150-155). Once in power, the *siloviki* made an effort to catch up on property re-distribution and significantly shaped the state-business relations, as will be addressed in more detail later.

The election of president Medvedev, who can be viewed as an integral part of Putin's team, allowed the incumbent elite to stay in power, Putin's return to the president's office in May 2012 being a testimony. Despite his liberal rhetoric president Medvedev contributed to the consolidation of the political regime that emerged under Putin. For example, Medvedev extended the duration of the presidential term by two years and considerably expanded the power of the KGB's successor FSB to control the population (Kynev 2012: 35). In a similar vein, much of the liberal rhetoric regarding human rights and fundamental freedoms was not put in place (Rogoza 2011: 15).

The Legal Dimension

Putin's announcement to establish the 'dictatorship of the law' indeed entailed some legal improvements. Major amendments to the Civil Code and the Criminal Code were adopted, jury trials were introduced in all Russian regions and the resources allocated to courts and judicial bodies were greatly increased (including judges' salaries), reducing the dependence of judges on regional authorities in terms of basic needs and premises (Frye 2011: 121f., Hendley 2010). The activity of the 'violent entrepreneurs' and criminal 'roofing' were pushed back. The attitude of business to the establishment of the rule of law changed, too: while in the 'wild 1990s' many businessmen became rich overnight and were not interested in transparent laws, after 2000 they had a vested interest in a functioning judiciary in order to legalise and protect their wealth (Gudkov and Zaslavsky 2011: 95).

However, despite formal legal improvements, law enforcement remained weak throughout the 2000s. The judicial practice was highly selective and often depended on the political loyalty of business, on the personal interest of policy-makers and on the compliance of the courts with the political will (Myant and Drahokoupil 2011: 151, 158). The confiscation of the oil company *Yukos* in 2003 and the legal prosecution of its owner Khodorkovsky, widely perceived as politically motivated, is a case in

point. The *Yukos* affair demonstrated that business could count on legal security only in return for political loyalty and gave rise to the term 'telephone justice', referring to the political interference into the judicial process and the dependence of the courts (Ledeneva 2011). As a consequence, business preferred to rely on informal personal networks rather than on the regulative institutional pillar, which perpetuated the vicious circle of the weakness of the rule of law.

The *Yukos* affair paved the way for the interference of the authorities with business and brought the violations of property rights, raids and expropriations back on the agenda.⁶ However, the hostile illegal takeovers of the 2000s were carried out not by criminals like in the 1990s but by corrupt state agents who deployed intelligence networks, state prosecutors and armed forces to intimidate business or to persecute business rivals (Golovshinskii et al. 2004: 27f.). In this sense, the practice of 'roofing' de facto remained intact.

Legal uncertainty was exacerbated by corruption: litigant parties could influence the judge's decision by competing who pays a bigger bribe, or business could bribe the law-enforcing authorities so that they prosecute the undesirable competitor (Satarov et al. 1998: 32). Even the lowest, municipal level of law enforcement was corruption-prone due to legal 'loopholes': blanket provisions (legal provisions that have a general character), subject to the discretionary power of local authorities, provided numerous opportunities for extortion (Golovshinskii et al. 2004: 16).

Overall, judicial rules and legal procedures became formally more institutionalised in the 2000s compared to the 1990s. However, even though thousands of mundane cases had been resolved without political interference, the rule of law remained fragile, selective and susceptible to manipulation by the authorities. Law enforcement remained weak, too. In

⁶ For instance, Putin's public harassment of the private metallurgic giant *Mechel* (2008), accused of dumping, cost the company 30% of its value on the Russian stock exchange (Vesti 2008). Prominent cases of hostile illegal takeovers include the expropriation of three subsidiaries of the international investment fund *Hermitage Capital* in 2008 as well as the corporate raid on Yevgeny Chichvarkin's mobile communication company *Evroset*, realised by several police officers (Frye 2011: 123, OECD 2011: 78).

this context, unwritten rules, informal arrangements and illicit actions continued to shape the Russian state-business relations and often appeared more important than the legislation.

The Economic Dimension

While Putin's economic record during his first term can be characterised as largely liberal, the dominant stance of Putin's policy towards business during his second term was etatisation. In particular, the state increased its stake in strategic economic sectors via nationalisation and created vertically integrated state corporations.

The partial re-nationalisation occurred primarily in the lucrative hydrocarbon sector. The government re-asserted its control by acquiring the assets of companies that had been privatised under Yeltsin, by limiting foreign investment and by putting pressure on private companies to sell the majority stake to the state-owned companies.⁷ As a result, by 2007 the state controlled over 50% of the oil sector, compared to less than 20% in 2004, and brought the controlling stake in the gas monopoly *Gazprom* under its control (Cooper 2009: 13).

Between 2004 and 2006 the government took control of several private companies in other strategic sectors such as aviation, power generation and machine building. At the same time, the state increased its stake in firms where it already had shares: the percentage of firms in which the federal government held a majority stake increased from 25% in 2005 to 61% in 2008 (OECD 2011: 80). The overall percentage of state ownership in the economy increased from 30% (1994-2004) to 35% (EBRD Structural Change Indicators).⁸

Another measure concerned the creation of vertically integrated state conglomerates called *goskorporacii*. Governed by separate laws and

⁷ For instance, the Russian government forced *Royal Dutch Shell* (2006) and *British Petroleum* (2008) to cede controlling stakes in major gas fields to the state-owned *Gazprom* by claiming environmental violations or revoking licenses (Rutland 2008: 1059).

⁸ It has to be noted that this figure includes only formal state ownership. According to other estimates that include informal state control, by 2008 state ownership reached 40-45% (Kudrov 2009: 44) or even 60% (Gudkov and Zaslavsky 2011: 161).

exempt from most auditing and reporting obligations, *goskorporacii* included many state-owned companies in strategic economic sectors such as nuclear energy, nanotechnology and defence but also absorbed some private firms. The directors, appointed by the president, had considerable leeway to manage the assets of the corporations (Luzan 2009: 280). Putin ensured that the leading state corporations were headed by the people loyal to him, placing the incumbent members of the executive branch - foremost the *siloviki* - on corporate boards (Treisman 2007: 143ff.). In this way whole swaths of the economy were entrusted to the 'state oligarchs'. Even though most of them had to leave their positions on corporate boards following an order by president Medvedev, their aids filled their positions, securing the control of the incumbent clan (Rogoza 2011: 17).

I suggest considering the emergence of the state corporations and the 'state oligarchs' from the perspective of power-ownership, a concept by Runov and Tambovtsev (2009) largely unknown to western scholars. *Vlast-sobstvennost*, literally power-ownership, is essentially a factual property right tied to the position in the state bureaucracy. Thus power-ownership refers to the power of the bureaucrats to control property (business) as if they owned it. Such de facto property rights apply only as long as the incumbent is in office and concern primarily the cash flow from property, but not the debts, liabilities and risks associated with legal ownership. Most importantly, factual property rights, which obviously lack a legal status, appear to be better protected than the legal rights since the latter can be successfully contested by the state in a dependent court. At the same time, state agencies are able to prevent or manipulate a lawsuit brought against corrupt bureaucrats or raiders. As part of a vicious circle, the factual property right – power-ownership – becomes strengthened in the long run at the expense of the legal ownership (Runov 2009: 69ff.).

Viewed from the perspective of power-ownership, the policy of the 2000s seems to be not a nationalisation but rather as a re-distribution of property at the benefit of the incumbent clan. The *siloviki*, having been weak as an elite group up until the late 1990s, for the most part failed to take part in the distribution of property in the course of the privatisation of the 1990s. Once in power, they were eager to compensate for the lost opportunities.

Having acquired key positions in the state bureaucracy under president Putin, the *siloviki* profited from the nationalisation of lucrative economic assets and their concentration in state corporations. Viewed from the perspective of power-ownership, in this way the *siloviki* obtained factual property rights, or access to the cash flow from property under their control. In other words, the state's economic policy in the late 2000s appears not as a genuine *nationalisation* in the sense of a return of strategic economic assets into state ownership as part of a particular development strategy, but rather as a *re-privatisation* in favour of the *siloviki* (Tucker 2010: 172ff.). Thus the concept of power-ownership offers an interpretation of the changes in the Russian political economy in the 2000s, revealing the underlying continuity of the partial fusion of the state and business.

The state policy towards business since late 2008 can be seen as a continuation of Putin's statist policy, despite president Medvedev's verbal commitment to the reduction of the state's role in the economy. The economic record comprised the anti-crisis programme and the pursuit of large-scale national projects, such as Sochi Olympic games, Skolkovo innovation centre or Asia-Pacific Economic Cooperation Leaders' Summit in Vladivostok (Rogoza 2011: 29).

The 2008-09 financial crisis hit Russia particularly hard as the oil prices plummeted and the foreign credits that Russian banks and firms relied on dried up. The crisis invariably entailed an increase of the state's interference in the economy. Tapping the vast reserves accumulated during the boom years, the government launched rescue and stimulus packages for troubled banks and companies and later reduced the corporate tax rate to stimulate investment (Cooper 2009: 19). As a result, the share of budgetary subsidies and transfers reached 7.1% of GDP in 2009, compared to 3.7% in 2004 (EBRD Structural Change Indicators).

State support was given primarily not to the SMEs but to large 'system relevant' firms such as *Gazprom* or *Russian Railways* in order to prevent large-scale job losses, especially in single-industry towns. The military and the defence sector alone accounted for one quarter of the governmental support (Gudkov and Zaslavsky 2011: 163). More recently, an upsurge of inflation driven by food and energy prices has resulted in a number of ad hoc interventions by the authorities, such as the prevention

of the real increases of electricity prices, a ban on the export of grain and an imposition of a prohibitive tax on petrol (OECD 2011: 80).

The new wave of privatisation announced in 2010 did not reduce the overall share of state ownership since the privatisation concerned only minority shareholdings in state-owned companies (ibid.). Other liberalisation attempts by Medvedev, including the attempt to liquidate state corporations, were de facto not implemented. The SMEs continued to develop slowly – Russia has seven SMEs per 1,000 inhabitants, while the European Union has about 45. Also the share of the GDP generated by the Russian SMEs - 12% - remains low compared to the advanced market economies (OECD 2011: 69). Most of the 'natural monopolies' as well as the subsidisation of parts of the economy have endured, too. For example, the domestic energy prices are kept artificially low, allowing the cross-subsidisation of domestic manufactures (Rutland 2010: 168).

Continuity in the Russian State-Business Relations

The Legacy of Patrimonialism

Entrenched patrimonialism has been traditionally characteristic of the Russian political environment. In a patrimonial system the state does not pursue the public good but operates in the interest of clans and informal networks that 'privatise' the state institutions for personal enrichment. This implies a system of government administration in which state officials are responsible to the top political leadership but at the same time are given wide leeway and treat their job as an income-generating property (Brinkerhoff and Goldsmith 2002: 40).

In Russia a system of personalised exchange relationships and clientelist politics has flourished since Tsarism, blurring the distinction between politics and the economy. The Soviet patrimonial system was marked by hierarchical chains of personal dependence between party leaders and their underlings, who extracted economic rents from the state property under their control (Brinkerhoff and Goldsmith 2002: 8, Jensen 2001: 34). Since the old Soviet elite largely remained in control of the state apparatus after the collapse of communism, Russia has inherited the patrimonial character of the Soviet public administration.

At the heart of Russian patrimonialism lies the tradition of entrenched paternalism, rooted in social passivity, the legacy of forced labour and the ingrained respect of authority. For instance, the Russian workers prefer to rely on informal, paternalistic relations with the enterprise managers rather than join collective action to defend their interests (see the next section). By the same token, having 'made friends' with the authorities or having agreed on a kickback scheme, businessmen are eager to retain informal contacts with the bureaucrats instead of following the official rules. In a similar vein, the Russian public, being used to be patronised by the 'father state' and at the same time disbelieving that anything can be changed 'up there', seldom attempts to contest the official rules of the game but rather seeks unofficial ways to circumvent them. This has made particularism and the pursuit of private gain, as opposed to universalism and the pursuit of the common good, the guiding social principles in Russia.

The dominance of particularism has led to the society-wide spread of informal relations, unwritten rules and ad-hoc arrangements that count more than laws and written contracts. *Dogovoritsa* - a Russian verb that refers to all kinds of 'private solutions' negotiated between the bureaucrats, businessmen and workers - affects virtually every aspect of the Russian political economy and, most importantly, is regarded as 'normal' by large parts of the Russian public. According to a recent poll, virtually nobody in Russia believes that all court decisions are made in accordance with the law (OECD 2011: 78). All in all, the persistence of paternalistic attitudes and the dominance of informal ways of interaction sustain and reproduce Russian patrimonialism. One of its most salient manifestations is the enduring corruption.

Corruption

Corruption, or abuse of public power for private gain, goes back to Tsarism and to the informal activities ('*blat*') and the shadow economy under state socialism (Pleines 2001: 283, Ledeneva 1998). Given the weak legal environment and payment arrears in the state bureaucracy in the aftermath of the collapse of the Soviet Union corruption flourished and basically served as a substitute for the universal rules of the game (Satarov et al. 1998: 24f.). Rampant but somewhat 'randomised' corruption of the 1990s gave way to systemic and 'institutionalised'

corruption of the 2000s. While in 2002 14.7% of firms identified corruption as a major constraint to doing business, in 2009 the figure reached 50% (BEEPS 2009). According to one estimate the monetary value of corruption flows equals up to one quarter of the Russian GDP (Nemtsov and Milov 2010).

Despite the formal ease of the administrative burden under president Putin, bribery and extortion persisted and even augmented in the 2000s. When interacting with the Russian authorities, businessmen occasionally give 'gifts' for obtaining licences, for receiving preferential treatment or for letting the bureaucrat turn a blind eye to illegal conduct. Thereby it is estimated that the amount of an average 'gift' in 2001 equalled the cost of a 30 sq.m flat, whereas four years later an average bribe 'bought' already a 200 sq.m flat. (INDEM 2005: 14).

The authorities in their turn treat business as a 'cash cow', resorting to corrupt methods such as unofficial charges or arbitrary fines. Most infamous are the state agencies authorised to register and to inspect firms such as the fire-fighting service and the sanitary-epidemiological agency. Controlling authorities often impose arbitrary fines, drop in for an unofficial check-up on the eve of a holiday and expect 'gifts', demand an expensive 'training' for the employees as a condition for obtaining business permits or impose more expensive and less efficient solutions, for instance forcing to purchase security equipment from specific suppliers. The same applies to the police that is authorised to undertake practically any kind of business check-ups (Golovshinskii et al. 2004: 24-8).

In the environment of corruption, administrative decisions turn into goods that are traded on a shadow market. Creating an artificial shortage of rights (such as the right to open a business), bureaucrats generate a source of rents. In this way any Russian firm becomes a forced joint venture with the local bureaucracy. Beyond bribes or extortion, the state officials are eager to institutionalise this profitable 'partnership' by imposing on-going obligations on business, such as renovation of the bureaucrat's office or organisation of a banquet. The existence and survival of firms often depend on the fulfilment of these obligations. In this context firms treat the expenses associated with the maintenance of 'good relations'

with the authorities as a reasonable investment (Kliamkin and Timofeev 2000: 94-97).

The Russian energy sector represents a particularly lucrative source of rents that happen to end up in the pockets of the state officials and their crony businessmen. The hydrocarbon trading is one of the most conspicuous examples of the enduring corrupt practices. Both private and state-owned exporting energy companies have been using shell companies, shadowy subcontractors and offshore banking for selling oil and gas at low prices and then re-selling it via subsidiaries at higher prices, embezzling huge profits. This corrupt practice extends back to the 1990s but became even more entrenched in the 2000s. Until today about 30% of the Russian oil exports are channelled through a Swiss-based intermediary *Gunvor*, which is owned by Putin's close associate Timchenko (Rutland 2008: 1058).

A form of corruption that became prominent in Russia in the 2000s is the so-called *raspil*, literally 'sawing-through', or a system of institutionalised kickbacks in public procurement. The mechanism behind *raspil* is that public contracts are awarded not according to the best price or quality, but as a result of collusion between state officials and their crony businessmen. For instance, firms owned by persons with close ties to Putin or to the ministers get awarded lucrative procurement contracts for constructing large infrastructural facilities.⁹ Thereby the cost of the service exceeds the market price while the government allows itself to be overcharged. The resulting price difference is the kickback. The scope of kickbacks in Russian public procurement is estimated at 30 to 60% of the contract volume, leading to the embezzlement of billions of dollars annually. (Rogoza 2011: 18, Makarov 2011).

⁹ For example, in 2011 the company *Stroygazmontazh*, controlled by Putin's aide Rotenberg, became the general contractor for the construction of the Nord Stream pipeline; Rotenberg's *Mostotrest* received contracts for building the Olympic facilities in Sochi and other sports facilities worth 100 million USD (Rogoza 2011: 18). Similarly, between 2008 and 2010 a construction company that belonged to a friend of the transportation minister won 30 tenders with a cumulative volume of more than 3.6 billion USD (Makarov 2011).

Transformation of the Capital-Labour Relations

In the Soviet centrally planned economy, labour relations were regulated primarily by the state, which guaranteed full and stable employment in exchange for labour peace. The Soviet labour model represented an 'organised consensus' and included secure jobs, largely egalitarian incomes and the ban on strikes. The trade unions never fulfilled the function of institutionalised channels for the workers' interest articulation but rather formed part of the Soviet authoritarian enforcement and control machine in charge of labour discipline and mobilisation of workers for fulfilling the plan. In this context Soviet workers had to rely on the informal relations with the enterprise managers to address their needs and problems. Thus paternalism was at the heart of the Soviet labour model and represents perhaps the most enduring continuity in the Russian industrial relations (Sobolev 2010: 22f.; Gudkov and Zaslavsky 2011: 31, 39f.).

The Russian labour model that emerged in the 1990s and consolidated in the 2000s differs from the Soviet model given the social, political and economic changes that accompanied the transition from the planned economy. Yet at the same time the Russian labour relations were shaped by the Soviet legacies and enduring continuities and arguably underwent an 'adaptation without restructuring' (Kapelushnikov 1999: 91). The core elements of the Russian labour model, which will be discussed in detail below, are:

- stable employment loosely correlated with the GDP fluctuations;
- small role of the trade unions and a low strike activity;
- spread of the informal capital-labour relations instead of the reliance on the institutionalised channels;
- gap between the rigidity of the formal regulations and the flexibility of their application.

Partial liberalisation (the 1990s)

The economic breakdown and the 'shock therapy' of the early 1990s made high unemployment (at least 25%) seem inevitable. Mass layoffs were bound to happen given that the Soviet enterprises were notoriously

inefficient and overstaffed, experts warned. However, things turned differently. Unlike the transition economies of Central and Eastern Europe, Russia experienced a much deeper recession but at the same time a disproportionately low and slow rise of unemployment. Bankruptcies were rare and official unemployment reached its peak of just 13% in 1998 and has decreased ever since. There is no doubt that the factual unemployment was considerably higher than the formal one, let alone the proportion of people who registered as unemployed, since many troubled enterprises continued employing excess workers only nominally, pushing them into the informal economy. However, on the whole the nascent Russian labour model proved to be successful at amortising shocks and crises, as will be discussed below. Yet at the same time the Russian labour model has hampered the transformation of the labour relations in the long run, encouraging informal relations between the managers and the workers at the expense of the institutionalisation of the labour relations (Kapelushnikov 1999: 71ff., 92).

President Yeltsin sought to free the workers from state control and to democratise the relations between the tariff partners. In the course of the 1990s a new labour legislation was issued. It included a right to strike and to form independent trade unions; a process through which firms could legally dismiss workers; a minimum wage; basic unemployment benefits; rules for tariff negotiations and a tripartite system of social partnership (Sil 2005: 7, Gudkov and Zaslavsky 2011: 26, 40).

However, the institutionalisation of the labour relations remained largely nominal. Just as many other legal provisions in the 1990s, formal regulations governing the labour relations were often at odds with the actual practice given the weakness of the legal system and the low enforcement capacity of the Russian state. In this context the 'Russian labour miracle' can be explained rather by the informal adaptation strategy adopted by the troubled enterprises and their workers under adverse economic conditions of the 1990s. The adaptation strategy, which decisively shaped the Russian labour relations, comprised two fundamental elements: first, prevention of mass unemployment via flexibilisation of working time and wages; second, the spread of the informal labour relations (Kapelushnikov 1999: 91ff.).

The first component of the adaptation strategy implied the retention of excess workforce at the cost of economic efficiency. Russian enterprises were reluctant to initiate mass layoffs and continued to keep redundant workers on the payroll, reducing the labour costs by cutting both the working time and the wages. The wage reduction strategy included real wage cuts, exacerbated by the galloping inflation (real wages fell by 60% between 1991 and 2000), mounting payment arrears (at their peak in 1998 wage arrears encompassed 3/4 of the Russian workers), the cancellation of bonus payments, which used to constitute up to 20% of the wage, the spread of in-kind payments and the cut-down of social benefits. The average yearly working time decreased between 1991 and 1996 by one month, or 12% (15% in the industry). Many workers were routinely sent on unpaid leaves (Kapelushnikov 2009: 12-16).

Concerned over labour unrest, the Russian government supported the adaptation strategy of the enterprises for the sake of social stability. This decision - possibly rather a spontaneous than a consequent one - was not in line with the liberal reforms, especially with the minimum wage provisions and the regulations authorising dismissals. However, the government used carrots and sticks to make factories keep their personnel, continued to subsidise many enterprises and avoided mass layoffs in the public sector by drastically cutting the wages. As a result, the continuity of over-employment endured: in 1997 from 75 million people of working age 8 million were unemployed and additional 12-13 million constituted excess personnel (Gudkov and Zaslavsky 2011: 19, 24-27). In this context wages decreased, often falling below the subsistence minimum in the public sector, thus providing a fertile breeding ground for corruption and at the same time serving as an excuse for low wages in private companies (Sobolev 2010: 26).

The second equally important aspect of the adaptation strategy was the spread of the informal labour relations. As real wages were decreasing and payment arrears skyrocketing, the dramatically deteriorating living standard of the workers left them at the mercy of the enterprise managers. The latter granted the workers access to shadow salaries, which constituted up to 40% of the official wages, to non-wage supplements and informal mechanisms that allowed the workers to earn additional incomes. The tangible benefits from covert earning schemes promoted a

personal dependence of the workers on the enterprise managers and thus strengthened the paternalistic ties which used to be at the heart of the Soviet labour model (Sobolev 2010: 22f.; Birdsall 2000). As a result, the workers, who often had no alternative to their current employment, notably in single-industry towns, did not rely on the trade unions as defenders of their rights and were reluctant to join a strike despite their deteriorating economic situation (Gudkov and Zaslavsky 2011: 41ff., Sil 2005: 10).

The fact that the workers preferred to turn to enterprise managers rather than to the trade unions to address their problems and pressing needs, coupled with a low level of trust in the unions, certainly hampered the transformation of the trade unions into viable workers' organisations in the course of the 1990s. Unions that belonged to the newly established Federation of Independent Trade Unions of Russia, which was carved out of the Soviet trade union apparatus, were afraid to lose members and continued the old practice of distribution of social benefits although they lacked the resources. New, genuinely autonomous trade unions struggled for members and often faced difficulties and even harassment since both the state and business continued to view the trade unions as nuisances (Sil 2005: 11). As a result, the traditional paternalistic alliance between the enterprise managers and the workers has endured at the expense of the institutionalisation of the Russian labour relations and has decisively shaped their further development.

Adaptation without restructuring (the 2000s)

The 2000s witnessed an improvement of the economic situation of the workers along with the general recovery of the economy. Unemployment was steadily decreasing and fell to 6.3% in 2008. The average working hours increased, having grown by 16% in the industry by 2008. Real wages increased threefold between 1999 and 2008, and wage arrears almost disappeared, affecting merely 1% of workers (Kapelushnikov 2009: 13-18). However, wages were lower than the cost of the reproduction of labour and were in decline as the proportion of the production costs, a study by Sobolev shows (2010: 34-37). At the same time, Russia's senior managers were much better paid than their counterparts both in the west and in the other BRICs, indicating a huge

gap between the workers' and the managers' salaries (The Economist 2008).¹⁰

Just as in the 1990s, in the 2000s enterprises attempted to keep the labour costs as low as possible, reducing the share of fixed payments and increasing the 'black' part of the so-called 'black-and-white salaries' that were widespread both in private companies and in the public sector, where the black cash originated from the kickbacks or from *raspil* in public procurement. Not fixed in any contract, the 'envelope payments' could be cut anytime, keeping the labour costs flexible and at the same time enhancing the personal dependence of the workers on the employer. In this context it is not surprising that strike activity remained low in the 2000s (with the exception of the traditionally well-organised mining industry). Similar to the 1990s, the workers preferred to rely on personal informal relations with the management instead of collective bargaining (Sobolev 2010: 37, Kapelushnikov 2009: 63).

In terms of the legislation, the Putin government pursued institutionalisation and formalisation of the labour relations. A new Labour Code adopted in 2001 can be considered rigid as compared to international standards, granting the state a great role in the control of the capital-labour relations (Ashwin and Clarke 2002: 111-14). For instance, under the new Labour Code enterprises had less leeway to cut wages and the working time, and layoffs became a particularly costly and sophisticated undertaking. Also the enforcement of the labour legislation improved in the 2000s compared to the 1990s in line with the general increase of the state capacity. A successful fight of wage arrears and an improved observance of collective agreements are the most telling examples (Kapelushnikov 2009: 20f., 55).

These improvements were put in perspective by the 2008-09 economic crisis. The preference of the state for employment stability, the informal adaptation strategies of the enterprises and the low strike activity of the

¹⁰ A survey conducted by *Hay Group*, a consultancy, calculated the disposable incomes of top CEOs in 51 countries, having adjusted the salaries for taxes and living expenses. Russian CEOs are ranked 9th in the survey, while managers from Japan and the USA rank 39th and 41st respectively. China is ranked 17th in this survey, Brazil 23rd, South Africa 36th and India 38th (The Economist 2008).

workers revealed the continuity of the labour model that emerged in the 1990s.

In the wake of the crisis the Russian labour market showed its resiliency yet again. While the GDP dropped dramatically, unemployment increased inconsiderably, reaching 8.7% in 2009 and decreasing again the next year already.¹¹ The state was again concerned over social unrest and interfered heavily in the economy to prevent mass layoffs. The case of the Russian single-industry town Pikalevo became emblematic of the Russian crisis response. In 2009 three concrete plants, owned by the oligarch Deripaska, were to be closed down, leaving 4,500 people (almost the whole working age population) without jobs. Demands of the trade unions were ignored by the local authorities. Thereupon the workers started massive protests and blocked one of the main federal roads. In a demonstrative rescue operation Putin arrived in the troubled town by helicopter and forced Deripaska to resume the work of the factories and to guarantee employment to the citizens of Pikalevo in front of running cameras. The very same day the state compensated wage arrears equivalent to 1.3 million USD from the federal budget (Vremia Novostey 2009, Izvestiya 2009).

Just as in the 1990s, firms reacted to crisis with flexible working hours and wages, although the room for manoeuvre was clearly limited under the new rigid legislation. However, it was perhaps the very rigidity of the formal regulations that encouraged firms to seek new, often illegal ways to circumvent the regulations and to cut the labour costs. This pushed the labour relations further into the shadow in line with the popular Russian wisdom that reads 'the imperfection of our laws is compensated by their non-observance' (Ledeneva 2001: 2). For instance, employers cut wages by cancelling the bonuses and shadow payments. Another popular method was the proliferation of the unpaid 'voluntary' leaves and

¹¹ Apart from the adaptation strategies to crisis chosen by the Russian state and the enterprises, other factors prevented the explosive rise of unemployment in the wake of the 2008-09 crisis. Among them is the smaller share of excess workforce as compared to the 1990s, the structural change of the Russian economy towards services and the expansion of the non-corporate and the informal sectors (Kapelushnikov 2009: 60f.).

'voluntary' layoffs, which did not require financial compensation. Under informal agreements the employees continued to work and received their salaries 'in envelopes'. This de-formalisation of the labour relations has strengthened the paternalistic interdependence of the workers and the managers (Kapelushnikov 2009: 61ff.).

To conclude, the Russian labour model was formed in the 1990s and, having undergone an 'adaptation without restructuring', consolidated in the 2000s. The Russian labour relations are marked by a stable employment achieved through flexible wages and working hours; by a feeble development of the trade unions and a low level of the industrial conflict; and, finally, by a spread of the informal, paternalistic relations between the workers and the managers, being at odds with the rigid labour legislation.

Similar to the development of the state-business relations, the main direction of the adaptive change of the Russian capital-labour relations was etatisation, expressed in the somewhat enhanced enforcement of the labour legislation, coupled with an increased involvement of the state in the labour relations. The pronounced role of the state became conspicuous during the 2008-09 crisis when policies directed at employment stability were pursued. The main continuity of the Russian labour relations is - similar to the state-business relations - the entrenched patrimonialism, expressed foremost in the de-formalisation and individualisation of the capital-labour relations. Instead of stable institutions and independent organisations of entrepreneurship and interest representation, the Russian labour relations are based on a web of paternalistic and semi-legal relations of personal dependence.

The paradox of the Russian labour model lies in the contradiction between the rigid formal regulations and the largely informal, paternalistic relations between the managers and the workers that allow a flexible adaptation to crises. The gap between the formal rules and the actual practice indicates yet again the weakness of the rule of law, the low level of enforcement of the general rules of the game and the dominance of the particularistic, patrimonial practices. This tendency echoes the theory-praxis gap in the state-business relations and thus appears to be typical of Russian capitalism as a whole.

Conclusion

The development of the Russian political economy is a complex interplay between continuity and change. 'Capitalism Russian style', which emerged in the wake of the collapse of the Soviet centrally-planned economy, has undergone a transformation in the course of the last two decades but has maintained some Soviet-era characteristics that continue to shape the Russian political economy.

Viewed against the backdrop of the statist, liberal and patrimonial ideal types of capitalism, the main direction of change in the Russian political economy is expressed in the shift in the proportion of the liberal and statist elements. While between 1992 and 2002 Russian capitalism can be characterised as largely liberal, after 2003 the trend towards increased statism became pronounced. Etatisation of Russian capitalism was expressed in the partial increase of the state capacity, in the shift from the liberal to conservative political elites and in the partial nationalisation of the strategic economic assets, coupled with an overall increase of the state's involvement in the economy and the labour relations.

The major continuity of the Russian capitalist development was found in the persistence of patrimonial elements. The continuity of patrimonialism is expressed in the pervasive weakness of the rule of law, in the endurance and perhaps even increase of corruption, in the partial fusion of the state and business and in the spread of the informal state-business and capital-labour relations, which are at odds with the formal regulations governing these relations.

My analysis has pointed out that the continuity of Russian patrimonialism underlies the change towards increased statism: behind the etatisation of the Russian state-business relations in the second half of the 2000s was arguably a re-distribution of property at the benefit of the incumbent clan of the *siloviki*. This process was facilitated by the feeble rule of law, by the insecurity of property rights, by the dominance of particularism and corruption and, finally, by the political environment in which clans and networks of patronage and informal exchange supplanted formal state institutions.

For understanding the mechanisms behind the Russian patrimonialism we need to address factors, contexts and circumstances that serve the

bureaucrats as power resources and enable them to extract administrative rents from property under their control. We also need to research the scope of the Russian patrimonialism and the eventual differences between the 1990s and the 2000s. All in all, considering change in the context of continuity may contribute to a better understanding of the changing capitalism in Russia and possibly in other emerging countries.

The final remarks regard Russia's possible trajectory in the future. Recent developments provide a mixed picture. On the one hand, given the WTO accession Russia may be exposed to the pressure to liberalise its economy. Additionally, the diminishing Russian hydrocarbon reserves and the lack of diversification may soon reveal the limits of the resource-driven rentier development and ultimately push for change; at the same time, the discovery of shale oil and gas in the USA may reduce the importance of Russia as a gas supplier for Europe and get the gas price down, which would be a serious challenge for Russia's budget.

On the other hand, Putin's return to the president's office in May 2012 and the continued political dominance of the *siloviki* point to the likely perpetuation of the trajectory that Russia has taken since the second half of the 2000s. However, the public approval of Putin, though still comparatively high, was at a historic low of 62% in January 2013, down from over 70% throughout Putin's first two presidencies (Levada Centre). The public protests since the December 2011 Duma elections and the timid awakening of the civil society also point to the limits of Putin's consensus based on loyalty to the incumbent regime in return for the oil-driven economic growth. In this context it is unclear whether there is a prospect for change or whether Russia will rather face the consolidation of the statist-patrimonial regime.

Chapter 2:

Russia's political economy re-conceptualised: a changing hybrid of liberalism, statism and patrimonialism¹²

Abstract

Russian political-economic development since the early 1990s has been described as one of initial liberalisation and subsequent re-etatisation a decade later. Our paper critically builds upon this view, systematically adding patrimonialism as third dimension and conceptualising Russia's trajectory as varying with respect to ideal-typical liberalism, statism and patrimonialism. We argue that Russian patrimonialism hindered the rise of the economically facilitating state capacity and undermined both liberalisation in the 1990s and re-etatisation in the 2000s. Furthermore, we add a comparative BRICs perspective that clarifies the peculiarity of Russia's development based on statistical data from the World Bank, the OECD and Heritage Foundation. The data confirm the de-liberalisation of Russia and show an increase of patrimonialism. Another finding is that Russia was the only BRIC country that de-liberalised and increased its level of patrimonialism in the period under consideration.

¹² This chapter has been published in *Journal of Eurasian Studies* (Becker and Vasileva 2017)

Introduction

It is widely acknowledged that Russia's political economy underwent a liberalisation in the 1990s, followed by re-etatisation in the 2000s (cf. Aslund 2007; Goldman 2010; Hanson 2007; Rutland 2008; Yakovlev 2006). However, further differentiation is required for a more exhaustive and systematic analysis of change in Russia's political economy during the past two decades. Such differentiation is the objective of this study. It makes a case for supplementing the better known statist and liberal dimensions of Russia's trajectory with systematic incorporation of a third dimension: patrimonialism, understood as a distinct structural mode of political-economic organisation based on clientelism and patronage. Many scholars acknowledge patrimonialism as one of the defining features of the Russian political economy but have difficulties assessing its interaction with the formal, legal-rational aspects of the system (e.g. King 2007; Robinson 2011; Sakwa 2013). We build upon this scholarship and assess empirically the impact of patrimonialism on Russia's politico-economic development. We show how patrimonialism undermined both the liberalisation of the 1990s and the etatisation of the 2000s and offer a quantification of the process.

In this paper we develop an analytical framework and quantitative tools for comparatively exploring the specificity of Russia's political-economic development over the past two decades. First, we systematically address change by conceptualising the trajectory of the Russian political economy as a case that changed location in the field between the liberal, statist and patrimonial ideal types. This approach differs both from static classifications (i.e. Russia having, for example, 'state-led capitalism' (Lane 2008) or 'patrimonial capitalism' (King 2007)) and from analyses cited above which focus on the shift from liberalisation to etatisation but do not grant enough attention to the impact of patrimonialism. Second, we quantify such developments in Russian political economy, placing it in a comparative BRIC context and illuminating the particularities of Russia's development.

In doing so, the paper builds on the literature on comparative capitalisms. We depart from predominant accounts in the field in two important respects. First, our approach differs from static classification of national political economies where large numbers of cases, including Russia and

other post-communist countries (e.g. Lane 2005; Myant and Drahokoupil 2011), are crowded-together under the label of one or another 'type', calling cases in plural, for example LMEs (liberal market economies) or CMEs (coordinated market economies). In such conceptualisations it is difficult to conceive of change other than a radical overhaul from one 'type' to another (Thelen 2004: 3). As an alternative view, we present a more dynamic approach by distinguishing between ideal types of capitalism (theoretical models) and empirical political economies (hybrid cases). This distinction gives space to grasp nuances and gradual change: an empirical case only approximates an ideal type and contains elements of several types, the proportion of which can change over time. Second, our approach goes beyond the predominant accounts in comparative capitalism scholarship by deploying an additional ideal type of capitalism - patrimonialism - which we argue represents an alternative way of organisation and functioning of a political economy and is crucial for understanding the specificities of the BRICs and Russia in particular (Becker 2013). These points will be detailed in the next section.

The paper clarifies Russia's political-economic development in these ways, through two distinct but interrelated steps. The first, historical-analytical step provides insight into changes that occurred in the political economy of post-communist Russia in the conceptual framework of three ideal types of capitalism. The assessment is based on a critical reading of secondary literature supported by newspaper articles and interviews with entrepreneurs conducted in Russia in the spring of 2014. We make the case that Russia experienced an attempt at liberalism in the 1990s, which was followed by an attempt at statism in the 2000s. Both processes were accompanied, and indeed undermined, by patrimonialism. The study of the impact of patrimonialism on the processes of liberalisation and etatisation is central to the analysis. Notably, the attempted move towards greater statism hardly implied a general strengthening of the state, although it became more centralised and the extent of state ownership and state activities increased. State capacity, understood broadly as capacity to formulate and implement policy, rose only in coercive terms, not in terms of facilitating economic development which involves creating incentives for private entrepreneurialism, providing legal certainty and improving education, R&D and the infrastructure (we dub it 'facilitating state capacity'). The rise of the facilitating state capacity has been

hindered by patrimonialism, notably the widespread patron-client ties and private appropriation of the public realm by political and bureaucratic agents.

The second step in the paper aims to 'individualise' (Tilly 1984) Russian political economy in comparative BRICs perspective and to examine whether the direction of change as identified in the first step can be quantitatively revealed. The BRIC countries are selected as comparison cases since they are all large emerging and internationally significant political economies. No doubt there are notable differences between the BRICs as regards size, historic legacies and factor endowment, to name a few, which are interesting for the purpose of comparison. For the purpose of this research, however, we want to point out some similarities between the BRICs. Figures of economic performance, competitiveness and investment indicate growing importance of these countries and imply a shift in global economic power beyond the 'hype initiated by the Goldman Sachs *BRICs ... studies*' (Nölke et al. 2015: 539). For instance, the share of the BRICs in global production increased from 15% in 1995 to 25% in 2010 (IMF 2012). Politically, since 2009 the leaders of the BRICs¹³ have been meeting at annual summits, aspiring to give emerging countries a stronger voice in international governance and to advance an alternative agenda on economic development, in particular through a more pronounced role of the state.

The focus of the comparison will be on Russia: we do not attempt a detailed treatment of other BRICs nor aim to compare or explain in depth their trajectories. A general statistical comparison, however, is possible and appropriate, using data provided from the *Index of Economic Freedom*, the *World Governance Indicators* and the *OECD* on product market regulation and employment protection legislation. The main finding is that the data confirm the de-liberalisation of Russia and show an increase of patrimonialism. Another finding is that both processes ran counter to the developments in other BRIC countries. In terms of its trajectory of change Russia is revealed to be an outlier: Russia was the only BRIC country that de-liberalised in the 2000s compared to the 1990s, while India, China and, to a lesser extent, Brazil liberalised in this

¹³ The club was extended by South Africa in 2010, which is not included in the study due to the lack of necessary data for the time period considered.

time period. Russia was also notably the only country that experienced a growth of patrimonialism, which decreased in other BRICs.

In taking these two steps, the paper makes both a theoretical and an empirical contribution. In theoretical terms, the paper contributes to efforts to incorporate patrimonialism into the comparative capitalism framework. While the concept of patrimonialism is widely deployed in studies of political systems or governance regimes (e.g. Adams and Charrad 2011), it is seldom applied to the economic domain (Schlumberger (2008) and Robinson (2011) being among the notable exceptions), although it shapes to a considerable degree the organisation of the political economies of emerging markets.

In empirical terms, the paper provides a systematic analysis of change in the Russian political economy within an original conceptual framework and offers a tool for the quantitative assessment of that change. The incorporation of patrimonialism in the framework allows to become more precise than the existing analyses on the scope of patrimonialism and its impact on other dimensions of Russia's trajectory. In particular, scholars recognise that Russia combines both legal-rational and patrimonial features (e.g. Sakwa 2013; Whitmore 2010) but have difficulty assessing 'this complex interaction' (Whitmore 2010: 1003).¹⁴ We want to contribute to this research agenda by offering a qualitative and quantitative assessment of how patrimonialism interacts with other, legal-rational elements (liberalism and statism), and how this affects the development of the political economy as a whole. The conceptual framework is applicable to other political economies given the data are available.

The empirical contribution offers an attempt to establish with the best available data and with *some* precision the character and development of political economies as conceptualised with respect to patrimonialism, liberalism and etatism. Social scientific texts often talk of 'more or less'; we try to be somewhat more precise, even if the available data are not perfect and we generally should not confuse social sciences with physics.

¹⁴ For instance, in her study of parliamentary oversight in Russia, Whitmore merely finds that "the equilibrium between legal-rational and patrimonial spheres of the state shifted towards the prevalence of the patrimonial during Putin's presidency" (2010: 1022).

Interpretation and estimation are the main ingredients of social-scientific research, they express the complex, interdependent character of social reality and should not be ‘analysed away’ (Hall 2003: 386) by reducing the latter to independent and dependent variables. Of course, our empirical contribution must come with more-than-the-usual caveats regarding data availability and limited precision (see the discussion in the following sections). Nevertheless, the measures presented in this article are to date the only suitable available data for a comparative politico-economic analysis of the BRICs, and Russian political economy in particular.

The next section will set forth the conceptual framework. It will present the criteria for creating the typology and explain the construction of ideal types, granting particular attention to patrimonialism. The section that follows discusses the sources of the persistence of Russia's patrimonialism, providing a background for the subsequent historical analysis of Russia in terms of ideal-typical liberalism, statism and patrimonialism. The following section quantifies Russia's development in the comparative BRICs context. Finally, in the conclusion we summarise the argument and reflect on the broader impact of the study.

Conceptual framework: liberal, statist and patrimonial ideal types

We suggest a typology of capitalist varieties as a tool to comparatively individualise political economies. Typology is a means to ease comparative analysis: it reduces the differences between the empirical cases to a few fundamental ones. In the Weberian tradition we distinguish ideal types and empirical cases. Ideal types are theoretical models based on comparative empirical knowledge which represent a tool to ease comparative analysis. Empirical cases, by contrast, are hybrids that only approximate ideal types to a certain degree and contain elements of more than one type; over time cases may change location in the field between the ideal types. Therefore the distinction between ideal types and empirical cases is a requirement for making gradual change in a given political economy intelligible, as well as gradual differences between the countries (Becker 2009: 44ff.; Crouch 2005).

We construct our typology based on two criteria that point to fundamental features of a political economy and its working— primarily, state-economy relationship and, secondarily, capital-labour relationship, which cover most of the institutional components in the comparative capitalism literature. The state-economy relationship is at the heart of every *political economy* and includes the character of economic policy, employment protection and the welfare dimension, product-market regulation, privatisation/nationalisation of firms and the (non-)regulation of wages, supply and demand (Becker 2014: 34). The capital-labour relationship is the most fundamental cleavage in capitalism and includes the union-employer and management-employee relations and, connected to this, corporate governance and stakeholder-shareholder relations (ibid; cf. Schmidt (2002: 107f.)). Our typology is conceived for the analysis of the entire range of capitalist variety and contains five ideal types. Relevant for the analysis of Russia are three of them: liberal, statist and patrimonial types of capitalism.¹⁵ The liberal type has never been disputed since capitalism is basically a market economy and therefore to a substantial degree liberal. Two other non-liberal ideal types - statist and patrimonial - emerge from our decision to abandon the predominant dichotomous construction of liberal versus coordinated type (we prefer to call the latter type, in the tradition of Polanyi (1957), 'embedded'). We argue that the embedded ideal type of capitalism is a catch-all concept that conceals fundamental distinctions and needs differentiation. Therefore we split the embedded type - where the market is embedded in politically or culturally induced non-market configurations - into the statist and patrimonial types. Both statism (Schmidt (2002: 108f.) also uses this concept) and patrimonialism are plausible choices since they play a role in a large number of political economies, notably emerging ones.

Based on this conceptualisation, we define the proposed three ideal types of capitalism as follows. In the liberal ideal type the market is conceived as governing every aspect of the economy, and politics unrestrictedly facilitates private property and the market – apart from basic legal and

¹⁵ The typology furthermore contains the corporatist type (relevant for instance in Brazil), where capital and labour cooperate on macro-economic policy, and the meso-communitarian type (relevant for example in South Korea or Japan), where management and labour in huge business conglomerations form a community (cf. Becker 2013).

social regulations. State interventionism is limited, industrial relations tend to be individualised and workers as well as companies are commodified. The USA and other Anglo-Saxon political economies approximate the liberal idea type. Any move to strengthen private property and the market in any given country is also a move in the liberal direction.

In the statist ideal type the market is restricted by political regulation which intends to determine the course of the economy. By implication, the state capacity to facilitate economic development must be high. Importantly, like in the liberal type, the state acts on the basis of universalistic norms. The state assumes to know best what the common interest is and state-owned firms might have a prominent place in the economy. The preponderant conception of organisation and decision-making is hierarchical and the rights of labour are limited. Emerging political economies that have chosen a state-directed course of development feature a considerable degree of statism.

The patrimonial ideal type deserves a longer treatment. While not part of the conventional comparative capitalism framework, it is central to the understanding of political economies of non-OECD countries. The notion of patrimonialism goes back to Max Weber (1972 [1925]). Weber looked at pre-modern societies like Imperial China, late Roman Empire and Tsarist Russia and constructed ideal-typical patrimonialism as a state-society nexus consisting of personal hierarchical relationships based on loyalty and mutual services between rulers and ruled and without a strict distinction between public and private (*ibid.*, pp. 580-653). The patrimonial set-up derives from a household administration of a chief who grants clients tax-farming opportunities in form of prebends, fiefs or the like. According to Weber, the main feature of patrimonialism is private appropriation of resources by those who hold political power and enjoy corresponding economic rights. Weber described patrimonial state administration as based on interpersonal rather than impersonal relations of authority and thus sharply demarcated it from the universalist rational bureaucratic state (*ibid.*: 586, 598).

The concept of patrimonial rule gained prominence in social sciences since the 1960s in the study of Latin America, Asia and later also Africa (Bach 2011). The ambivalence related to the application of a concept

associated with traditional rule to modern states was resolved by Eisenstadt (1973) who coined the concept of neo-patrimonialism. The prefix 'neo-' came to define the co-existence of legal-rational and patrimonial elements within a political system (we do not opt for the term because in our conception it is empirical cases that are mixed while ideal types are pure). At the same time, (neo-)patrimonialism attained a negative connotation as it came to be associated with predatory, 'anti-developmental' forms of politics (Bach 2011: 279ff.).

We provide a slightly different perspective on patrimonialism, deploying the concept to denote not a state administration or governance type but an ideal type of political economy. We argue that patrimonialism qualifies as a separate ideal type for two reasons. First, rather than being an incidental feature of certain social arrangements, patrimonialism is a distinct structural principle of the politico-economic organisation of a society as a whole, affecting both criteria for the construction of an ideal type, as detailed below (Becker 2014: 36). Second, patrimonialism qualifies as an ideal type of its own because of its salience in most political economies outside North-Western Europe and its former American and Oceanian settler colonies (cf. Adams and Charrad, 2011; on patrimonialism in post-communist states, see Bach 2011: 286f.).

In our definition, the core organising principle of ideal-typical patrimonial capitalism is patron-client relations between political and economic elites, which deeply penetrate the social fabric. The ruling groups regard society as their own private domain; the lack of distinction between office and office-holder allows private appropriation of public resources for personal gain (Kohli 2004). The state intervenes in the economy on the basis of political considerations and particularistic gains (unlike in the statist type where the state regulates the economy based on universalistic rules). By the same token, managers regard the fulfillment of corporate functions as a legitimate means to their own personal enrichment. Capital-labour relations are based on clientelistic arrangements between managers and employees rather than on institutionalised interaction. The economy is typically reliant on rents (e.g. from natural resources) which are central for the survival of patrimonial capitalism, sustaining the rent-seeking ruling elite and cronies in business and at the same time enabling patronage of the society.

Patrimonialism may undermine the common good and economic development: proprietorial office holding can be associated with corruption, while the state may become a 'vehicle through which rapacious elite groups commandeer the resources and property of others' (Robinson 2013a: 193). Patrimonial exchanges above a certain level are said to weaken the facilitating state capacity (see, for example, Kohli (2004: 9)) as well as competition and meritocratic principles, and therefore may undermine the efficacy of the market and the economy as a whole. However, one should be careful with this argument because China, despite its strong patrimonialism (cf. further Table 5 and McNally (2012)), demonstrates the ability to trigger technological progress. Chinese patrimonialism could have facilitated economic development in periods of reform when space for entrepreneurial initiative was bought by business people bribing state officials (cf. Gregory and Zhou 2009: 5). Examples of Indonesia and the Asian Tigers also indicate a co-existence of patrimonialism and successful economic development (Bach 2011: 284f.).

How to account for the process of politico-economic change in our conceptual framework? To recapitulate, we conceive of empirical cases as hybrids that contain elements of different ideal types; liberal ideal type of capitalism is conceptualised as opposite to the two embedded types, namely statism and patrimonialism. Therefore, in our conception change is a shift in the proportion of elements of ideal types in an empirical case: liberalisation implies a decrease of statist and/or patrimonial elements in a political economy; conversely, de-liberalisation implies either a movement into the direction of increasing statism or, alternatively, patrimonialism (or an increase of both).

To sum up, our conceptual approach seems well-suited to comparatively analyse change in the political economies of the BRICs. First, it allows to capture gradual change through the distinction between empirical cases and ideal types of capitalism. Second, it systematically integrates patrimonialism, characteristic of politico-economic organisation in most emerging economies, and accounts for its impact on the process of politico-economic change.

In the following section we will analyse Russia's political-economic development since the break-up of the Soviet Union in 1991 in the

framework of the suggested three ideal types of capitalism. Our focus will lie on the implications of patrimonialism for the processes of liberalisation and subsequent etatisation. The section will serve as a basis for the second part of the paper, which provides a quantitative assessment of the identified developments in Russian capitalism in a comparative BRIC context.

The trajectory of the Russian political economy reconsidered

The Legacy of Patrimonialism

The legacy of patrimonialism extends back to the origins of Russian statehood. The sources of the persistence of patrimonialism can be roughly divided into two categories - 'top down' and 'bottom up', associated with politico-economical and socio-cultural factors, respectively.

'Top down' explanations of the endurance of Russian patrimonialism revolve around factors associated with the state and the legacy of politico-economic organisation such as the tradition of authoritarian rule, the lack of private property (Pipes 1999) and the historical continuity of social structure based on clientelistic relations and particularistic exchange (Robinson 2013b). For instance, the social structure of Muscovite and later Tsarist Russia developed the system of *kormlenie*, or 'feeding': the monarch, who was literally the possessor of all Russia, granted land (*pomestye*, or prebend) to the nobility in exchange for their service and loyalty (Pipes 1999: 160). This clientelistic system became further entrenched under socialism: the communist state and the party controlled all significant property and delegated its administration to the *nomenklatura* - holders of key administrative positions, whose appointment had to be approved by the Communist Party and thus embodied the principle of patronage. In this hierarchical and highly personalised system, the executives of state-owned enterprises took advantage of the opportunities for enrichment under the auspices of their party patrons (Solomon 2008: 81ff.). More generally, the specificities of the Soviet economic system encouraged transactions that were not monetised, like in a market economy, but rather represented particularistic exchanges based on acquaintance and trust, which allowed

members of elite networks to convert power resources into other goods and services (Robinson 2013b: 20ff.).

In light of the politico-economic explanations, patrimonialism outlived the collapse of the Soviet Union due to the continuity of the system of particularistic exchange: barter and the factual preservation of soft budget constraints allowed enterprises to stay afloat in the 1990s (Robinson 2013b). In this way economic elites preserved their political power and used their connections for appropriating state assets during Soviet unravelling, hindering the liberalisation, as will be addressed in the next section. Moreover, due to the high level of elite continuity - as of 2001 nearly 60% of federal officials were hired during communism (Brym and Gimpelson 2004: 109ff.) - modern Russia inherited the patrimonial character of the Soviet public administration and the proprietorial office holding resembling the system of *kormlenie* (Fisun 2012: 91). The system of particularistic exchange endured in the 2000s despite the consolidation of the political power: access to wealth and economic resources followed from connections and proximity to power, rather than possession of money (Robinson 2013b). Under president Putin, patron-client relations in Russia's political economy flourished and became further entrenched due to the favourable economic situation, which implied an increase of assets that could be distributed. Given Russia's dependence on hydrocarbons and other primary exports, factors associated with the 'resource curse' (e.g. Ellman 2006) as well as rent-distribution from the hydrocarbon sector to the industry (Gaddy and Ickes 2013) may have further contributed to the entrenchment of patrimonialism.

'Bottom up' accounts of the endurance of Russian patrimonialism explore its socio-cultural sources, for instance deep-seated societal attitudes such as paternalism and social passivity (Dubin et al. 2008), the Soviet legacy of 'doublethink' and 'doubledeed' (Ledeneva 2013) and, crucially, the traditional prevalence of informal practices (Ledeneva 2006) and the existence of a vast shadow sphere in public life. The engrained preference for informal arrangements and ways to circumvent the law historically evolved as an adaptation strategy to the overregulating and often arbitrary Russian state in line with the popular wisdom that reads 'rigidity of our laws is compensated by their non-observance'. Thereby the traditional response to illicit activities has been promulgation of ever more rigid

laws, which has exacerbated the vicious circle by promoting further circumvention. For instance, in Soviet times, unwritten rules and informal practices proliferated as people struggled to adapt to the perennial shortage and an oppressive legal system in which legality (*zakon*) and justice (*spravedlivost*) were often far apart. Similarly, in the 1990s informal practices thrived given the deteriorating living standard, poor law enforcement and proliferation of crime (Ledeneva 2006).

The policies of the Putin administration and the increased living standard in the 2000s, however, have not undermined informality and patron-client relations due to the predominant socio-cultural attitude, or *normality of informality*. Many of the informal practices are still regarded normal in large parts of the Russian society, laws are routinely circumvented and most formal institutions are utterly mistrusted (Shlapentokh 2006: 155f.). Personal informal relations with local officials are perceived as vital because they guarantee special treatment and help to 'resolve issues'. One Moscow businessman refers to it as 'administrative resource': 'When you become big [business], you have friends in the procuracy, the investigation committee, the ministry of the interior ... No need to pay bribes to anyone.' (interview with B23¹⁶). However, corruption is entrenched, along the motto 'I never bribe traffic police. Only if they want to take away my driving license!' (interview with B16). Corrupt practices such as tax evasion (B8, B20, B22), kickbacks (B7, B12) or bribery and the use of black cash (B3, B14) are lamented yet sometimes considered inevitable given the widespread notion that 'everybody else does it'. This bolsters the acceptance of informal practices, turning them into the social norms of everyday life and business operations. Normality is a crucial aspect since it renders society inert and helps sustain the continuity of patrimonialism.

Patrimonialism subverts liberalisation

In the 1990s Russia moved towards liberalism by privatising large swaths of the formerly state-owned economy and liberalising the labour relations. However, patrimonialism arguably subverted the liberalisation process, having turned the privatisation of state assets from a classical liberal policy into a particularistic appropriation of formerly state-owned

¹⁶ For the list of interviews please refer to the appendix.

assets by politically-connected insiders, thus perpetuating the traditional close link between power and property.

The major beneficiaries of Russia's privatisation were the Soviet-time enterprise managers ('red directors') and the Russian bankers who later became known as the oligarchs. Both groups were able to appropriate lucrative assets thanks to their political connections back in Soviet times: the red directors per se belonged to the former Soviet *nomenklatura*, while the future oligarchs had links to it or to the communist youth organisation *Komsomol* and hence had access to insider information and the financial resources of the Communist Party (Kryshtanovskaya and White 2005).

The appropriation of state assets by the insiders started during Gorbachev's *perestroika*, favoured by the waning state control and partial economic liberalisation. This 'spontaneous privatisation' allowed the oligarchs to make their first fortunes and the incumbent managers to reap profits and tap resources from state-owned enterprises without legally owning them (Aslund 2007: 57ff., 160). This paved the way for further asset appropriation after the fall of the Soviet Union in the course of privatisation. Its first round, the voucher privatisation of 1992, benefitted primarily the former enterprise managers, who had a vested interest in protecting their de-facto ownership from re-allocation and were ultimately able to seize control and effective ownership of the companies they were managing (McFaul 1995).

The second round of privatisation, the 'loans-for-shares' auctions (1995-1997), was captured by the oligarchs, who thanks to the direct access to president Yeltsin were able to rig the auctions and obtain stakes of the country's leading enterprises at a fraction of their potential market value. In order to secure their ill-gotten wealth, in 1996 the oligarchs ensured the re-election of the increasingly unpopular Yeltsin through massive financial and media support (Goldman 2010: 63ff.). We conclude that the infamous scheme was not only an instance of state capture by big business, as the predominant assessment suggests (e.g. Yakovlev 2006), but also a manifestation of patrimonialism because it demonstrated the entrenchment of patron-client relations: the oligarchs, historically connected with the political establishment, financed the latter and in return exerted influence on political decision-making and received

privileged access to the most profitable forms of entrepreneurship. Overall, contrary to the intentions of the reformers, Russia's privatisation programme did not create a fully-fledged liberal market economy but rather implied two waves of patrimonial asset appropriation by well-connected insiders in the context of a weak state.

Patrimonialism limited also the liberalisation of the capital-labour relations. Despite privatisation and a dire financial situation many enterprises kept redundant workers on the payroll since managers, who nurtured relationships with government officials, were keen to secure their own jobs and thus private access to resources (noteworthy, many troubled enterprises continued employing excess workers only nominally, pushing them into the informal economy). Rather than adapting to competitive market, enterprises pursued the system of particularistic exchange, which implied rent seeking, spread of barter as well as mounting payment arrears and proliferation of unpaid leaves. Liberal reforms, especially minimum wage provisions and regulations authorising dismissals, were subverted this way. Moreover, many firms routinely circumvented legal provisions governing labour relations given the low enforcement capacity of the state, leading to informalisation of employer-employee relations (e.g. employment without formal contract, 'envelope' salaries etc.) (Kapelyushnikov 2009: 20f.).

Despite the deteriorating situation of the workers and the legal recognition of the right to strike the level of industrial conflict remained low: instead of going on strike workers preferred to rely on clientelistic arrangements with the management, which gave them access to non-wage supplements and covert earning schemes (Kapelyushnikov et al. 2012: 181ff.). This perpetuated the paternalistic ties between workers and managers that used to be at the heart of the Soviet labour model and hampered the transformation of trade unions into viable workers' organisations (Cook 2012: 320). The holdover communist-era union federation FNPR continued the old practice of cooperation with the management and the state rather than on defending workers' rights, and concentrated on protection of union prerogatives as well as on management of vast property inherited from Soviet times, including prestigious premises, sporting facilities and holiday resorts (Ashwin and Clarke 2002: 90ff.).

Patrimonialism undermines etatisation

Patrimonialism not only had an impact on the process of liberalisation in the course of the 1990s, it also subverted Russia's turn to statism in the 2000s. Two major statist policies of Putin's administration – strengthening of the state and nationalisation in 'strategic' economic sectors (Goldman 2010: 99ff.) – were undermined by entrenched patron-client ties between the state and business, even though the terms of those relations were changed to the fiscal advantage of the state (Robinson 2013a: 194), and enabled further appropriation of productive assets, notably by the bureaucratic elites.

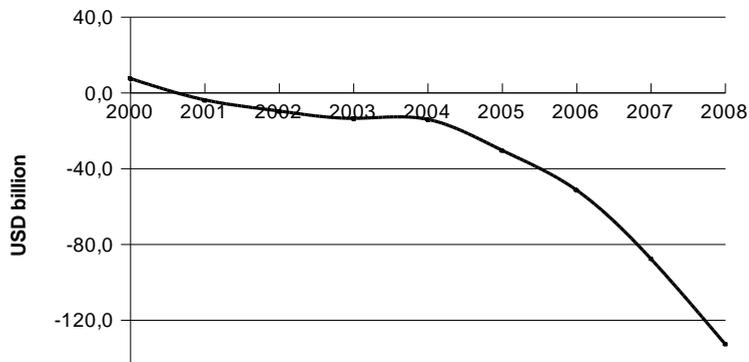
The policy of the strengthening of the state was ambiguous: on the one hand, the windfall from hydrocarbons indeed allowed the president to bolster his political power, to receive a larger basis for elite mobilisation and to centralise the state (albeit at the expense of some democratic freedoms); on the other hand, these moves concerned primarily the coercive state capacity as illustrated by the increased powers of the security agencies. At the same time, the facilitating state capacity was undermined by patrimonialism: clientelistic connections allowed Putin's friends or aides to advance into key positions in politics and economy (Albats and Ermolin 2011¹⁷), while the implementation of ambitious socio-economic programmes suffered from administrative weakness and corruption. Proliferation of kickbacks in public procurement is an illustration (Makarov 2011; Nemtsov 2013; Arkhipov and Meyer 2013), leading to large-scale embezzlement and considerable financial pressure notably on small- and medium-sized companies. For example, an owner of a small Moscow-based construction firm laments: 'If we win [a tender] with the known contractors..., sometimes we come to an arrangement to reduce their share [of the kickback]. ... But bargaining does not always work.' (interview with B7). Moreover, the state's ability to set strategic priorities, implement policies and act innovatively and flexibly was declining throughout the 2000s, from 6 out of 10 points in 2003 to 4.7 points in 2014 (Bertelsmann Transformation Index, indicator 'steering capability'; in comparison, in 2014 the steering capability was 5 points in China, 8,3 in Brazil and 7 in India). Instead of routinely addressing

¹⁷ For the workings of Putin's paternalism and system of governance, see an excellent account by Ledeneva 2013.

arising problems, the state often resorted to 'manual steering' which required the involvement of the top political authority (Petrov 2011).

The weakness of the facilitating state capacity can be further illustrated by Russia's 'innovation gap' to the advanced economies, which has increased in the decade up to 2010 (Pro Inno (2011); those of China and Brazil have narrowed, and that of India has remained stable). Diversification of the economy away from hydrocarbons was not achieved: Russia's non-oil and non-gas exports have sharply declined, as the negative trade balance figures reveal (Figure 2), and attempts to develop a vivid high-tech sector have not been successful.

Figure 2: The Russian non-oil and –gas trade balance, 2000-2008



Source: OECD 2009: 9.

Patrimonialism further subverted another major statist policy of Putin's administration - nationalisation in the pivotal industries and concentration of strategic economic assets in state corporations. These moves do not appear as genuine statist policies deemed to be in the public interest for the sake of economic development. Rather they appear as clientelistic redistribution of property in favour of the incumbent bureaucratic elites akin to Weber's granting of prebends and tax-farming opportunities: loyal incumbent members of the executive branch - foremost the *siloviki* (officials of law-enforcement agencies) - were placed on corporate boards of state companies, providing the officials with access to budget funds and hence vast rent seeking opportunities (Sakwa 2013: 87).

The appropriation of assets by the bureaucratic elites was facilitated by the legal environment marked by excessive and often ambiguous business

regulations. This encouraged circumvention and made the breach of some formal rules inevitable (Yakovlev 2006: 1048), thus making business vulnerable: the Damoclean sword of sanctions was hanging over virtually every entrepreneur. Moreover, business was exposed to pressure by state officials who used formal rules as a pretext for achieving personal goals. For instance, bureaucratic extortion became commonplace, typically during tax inspections. In the words of a furniture manufacturer from the provincial town of Kaluga, who faces regular tax extortion, '[tax inspectors] come with an obvious 'plan': penalty strictly depends on your turnover. ...The tax collection plan definitely exists. I know for sure because I talked to the folks from the tax authority.' (interview with B17). Doing business in many regions became contingent on 'cooperating' with designated 'affiliated firms', owned by local politicians' relatives. Another businessman recalls negotiating to build a factory in a provincial region:

'The mayor came and said: "We need a fountain. Costs - 10,000 Euro. You build a fountain at the city square and everything will be good." He gave us a company that builds fountains, we paid to that company. As a result a small puddle was built on the square and a huge fountain at the mayor's summer residence.' (interview with B14).

Against the backdrop of patrimonialism, the strengthening of the coercive state capacity exacerbated the situation, empowering state officials to subvert formal institutions, such as courts and tax authorities, and to turn them into a tool for legal harassment, expropriation and, ultimately, private enrichment. The proliferation of illicit corporate raiding - hostile takeovers of assets by means of physical and administrative coercion - is a case in point (Rochlitz 2013). The apparent increased involvement of the *siloviki* in raiding in the course of the 2000s marks an informal redistribution of productive assets in favour of this group (Ledeneva 2013: 189ff.).

Patrimonialism undermined also the development of the capital-labour relations further on through the 2000s. Formal policy was aimed at de-regulation: the new Labour Code, adopted in 2002, on paper liberalised the labour relations and introduced greater flexibility in, among other, hiring and firing (Cook 2012: 323). Also the enforcement of the labour legislation improved compared to the 1990s. Nonetheless, clientelistic

arrangements continued to flourish, demonstrating the persisting gap between formal rules and the actual practice. For instance, the 'black-and-white salaries' proliferated both in private companies and in the public sector where the black cash typically originated from kickbacks in public procurement. Not fixed in any contract, the underhand 'envelope payments', which are estimated at about 50% to the official average wage, kept the labour costs flexible, at the same time enhancing the personal dependence of the workers on the employer (Kapelyushnikov et al. 2012: 185). Similar to the 1990s, oftentimes workers preferred to rely on paternalist relations with the management and individual arrangements instead of collective bargaining. Conspicuous labour quiescence in the 2000s was also due to the fact that strikes became almost impossible given the numerous restrictions in the new Labour Code, while collective rights of unions eroded and the leading trade union federation FNPR became incorporated into an alliance with the ruling party *United Russia* (Cook 2012: 322ff.).

On balance, the development of Russia's political economy in the 2000s implied a very specific turn towards coercive statism blended with patrimonialism. The latter hindered the rise of the economically facilitating state capacity and subverted the policy of nationalisation as well as the institutionalisation of capital-labour relations. Bureaucratic elites (including trade union functionaries) advanced as the primary beneficiaries of this process, who were able to use public property for personal aims and to tap the cash flow from private firms.

Russian development comparatively specified

The goal of this section is to become more precise on identified political-economic changes in Russia. How much did Russian capitalism de-liberalise under Putin as compared to the Yeltsin years, and which scope and impact did patrimonialism have? To tentatively answer these questions we will make use of statistical data on Russia. To determine the specificity of the Russian development, we will also consider data of other three BRIC countries and the USA as highly liberal contrast. To recapitulate, we work with a two-stage typology: stage one is dichotomous and consists of liberal and embedded capitalism, which is

sufficient to identify levels of (de-)liberalism; stage two differentiates embedded capitalism into its statist and patrimonial components.

Indicators, data and limited precision

The localisation of empirical capitalist varieties and their trajectories in the field between the ideal types at time T_1 and at T_2 has to be based on data and features that indicate the locations, such as for instance level of private company ownership, political market regulation, tax progression, public expenditures, employment protection and corruption. It has to be stressed that only some precision of measurement is possible here since the indicators are often 'soft' survey-based data, while qualitative data needs to be quantified. Regarding certain indicators or years data are lacking and those available only crudely approximate the relevant reality. Sometimes data are to some degree 'subjective' and comparisons lopsided. If not all indicators should have the same weight, what is the logic of differentiation? Any quantification of quality and any weighting of indicators involves some degree of arbitrariness and therefore inevitably violates the principle of precision (cf. Becker 2014).

The available data are based on surveys and law texts and are collected by the Heritage Foundation (*Index of Economic Freedom; IEF*), the OECD (indices of *Product Market Regulation [PMR]* and *Employment Protection Legislation [EPL]*) and the World Bank (*Worldwide Governance Indicators [WGI]*). These organisations have a liberal bias (the IEF, for example, attributes extremely low scores for high levels of public spending) but this does not distort every use of the data. The PMR, EPL and IEF indices reveal a dichotomous structure of market versus political regulation with the IEF adding corruption as third dimension. They are suitable for the differentiation between liberal and embedded capitalism. Each the IEF and the OECD data will count for one half of the total liberal score. The score for embeddedness is the residual one. This method is justified by the fact that the indices run from totally liberal to totally non-liberal. Therefore, the non-liberal score can be specified into the score of embeddedness. The WGI data measure effective political and judicial regulation and can help to differentiate the residual score of embeddedness into statism and patrimonialism. Here, where low statism

corresponds with high corruption levels, patrimonialism is the residual category.¹⁸

Stage 1: the movement between liberal and embedded capitalism

Let us start with the *Index of Economic Freedom*. It is the broadest index and works with a scale of 0 to 100 of 'freedom'/liberalism. The IEF is composed of ten single indicators, each of them with the same weight: 1) business freedom, 2) trade freedom, 3) fiscal freedom (taxation level), 4) government spending, 5) monetary freedom (how much inflation and political price distortion?), 6) investment freedom, 7) financial freedom, 8) property rights (legal protection of private property), 9) freedom from corruption and, since 2008, 10) labour freedom. So we have nine indicators for 1998 and 2008 of which we will neither include monetary freedom because it is strongly bound to a certain idea of the causes of inflation and price distortion nor property rights, which are an aspect of the rule of law and accounted for in the WGI.

Attempting to soften the liberal bias of the IEF, we have put together freedom of trade and freedom of investment, because separately they would count too much as compared to, for example, business or labour freedom. We also merged the related fiscal freedom and government spending because taxation and public spending are highly related. Moreover, the IEF gives very high scores to low spending. The reasoning is: the less a polity spends, the more liberal it is. However, taxes and public spending are generally relatively low in the BRICs. Given their stage of economic development and social individualisation this is quite normal, particularly in China and even more in India, and is hardly a result of liberal policy.

Thus, the selected indicators of the IEF are: *business freedom* (level of regulation of business operations); *trade freedom* (level of trade restrictions) put together with *investment freedom* (easiness to invest; level of equality of opportunity to invest); *fiscal freedom* (the taxation

¹⁸ In the WGI the continuum runs from effective statism to non-effective statism. Parallel the WGI includes a continuum from high to low corruption. This continuum is only indirectly related to the former one, but we understand it as opposite to effective statism and therefore use it as a residual category of patrimonialism (of which corruption is the main ingredient).

level) put together with *government spending*; *financial freedom* (the business freedom of the financial sector) and *freedom from corruption*. Table 1 shows the scores.¹⁹

Table 1: Index of Economic Freedom, 1998 and 2008; selected indicators (range 0-100)

	Average ¹		Business		Average of fiscal F & public spending ²		Financial		Average investment & trade F		Freedom from corruption	
	1998	2008	1998	2008	1998	2008	1998	2008	1998	2008	1998	2008
Brazil	45.5	44.1	70	54.0	81.6	62.0	33	40	53.9	65.6	30	33
China	39.6	40.5	55	50.3	88.2	78.1	33	30	42.0	50.1	24	33
India	36.4	42.3	55	50.9	78.5	74.6	30	30	31.6	60.5	26	33
Russia	48.1	38.6	55	53.7	70.8	74.4	70	40	54.3	37.1	26	25
USA	73.7	82.1	85	92.6	62.3	81.3	70	80	74.2	83.4	77	73

¹ Average of 7 of 10 indicators (monetary freedom, property rights and labour freedom – only data for 2008 – are excluded); ² Regarding the BRICs this indicator only counts for 50% in the calculation of the average.
Source: Heritage Foundation 2012

The table shows that the BRICs experienced a differentiated development. The data show Russia having de-liberalised, particularly in the sectors of finance, trade and investment. Although not reflecting the nationalisation of some key industries, this development is roughly in line with the account of the previous part of this paper that emphasised Russia having de-liberalised under Putin. It also shows that the corruption level in Russia has remained stable and is higher than that of the other BRICs.²⁰ Overall, China appears to have hardly changed, Brazil appears

¹⁹ A general feature of the IEF is that the average country scores are relatively close to each other. This is due to the systematic of the IEF. It implies that the differences between the countries mentioned would become larger when the range from 30 to 100 would be set 0 to 100. From 0 to 30 there are no overall scores. Something similar can be said about the PMR and EPL scores with their scale from 0 to 6. There are nearly no scores higher than 4.

²⁰ The scores of the *Corruption Perception Index* of Transparency International (2011) in many cases deviate from those of the IEF. In Russia, for example, corruption has increased more in the CPI than in the IEF. Its score moved from

relatively stable (though year-by-year data show it liberalising until 2003 and then de-liberalising – particularly due to the social policies of the Lula government; cf. Boschi and Gaitan (2009)) and India is the only BRIC country that has considerably liberalised. Taxes and public spending also rose in China and India, but more than in the richer Brazil this has probably been the result of the fast modernisation related to industrialisation and urbanisation.

To see whether the OECD's scores for *Product Market Regulation* and *Employment Protection Legislation* confirm or correct the IEF data we have to refer to Table 2. EPL informs about the commodification of labour, and in this text it is the main indicator of the capital-labour relation. PRM is more complex and consists of many sub-indicators. The first layer contains 'state control', 'barriers to entrepreneurship' and 'barriers to trade and investment', which all count for one third in the overall PMR index. While the last two sub-indicators are also part of the IEF and might balance the IEF data, state control is specific to the PMR index. Sub-indicators of state control are 'public ownership' and 'involvement in business operations', which at a lower level are subdivided in 'scope of public enterprise', 'price control' and a few other indicators (Wölfl et al. 2010: 8).

Table 2: Product Market Regulation and Employment Protection Legislation

	Product Market Regulation ¹		Converted PMR ³		Employment Protection ^{1,2}		Converted EPL ³	
	1998	2008	1998	2008	1998	2008	1998	2008
Brazil	(2.00)	1.94	66.7	67.7	2.6 ⁴	2.3	58.4	61.7
China	(3.40)	3.30	43.3	45.0	3.0 ⁴	2.7	50.0	55.0
India	(3.71)	2.75	47.5	54.1	2.8 ⁴	2.3	53.3	61.7
Russia	(2.34)	3.09	61.0	48.5	1.9 ⁴	1.9	68.2	68.2
USA	1.28	0.84	78.7	86.0	0.7	0.7	80.0	83.0

2.4 in 1998 to 2.1 in 2008 (the lower the score, the higher the corruption) while Brazil moved from 4.0 to 3.5, China remained stable at 3.5 and India improved from 2.9 to 3.4.

¹ Scale 0 (no regulation/protection) - 6 (fully regulated/protected); the scores for the BRICs in 1998 are estimated on the basis of their development in the IEF; ² version 2; ³ 6 minus PMR and EPL score respectively multiplied by 100/6; ⁴ 2003 Sources: Employment protection: OECD Library (n.a); OECD 2010: 171 (BRICs 2003), Product market regulation: OECD Statistics Portal (n.a.)

In the realm of PMR the results are very similar to that in Table 1: Brazil was rather stable, China liberalised a bit, India's liberalisation is worth mentioning, and Russia de-liberalised considerably, although – contrasting the IEF statistics – the country appears still more liberal than China. We should not forget, however, that the BRICs' scores are derived from the data for 2003 and then have been estimated for 1998 on the basis of their development in the IEF (in the table indicated by brackets). Keeping in mind that re-etatisation by the Putin administration commenced around 2003, the Russian estimate should be roughly correct. In India, China and Russia PMR is still much more rigid than in the USA, and Brazil is in-between. A look at the sub-domain of state control (the extent to which governments influence firm decisions; this indicator determines the PMR index for one third) reveals a similar picture. In 2008 the USA scored 1.1 while China (4.63), Russia (4.39) and India (3.58) still had a high level of state control and Brazil (2.69) was again located in-between. The development of the EPL level reveals a similar picture. China and Brazil liberalised more than in PMR, but the most significant exception is Russia where, according to the data in the table, the level of employment protection did not change at all. This may be due to the fact that no data are available before Putin's reform of the labour market in 2003. However, in part one we have seen that on paper capital-labour relations were liberalised under Putin, even though formal rules have been undermined by patrimonial practices.

Now we can average the IEF, PMR and EPL scores to calculate overall values of economic liberalism, and, by subtracting these scores from 100, overall scores of embeddedness. However, depending on the level of corruption reality might differ from the intentions of law texts and other codified regulations that the PMR and EPL indices are based upon. For this reason it makes sense to adjust the PMR and EPL figures for corruption. It will be done by using the corruption data of the *Index of Economic Freedom*. In Table 1 corruption determined the average scores

for 20%. Giving corruption with respect to PMR and the EPL the same weight as in Table 1 the formula to be applied in Table 3 is: $([2 \times \text{PMR}] + [2 \times \text{EPL}] + \text{IEF-corrption}) / 5$.

Table 3: Overall liberal scores in 1998 and 2008 (scaled 0-100)

	Economic Freedom average		Average of PMR and EPL adjusted for corruption ¹		Overall liberal score		Extent of embeddedness	
	1998	2008	1998	2008	1998	2008	1998	2008
Brazil	45.5	44.1	56,0	57.8	50.8	50.9	49.2	49.1
China	39.6	40.5	42,1	46.6	40.9	43.6	59.1	56.4
India	36.4	42.3	45,5	52.9	41.0	47.6	59.0	52.4
Russia	48.1	38.6	56,9	51.7	52.5	45.1	47.5	54.9
USA	73.7	82.1	78.9	82.2	76.3	82.2	23.7	17.8

¹ Adjusted by the corruption score of the Index of Economic Freedom; as in Table 1 it is related to four other scores, in this case to two times each the converted PMR and EPL scores

Table 3 confirms that Russia was the only BRIC country that de-liberalised between 1998 and 2008. This finding is in line with the case made in part one of the paper: Russia underwent a de-liberalisation in the 2000s. China and India liberalised (for different views see Huang (2008) on China and Kohli (2006) on India) while Brazil hardly changed. Based on Table 3 we can draw a figure localising the BRICs' political economies on the axis between ideal-typical liberal capitalism and ideal-typical embedded capitalism (Figure 3). Fractional digits are not relevant here. Since there are no scores below 40, the axis starts at level 25.

Figure 3: Location of select political economies on the axis between the liberal and embedded ideal types in 1998 (beginning of arrow) and 2008 (end of arrow)



Stage 2: Indicating change in the field between liberalism, statism and patrimonialism

The next step is to divide the scores of embeddedness into those of statism and patrimonialism. This will be tentatively done on the basis of the values of the *Worldwide Governance Indicators* – tentatively because the WGI data are not exhaustive. Rather pointing to state capacity, WGI data only indirectly indicate statism. Put into this perspective, we cautiously assume that the higher the WGI scores for 'government effectiveness', 'regulatory quality' and 'rule of law', the higher the level of statism within the residual category of embeddedness. Table 4 shows the scores of the WGI. In the WGI scale the highest score is 2.5 and the lowest –2.5. Again, at first sight it seems that the differences between the BRICs and the USA are large. Yet the differences shrink when the WGI scores are converted in a scale from 0 to 100 (column 4 of Table 4). With statism embeddedness to be quantified in this table, patrimonial embeddedness will be left in the basket as residual category.

Table 4: Worldwide Governance Indicators 1998, 2008, scaled -2.5 - 2.5 and converted

	1: Government Effectiveness ¹		2: Regulatory Quality ¹		3: Rule of Law ¹		4: Converted average of 1, 2, 3 ²	
	1998	2008	1998	2008	1998	2008	1998	2008
Brazil	-0.13	0.00	0.44	0.07	-0.32	-0.37	50.0	48.0
China	-0.14	0.19	-0.26	-0.16	-0.37	-0.34	44.8	48.0
India	-0.06	-0.02	-0.36	-0.33	-0.28	-0.08	45.4	47.2
Russia	-0.76	-0.37	-0.47	-0.45	-0.94	-0.96	35.6	37.8
USA	1.76	1.52	1.62	1.55	1.59	1.66	83.1	81.6

¹ Scaled from - 2.5 to 2.5, ² -2.5 is converted into 0, the original 0 into a converted 2.5, the original 2.5 into the converted 5 and all scores are multiplied by 20.

Source: World Bank 2012

The most striking feature is that the Russian scores of the indicators 1 - 3 in both 1998 and 2008 are clearly below the level of those of the other BRICs. The average value of the Russian scores has slightly increased, although 'regulatory quality' and 'rule of law' have not. This is roughly consistent with the description in part one of this paper, which noted a poor steering capability, a low facilitating state capacity as well as the weakness of the judicial system, which is often misused by rent seeking officials to harass entrepreneurs or extort bribes. Notably, the level of statist embeddedness in Russia is still low, as suggested by the average scores of the three WGI indicators in the last column of the table. This indicates that state involvement, which should not be confused with statism, is more patrimonial (i.e., based on particularistic gains) than statist (i.e., based on universalist principles).

With the mentioned precision limits in mind, the level of statism (S) can be determined on the basis of the preceding tables. It will be done by calculating the average converted score of 'government effectiveness' (WGI₁), 'regulatory quality' (WGI₂) and 'rule of law' (WGI₃) as percentage of the extent of (statist/patrimonial) embeddedness (E) as fixed in Table 3. The formula is: $S = (WGI_{1+2+3}) \times E/100$. Subsequently, the residual level of patrimonialism (P) can be established by subtracting

statism (S) from the extent of embeddedness (E): $P = E - S$. Table 5 shows the results.

Table 5: Establishment of rough levels of statism and patrimonialism (%)

	Level of liberal capitalism		Average of WGI _{1, 2, 3} as	% of the extent of embeddedness	= level of statism	Average of WGI _{1, 2, 3} as	% of the extent of embeddedness	= level of statism	Relative level of 'patrimonialism'	
	1998	2008	1998	1998	1998	2008	2008	2008	1998	2008
Brazil	50.8	50.9	50.0	49.2	24.6	48.0	49.1	23.6	24.6	25.6
China	40.9	43.6	44.8	59.1	26.5	48.0	56.4	27.1	32.6	29.3
India	41.0	47.6	45.4	59.0	26.8	47.2	52.4	24.7	32.2	27.7
Russia	52.5	45.1	35.6	47.5	16.9	37.8	54.9	20.8	30.6	34.1
USA	76.3	82.2	83.1	23.7	19.7	81.6	17.8	14.5	4.0	3.3

The conclusion based on Table 5 is that at both points in time, in 1998 and 2008, the BRICs represent a rather homogenous group of countries: all of them are much less liberal than the USA and feature high levels of statism and similarly high levels of patrimonialism. However, if we focus not on points in time but on the process of change - the core interest of this paper - we find a different development in Russia as compared to other BRICs. The main finding is that, based on our indicators, Russia moved into the *opposite* direction than the BRICs: it was the only country that de-liberalised. India liberalised considerably, China liberalized somewhat while Brazil hardly changed.²¹ While Russia was the most liberal BRIC country in 1998, it de-liberalised so much that it became the second (after China) least liberal BRIC country in 2008. Brazil was the most liberal country in 2008, followed by India.

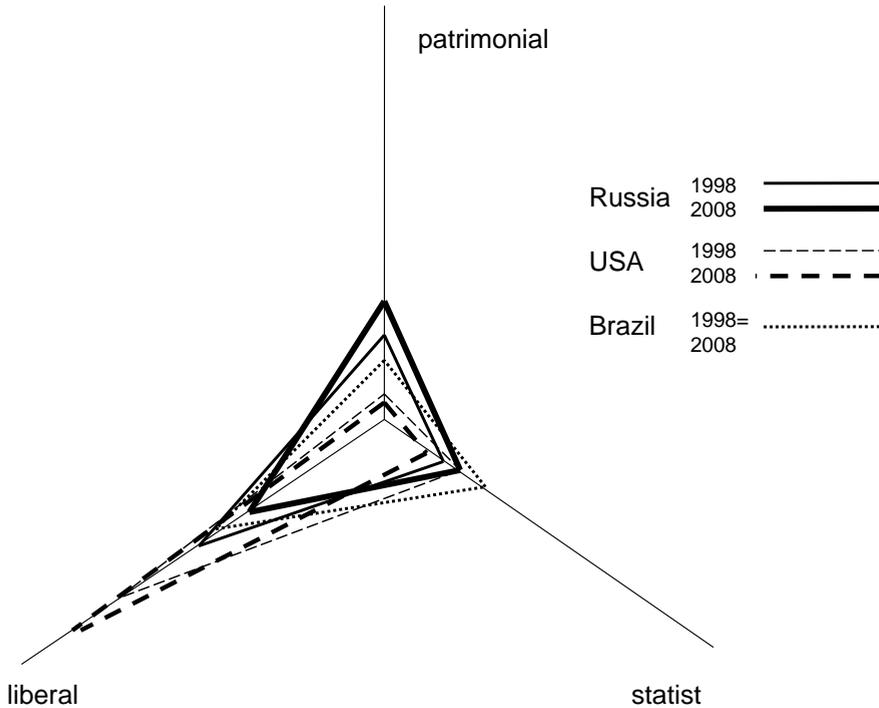
At the same time, Russia is revealed to be an outlier in terms of patrimonialism: it was the country with the highest level of patrimonialism and the only BRIC country where patrimonialism considerably increased between 1998 and 2008. Based on our indicators, in 1998 the Russian level of patrimonialism resembled that of China and

²¹ For a detailed treatment of the trajectories of the BRICs, see Becker 2014: 47ff. and the respective country chapters in the same volume.

India (in fact, it was even lower), but in 2008 it clearly exceeded it. While China and in particular India diminished their levels of patrimonialism between 1998 and 2008, Russia's patrimonialism increased. As for Brazil, its patrimonialism hardly changed, but was significantly lower than the Russian value for both years. Moreover, Russian patrimonialism is revealed to be much higher than the country's level of statism, which in both years was lower than in other BRICs. This supports the analysis of part one of this paper where we stressed that patrimonialism undermined both the liberalisation of the 1990s and the turn to statism in the 2000s.

One might twist whether the WGI 1, 2 and 3 data are appropriate indicators of statism and whether the residual value, the only identifiable indicator of which is corruption, truly reflects the level of patrimonialism. At this moment, however, the IEF, PRM, EPL and WGI data are the sole coherent basis for determining with some precision the respective levels of liberalism, statism and patrimonialism in emerging economies. Bearing these caveats in mind, we can comparatively map the development of Russian capitalism. This exercise has to give an impression of the trajectory of change at a glance. Fractional digits and even single percentage points will be ignored, and very small differences like those between Brazil in 1998 and 2008 cannot be shown (on a ray of 10 cm, one index/percentage point would be one millimetre). For the sake of clarity the Chinese and Indian values, which are often very close to the Russian ones, are not included. The comparative perspective is therefore limited to the highly liberal contrast case of the USA and to Brazil. The latter is somewhat similar to Russia in terms of size and dependence on basic materials.

Figure 4: Russia, Brazil and contrast country USA mapped in the field between three ideal types*



* Each ray starts at zero in the center of the figure and has a value of 100. 100 is also the true value of each spider wire over the three dimensions.

Concluding remarks

According to a widely shared interpretation, Russia's political economy was liberalised since the early 1990s and started a process of re-tatisation a decade later. We have amended this interpretation by a systematic incorporation of patrimonialism - political-economic organisation characterised by clientelistic state-business and capital-labour relations as well as patronage. Thereby we built on the work of scholars concerned with the interaction of the patrimonial and the legal-

rational sphere and proposed a framework for assessing the scope of patrimonialism in Russia's political economy and its impact on the country's trajectory of change.

We integrated patrimonialism into the analysis by conceptualising Russian political economy as a dynamic hybrid of three ideal types of capitalism: liberalism, statism and patrimonialism. This hybrid changed from a fairly liberal and, to a considerable degree, patrimonial economic form in the 1990s, to a less liberal, more statist and, notably, even more patrimonial form in the course of the 2000s. Thus the main direction of change was decreased liberalism and increased patrimonialism. We showed that the latter decisively affected Russia's trajectory: in the 1990s patrimonialism undermined the liberalisation, turning it into a sell-off to rent-seeking insiders; in the 2000s patrimonialism hindered the rise of statism in the sense of higher facilitating state capacity. It was the coercive state capacity that rose – a capacity in the context of which private enrichment of elite groups, notably the *siloviki*, could flourish. Similarly, patrimonialism hindered the institutionalisation of capital-labour relations by sustaining patron-client networks, perpetuating paternalistic arrangements between managers and workers and by allowing some managers and trade union functionaries to use the power of their respective positions for private appropriation of economic advantages. We also conclude that Russian patrimonialism changed its form between Yeltsin- and Putin-periods, from predominantly society-initiated to predominantly state-initiated. In the 1990s patrimonialism had a largely bottom-up character with a central role of the oligarchs, while in the 2000s it had a more top-down character with a central role of the *siloviki*.

In comparative perspective the main finding is that Russia was the only BRIC economy that de-liberalised in the decade after the late 1990s, while Russian patrimonialism increased to the highest level among the BRICs by 2008. Thus in terms of trajectories of change, Russia is an outlier, even though generally all BRICs share, relative to for instance advanced industrial economies, similar levels of relatively low liberalism and relatively high statism and patrimonialism. Generally, the statistics corroborate the paper's conceptual assessment and quantitatively reveal the direction of change. The data also underscore that Russia's re-

etatisation in the 2000s signals merely a rise of state involvement, not a move to more statist political interventionism on the basis of general rules. Government effectiveness, including the effectiveness of its coercive tasks, slightly increased, but regulatory quality and the presence of the rule of law remained at their very low levels. In other words, the Russian state increased its political-economic involvement not in universalistic terms, but in particularistic, patrimonial terms.

The empirical contribution of the above study is the quantitative assessment and comparative mapping of the trajectories of change in emerging economies offered here with reference to the BRICs. The suggested tool operationalises and combines measures of liberalism, statism and patrimonialism in ways that can be applied to other comparative studies and time periods, and should enhance our understanding of other emerging economies.

In theoretical terms, the main contribution is our conception of 'varieties of capitalism' that take explicit account of patrimonialism. We have argued that patrimonialism is more than an incidental feature like corruption or blemish on a particular type of capitalism. Instead, it is a competing logic of economic and social organisation that systematically obstructs and undermines ideal-typical liberalism and statism. More generally, political economies beyond the OECD world feature high levels of patrimonialism and cannot be adequately understood without the systematic attention to this clientelistic, particularistic dimension of politico-economic organisation.

In this context, our study may have established some useful theoretical and empirical ground rules for understanding the role of patrimonialism in comparative political economy, but it has only touched upon questions pertaining to the origins of patrimonialism and its impact on economic development. The study has been able to say little about where a given country's or period's combination of liberalism, etatism and patrimonialism might come from. What role do external factors, ideological conditions, technological or political conflict play in shaping the persistence of patrimonialism in Russian political economy relative to its BRICs counterparts, and in recent decades compared to the early post-Cold War period? An in-depth analysis of the origins and workings of Russian patrimonialism is yet to be done. Just as important, the present

study has been able to say little about the implications of patrimonialism for development goals. Which levels of patrimonialism are detrimental for economic development? Might patrimonialism in some ways 'facilitate' and compensate for the shortcomings of the formal system? All such questions we must leave for further study, but the present portrayal of patrimonialism as central descriptor of Russian and BRIC political economies underscores their urgency.

Chapter 3:
Trapped in informality:
The big role of small firms in Russia's statist-patrimonial
capitalism²²

Abstract

Manifestations of patrimonialism such as corruption and state predation on business are widespread in many emerging economies. This paper presents the case of Russian political economy, dubbed 'statist-patrimonial capitalism', which is marked by state threats to private property rights through bureaucratic extortion or legal harassment. How can we explain the resilience of Russia's statist-patrimonial capitalism? Predominant accounts focus on the lack of institutional constraints on state predation. The paper offers a different perspective by exploring the often-overlooked contribution of small- and medium-sized enterprises (SMEs). First, statistical data show a steady rise of SMEs in the 2000s despite increasing state predation, suggesting that SMEs are not simply subjugated by the state. Second, in-depth interviews with Russian entrepreneurs reveal that business contributes to the maintenance of the statist-patrimonial system through the mechanism of the 'informality trap': firms that choose the informal strategy have difficulties to return to the legal sphere and get stuck in informality. The drivers of informality include firm-specific characteristics, institutional factors and socio-cultural factors dubbed 'normality'. The mechanism of the 'informality trap' highlights the agency of firms in corrupt polities and may be applicable to other emerging economies.

²² This chapter is published in *New Political Economy* (Vasileva 2017).

Introduction

Overcoming corruption, tackling the shadow economy and limiting government predation on business are widely regarded as crucial for successful socio-economic development (Hickey 2012; Auberbach and Azariadis 2015). Many emerging economies face these challenges, Russia as much or more than most. Its current model of political economy emerged in the early 2000s and was consolidated during president Putin's rule. The model is marked by the pronounced involvement of the state in the economy, often referred to as 'state capitalism' (Lane 2008; Sakwa 2008; Hanson 2007), as well as various entrenched manifestations of patrimonialism such as clientelism, rent-seeking and corruption (Becker 2014; Robinson 2011; Easter 2008, King 2007)²³. One of its key manifestations is state-sponsored violent pressure on business, such as extortion, legal harassment and even illicit asset-grabbing (Gans-Morse 2012; Rochlitz 2013; Yakovlev et al 2014; Kosals and Dubova 2012). I dub this model 'statist-patrimonial capitalism'.

Such a pattern presents political economy scholars and policymakers with an important question: How does the statist-patrimonial system maintain and reproduce itself, and what role does business play? The various answers to this question in existing scholarship tend to emphasise the view that firms, in particular small and medium-sized enterprises (SME), are victims of state predation. One prominent argument explains the maintenance of Russia's statist-patrimonial political economy as reflecting the lack of effective institutional constraints on state predation (Markus 2012; Kluge 2017; cf. North and Weingast 1989). Thereby the state is viewed either as a strong authoritarian actor that subjugates business (Gans-Morse 2012; Paneyakh 2014), or as a weak institution that falls prey to corrupt officials who harass firms (Mendras 2012; Petrov 2011a; McFaul and Stoner-Weiss 2008). In this context SMEs²⁴ are commonly assumed to be suffering and squeezed by the state and its cronies in big business.

²³ Other attempts to characterise the Russian type of political economy were produced, for example kleptocracy (Dawisha 2014) or crony capitalism (Sharafutdinova 2010).

²⁴ I use 'small firms' and 'SMEs' interchangeably.

Another strand of research focuses on business strategies by firms, small or large, that actively resist state pressure. Studies examine formal tactics to protect property rights such as the use of courts or mobilisation of stakeholders (Markus 2012; Aitchison 2014; Gans-Morse 2012). Here, the expectation is that small firms ought to include at least some that seek such formal institutional resistance. This intuition emphasises formal defence strategies and downplays any informal strategies that often might prevail among firms in interactions with state agents (Yakovlev et al. 2014: 188). Informal business strategies are discarded as not deserving further investigation, perhaps reflecting a liberal bias and teleological perspective of studies of Russian political economy (Hedlund 2008), or the practical difficulties associated with the study of informality (Ledeneva 2013: 150). In this view, in any event, SMEs are thought to be important in Russia's political economy as potentially, but in fact weakly, resisting the development of statist-patrimonial capitalism.

This paper takes issue with these views of the role of SMEs in the development in Russian political economy. Acknowledging the important contribution of the state to that development, I argue that the recent consolidation of Russia's statist and patrimonial capitalist form was not purely a statist grab, and is more nuanced than a story of 'business subjugation'. In particular, I demonstrate that the bulk of economic actors, actors that are mainly SMEs, are implicated in the current politico-economic system and represent one of its pillars. At the same time, acknowledging the importance of formal corporate defence strategies, I argue that the much more widespread strategy involves informal arrangements, and that informal activities by SMEs contribute to the maintenance of the statist-patrimonial political economy.

My central hypothesis is that SMEs are one important pillar of the Russian statist-patrimonial politico-economic order. SMEs contribute to the maintenance of this order via the mechanism of the 'informality trap'. At the core of this mechanism is a vicious circle of informality: if a firm adopts an informal strategy (e.g. evades taxes or pays bribes), officials can use these illicit practices as a pretext for prosecution; to defend itself, the firm cannot readily deploy formal means (e.g. court) because of the committed violation and thus depends on informal arrangements with the officials. Stuck in the informality trap, SMEs inadvertently express

tolerance of the politico-economic system, profit from it, provide it with legitimacy and thus help sustain it.

To show how this might be so, I develop two sub-claims that clarify the vibrant coexistence of SMEs and Russian statist-patrimonial system, and the ways that such coexistence might be more than coincidence but in fact reflect SME contribution to that system: (1) Using descriptive statistics of the sector, I show that SMEs have not been suppressed but in fact have been rapidly developing despite state threats to property rights; (2) Focusing on informal business strategies of SMEs on the basis of in-depth interviews I can trace an active role of SMEs in the maintenance of the Russian system of economic governance and development.

A challenge to this argument might be that the statist-patrimonial political economy and informal strategies of firms may be causally unlinked. The system may maintain itself thanks to natural resource extraction (Rutland 2008) and rent-distribution chains (Gaddy and Ickes 2013), while SMEs' informal activity, tolerated by the system, may be due to underdevelopment, that is, poor legal institutions or the lack of resources. Indeed, a large body of literature in development economics shows that corruption may be even beneficial in the early stages of development, helping business to cope with institutional uncertainty and 'greasing the wheels' of economic development (Easterly 2006). Contrary to this interpretation, I will argue that SMEs' informal strategies may be not only a response to underdeveloped institutions or objective state pressure such as extortion, but also a matter of conscious choice reflecting the predominant societal 'normality of informality'. Rather than merely echoing corrupt patterns in the higher echelons of the political economy (see, for example, Barsukova and Radaev 2012; Ledeneva 2013), SMEs' behaviour has a causal impact on the statist-patrimonial system of its own.

The empirical contribution of the study lies in the account of the distinct role of small firms in the functioning and maintenance of Russia's statist-patrimonial political economy through the analysis of statistical data and evidence from in-depth interviews. I show how, far from being victims, small firms are complicit in the functioning of the statist-patrimonial system and actively reproduce it. I also account for the often neglected fact that different behaviour strategies (formal versus informal) may be

not equally available to firms. By examining a set of factors that make business opt for a particular strategy I explain why and under what circumstances firms may fall into the informality trap. In theoretical terms, the notion of informality trap offers an instrument for understanding the working and sustenance of Russia's current economic form and may help shed new light on broader questions about the resilience of highly patrimonial political economies (Becker 2014).

The empirical basis of the study is historic statistical data on SMEs from the Russian statistical service Rosstat, secondary literature and anecdotal evidence from semi-structured in-depth interviews conducted in spring 2014. Given the character of the data and the interpretation involved, it should be noted that no hard evidence can be provided for the working of the informality trap and the causal effect on the maintenance of Russia's statist-patrimonial capitalism that I describe. But the evidence is suggestive in its support for the hypothesised informality trap. My argument does not attempt an all-encompassing explanation of stability of Russia's current economic form. But it draws attention to an important factor that has not received sufficient attention in the discussion.

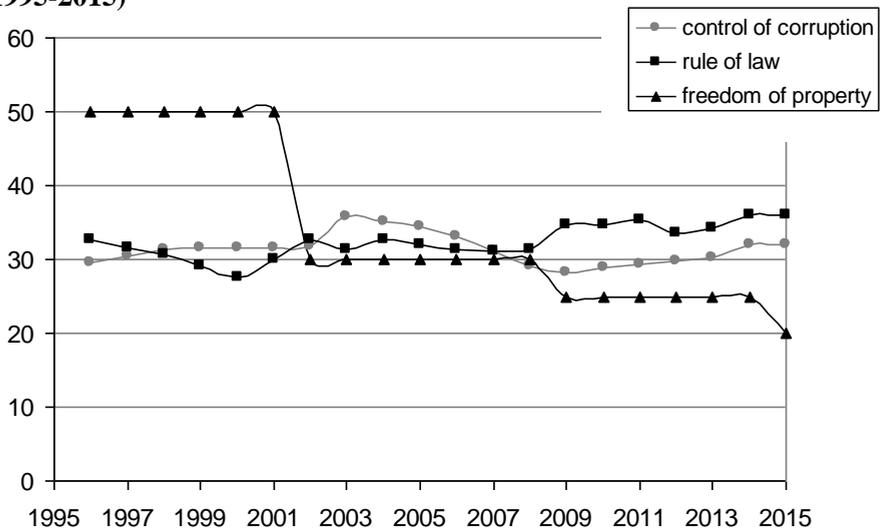
The remainder of the paper is structured as follows. Section II shows SME growth despite state threats to property rights by reviewing statistical trends. Section III details firms' contribution to the functioning of the statist-patrimonial system through the mechanism of informality trap, by providing a detailed analysis of firms' strategies based on data from the interviews. The concluding section IV reflects on the findings and suggests directions for further research.

The dynamics of small firm development

From examining Russia's business environment, it is evident that the indicators 'control of corruption', 'rule of law' and 'freedom of property' have done poorly in the past two decades (figure 5; cf. Becker 2014). *Freedom of property* has deteriorated, dropping from 50 to 20 points out of 100 since the 1990s, according to the Index of Economic Freedom (Heritage Foundation 2015). Private coercion (criminal protection rackets) that was rife in the 1990s has given way to state aggression such as extortion and legal harassment in the 2000s (Gans-Morse 2012). Regulatory officials and law enforcement agents have become notorious

state predators in Putin's Russia, using the judiciary and coercive state machinery for the attainment of their private goals. For instance, one quarter of firms surveyed by Gans-Morse in 2010 faced conflicts with the authorities regarding payments and fines, almost a fifth experienced extortion from tax agencies, 6% faced trumped-up charges and 8% came under a raiding attack (Gans-Morse 2012a: 6). A penalty like 'halting the operations up to 90 days' can be given for many, even minor, violations (for example, regarding ecological, sanitary or labour norms), and can make a small firm go bankrupt (interview with L2). This threat became imminent after the adoption of a new law in 2014, which allows not only judges but also law enforcement agents to impose this penalty. Moreover, law enforcement agents can threaten firms with criminal prosecution, often with the goal of extorting bribes or seizing lucrative assets (Volkov et al. 2010). The ban that prohibited pre-trial arrests of businessmen accused of economic offences along with other attempts to 'liberalise' the Criminal Code in 2010 did not have any significant effect on law enforcement practices. Overall, they did not help to reduce violent pressure on business (Yakovlev et al. 2014: 178).

Figure 5: Dynamics of corruption, rule of law and property rights (1995-2015)



Source: World Bank, World Governance Indicators; Heritage Foundation, Index of Economic Freedom. Note: all indicators are converted to a scale from 0 (lowest) to 100 (highest).

Similarly, a continually low level of *control of corruption*, though not a direct indicator of state predation, points to an adverse business environment. According to the World Bank, after improving in the early 2000s the situation has worsened again since 2003. Despite another very modest improvement since 2010, control of corruption has remained very low, just 32 points out of 100 (World Bank 2015). The share of firms who identified corruption as one of the top constraints to doing business in Russia more than doubled between 2002 and 2012, reaching 33% (BEEPS 2012). Similarly, a survey by Frye and colleagues shows that among manufacturing firms the perception that bribery is a major problem also increased between 2000 and 2007 (Frye et al. 2009: 41).

The *rule of law* improved slightly in the 2000s, but overall it remains at a very low level, according to the World Governance Indicators (36 out of 100 points in 2015). Such weak rule of law is expressed in biased judiciary and bureaucratic discretion in law enforcement. Both factors facilitate the predatory behaviour of state-backed wielders of violence. The judicial system is closely connected to and often sides with law enforcement bodies like the police, or investigation and prosecution authorities. This in turn results in the bias towards prosecution (Yakovlev et al. 2014: 175). Additionally, the internal performance standards and promotion incentives in the police (the so-called 'stick system', Paneyakh 2014) and rent-seeking of law enforcement officials has intensified the criminal prosecution of businesses (Nazrullaeva et al. 2013). The fact that economic crimes require a proactive investigation by Russian legal authorities provides its officials with significant discretion to probe and persecute a wide range of firms (Gans-Morse 2012: 285).

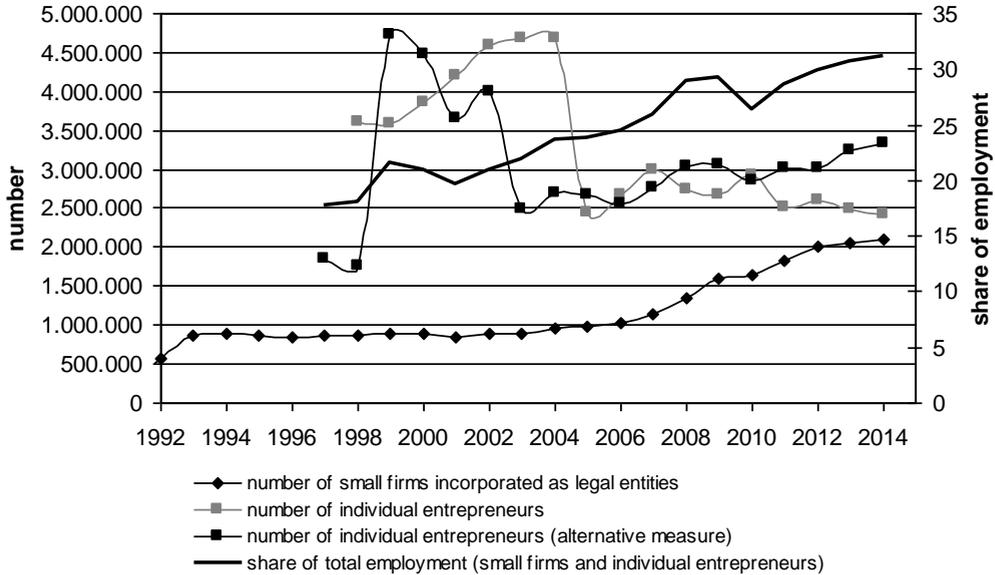
The World Bank's Ease of Doing Business ranking, which focuses on time and costs needed related to starting a business, registering property, getting electricity, construction permits and the like, shows an improvement in Russia's business environment: from the 123rd rank out of 183 economies in 2011 to the 36th out of 189 in 2016 (in 2017, it slid to the 40th place) (World Bank n/a). However, since the ranking captures formal requirements and does not necessarily reflect the reality on the ground - such as corruption and bureaucratic discretion - we need to take the results with a grain of salt.

Despite the adverse business environment and predatory pressure from rent-seeking bureaucrats, SMEs have been growing as a share of the economy.²⁵ Overall, the Russian SME sector is comparatively small, contributing roughly 20% of GDP as opposed to 50-60% in advanced industrialised economies. Big firms traditionally loom large in the Russian economy (Tompson 2012: 259). Only 2% of people consider starting their own business, compared with 26% in countries with comparable income (OECD 2014: 64). However, SMEs have been rapidly increasing since the 1990s, both in absolute numbers and in their share of total employment (figure 6). SMEs that are incorporated as legal entities²⁶ have increased almost tenfold in the last two decades, reaching more than 2 million in 2014. The rise was especially steep in the 2000s up until the 2008/2009 economic crisis. After 2009 SME growth slowed but recovered from 2011 onward. It should be noted that in the 1990s many firms were operating in the shadows and thus were not captured in official statistics. However, this is likely offset by the similarly high number of registered but idle firms, as well as shell companies (Polishchuk 2001). As a percent of the total number of firms SMEs also increased their share in the last decade and a half, from 92% in 1996 to 95.5% in 2014²⁷.

²⁵ In this statistical overview of SMEs I include firms (legal entities) and sole proprietors (individual entrepreneurs).

²⁶ I include legal entities with up to 100 workers, following the threshold used by the Russian statistical service (the standard international threshold is 50 workers). Although before 2008 Rosstat used a different assessment (various thresholds depending on the economic sector), we can assume the general comparability of the data. Firms with 101–250 employees are not included because data on them were not collected before 2008.

²⁷ Own calculations on the basis of Rosstat data.

Figure 6: Development of Russian SMEs (1992-2014)

Source: Rosstat, own calculations.

According to official Rosstat figures, the number of people employed by small firms incorporated as legal entities has almost doubled between 1997 and 2014, accounting for a 23% share of employment. My own calculations²⁸ yield a more modest increase from 10% to 15%. One reason for this deviation may be that the available indicator for the number of employees in small firms - 'average listed quantity of workers' - does not accurately capture the actual number of workers because the statistical assessment includes estimates. However, we can expect that employment figures are under- rather than overestimated. As numerous examples from my interviews suggest, many firms use various bookkeeping 'tricks' or prefer to hire some of the workers unofficially in order to avoid taxes or qualify for government support programmes and

²⁸ The total number of people working in small companies divided by the number of total employment in Russia. Both indicators are available on the website of Rosstat.

simplified tax schemes as 'small businesses' (that have 100 employees or fewer). In any case, even if we stick to the more modest estimate obtained through my own calculations, we can see impressive growth in the share of SME employment.

The development of individual entrepreneurs has been less even. Official figures show abrupt rises and falls in the number of individual entrepreneurs during the late 1990s and early 2000s. One reason for this may be that the sector fluctuates strongly. Thousands of sole proprietors open and close down each year, and the average 'life span' of such a business is relatively short (Rosstat 2012). For instance, in 2013, after the state doubled the social tax, almost half of individual entrepreneurs closed down in the following year (this drop is not yet reflected in the available statistics). Another reason for the uneven development of individual entrepreneurs may be due to the inconsistent measurement in annual SME surveys.²⁹ Most likely this accounts for the 'jump' in the data between 2004 and 2005 (grey line in figure 6). To address these caveats, I included an alternative form of measurement based on people's self-reporting in general employment surveys. According to this measurement individual entrepreneurship experienced a steady rise in the past decade - from 2.5 million in 2003 to 3.3 million in 2014. However, prior to that decade the numbers show very uneven development: the very large increase in 1999 (from 1.8 to 4.7 million) may be due to the default of 1998 and the subsequent economic crisis that left many Russians unemployed and may have prompted them to open their own business. Subsequent drops in individual entrepreneurs' numbers until 2003 may be due to the stabilisation of the economic situation.

Individual entrepreneurs, who in Russia can hire employees, more than doubled their share of employment, from 7% in 1997 to 16% in 2014. Here the official Rosstat figures are roughly in line with my own calculations. Bearing in mind the caveats regarding how the number of people working in this sector are counted, we can conclude that

²⁹ While until 2004 Rosstat counted individual entrepreneurs on the basis of registration with the tax authorities, after 2005 it only accounted for those that were 'included in the unified state registry'. Since 2008 Rosstat switched to an even more opaque measure of the number of 'factually operating' individual entrepreneurs.

throughout the last two decades individual entrepreneurs comprised a similar share of total employment as the small legal entities did. The combined share of employment from legal entities and individual entrepreneurs grew from around 18% to over 31% (steady black line in figure 6). On balance, half of the people employed in the Russian SME sector work for the smallest businesses, that is for individual entrepreneurs. Also, the majority of those who are employed at small legal entities work in the smallest ones, known as microfirms. Like in the West, around 80% of the Russian small firms have less than 15 employees. A large proportion of SME employees work in retail; 38% of the legal entities and 52% of individual entrepreneurs engage in retail and trade (Rosstat 2012: 56f).

My analysis of statistical data corrects two impressions that may appear in predominant accounts of Russia's statist-patrimonial capitalism. First, SMEs are not crowded out by big business, even though big firms account for the larger part of the economy in terms of employment and GDP. In fact, the share of big firms has been falling, whereas that of small firms has been on the rise. Second, and somewhat counter-intuitively, SMEs seem to represent a dynamic and developing sector during a period marked by the rise and intensification of Russian state predation. This trend accommodates my central claim that the Russian SMEs are a pillar of the Russian political-economic system. They have managed to adapt to it and perhaps even to contribute actively to its maintenance. To be sure, various factors may be responsible for the growth of small firms despite state predation.³⁰ However, for the purposes of this paper I will not explore this issue. Rather, I will analyse how small firms' strategies may have contributed to the maintenance of Russia's statist-patrimonial capitalism through the mechanism of the informality trap.

³⁰ Among the conceivable factors are: 1) 'a dead cat bounce': inevitable rise of SME numbers from a very low level after the collapse of communism; 2) 'dualism': some activities are not profitable for big business and are inherently relegated to SMEs. I owe these points to Andrew Schrank.

Informality trap

To make sense of the thinking and decisions that might plausibly underlie the trends in persistence and, indeed, growth captured by the statistics presented above, I conducted wide-ranging interviews with SME owners and managers. My interviews were with 23 small and medium-sized entrepreneurs, three business association executives, two business lawyers, two journalists and four academic experts (see detailed table in the annex). Corruption and informal behaviour are known to be sensitive topics, not readily amenable to social inquiry. As has been widely acknowledged, obtaining reliable data on state-business interaction in a corrupt environment is inherently difficult and runs the risk of a selection bias. To address this issue, I selected businesses capturing a sectoral variety among the Russian SMEs and chose my respondents as independently from each other as possible (see annex). Sometimes I relied on personal connections and recommendations to establish trust needed for a frank conversation about experience in dealing with the authorities in a corrupt environment (Ledeneva 2013; Lonkila 2011).

Most of the respondents were based in Moscow, with the exception of four entrepreneurs with companies in St Petersburg, Tver Oblast and Moscow Oblast. While this sample does not capture the geographical variety of Russian small businesses, and in general any results obtained through non-random sampling cannot be claimed as representative of the entire population of companies, there are good reasons to assume that small firms behave similarly across Russia. Regional specificities notwithstanding, Russian SMEs face similar environments and constraints: threats to property rights such as legal harassment, bureaucratic extortion or illicit asset-grabbing occur in all regions without significant variation, as Markus (2015) has shown. Therefore it is possible to draw generalisable conclusions from my interviews (cf. Vinogradova 2006).

Remarkably, my respondents talked to me relatively openly about their informal (and often corrupt) activities, however often misrecognising the latter and not calling a spade a spade (Ledeneva 2006). This may be due to the 'interviewer effect' of me being a young female native speaker, while my respondents were mostly men in their forties to sixties. At the same time, I came to conclude that this remarkable openness may in part

reflect the predominant 'normality of informality' - an issue that I address at length in the following part.

These interviews revealed, in any event, a clear pattern in the strategies and thinking among SME representatives. As elsewhere in the world, in Russia there are two fundamental business strategies - the formal and the informal. The formal business strategy (commonly referred to as 'white business') entails compliance with legislation and formal mechanisms to solve conflicts with the authorities, for example through courts (Gans-Morse 2012) or stakeholder mobilisation (Markus 2012, Yakovlev et al. 2014). However, in a corrupt environment the formal strategy does not always preclude government predation: in some cases clean bookkeeping may be even an invitation to trouble (Markus 2012: 256). Conversely, the informal business strategy, dubbed 'grey business', entails shadow practices such as tax evasion. 'Grey' firms typically solve problems with the authorities by using bribes or personal networks of 'useful acquaintances', based on mutual trust and a sense of obligation and reciprocity (but not necessarily bribes) (cf. Ledeneva 2006).

Even though various shadow business practices are widespread in Russia (e.g., Ledeneva 2006), doing 'white business' is far from impossible. Nine of my 23 business respondents claimed that their firms were 'white' (I believe that at least four of them were indeed in legal compliance), while eleven respondents admitted doing 'grey business'. The remaining three companies can be assumed to be engaged in some informal practices, too (see annex). There are good reasons to believe that this distribution roughly captures the occurrence of the two business strategies among Russian SMEs, but no hard data exists.

In practice, the formal and informal business strategies are mutually exclusive and cannot be easily switched. Firms conducting business in the formal fashion have little leeway to deploy informal practices such as bribery. But if they do, a return back to formality proves to be difficult because firms that behave informally may get trapped in informality. The mechanism of the informality trap is a vicious circle. Having violated regulations, evaded taxes or paid bribes, firms can be 'grabbed by the scruff of the neck' (interview with B15) since exposure of illicit conduct provides the authorities with a ground for bringing formal charges against companies (Yakovlev et al. 2014: 177, 189). At the same time, because of

legal noncompliance firms cannot easily defend themselves in a formal fashion, for instance in court. This makes firms opt for informal ways of defending their rights and solving conflicts with the authorities, for example through bribes or personal networks. As a result, firms face potential sanctions yet again (Ledeneva (2013) refers to this as 'suspended punishment'). Trapped in informality, through their behaviour firms inadvertently contribute to the functioning of the statist-patrimonial capitalism marked by insecure property rights.

Why and under which circumstances do firms fall into the informality trap? Acknowledging that the pervasiveness of informal practices in Russian business has numerous and complex reasons, I focus on three broad factors driving firms' informal strategy: a) institutional characteristics; b) firms' characteristics; c) socio-cultural characteristics dubbed 'normality'.

Institutional characteristics

The first group of factors driving the informal strategy pertains to institutional characteristics. Institutions are deemed to shape and constrain the behaviour of actors, for instance by imposing transaction costs. Thereby the informal business strategy may be viewed as a response to institutional inefficiencies (Johnson et al. 2000). In the Russian case, flaws of the legal environment and law enforcement often make small firms behave informally (that is, commit violations) - both consciously and inadvertently. Thereby they seriously constrain firms' agency. In particular, three institutional characteristics appear to matter: overregulation; bureaucratic discretion in law enforcement; and bureaucratic extortion.

First, the overregulation of business activity is a serious obstacle for Russian SMEs. A 2009 survey of over 2,000 small Russian firms in 20 regions showed that the regulatory burden imposed by inspections, licensing and registration had remained largely unchanged since the mid-2000s (Bessonova et al. 2010). Moreover, the complexity and partial ambiguity of the rules makes breaches inevitable in some cases. For instance, a Moscow kiosk operator complains about the government-sponsored auctions for retail space that make it almost impossible to acquire appropriate space:

'[The state] creates a field in which it is impossible to do everything in accordance with the law. For example, 7 sq.m were auctioned for fish. Not even a fridge would fit in that. Or a pharmacy - 10 sq.m. According to the sanitary standards you need to have provision for sewage there. ... He [the official from sanitary agency] comes and says, "Why don't you have a water supply?" Non-compliance. They can close you down'. (interview with B19).

Other regulations are cumbersome or challenge the common sense, such as the rigid regulations on fire safety or sanitation. For instance, it is difficult to receive approval from the fire authorities for an exhibition booth at a trade fair without a bribe, unless you use unreasonably expensive materials deemed fireproof by the authorities (interview with B3).

The second institutional driver of informality is bureaucratic discretion in law enforcement, which is a predicament for many small companies. It may take the form of blatant legal harassment, like I unexpectedly experienced during one of my interviews, scheduled in a Moscow restaurant. The entrepreneur, whom I was going to interview, came with a 'friend', who turned out to be an assistant of a Duma (Parliament) deputy. Dissatisfied with the food and the service, the assistant brandished the Duma ID and threatened to call on the city authorities to close down the restaurant (interview with B1).

Bureaucratic discretion also comes to the fore in situations when officials strictly follow the letter of the law, but violate its spirit. For example, one entrepreneur illustrates the absurdity of the broad interpretation of the criminal law by rent-seeking authorities:

'The Criminal Code retains the spirit of Soviet-era prohibition against private enterprise. ... In particular, profit is often interpreted as the extraction of selfish interest. ... [The entrepreneur] sold for 100 roubles instead of 90, so the 10 roubles must be stolen. And where is the motive? Apart from the fact that the motive of every entrepreneur is to make profit?' (interview with B10)

Facing legal harassment, businesspeople are keen to avoid legal prosecution and try to resolve the conflict informally, making use of their networks or paying bribes. The reason for this is the financial and reputational damage caused to a company in case of legal prosecution. Business operations are usually suspended, bank accounts frozen and owners may even be imprisoned. Once in custody entrepreneurs have very limited possibilities to defend their rights (interview with L1).

Bureaucratic discretion in law enforcement may also entail more subtle pressure on firms. For example, the tax authorities are not keen on loss-making firms, which spoil the tax collection statistics, and make such firms forge financial statements. A furniture manufacturer from Kaluga recalls such a situation, echoing similar stories by a Moscow construction company (interview with B12) and a metal manufacturer from Tver Oblast (interview with B14). This example is particularly telling because it demonstrates how a 'white' firm is pushed to step outside the law without having committed any violation in the first place:

'If you report losses, the [tax authorities] summon you up and read you the riot act: "This is not allowed. You'd better not show [losses]; leave them out in the financial statements, we'll come to an agreement." On one hand, I want to be safe, to avoid further claims. But on the other hand I surrender and compromise. Later on I can be caught out by this compromise any time. You're on the hook.' (interview with B16).

The third institutional driver of the informal business strategy is bureaucratic extortion. Extortion by the tax authorities is among the most commonly-cited problem by Russian companies (Markus 2012: 256) and featured in many of my interviews. Sometimes extortion occurs in a crude fashion, when inspectors assert suspicions of tax evasion or are behind alleged 'tax collection plans' (most of my business respondents believed that such plans exist). The resulting fines and exorbitant back-tax claims can be lowered for a bribe, which some inspectors demand openly. Firms that evade taxes often prefer to pay a bribe and have cash that is off the books for that purpose. But even 'white' firms sometimes succumb to extortion and prefer to 'go with the tide' for pragmatic reasons, because a thorough inspection of the books, which may last

several weeks, is a waste of time for the business owner (interview with B3). However, by paying bribes 'white' entrepreneurs enter the grey zone, which makes them vulnerable to further extortion and legal harassment.

Bureaucratic extortion may be less apparent if it occurs through private companies affiliated with the authorities. These 'risk-free companies' often do not have local competitors and offer services that firms are legally required to purchase (interview with A3). As a result, the beneficiary of the company enjoys a stable revenue stream. A business association executive recalls an example:

'A person works as a chief of the fire inspectorate while his wife's firm provides services to entrepreneurs for risk assessment. This [risk assessment] is mandatory. ... So he [the chief of the fire inspectorate] demands from entrepreneurs that they order a risk assessment in this particular company. And he does so in a fairly blatant way.' (interview with A2)

In some regions the market appears to be divided informally into almost 'neo-feudal' zones of influence, under the purview of particular bureaucrats or affiliated companies (interview with E1). This indirect capture of parts of the economy by state-related actors limits competition and impedes market entry for new SMEs.

Firms' characteristics

From the discussion of institutional constraints on small firms' behaviour it may appear as if firms had no agency at all - but in fact firms' characteristics may make a difference as they provide different room for manoeuvre. While small companies are mostly treated as a homogenous group, in practice they may be not equally likely to behave informally since they face different incentives and are not equally exposed to regulations (cf. Luo and Han 2009). Four firm characteristics appear to matter for the informal strategy: size, sector, 'outsourcing' capacity and ability to use courts.

First, size matters: larger and more profitable SMEs, such as in the pharmaceutical sector, or SMEs that have few competitors, such as producers of special products or popular brands, can 'afford' legal compliance. Such firms will have bookkeepers and lawyers, who are essential for navigating the numerous regulations governing businesses

and are better equipped to carry the cost of potential litigation (interview with L1). In contrast, smaller or less profitable SMEs tend to have fewer resources to pursue a formal strategy and are thus more likely to fall into the informality trap. Similarly, smaller or low-profile firms are ill-equipped to mobilise stakeholders or raise public awareness for defending property rights. Finally, few small firms can devote resources to lobbying or are members in business associations. The latter are deemed to provide at least some protection for their members given the pooling of resources, like Aitchison (2014) finds on the example of a successful lobbying effort of Russian SMEs to curb bureaucratic excess in the area of inspections.

Second, depending on the business sector firms are not equally exposed to administrative regulations and thus have more or less intensive contacts with state officials. The more contacts a company has with state agents, the more state threats to property it may face and, as a result, the more compelled it may feel to deploy informal practices. As a rule, more regulations, inspections or licensing requirements apply to firms in manufacturing, construction or food as opposed to firms in the service sector (retail, IT, consulting or publishing). The former firms tend to have more encounters with the officials and are thus more susceptible to corruption. Moreover, firms in the service sector are less vulnerable to state-backed asset-grabbing than firms in other sectors because 'the [main] asset are the people who work for us and the process that we built with our brains' (interview with B4). Some firms are bound to closely interact with the state and sometimes can hardly avoid informal practices. For instance, most construction companies that live off state contracts face pressure to pay kickbacks. The ability to conduct 'white business' is highly limited in these cases (interviews with B7, B12). However, a firm's negotiating position with the government contractor may vary depending on the kind of good or service provided: for instance, a Moscow-based company was able to avoid paying kickbacks as a sole supplier of a unique chemical vital for Gazprom - a state gas company infamous for corruption (interview with B10).

Third, firms differ in their ability to distance themselves from or outsource corruption-prone activities (cf. Polishchuk 2004; Shestoporov et al. 2008), which technically allows them to remain in the 'white' realm. For example, customs clearance or licensing procedures may be

delegated to professional consultants for a fee (interviews with B3, B9). Similarly, firms that choose to rent premises (widespread in the service or retail sector) rather than owning them (more typical in manufacturing) are not exposed to extortion by most agencies authorised to inspect businesses: usually the owner of the premises deals with them, including potential 'bribe expenses' in the rent (interviews with B5, B7). Finally, larger SMEs can afford to have opaque or sham subsidiaries that handle corrupt transactions (interview with B23).

Forth, the main formal mechanism for defending property rights - a court - in practice may be not equally available to all SMEs. On one hand, Russian firms seem increasingly willing to use courts to defend their property rights in disputes with state authorities. For instance, cases against the tax authorities and other government agencies increased almost fourfold between 2000 and 2008, reaching altogether about 90,000 cases a year or 20% of all cases initiated by firms. Win rates against the tax authorities hovered above 70% (Gans-Morse 2012: 274). On the other hand, suing the state may not be always feasible or desirable; instead, firms may opt for an informal defence of their rights. One reason is the retaliatory stance of some state agencies. For example, a medium-sized metal manufacturer from St. Petersburg, who won a lawsuit against the tax authorities, was later told by the very same authority that in the future his firm will be given 'very close attention' (interview with B18). Another businessman notes an unspoken practice that 'if a firm starts suing them [the tax authority], the bias of check-ups increases' (interview with B17). No matter whether a firm is 'white' or 'grey', the retaliatory stance of the inspection authorities may provoke further conflicts, which in turn may encourage or push firms to find informal solutions.

Furthermore, firms may prefer not to resolve disputes with the authorities in court for the sake of 'not spoiling relations'. This applies particularly to the kickback-ridden public procurement. A contractor may become hostage to a corrupt system and 'will not even think of fighting [formally]' (interview with B10). For example, entrepreneurs may prefer not to sue the state client even if it seriously delays or suspends payment because this may be counterproductive for future cooperation. An entrepreneur from St. Petersburg notes:

'The blackmailing is simple: "If you want to work with us [the state client], you will have to wait. If you do not want to work - feel free to sue us. For sure we will pay you. But in this case we will also put you in an informal black list".'
(interview with B18)

Similarly, when local administrations demand 'voluntary' contributions from entrepreneurs to the municipal budget or the financing of pet projects, entrepreneurs are wary to complain 'since local authorities can make his life unsavoury.' (interview with A2).

On balance, some Russian SMEs are more likely to embark on an informal business strategy than others depending on certain firm-specific characteristics. Smaller and less resourceful firms, firms in manufacturing as well as those that engage in public procurement face some incentives to deploy informal practices. They often objectively have little room for manoeuvre for doing 'white business'. At the same time they may also face subjective incentives to 'hide' or stay 'below the radar screen' of the authorities, for instance for evading taxes, as discussed in the following section. In this context it is important to bear in mind that informal behaviour is not only a matter of pure necessity or objective constraints but may also be a matter of expedient choice, even for the smallest firms. This partly explains why some of the firms with similar characteristics, for instance small companies in the service sector, which make up the majority of my sample, choose different business strategies. In contrast, larger and more resourceful firms, as well as firms in the service sector, have more room for manoeuvre to avoid informal practices and be in legal compliance. At the same time those very firms also have more resources to afford evasion schemes and to 'outsource' corrupt activities. Here we see again that informal behaviour is determined not only by objective firms' characteristics but is also conditional upon rather subjective expedient choices (within existing constraints) reflecting the predominant societal normality, like we will discuss below. Even though it is not always possible to detect uniform behaviour patterns across similar firms, the focus on firms' characteristics does indicate which strategy the company is more likely to pursue. In any case, those firms that deploy informal practices are automatically in legal non-compliance and may fall into the vicious circle of the informality trap.

Normality

The above examples amply illustrate that Russian firms may behave informally reflecting certain incentives tied to firms' characteristics or as a result of institutional pressures. However, often firms resort to shadow practices consciously (if not exactly voluntarily), reflecting widespread popular perceptions of normal and appropriate behaviour (Thompson et al. 1990), and thus responding to rather subjective incentives. I dub these taken-for-granted perceptions 'normality'.

'Everybody does it'

One aspect of normality concerns the prevalent notion that the whole business community allegedly engages in illicit practices. A businessman from St Petersburg pointedly expresses this view: 'In our country it is simply impossible to do business fair and square. ... [Illicit] schemes always exist.' (interview with B18). Indeed, the World Bank's World Business Environment Survey finds that in emerging economies with entrenched corruption, informal business practices may be considered a norm (Batra et al. 2003). Similarly, in post-communist states, individuals justify their own corrupt behaviour by the pervasiveness of corruption (Rose-Ackerman 2001: 438) according to the motto 'If others do it, so can I'. Another study of determinants of corruption in post-Soviet transition economies finds that widespread informal norms increase the likelihood of corrupt behaviour (Tonoyan et al. 2010). In this context Russian businesspeople tend to view informal practices as part and parcel of day-to-day business operations: 'This is the rule followed by the whole business community of the country.' (interview with B20). Legal compliance is considered an option rather than a norm (interview with B6). Moreover, cutting corners is viewed as a factor of competitiveness - if you do not join in, you lose out:

I do not want to be a tax violator, to be under the sword of Damocles. But what is going to happen in such a case? I immediately become uncompetitive, because this [shadow scheme] is the rule by which the whole market plays. You will not be able to compete price-wise. You will pay taxes several times larger than those that everybody else pays.' (interview with B20).

'It is a pity to pay taxes'

Another aspect of normality concerns the deeply embedded attitude towards the state as an oppressive and venal institution. Historically, the officialdom has been feared and despised by the Russians while the state has been perceived as working not for the society, but against it (Stoner 2012: 975). Law in Russia is traditionally associated with the power of the arbitrary state machine rather than any notion of justice; it is feared and circumvented rather than respected (Ledeneva 2006: 27).

In this context 'beating the system' is commonly perceived as morally acceptable. Back in Soviet times, stealing from the state was considered a normal response to state ownership of the means of production (Goldman 2003: 43). Pilfering, or abuse of the working position and the misuse of state-owned enterprise resources, was widespread and not considered illegitimate (Barsukova and Radaev 2012: 5). Against this backdrop, some small businessmen consider paying taxes a waste, a nuisance or even a donation to the corrupt bureaucrats: 'I am not sure that our taxes go where they are supposed to. It is even a pity to pay them.' (interview with B12). The notion of a state keen to fleece entrepreneurs propels a lax attitude to taxes: firms do not shy away from admitting paying only 'some taxes' (interview with B7), 'half of what we are supposed to' (interview with B9) or paying taxes 'according to our possibilities' (interview with B12).

'Let's come to an arrangement'

While the state as an anonymous machinery is utterly mistrusted and widely perceived as inefficient and corrupt, personal connections with state officials based on trust and reciprocity are cherished. Such connections 'for the sake of maintaining good relations for the future' (interview with B5) are regarded vital for the security of businesses and are used to prevent or solve problems.

Having established personal relations with bureaucrats, small businessmen expect not privileges but rather absence of obstacles. This practice goes back to the 1990s, when the Russian state was largely dysfunctional and the bureaucracy underpaid, so that citizens and entrepreneurs gave 'gifts' to state officials to perform even their basic duties. Today's custom of generously 'thanking' officials or doctors for

proper services or treatment reflects the same practice. As Vladimir Pastukhov puts it, 'it is not the violation of the law but its fulfilment that is paid for in Russia' (2002: 68). For instance, the owner of a small medical clinic offered a job to 'the son of the official who was inspecting my business ... in order to head off any artificially created problems' (interview with B6). Similarly, some manufacturing firms adopt voluntary 'social responsibility' in the form of support for local projects in order to establish 'good relations' with the authorities. For example, a plant owner from Tver Oblast admitted supporting two local colleges (interview with B14), while a factory owner from Moscow Oblast reported that he financed a canteen for local veterans, hoping to appease the authorities (interview with B22). This anecdotal evidence echoes Frye's (2006) finding that investing in public goods helped formerly state-owned firms privatised in the 1990s to prevent state threats to their property rights.

Informal connections with state agents can also help to solve problems. *Dogovoritsa*, or 'to come to an arrangement', is one of the most common verbs used by entrepreneurs to describe the resolution of conflicts with the state. Having high-placed 'friends' in the state administration is considered crucial for negotiating such informal arrangements (not all of which involve bribes, as I learned in the interviews). For example, several times during the interview the owner of a sausage kiosk chain instantaneously solved problems with local migration police who were harassing his foreign-looking employees by calling one of his patrons in the police department on his mobile phone (interview with B13).

On balance, many Russian entrepreneurs seem to regard personal connections and informal arrangements a better protection of property rights than formal channels. At the same time, informal arrangements undermine the rule of law because they foster the exclusiveness of the legal system. Rather than applying general rules, 'specific affair is solved as an exclusive matter in a special way' (Pastukhov 2002: 68). This is conducive to the informality trap.

Doing business 'by acquaintance'

Finally, normality concerns the - fairly cynical - perception of the most effective ways to do business. In matters of registration, licensing and business inspections informal deals appear to be a welcome shortcut in a cumbersome Russian regulatory jungle:

'It is much easier to *dogovoritsa* [come to an arrangement], than carry formal costs. ... It is just quicker, more mobile and easier to make money instead of waiting for all those permissions. It is easier to bribe than not to work for a month. ... Everything is in the grey zone of personal contacts, well-established relations. This accelerates the process and makes it cheaper.' (interview with B5)

Given that the noncompliance with some, sometimes even minor, requirements (many of them purely technical, for example, quality of water or intensity of light) may lead to serious sanctions, 'it is easier to *dogovoritsa* with him [inspector] than try to comply with all those minor regulations' (interview with L2), admits a lawyer specialising in conflicts with state organs. In general, paying taxes, obtaining licences or drawing up proper work contracts and invoices is sometimes viewed as unnecessary transaction costs rather than a *sine qua non* of a legal business operation. Some small companies consider doing business 'po znakomstvu', literally 'by acquaintance', more efficient. An owner of a small company providing legal services notes: 'We have a lot of clients who do not need any paperwork [invoice]. ... We work with five big regular customers. I know them personally.' (interview with B9). Similarly, an owner of a private kindergarten prefers not to bother with cumbersome licensing believing that the parents 'are our loyal clients that are satisfied with everything' and thus will not complain to the authorities (interview with B8). Doing business 'by acquaintance' firmly puts firms in the 'grey' realm and pushes them into the informality trap.

From the previous discussion two points appear noteworthy: First, SMEs' informal behaviour is not only a matter of institutional constraints but also of firms' given characteristics such as size and sector that to some extent determine the room for manoeuvre. Second, informal behaviour may be also driven by more subjective incentives that reflect the

dominant societal normality and may lead similar companies in the same environment to behave differently. Within given constraints, the informal choices that SMEs make in response to certain incentives often trap them in the vicious circle of informality and thus make them inadvertent contributors to Russia's statist-patrimonial political economy.

Concluding remarks

This paper examined one mechanism of the maintenance of Russian statist-patrimonial political economy from the perspective of an often overlooked player - small and medium-sized firms. Quantitative assessment of the evolution of Russian SMEs in Putin's Russia revealed that statist-patrimonial capitalism accommodated a living small enterprise sector: SMEs grew as a share of the economy in the course of the 2000s despite increasing state predation. Drawing on evidence from in-depth interviews, I concluded that this coexistence was more than coincidence. In fact it reflected SME involvement in the statist-patrimonial system and their contribution to its maintenance through the mechanism of the informality trap. Having embarked on an informal behaviour strategy in relations with the authorities, firms deviate from legal compliance and thus deprive themselves of most legal ways to secure their property. As a result, firms are bound to behave informally in further interactions with the authorities and get trapped in a vicious circle of informality. This circle reinforces itself and thereby gives sustenance to the particular mode of operation of Russian capitalism.

Three groups of causal factors were studied in order to examine why firms fall into the informality trap - institutional characteristics, firm characteristics, and socio-cultural characteristics. Thereby the study revealed that only part of the informal business activity could be attributed to institutional constraints such as cumbersome regulations, poor law enforcement or bureaucratic extortion. This finding is in line with the predominant assessment in the literature that attributes the maintenance of Russia's politico-economic system mainly to underdeveloped institutions and state predation. Much more tellingly, the study also revealed that firms in some cases embarked on an informal strategy as a matter of own choice, reflecting various aspects of deeply embedded social norms and routines dubbed 'normality'. In other words,

companies embarked on informal practices not responding to objective constraints or by necessity but reflecting their own expedient choices which were not inevitable as a condition for staying in business. The origins of the normality of corruption, of cheating the state as well as of personal relations with state agents could not be addressed in the study and present a challenging and intriguing avenue for further research.

The study further addressed a largely overlooked issue that in practice a particular business strategy is not equally available to all small firms. A formal business strategy may be more or less feasible depending on the specificity of business (such as size or sector), on the exposure to particular regulations and the ability to outsource corruption-prone activities. Many small firms lack the according characteristics and are compelled to behave informally.

To be sure, the present analysis highlights only one possible causal interpretation of how the statist-patrimonial system is sustained, namely the - albeit limited - agency of firms. A challenge to this interpretation concerns the relation between the agency of small firms and the institutional context in which they are situated: by behaving informally, firms could be merely reacting to the statist-patrimonial system and adapting to institutional contexts by which they are constrained. However, even if the informality trap is an effect of the pre-existing politico-economic order rather than its cause, this study has demonstrated that the informality trap is nevertheless functional to the maintenance of that order. In this context we should imagine the behaviour of SMEs as one link in the causal chain that has a recursive effect on the stability of Russia's statist-patrimonial capitalism.

The presented argument does not aspire to provide an all-encompassing explanation but rather represents one - so far largely overlooked - piece of the puzzle. A comprehensive answer to the question why a statist-patrimonial politico-economic form got entrenched in Russia requires a broader look that encompasses a number of factors on different levels of analysis. Among them is the failure of the rule of law, low public accountability of politics, short planning horizon and high uncertainty that imperil long-term investment and poor access of firms to finances, to name a few. Moreover, further research is required to analyse the role of

large companies and whether similar mechanisms like that of the informality trap apply to them.

In conceptual terms, the central notion of informality trap may have offered an instrument for understanding the working and sustenance of a highly patrimonial political-economic form, potentially useful for the analysis of other non-Western political economies (see, for example, Natrass' (2014) account of South African capitalism). Above all, the presented argument challenges the top-down perspective, which focuses on the role of the state and its rent-seeking servants, providing evidence for the contribution of the bottom-up forces of society. In theoretical terms, the study reminds us of the necessity to complement predominant institutional approaches to the study of emerging economies with approaches that consider socio-cultural factors (Staricco 2017). However, the study has been able to say little about the origins of the highly patrimonial political-economic system and the role that informality trap may have played in its creation. Has the small business sector helped shape the trajectory of Russian political economy through the way how it operates in it? The results of this research suggest a tentative 'yes': the evolution of Russian capitalism may have been conditioned not only by the interplay of post-communist political elites and the oligarchs, the citizenry being at the receiving end, but possibly also by the activity of the bulk of economic actors. Further research could provide insights into causal implications of the informality trap for the rise of the statist-patrimonial economic form. In this context, the present depiction of the substantial contribution of small firms to the functioning and reproduction of Russia's statist-patrimonial capitalism underscores the salience of such topics.

Chapter 4:

Digging their own graves: how small Russian companies contributed to the emergence of Russia's statist-patrimonial political economy³¹

Abstract

The paper analyses in historical perspective the origins of Russia's statist-patrimonial political economy, marked by insecure property rights and particularistic state-business relations. Based on in-depth interviews, the paper argues that statist-patrimonial capitalism is not only a result of top-down activity of the state sovereign, its corrupt agents or cronies in big business but is also a system that rests on the bottom-up activity of the bulk of economic actors - small and medium-sized firms. They are not just passive victims of state threats to property rights but in many cases are also a contributor to their emergence. This contribution happened - often inadvertently - through informal practices that locked small firms in the long run in the 'informality trap'. Back in the 1990s some of those informal practices were not the only choice but were taken up by companies out of expediency. In the 2000s firms' informal behaviour backfired as the corrupt state took advantage of the informality of some companies and exploited it to violate property rights of virtually any business actor. Thus the advent of statist-patrimonial capitalism in the 2000s was facilitated, among other factors, by the informal choices and practices of business actors in the previous decade.

³¹ This chapter is in preparation for submission.

Introduction

When states are weak and do not provide a stable legal environment and an adequate protection of private property rights, firms often have to rely on informal ways to do business and secure their property. The seminal example is the Italian mafia (Gambetta 1993), but equally important for contemporary political developments are the examples found in many post-communist states during the 1990s following the dissolution of the Soviet Union. There and then, criminal racketeering and private contract enforcement proliferated, while most state institutions such as tax collection, judiciary and the police were underfinanced, largely dysfunctional and corrupt (Volkov 2002; Vinogradova 2006). In such a hostile and uncertain environment, many nascent private firms got involved in corruption, tax evasion and other informal practices. While such informal business behaviour may be rational or even unavoidable at the beginning of political-economic transformation, it is expected that after the transition period firms start demanding state accountability and stable, secure property rights (Markus 2015). This did not happen in Russia, however. There, the mafia was pushed back by the strengthened state, but informality and insecure property rights got entrenched, and since approximately the mid-2000s Russia developed a form of political-economic governance that I call statist-patrimonial capitalism. It is defined by the strong role of the state in the economy, both by way of its formal involvement and, notably, its informal interference through corrupt bureaucrats. These state agents deploy the power of their position for personal gain and, most notably, threaten private property rights through predatory practices such as bureaucratic extortion, legal harassment and illicit asset-grabbing (see, for example, Gans-Morse 2012).

I treat such state threats to property rights as a fundamental characteristic of Russia's statist-patrimonial capitalism. They have proliferated since about the mid-2000s and nowadays occur in all Russian regions without significant variation, as research by Markus (2015) shows. State threats to property are perceived as a serious constraint for doing business by a majority of Russian firms (ibid). The problem is acknowledged at the highest political level: President Putin has repeatedly lamented, most recently in his annual address to the federal assembly in 2016, that

'pressure on business from some people in the law enforcement agencies [leads to] successful businesses collapsing and people having their assets taken from them' (Putin 2016). The emergence of a quite predatory form of economic governance is, or should be, puzzling, and motivates this article's central question: Why did informality and insecure property rights get entrenched in Russia in the form of statist-patrimonial capitalism instead of remaining a mere transitional feature? By addressing this question the article seeks to explore the origins of Russia's statist-patrimonial capitalism.

The predominant scholarly discourse on the emergence of Russia's statist-patrimonial capitalism focuses on the role of the state and historical legacies. One strand of research treats the post-communist state as the 'main culprit' of Russia's 'wayward transformation' and its 'corrupted' capitalism (Easter 2013: 200). It emphasises the strength of the state and the lack of institutional constraints on sovereign predation (e.g., Yakovlev et al. 2014; Hanson 2007; Dawisha 2014), with some scholars focusing on the legacy of patrimonialism and the historical continuity of preponderance of state power resources (such as coercion and capital) in relation to society (e.g., Pipes 1999; Easter 2013). Conversely, another strand of research views the Russian capitalist form as a product of the weakness of the Russian state, unable to control its lower bureaucracies that prey on business (see, most notably, Markus 2015). Either way, the statist paradigm focuses on top-down factors³² in the emergence of statist-patrimonial capitalism. Society, and business in particular, appears as a passive participant in the process. Accounts that acknowledge the active role of business, focus on large firms and their political leverage (Yakovlev 2006; Hellman 1998). Small companies, on the other hand, appear as passive victims of state predation, pushed to collude or hide.

In this article I want to complement the dominant accounts by providing a different perspective - one that reassesses the role of small business. My main argument is that patrimonial capitalism is not only a result of the top-down activity of the state sovereign, its corrupt agents or cronies in big business, but also a system that rests on the bottom-up activity of the bulk of economic actors - small and medium-sized enterprises (SMEs).

³² By the term 'top-down' I mean factors associated with the state, from the top political elite to low-level bureaucracies.

Viewed from this perspective, businesses are not merely passive victims of state threats to property rights, but may have also been in many cases an active, or at least inadvertent, contributor to their emergence. This contribution happened - often inadvertently - through some of the small firms' informal business practices in the 1990s, some of them targeted, ironically, at securing property. I make the case by providing evidence that small Russian business initiated some of the corrupt and predatory practices at the beginning of Russia's post-communist transition in the 1990s. I discuss the motives for such practices and scope for alternative behaviour, showing that the particular firms' choices played a role in the emergence of Russia's statist-patrimonial capitalism. Certainly, in the 'chaotic' first decade of Russia's capitalist transformation some of the informal business practices were virtually inevitable. However, a notable part of informal practices were not, and it is these practices that, as I will argue, helped lay the foundation of Russia's capitalist form as we know it today.

The main causal mechanism of this dynamic is dubbed 'the informality trap': having embarked on informal behaviour in the 1990s, which may have been expedient or in some cases inevitable back then given the uncertainty of transition, small Russian firms experienced difficulty in returning to the formal sphere because of their legal noncompliance and the prospect of a pending punishment. As a result, their property became a welcome target for predatory state agents in the 2000s. To use a metaphor, by embarking on informal strategies business dug its own grave: those practices backfired and undermined the security of property rights, notably not only for those particular firms but also for the business community at large, thus laying an important foundation of Russia's statist-patrimonial capitalism. In other words, the informality trap made the transitory behaviour of firms a persistent feature of the Russian political-economic system as we know it today and thus sheds new light on its origins.

The article proceeds as a historical study of the informality trap using a longitudinal narrative involving process tracing of decisions by groups of firms and political actors. I first describe the informal business practices of the Russian small firms in the 1990s, analyse the motives for informal behaviour beyond pure necessity and discuss options for alternative

action. Thereby I trace how small firms fell into the informality trap. I then show how in the 2000s the firms' informal behaviour backfired and ultimately undermined the overall security of property rights. Process tracing reveals patterns that question the causal, top-down mechanisms presumed by conventional accounts, and demonstrates a step-by-step mechanism linking bottom-up informal activity of small firms to the emergence of statist-patrimonial capitalism. For data I rely on two sets of in-depth interviews on day-to-day interactions between small firms and state bureaucrats: one that I conducted in Moscow and St Petersburg in spring 2014 (see appendix) and another conducted in several Russian regions the late 1990s and published in full transcript by Kliamkin and Timofeev (2000). I supplement this primary material with relevant newspaper articles and secondary literature.

The findings contribute both to the empirical studies of the evolution of Russia's political economy and to the theoretical debate about the relative role of the state and societal actors in the process of social change. The analysis offers a novel perspective on small Russian business as an active contributor to Russia's current political-economic form, rather than being simply a passive victim of state predation or a force trying to resist it. More broadly, the re-assessment of the relative role of state and business in the emergence of Russia's variety of capitalism underscores the importance of bottom-up forces of society as a complementary factor to the top-down forces of state. It suggests that a distinct bottom-up process may lead to entrenched informality and insecurity of property, and highlights the informality trap as an important but overlooked mechanism of this process.

The section that follows elaborates on the argument of the paper in the context of existing accounts. The following empirical part traces in historical perspective how Russian companies fell into the informality trap from the start, and thus co-created the foundation of insecure property rights and informal particularistic state-business relations that define patrimonial capitalism. The final section concludes and reflects on theoretical implications of the results.

The argument: bottom-up forces of business versus top-down forces of the state

The study of the origins of Russia's statist-patrimonial capitalism - and the origins of insecure property rights in particular - is typically approached from a structural, top-down perspective. The conventional approach emphasises the legacy of patrimonialism, patronage and clientelism (Hosking 2000; Robinson 2013), the lack of tradition of private property rights and the historical fusion of sovereign property ownership and power (e.g., Pipes 1999; Tambovtsev 2009; Hedlund 2001; Jensen 2001; Solomon 2008a). In this context a strong emphasis is put on the role of the state. Two major arguments within this scholarship stand out.

The first argument views the 'restoration of the state' in the 2000s under President Putin as a crucial factor in the emergence of Russia's variety of capitalism (e.g., Yakovlev 2006; Hellman et al 2000; Gelman 2012; Yakovlev et al. 2014). It assumes in line with the 'state commitment' paradigm (e.g., Acemoglu and Robinson 2012; North et al. 2009) that the key reason behind insecure property rights are abuses by the predatory state ruler for the purpose of self-enrichment. Underlying this is a highly centralised model of corruption: the political elite permits state officials to engage in corrupt activities in exchange for loyalty (cf. Stefes 2006: 2f.). Viewed from this perspective, the lack of constraints on sovereign predation - on law enforcement apparatus in particular (the so-called *siloviki*) - explains the origin of Russia's politico-economic form (e.g., Yakovlev et al. 2014; Dawisha 2014; Ledeneva 2013: 198; Easter 2013; see also Sharafutdinova 2010: 7). The second argument within the state-centred paradigm proceeds from a contrary assumption - the weakness of the Russian state, unable to control its predatory agents (i.e. lower bureaucracies). The activity of these predatory state 'piranhas' can be viewed as the cause of Russian patrimonialism (Markus 2015).

Another strand of scholarship sees the activity of large business actors as key to the emergence of Russia's statist-patrimonial capitalism. This scholarship is inspired by a seminal article by Joel Hellman (1998) on the reform process in post-communist countries (Sonin 2003, Aslund 2002).

Hellman calls such actors early winners³³ of market reforms and posits that they subverted property rights security by blocking further reform in order to preserve 'the special advantages and market distortions upon which their own early reform gains were based' (1998: 204). Such powerful economic actors no doubt had an important impact on the development of Russia's post-communist political economy, as detailed in subsequent studies of state capture (Hellman et al. 2000; Yakovlev 2006), virtual economy (Gaddy and Ickes 2002) and the tycoons known as the oligarchs (Guriev and Rachinsky 2005; Pappé 2000).

What is striking about all these accounts is that they miss the bottom-up dynamic of the evolution of Russia's capitalism by not granting attention to the role of small firms: they are considered to have a much smaller political leverage than firms studied by Hellman and followers, and are viewed for the most part as passive victims of state predation that merely adapted to imperfect institutions (Paneyakh 2007; Markus 2012; Gans-Morse 2012). The few studies that do consider the role of small firms focus primarily on business strategies employed to resist state predation. For example, Markus (2015) finds that some Russian firms successfully resist raiding attempts by mobilising relevant stakeholders, while Yakovlev et al. (2014) study how firms set up collective organisations aimed at restricting state violence against entrepreneurs. Similarly, in her research O'Neal (2014: 2016) emphasises firms' 'civic-ness', having found that Russian regions with higher small business activity score higher on democracy. However, what these accounts seem to underestimate is that

- a) informal ways of resisting state pressure, for instance through mobilising the so-called 'administrative resource' (i.e., bureaucratic connections), are far more widespread compared to the relatively rare cases of public resistance and formal defence of property rights (cf. Yakovlev et al. 2014: 177);
- b) historically small firms' activity was associated with the opposite to civic-ness, namely informal (and often illicit) practices that locked business in the informality trap - a

³³ Among them are 'bankers..., [s]tate managers turned private owners... [r]ising financial-industrial conglomerates' (Hellman 1998: 232f) and the 'former communist elite' (ibid.: 229).

mechanism that I will argue is at the origins of Russia's patrimonial capitalism.

In summary, whether the abovementioned accounts treat small firms as victims of state predation or as fighters against it, they underestimate the firms' complicity in Russia's statist-patrimonial capitalism. Just as property rights *security* may depend on the bottom-up activity of firms, as Markus (2015) shows, property rights *insecurity* may also be affected by the firms' activity. In short, scholars overlook the fact that actions of business actors may be actually conducive to state predation.

In this paper I emphasise the bottom-up agency of small Russian firms and argue that they were, at least to some extent, active contributors to the emergence of Russia's politico-economic form. The reason lies in the extensive use of informal practices in the 1990s, such as tax evasion, bribery and predatory corporate takeovers. These practices later became entrenched through the mechanism of the informality trap, and ultimately backfired in the 2000s. The mechanism implies that having once embarked on the path of informal behaviour, for instance having evaded taxes or paid a bribe, firms experience difficulty in trying to get out of the informality sphere. The reason is informal behaviour itself, or the legal non-compliance: as a result of it the firm faces pending legal prosecution as a sword of Damocles hanging over it, but at the same time cannot readily defend itself in a legal fashion. Therefore the firm is bound to 'buy off' the threat and becomes all the more vulnerable - both to further formal legal charges and informal state pressure such as bureaucratic extortion. The unintended consequence of action is important here: business behaviour that may have seemed rational or even beneficial in the short run may have the opposite effect in the long run. To put it bluntly, by behaving informally many small Russian companies inadvertently dug their own graves - and, as we shall see, in many cases they also dug the graves of those firms that were in legal compliance.

My argument echoes Hellman's in that I argue that at the beginning of transition period some Russian firms chose informal ways of doing business and exploited the loopholes and deficiencies in the 'murky water' of partial reform. An important difference, however, is the mechanism of the firms' agency. Hellman examines conscious efforts to 'impose policies that bring them [the winners] private benefits at a high social cost' (1998:

231) through the exercise of political power (especially in elections). In contrast, I focus on the unanticipated consequences of the firms' informal actions for the development of Russia's political economy. It is the implications of day-to-day business strategies rather than conscious political efforts that interest me.

Examining the reasons for informal behaviour is crucial for understanding how small firms fell into the informality trap. Undoubtedly many of the informal practices at the beginning of Russia's transformation were an adaptation to the adverse and unpredictable Russian business environment, as I will discuss in the next section. However, I want to complement this widespread view and suggest that it is no less important to consider cases of informal business practices that were initiated by the firms themselves out of expediency. Such cases show the firms' agency - understood as a conscious choice between potential alternatives - particularly clearly. I trace how certain choices made by the companies locked them in the trap of informality and backfired in the long run, allowing state actors to turn the tables and exploit the informality to undermine property rights. In a nutshell, the informal bottom-up activity of the firms at the beginning of Russia's transformation undermined the security of their property in the long run and thus can be considered one important origin of Russia's statist-patrimonial capitalism. At the same time, I do not advance the untenable claim that this factor alone can explain the advent of Russia's statist-patrimonial capitalism. Moreover, it is difficult to draw a line between informal behaviour that serves an expedient goal of the company and one that is a reluctant reaction to pressure, which in turn may be only *perceived* as inevitable and inescapable. Finally, the role of the state and historical legacies is important too, and will be discussed in the concluding section.

My argument draws on the seminal studies of Russian informality by Kliamkin and Timofeev (2000) and Alena Ledeneva (2006). Their rich ethnographies each detail the working of informal practices that are portrayed as being at the core of the Russian political economy and society more broadly. Kliamkin and Timofeev apply a transactional approach to informality (and corrupt behaviour in particular): bureaucrats, who act as sellers, and entrepreneurs, who act as buyers,

trade legal rights (for instance, the right to open a business) or the privileged opportunity to break laws in exchange for bribes. One of Ledeneva's main arguments is the ambiguity of informal practices: they compensate for some institutional weaknesses but at the same time may undermine those very institutions in the long run. I build on these arguments and extend them from the functioning to the origins of Russia's current political-economic form, trying to explicitly address why firms behave informally.

The empirical backbone of the study is formed by two sets of in-depth interviews. The first set comprises 22 interviews with Russian businessmen and bureaucrats from various regions regarding informality and corruption, carried out in the late 1990s and published in full transcript by Kliamkin and Timofeev (2000)³⁴. Secondly, I use material from my own 34 interviews with Russian small and medium-sized entrepreneurs (SMEs) and business association executives, lawyers and experts conducted in Moscow, St Petersburg and a few regions in 2014 (see appendix). While the first set of interviews gives a detailed first-hand account of informal practices and choices made by firms in the 1990s, the second set allows us to trace how some of those practices endured and backfired. This data is complemented by the results of surveys and in-depth interviews in the 1990s by the Russian scholars Radaev (1998; 1999), Paneyakh (2007) and Dolgopyatova (1999). I supplement these sources further with relevant newspaper articles, policy documents and secondary literature.

How small firms fell into the informality trap in the 1990s

In the early years of the Russian post-communist transformation the extent of informal business practices and the shadow economy was considerable: 27% of GDP in 1993 and 50% by the mid-1990s, according to the official estimates (Kosals and Rybkina 2002: 20). In the case of

³⁴ My work hugely profited from research on the Russian shadow economy by Kliamkin and Timofeev, who made their interview material available as transcripts at the back of their book (2000). This allowed me to profit not only from the authors' interpretation of the material but also from the original statements by the interviewees, which is a big asset for replication and future social scientific inquiry.

small and medium-sized firms, at least 30% of business activity was in the shadows, with tax evasion, double bookkeeping, cash operations and bribery being widespread (Dolgopyatova 1999: 51). Why was informality so widespread in Russia in the 1990s and why did it later get entrenched in the form of statist-patrimonial capitalism? To answer this question we need to understand why firms started behaving informally in the first place and how they got trapped in informality.

The causes of small firms' informal practices can be divided into two groups of causal logic: necessity and expediency. Many small companies were pushed to conduct part of their operations in the shadows by necessity, given the specificity of the Russian political-economic environment in the early 1990s, as we shall briefly discuss in the next section. I will not try to answer the question as to whether in the 1990s it was possible to do business in full legal compliance as it is beyond the aim of this article. However, we can and need to take the widespread popular belief that it was impossible to do honest business in Russia with a grain of salt: a considerable part of the informal practices was not inevitable and constituted a conscious entrepreneurial choice. This possibility implies a different cause of firms' informal practices: expediency.

Informal behaviour by necessity

At least five aspects of the Russian political-economic environment of the 1990s compelled many companies to break the law and pushed them into informality. The first aspect concerns the specificity of the regulatory environment of the 1990s, which was marked by excessive, contradictory and changing regulations (Frye 2002: 574; Frye and Zhuravskaya 2000; Paneyakh 2007; Ledeneva 2006). Consider the following case, exemplary for many of the incoherent SME regulations in the 1990s: for security reasons Russian jewellery shops were required to have barred windows, but at the same time those very bars contradicted fire safety rules. There was no way to satisfy both regulations. Very high taxes were also a

problem: some firms reported the tax burden approaching or even exceeding 100% of profit (Polonsky 1998: 525).³⁵

The second factor that pushed firms into informality was the weakness of the law enforcement institutions, the lack of coordination between various agencies authorised to inspect business and the ineffectiveness of courts. Additionally, bureaucratic discretion in law enforcement allowed arbitrary interpretation of particular business regulations and bureaucratic extortion. Firms often succumbed to these pressures and resorted to paying bribes.

Thirdly, criminal extortion rackets pushed firms to 'buy off' threats or to give away substantial parts of their profits. In the absence of a predictable and effective legal environment, criminal groups (so-called 'roofs') supplanted dysfunctional state institutions and under a threat of violence offered their clients 'protection services'. Calling the police in the case of a criminal racket was an 'utterly hopeless enterprise' (Radaev 1999: 50). Criminal 'roofs' also performed some of the indispensable functions that the state failed to deliver, such as debt collection and the enforcement of contracts (Vinogradova 2006; Gans-Morse 2012: 266; Radaev 1999).

Fourthly, an important driver of informal business practices was unfair competition with businesses affiliated with the bureaucrats. Consider a typical case from the late 1990s, reported by a Rostov entrepreneur who recalls a state tender for laying tiles on the sidewalks of the city:

The contract was won by the company "Tandem", unknown to anybody in the construction business, because it was created by Rostov bureaucrats and is now controlled by them. This company not only lays tiles but also produces them. They are produced in Rostov's prisons, of course illegally. The bureaucrats enjoy super-profits because no tax inspector will ever check this company.' (Kliamkin and Timofeev 2000: 483).

³⁵ In the 1990s, tax on profit was 35%. However, businesses had to meet more than 40 additional taxes and payments, which made the overall tax burden very high. However, it bears notice that in some cases profits were stellar, too. Consider the case of Mikhail, a Volgograd entrepreneur who started importing Finnish ice cream in the early 1990s and sold it at a whopping 100% profit margin in his popular café chain (Polonsky 1998: 529).

In addition, affiliated companies enjoyed privileged access to credit and other financial privileges. Competing with such companies often required paying kickbacks or cutting costs through shifting part of the operations into the shadows.

Finally, monetary constraints such as high inflation, difficulties in accessing credit, non-payments between business partners and barter often pushed companies in the 1990s to step out of the legal sphere, for example by cooking the books or evading taxes.

Serious as they were, these external pressures were neither universal nor totally unavoidable. Let us consider the example of extortion - both criminal and bureaucratic. Even though it is hard to estimate the exact scope of the criminal protection rackets, there are good reasons to believe that the range of the mafia may have been exaggerated in the popular view. For example, a 1997 survey by Radaev (1999: 39f) reveals that only about 45% of businesses were paying protection money, amounting to about 10-20%, occasionally 30% of their profit. The majority of surveyed firms did not perceive criminal rackets as a serious problem. Similarly, a survey by Frye and Zhuravskaya (2000) found that in 1996 about 40% of small Russian retail shops had contact with criminal protection rackets. Two years later, it was just 25% (Frye 2002).

Available data on bureaucratic extortion reveal a similar picture: the widespread view that nothing gets done in Russia without bribing the officials may be an exaggeration. For instance, a 1993 poll showed that while 62% of entrepreneurs experienced extortion (16% of them experienced it often), 38% did not experience any (Radaev 1998: 64). A 1997 poll showed almost identical results³⁶ (Radaev 1998: 64; Radaev 2002: 64). Moreover, apparently not all Russian businessmen who faced extortion by the bureaucrats succumbed to it: in Radaev's 1997 survey, 20% of businessmen reported not having paid the requested bribes despite bureaucratic extortion (1998: 65). A survey by Kliamkin and Timofeev (2000: 216) in the late 1990s came up with a similar finding: 22% of the surveyed entrepreneurs reported they had not faced corrupt activities or extortion by the bureaucrats in recent years (compared to

³⁶ 65% of enterprises experienced extortion (20% of them frequent extortion), while 35% did not.

58% of respondents among the general population). Even though these figures are aggregated and the actual experience of extortion and the ability to resist it may vary depending on the size of the firm and business sector, these figures put the widespread belief about the occurrence of bureaucratic extortion in perspective.

Informal behaviour by expediency

While informal practices were very widespread in Russia in the 1990s, given the various constraints and pressures, we need to bear in mind that those factors were not wholly external and that there was a certain demand for such practices in the business community (Radaev 1999). In this section we discuss the situations and circumstances in which small firms hid their revenues, bribed officials and used shadow business schemes not as a method to survive or cut through red tape, but rather as a business opportunity, exploiting the legal uncertainty to their advantage and colluding with corrupt state officials to beat the system. I argue that a considerable part of small firms' informal activity in the 1990s occurred not in response to crude pressure or objective circumstances, but as a matter of a conscious choice made by the entrepreneurs. The main reason for such choice was expediency: an attempt to cut costs, to secure a competitive advantage or a lucrative business opportunity. I will focus on three prominent practices:

- 1) Tax evasion and other illicit operations with the goal to hide revenue;
- 2) Bribery as a way of buying the privilege to break the law (or make the bureaucrat turn a blind eye to a violation);
- 3) Prepaid business attacks (*naezdy*) and illicit corporate takeovers (*raids*) by means of exploiting legal loopholes and making use of corrupt judiciary and law enforcement.

In the following we will discuss these practices using anecdotal evidence and available statistics.

Tax evasion

Tax evasion was very widespread in Russia in the 1990s: firms hid on average between 42% and 70% of their revenue. For example, in Vinogradova's sample of 45 shops in St Petersburg, only six shops

reported not concealing revenue (2006: 457). Many tricks were used to minimise profits for the purpose of tax evasion such as black cash transactions, partial payment of salaries in cash, the use of shell and offshore companies as well as various, sometimes very complicated, financial schemes (for details, see Ledeneva 2006: 156-159).

An account by the co-owner of a financial company gives an impression of the aim and scope of such schemes in the 1990s:

'The specialisation of our holding is devising and deploying accounting schemes, transferring our clients' money offshore. Thereby we do it in a way that no-one else can do. For each scheme we prepare a large pile of documents, which an outsider cannot sort out. Our schemes boil down to diminishing the size of necessary taxes to 2-3% of turnover. ... [Or take] another example: a manufacturer produces a good, which has a cost price of 50 rubles and sells it for 100 rubles. So she pays taxes on 50 rubles. We can prepare the documents in a way that the cost price becomes 90 rubles.' (Kliamkin and Timofeev 2000: 415).

On the one hand it is not always easy to tell whether the goal of tax evasion is expediency or sheer survival in terms of maintaining a profitable enterprise, as most entrepreneurs seemed to lament in the interviews of the 1990s made available to me. On the other hand, there are good reasons to believe that, as Ledeneva (2006: 159) notes, '[g]iven the skills and the determination to invent such schemes, it is unlikely that the reduction of the profit tax will be a sufficient stimulus for companies to give up these practices'.

One classic example of tax evasion for the sake of increasing profit is found in the manipulation of customs clearance. In the 1990s it offered handsome profits to the Russian SMEs, many of whom were engaged in selling goods imported from abroad. A manager of a retail firm recalls his experience with customs:

'When importing goods into Russia you can register them in various ways and pay different customs duties. ... Expensive goods - medicine, cigarettes, computers, video technology etc. - are registered as if they are food, cotton pads or some

other crap. Customs officers are being paid substantial sums of money [bribes] so that they do not inspect the freight according to all rules, but let the goods pass through customs with forged documents. As a result, the duty for crap is ten times lower than for medicine. The same happens with imported cars. There are a huge amount of fake documents for importing expensive foreign cars duty free... The customs officers turn a blind eye to forged documents and for a bribe let the cars pass and later levy a tiny duty on these cars.' (Kliamkin and Timofeev 2000: 482f).

Another very widespread practice concerned cooking the books: official records did not correspond to the actual revenue. For example, a retail trader from Moscow keeps a record of her operations, as required by law, but grossly understates the profit:

'For example, I bought the shampoo for 15 rubles, and sold it for 23 rubles, but [in the books] I write down only 18. ... It is impossible to catch us. About 80% is in the shadow. This is the only possible way. Everybody works this way. Every day I sell goods for 2000 [rubles], but show [only] 300 rubles.' (ibid: 436f.).

The system of tax evasion became further entrenched by the prevalence of undocumented cash payments: in the 1990s many Russian customers were ready to pay in cash without receipts for a wide range of purchased goods and services including repairs, construction and renovation. In fact it was considered absolutely normal (ibid.: 207).

Bribery

Bribery unsurprisingly is a two-sided story involving bribe-takers (state officials) and bribe-givers (entrepreneurs). However, there is an important difference between offering a bribe and a bribe being extorted. By bribing officials, entrepreneurs bought the right to shadow entrepreneurship, or the privilege to break the law by making the bureaucrat turn a blind eye to the legal violation. For a bribe entrepreneurs might also try to secure individual privileges or lucrative state contracts.

Available evidence in the 1990s suggests that cases where companies 'extend the envelope' i.e. gave a bribe are not rare. In a 1997 survey of Russian firms, about half of the firms conceded that entrepreneurs played an active role in corrupt relations with state officials (Radaev 1998: 71). Anecdotal evidence from interviews with entrepreneurs admitting bribery abound. Testimonies of bureaucrats further illustrate the fact that entrepreneurs initiated some of the corrupt deals. A high-ranking official from the cabinet of ministers of the Bashkortostan region of Russia recalls in a surprisingly open interview in late 1990s:

'Today a person came to me and offered 30,000 rubles for certain services. I sent him away, because I could not do what he was asking for - this is impossible today, nobody will be able to do what he wanted. Of course I did not take his money. However, if something depended on me [if I could have done something], then we would have had a different conversation. This is a normal practice. The reason is that by offering me 30,000 he counts on making 300,000. ... You see, I am on the other side of the barricades: I do not deal with corruption - it is the other people who have to deal with me. ... Nowadays, if a mayor or a head of the administration is not tied with shadow business and criminal structures, he will not be able to work within the given legal and economic space. Basically he is being forced to have such connections.' (Kliamkin and Timofeev 2000: 572f).

Evidence from in-depth interviews suggests that entrepreneurs tend to view bribes as yet another cost associated with doing business. Some of the entrepreneurs seem to compare the price of breaking the law, which is the bribe, with the cost of adhering to it: 'In the end every bribe is justified from the economic point of view' (owner of a clothing factory quoted in Radaev 1998: 71). Thus for instance many entrepreneurs preferred to 'buy off' threats instead of paying fines or fulfilling the regulations. The case of handling the utilities payment is one example of such cost-benefit analysis. The deputy Director of a brick factory in Rostov explains that instead of paying for electricity the enterprise routinely bribes officials after they cut off the electricity:

'You are wondering why our director does not simply pay for the electricity? Every entrepreneur strives to do business at the lowest cost possible. Nowadays it is cheaper to "buy off" [pay a bribe] than to pay in full for the electricity supply.' (Kliamkin and Timofeev 2000: 420).

The management of the same brick factory uses various tricks to fool the gas counter in order to reduce the bill:

'We have a silent contract with the lower officials: they turn a blind eye to the leakage of energy, and we regularly pay them before they come for an official check-up.' (ibid.: 421).

Another goal of actively offering bribes to state officials is to speed things up in the case of something that would otherwise have taken longer or involved a complicated formal procedure. A Rostov entrepreneur recalls:

'...bribing helps. For instance, if you urgently need some official document, for instance within a day, but it is normally issued within about a week. I could lose a client because of this delay. I have to "grease the palm", and the issue is solved.' (ibid: 450).

Similarly, an owner of a manufacturing enterprise recalls certifying his industrial equipment:

'Take the certification agency. I received the certificate of conformity for a bribe. Not because my equipment does not conform to standards. I just invited the official of this agency (to visit), paid for his journey, offered him a meal and so on.' (ibid: 406).

What is conspicuous about these examples is that the entrepreneurs choose to offer bribe without an obvious necessity and without extortion, but rather out of sheer expediency.

Naezdy and raids

While at the beginning of the 1990s firms waged their competitive battles with the help of their criminal roofs, from approximately the mid-1990s they switched to using corrupt officials, including officials from law

enforcement and fire inspection agencies and the tax police in order to carry out the so-called *naezdy*, or prepaid business attacks. Through *naezdy*, companies typically attempted to secure a business advantage or to harm their competitors. For example, *naezdy* could be used to recover a debt, to prevent certain transactions, to interfere with shareholder meetings, to promote desirable results or to simply harass competitors (Ledeneva 2006: 173ff). A manager of a computer firm interviewed by Radaev (1999: 48) concludes: 'A better means of competitive struggle is to send the law enforcement bodies after you'. Another businessman agrees:

'In the past, if someone refused to pay they could damage the shop or just burn it down. Now they've understood that it is cheaper and safer to get a fire inspection to close it down for a week or two. And the effect is the same.' (Volkov 2002: 51; cited in Gans-Morse 2012: 281).

While *naezdy* made the life of competitors difficult, a much graver interference with property rights that proliferated at the end of the 1990s was *raiding*. Raiding is an extreme form of hostile acquisition, or a forced change of ownership and management of a company undertaken by another business actor. Raiding attacks of industrial plants, profitable export-oriented enterprises and other companies became common practice at the end of the 1990s, recorded cases reaching thousands annually. This led to the largest redistribution of assets in the Russian economy after the privatisation of the early 1990s (Volkov 2004).

The spread of raiding was triggered by the introduction of a new liberal bankruptcy law in 1998 that made bankruptcy procedures relatively simple. The law permitted courts to initiate bankruptcy cases against companies whose external debt was as low as 1,500 USD if it was not repaid within three months after the due date. Typically raiders manipulated the law by buying the debt of a company, claiming it back and using it to initiate a bankruptcy procedure and thus obtain the right to appoint a temporary manager. The change of management at the discretion of the raider allowed them to poach the assets of the company or de facto to take it over (Volkov 2004: 533f.; Firestone 2008: 1210f.; Ledeneva 2006: 156). The practice involved bribing a variety of state officials in order to give an illicit hostile takeover a semblance of legality.

Central to the strategy was a prearranged court ruling and access to coercive resources such as special police forces in order to execute the change of ownership by means of physical coercion. To suppress resistance, raiders often initiated criminal investigations against the owners of the target company. The final step in a raiding attack often involved a quick money laundering action, achieved through the sale of the company to a good-faith purchaser. Even if the criminal charges against the initial owners were dropped, recovering property from a good-faith purchaser was rarely possible (Volkov 2004).

The described manipulation of the bankruptcy law was very widespread at the end of the 1990s and up until 2002: it is estimated that up to a third of bankruptcy cases dealt with by the state arbitration courts in 2000-2001 were contract bankruptcies, initiated with the goal of raiding in mind (Volkov 2004: 528). After the adoption of a new bankruptcy law in 2002, instances of raiding gradually receded. Raiding provides an example of predatory manipulation of existing legislation by companies, and undoubtedly constituted the most outright form of informal business behaviour undertaken out of expediency in the 1990s. The contribution of firms to undermining property rights through the practice of raiding is beyond dispute.

The informality trap and ways to escape it

The informal corrupt practices described above opened companies up to state predation and ultimately locked them in the informality trap - a vicious circle in which initial informal behaviour entails its perpetuation. Here is the mechanism of this negative dynamic. To the extent that the informal practice entails a legal violation, the company crosses the legal boundary. If the violation is uncovered, for instance during a check-up, the state has legal grounds to punish the company (e.g., through fines, by halting its operation, through demands for back tax or, in more serious cases, criminal prosecution). The firm cannot readily defend its rights in a formal fashion because its legal non-compliance can be uncovered during a court procedure. Instead, the company is bound to resolve the problem informally - often through 'buying off' the threat. In turn, the bureaucrat may use the fact that bribery has taken place as a means of extorting further money under the threat of legal prosecution. The director of a

wholesale trade company pointedly sums up this dynamic: 'If you start paying [bribes], you will never be able to break free from this [vicious] circle.' (Radaev 1998: 75). As a result, the company falls into the informality trap and at least part of its operation becomes firmly rooted in the corrupt sphere.

It is important to note that the informality trap was not unavoidable in the 1990s: there was room for choice on the part of the firms. Consider the choice between paying fines and bribes. If a company commits an infringement and faces fines (rather than criminal charges), it can choose either to pay an official fine or to negotiate a lower penalty for a bribe. Tellingly, evidence from interviews in the 1990s suggests that companies tended to view both payments as comparable business expenses and often opted for the latter one because it was 'cheaper'. However, there is a big difference between the two transactions: if a company opts for a fine, it remains in the legal realm and escapes the informality trap; a bribe may get a company into a vicious circle of 'buying off'. A Moscow entrepreneur underscores the increased vulnerability of companies that bribe to state attacks because they represent 'easy prey':

'As soon as you open this feeder [i.e., bribe], you become something like a "free cashier" at McDonalds... Everybody will come to you.' (Gans-Morse 2012a: 11).

Business practices that did not constitute bribery or outright evasion allowed companies to avoid the informality trap in the 1990s. One of the widespread practices involved the cultivation of personal relations with state officials. Such relations involved not bribes, but rather non-monetary favours and allowed companies to get around cumbersome regulatory procedures, to avoid bureaucratic extortion and to receive preferential treatment such as access to credit. Some companies employed a 'right person' (e.g., the relative of a bureaucrat) or made contracts with a 'right company' (Radaev 1998: 75). Other firms employed a 'specialist for the work with state organs', as an owner of a manufacturing enterprise explains:

'This is a person who can make friends with any official from the state agencies. We employ a woman. She regularly visits the respective state agencies, brings something for tea and

consults with them, talks heart to heart. ... And this is sufficient- there is no need to bribe. In this way we deal not with bribe-takers ... but with friends, with whom it is nice to talk and drink a cup of tea.' (Kliamkin and Timofeev 2000: 407).

Good personal relations with state officials - often referred to as 'administrative resource' or 'political capital' - allows for a kind of a patronage that may help to avoid bureaucratic pressure and bribe extortion. The head of a firm dealing with the supply of fuel recalls: 'If everyone knows that some firm ... indirectly is connected with the interests of a high-level official . . . naturally there will be no check-ups, no police, no sanitary control.' (Radaev 2002: 67). Similarly, the owner of a Moscow manufacturing enterprise recalls that he could avoid extortion from law enforcement agencies, which was very widespread in Moscow in the second half of the 1990s, thanks to his friendship with one of the employees of a law enforcement agency. The entrepreneur never had to 'buy off' but rather he told them that he 'came to them from "Ivan Ivanovich" [read: a good friend in the agency], so my security was granted special attention.' (Kliamkin and Timofeev 2000: 413).

Another way to avoid the informality trap was by making legal payments to service companies instead of paying bribes. This strategy sometimes allowed companies to square the circle: fulfil cumbersome regulations, stay profitable and remain in the legal realm. For example, specialised commercial firms helped resolve problems of registration, licensing and other business requirements. Thereby potential bribe expenses were included in the fees (Radaev 2002: 63). Sometimes such commercial firms were affiliated with the bureaucrats. An entrepreneur recalls negotiating with the fire safety officials:

'I invite him to visit me and say: "I was wondering who could help us draw up a plan of fire evacuation? I will pay for the work, of course." He readily replies: "My wife is a specialist in this." Then I say: "And could you perhaps buy the fire extinguishers for us? Here is the money and your per diem allowance." That's it, everybody is content and everything is clean. The money is paid for the work, no bribes.' (Kliamkin and Timofeev 2000: 408).

Another alternative informal practice concerned the diversion of attention from actual violations by intentionally leaving or making small mistakes in the bookkeeping (the so-called *oshibochki*). In the 1990s, when tax evasion was pervasive, the tax inspectors' main goal was to boost tax collection. To this end inspectors would routinely look for mistakes in the bookkeeping in order to file back tax claims and fines. By making small obvious mistakes in the bookkeeping entrepreneurs allowed tax inspectors to fulfil their duty and at the same time discouraged them from digging further and discovering a graver violation. Some entrepreneurs, like a St Petersburg businesswoman even openly colluded with the tax inspector, citing good personal relations:

'When I come to the tax inspection, she [the inspector] tells me: "Please leave some mistakes [in the bookkeeping]. I am obliged to file some back tax claims". When I do the paperwork, the balance sheets, I always write down the mistakes that I made [on purpose] on a separate piece of paper. Recently I brought the documents to the tax inspection. They asked me: "Did you bring the mistakes?" - "I did". They are obliged to file back tax claims, to find some mistakes in the bookkeeping. I make the mistakes for them. ... [Interviewer question:] "Did you bring any presents, or at least some chocolate?" - "No, no. Just good personal relations".' (Paneyakh 2007: 77).

At first sight such a scenario represents a classic route into the informality trap - after all, the company, by falsifying its bookkeeping, commits a violation that the inspector is aware of. However, what is important is the fact the entrepreneur pays an official fine rather than a bribe. On top of that, the entrepreneur maintained good relations with the inspector by allowing her to fulfil her tax collection plan.

In the 1990s Russian firms often deployed informal practices, sometimes struggling to survive, sometimes using the deficiencies of the regulatory system and legal enforcement as fantastic business opportunities and opportunities for predatory behaviour. By behaving informally, firms opened the door for bureaucratic predation and fell into the informality trap. In any case, the informal activity of firms compromised property rights security and undermined formal state institutions. In the long run,

in the 2000s, this contributed to the emergence of statist-patrimonial capitalism characterised by state threats to property rights, as will be discussed in the following section.

How state agents exploited the informality and started an assault on property rights in the 2000s

The proliferation of informal business practices in the 1990s had serious repercussions in the following decade for Russia's political-economic development. In the 1990s firms often manipulated weak state institutions as just another player in the market for protection or as a means of competitive struggle. As the state regained its monopoly on violence in the 2000s the situation reversed to the firms' collective disadvantage. The strengthened state seized the opportunity to exploit the informality of businesses through its corrupt officials and started a systematic assault on the firms' property rights through legal harassment, bureaucratic extortion and even raiding (Gans-Morse 2012). Remarkably, it was not only companies who had previously fallen into the informality trap who were facing these state-sponsored threats to property. Virtually any company could become vulnerable to state harassment as the room for manoeuvre and alternative behaviour became considerably smaller for all firms compared to the 1990s. Under these circumstances escaping the informality trap became difficult. A statist-patrimonial variety of capitalism consolidated in Russia.

Even though at first sight this development may appear as a clear top-down dynamic of state oppression, it is important to view it against the backdrop of its historic development. I argue that the massive state-sponsored assault on property rights in the 2000s was made possible by the informal behaviour of companies in the previous decade, among other factors. State agents exploited the informality of the firms and also adopted some of the predatory techniques that the firms were using in their own competitive battles in the 1990s.

Proliferation of state threats to property

When President Putin took office in 2000, he set out to increase state capacity, curb the political influence of big business, push back the shadow economy and make companies pay their taxes. His administration

succeeded in strengthening institutions by re-centralising them and improving their funding. The scope for conducting business in legal compliance considerably increased in the course of the economic reforms of the 2000s, which included a radical tax reform, a simplified customs procedure and a reduction of administrative barriers (see, for example, Aslund 2002). Interviews show that unlike in the 1990s, after 2002 small entrepreneurs deemed it possible to do business in legal compliance and to pay all necessary taxes (Paneyakh 2007: 122). As we shall discuss, this 'coming out of the shadow' did not necessarily safeguard companies against state predation.

At the same time, Putin's 'restoration of the state' happened at the expense of the quality of institutions. Institutions that were formerly assured at least some degree of accountability and control have gradually been dismantled; examples include the critical media, independent parliament and the elections of regional governors. The Federal centre's interference with legal cases undermined the independence of the judiciary (Mendras 2012: 175-181). Corruption did not decrease, but rather became centralised and institutionalised (Satarov 2013).

In this context it was the increased state capacity to collect taxes and fight economic crimes, backed up by toughened laws, that gave corrupt state officials a potent weapon to exploit the informality of firms for their private gain. Criminal prosecution by different law enforcement agencies became one of the most common extortion and harassment tools. For example, Nazrullaeva et al. (2013: 4) found an upward trend in the dynamics of economic criminal cases in 2004–2009, driven by the 'rent-seeking' of law enforcement officers and the system of assessment of police departments' performance (the so-called 'stick system'). The police also increasingly resorted to arrests of entrepreneurs on minor charges, thus weakening their ability to defend themselves against attacks (Rochlitz 2013: 14). About 150,000 cases are filed annually for so-called economic crimes such as fraud or embezzlement. As only a minority of cases (10-15%) resulted in sentencing, while other cases were dropped or not brought before court, Volkov et al. (2010) concluded that criminal prosecution indicates rent-seeking behaviour by law enforcement officials.

While in the 1990s corrupt state officials were for hire, in the 2000s they started acting on their own initiative. The proliferation of state-induced raiding is a case in point. The 2003 Yukos affair may have been a turning point - after that raiding increasingly became a state-initiated practice. While in the late 1990s and early 2000s private raiders 'hired' corrupt state officials to facilitate an illicit takeover, during the course of the 2000s state agents became the beneficiaries: they started conducting raids in the interest of higher placed officials or attacked companies for their own benefit (Rochlitz 2013: 12). Thereby the new state raiders were well-informed about the raiding techniques as the result of facilitating attacks and providing logistical support in the 1990s. State officials either started using the same techniques themselves or pushed raiders to carry out takeovers on their behalf.

Having examined 312 cases of raiding based on the analysis of 1,500 newspaper articles, Rochlitz finds evidence that the role of state agencies in raiding throughout the 2000s has been rising: between 1999 and 2002 illegal state involvement was mentioned in 37% of all cases, but between 2003 and 2010 state agencies were involved in 61% of the cases (Rochlitz 2013: 13). While companies are frequently mentioned as hiring raiding agencies to initiate attacks during the early years of the decade, from the mid-2000s onward newspaper articles increasingly reported that members of state agencies themselves ordered, initiated, and benefited from attacks (ibid.: 15). Among the victims in the second half of the 2000s were restaurants, hotels, car dealers, smaller supermarkets, other shops, local housing service providers, transport companies, and scientific research institutes. One of the victims was my respondent Vadim³⁷, the owner of a small Moscow dental clinic.

Vadim describes how his clinic was raided in the autumn of 2013 on behalf of his landlord, who turned out to be a highly-placed state official from Tver Oblast (the property was formally registered on the name of his wife). The conflict started when the landlord suddenly demanded a sharp rent increase. Vadim disagreed as he had an unlimited lease and expected to receive at least the legally guaranteed three-month notification. The landlord insisted. Shortly afterwards Vadim witnessed his clinic being raided by a group of masked people. The lock was

³⁷ Name changed.

removed, the dentists were 'kicked out' and their equipment was carried out. Having contacted the police, Vadim was not permitted to file a lawsuit and was told: 'They are the owners of the premises. They can do as they please.' As a result, Vadim lost his business, his medical equipment and the rent deposit of 260,000 rubles (about 8,000 USD). Vadim considers such raid a 'form of business': 'To get this money back is all but impossible, to put it mildly. Even going to court is pointless.' (interview with B6).

Limited room to escape the informality trap

Was there room for manoeuvre to resist state attacks and avoid falling into the informality trap in the 2000s? Certainly legally compliant companies had an option to defend their rights in court. Indeed, litigation was the most widespread means to resist the attack by the corrupt officials in the 2000s: the number of firms' lawsuits against state agencies soared (from 13,000 in 2000 to 50,000 in 2008) and win rates were relatively high, between 60% and 70% (Gans-Morse 2012: 274). However, suing the state was not always desirable because it could provoke retaliatory measures from inspection authorities, such as legal harassment. Moreover, litigation was feasible only for bigger companies that could bear the cost and mostly in case of smaller violations of property rights, such as unfair fines or penalties. Defence against criminal charges was much less promising - in fact most businessman preferred to avoid opening a criminal investigation in the first place because once a case is filed bank accounts are frozen and the owner is detained. As this implied the destruction of business, many firms facing criminal charges were bound to 'buy off' the threat and were drawn into the vicious circle of informality.

Room for other strategies that could help resist a state attack or escape the informality trap, like the ones used in the 1990s, became much narrower in the 2000s. Firstly, even conducting a legally compliant business was no guarantee against conflicts with the state. In fact, it was sometimes an invitation to trouble, because state inspectors took tax evasion for granted and could inspect a company with 'clean books' particularly thoroughly and perhaps impose arbitrary fines. In this sense, the informal behaviour of companies back in the 1990s made almost every company look

suspicious later on in the 2000s. Moreover, few legal barriers held if forces in the state bureaucracy were determined to harass, take away or destroy a business. For example, over 100 small trade pavilions were demolished overnight in the centre of Moscow in 2016 on behalf of the city authorities. A new law declared that the buildings had been built illegally, although the owners had valid construction permits (Gessen 2016). The co-owner of a Moscow chemical company, Anna³⁸, was imprisoned for over a year on trumped-up charges of involvement in the production of illicit chemical substances, even though the company was in full legal compliance. Anna assumes that the firm was attacked because it had refused to pay kickbacks to one of its clients - the state gas giant Gazprom (interview with B10).

Secondly, the toughening of regulations often left companies without the option of paying a fine instead of a bribe, a practice which had previously helped them avoid the informality trap. For example, the 2016 amendments to the Code of Administrative Offences tightened penalties for firms and increased fines by several orders of magnitude: instances where penalties were imposed included violations concerning security standards, sanitary norms and consumer rights. Penalties imposed could also force the liquidation of the business. Similarly, the period during which back taxes could be demanded was extended from one to three years, expanding the authority of law enforcers to probe firms (Vinokurov 2015). Facing exorbitant fines or criminal prosecution, firms had no choice but to 'buy off' the threat and thus fall into the trap.

Thirdly, informal connections to state officials or payments to affiliated structures, though still prominent, ceased to be a fully reliable strategy for preventing conflicts in the 2000s. This became all the more true after the onset of the economic slump in 2014, which was propelled by low oil prices and economic sanctions in the wake of Russia's annexation of Crimea. In the context of declining oil rents and intensified competition for resources among the bureaucratic elite, business was exposed to increasing informal bureaucratic pressure and bribe extortion. While before the crisis bureaucrats had expected to draw 'dividends' from their informal control over cash flow from private property over many years, after the advent of the crisis they seem to have been trying to extract

³⁸ Name changed.

maximum resources as quickly as possible, to 'fleece entrepreneurs as if it was their last chance'. Under these circumstances the well-established informal arrangements ceased to work as reciprocally as previously. Anecdotal evidence suggests that law enforcement agents were extorting increasing sums of money from businesses without providing protection or services in return, but rather they threatened companies with a criminal investigation (author's private correspondence; cf. Yakovlev 2014). For many Russian companies, the scope of choice was de facto reduced to two options: losing their business or being drawn into the informality trap.

To sum up, in the 2000s the corrupt state took advantage of the informality of some companies and exploited it to violate the property rights of virtually any business actor. From the perspective of the 'good citizen' firms, the proliferation of state threats to property may look like a top-down 'statist' story, where institutional constraints on sovereign predation are lacking and corrupt lower-level bureaucrats are out of control. However, I argue that the advent of statist-patrimonial capitalism, marked by state threats to property rights, was also made possible and in fact facilitated by the choices and practices of business actors back in the 1990s. These practices created a massive temptation for the state and made the state-sponsored assault on property rights in the 2000s possible. By having embarked on expedient, predatory informal practices in the 1990s companies dug their own graves. Ironically, they also dug the potential graves of everybody else. Being pushed into these graves by corrupt state officials became only a matter of time.

Conclusion

A significant part of developments in Russia's political economy may be described a 'statist' story: bad rules and their poor enforcement; lack of commitment by the state sovereign to protect property rights; a swarm of bureaucrats-piranhas uncoordinatedly persecuting businesses for their private gain; and finally, a communist legacy of command economy and a looming authoritarian state. This interpretation seems all the more plausible if we look at Russia's political-economic form as it has evolved since about the mid-2000s. In this article I suggested viewing the

emergence of Russia's statist-patrimonial capitalism from a different angle: first, by going further back in time, namely to the beginning of Russia's capitalist transformation, and, second, by reassessing the contribution of business.

I found that what may seem like a statist top-down story (and may be experienced as such by the entrepreneurs) - namely the proliferation of predatory bureaucratic pressure on business in the 2000s - was in fact to some extent made possible, among other factors, by the business community proper. I illustrated the argument using the example of the informal behaviour of small- and medium-sized enterprises (SMEs) in the 1990s with regard to tax evasion, bribery and prepaid business attacks. Russian firms behaved informally for a variety of reasons, some of which, as I showed, pertained to expediency rather than necessity and were meant to exploit the loopholes and business opportunities of the nascent Russian capitalist order. One particularly predatory informal business practice in the 1990s was raiding, or the illicit seizure of the property of a target firm or a competitor by means of the manipulation of law enforcement and the judiciary. This practice vividly illustrates the active contribution of companies to undermining the security of property rights.

Most importantly, I found that by embarking on informal business practices firms often fell into the informality trap - a vicious circle of informality and pending punishment that puts property rights in jeopardy. I made the case that the informality trap was not inescapable in the 1990s because there were alternatives to many informal business practices that did not entail a legal violation. However, in the 2000s the situation changed with the advent of Putin's 'strong state'. As the punishments became imminent and the penalties tougher, companies had less room for manoeuvre. The firms' agency closed and their informality backfired, as the state exploited the firms' informality through its corrupt agents. Vulnerable as they were under the circumstances of Russia's chaotic transition in the 1990s, by deliberately choosing to evade taxes, to bribe officials or harass competitors, the firms contributed to the insecurity of property rights and ultimately made themselves *and everybody else* vulnerable to later attacks by predatory state officials. Again, the case of raiding is exemplary: corrupt state agents adopted a predatory practice

once 'invented' by ruthless parts of the business community. Instead of being hired by the businessmen, they began engaging in asset-grabbing themselves.

Notably, state threats to property rights affected not only firms directly implicated in informal behaviour, but the whole business community, irrespective of its legal compliance. Even though 'white' companies had a slightly higher chance of defending their rights in court, overall the scope for the firms' agency and choice diminished drastically. Potentially every business could become target of a state attack, succumb to pressure and fall into the informality trap.

Viewed from the perspective of the informality trap, the origins of statist-patrimonial capitalism lie not only with the state, a corrupt bureaucracy and Soviet legacies. Parts of the business community made an important contribution to the advent of a predatory state offensive against property rights that defines today's Russian statist-patrimonial capitalism. This reassessment of the role of business – as an accomplice rather than a victim - is important if we want to gain a better understanding of the origins of Russia's contemporary political-economic form and perhaps that of other emerging economies too.

Conclusion

This dissertation provides novel insights into the development of Russia's particular form of capitalism over the past two and a half decades. It sheds new light on the working and origins of capitalism in Russia, finding that after a decade of liberalisation in the 1990s, Russia moved into a direction of increased statism and, notably, patrimonialism. Patrimonialism is a form of socio-economic organisation strongly based on clientelism and patronage. By incorporating patrimonialism into the analysis next to liberalism and statism, I uncover an indispensable yet underestimated third dimension without which the Russian trajectory cannot adequately be grasped. Patrimonialism subverted first Russia's attempt at liberalisation in the 1990s, turning privatisation largely into a sale of state property to well-connected insiders, and then Russia's move to increased statism in the 2000s, turning nationalisation of assets into a re-privatisation at the benefit of the bureaucratic elites. As a result, by roughly the mid-2000s, Russia developed its current variety of political economy dubbed 'statist-patrimonial capitalism'. The country thereby moved in the opposite direction from the other BRIC countries, defying a global trend towards liberalisation in the 2000s.

Shifting the focus from a description of the overall development of the political economy to an explanation of its functioning and emergence, the dissertation focuses on the role of small businesses in Russia's highly patrimonial environment. One finding is that this environment accommodated a dynamic and developing small business sector despite the rise of state predation. A crucial and somewhat counterintuitive finding is that small companies were active (though often inadvertent) contributors to the highly patrimonial system and provided sustenance to it from below. This contribution occurred through informal practices and, I suggest, through the mechanism of the informality trap, by which informal behaviour becomes a vicious circle.

By the same token, this analysis also reveals that small businesses played an active role in the emergence of Russia's form of capitalism. Far from being mere victims of state predation and unfavourable business climate, small firms facilitated the rise of the current Russian politico-economic

system through informal behaviour choices in the 1990s that allowed the state later to exploit them and push companies into the informality trap. In this way, informal strategies that companies used to employ as an adaptation tool and even a source of power in the first phase of Russia's development doomed these companies as the room for manoeuvre narrowed under President Putin's rule.

Summing up, on the higher level of abstraction the guiding question of the dissertation - *How can we grasp the changing political economies of emerging countries using the example of Russia, and what are the drivers of continuity and change?* - can be answered as follows: To understand change in emerging economies we need to account for the continuity of patrimonialism and the bottom-up forces in society which help create and sustain it.

This concluding section proposes directions for further research, reflects on the broader theoretical implications of the study and offers policy recommendations.

Directions for further research

Continuity and change in emerging economies is a vast topic that could not be dealt with exhaustively in this dissertation. Several questions remain unanswered and may provide avenues for future research. The issue of similarities and differences between the development trajectories of the BRICs stands out as one of the most interesting ones. While the dissertation reveals and describes those differences, their causes and the drivers of change in Brazil, China and India remain to be examined in future research. What role did the small business sector play in the developments of the other BRICs countries? Are informal business strategies as widespread in these countries as in Russia, and do companies there also fall into the informality trap? This would be an interesting topic for comparative research given the fact that Brazil's, India's and China's patrimonialism decreased in the timeframe considered. Perhaps firms in those countries found ways to gradually escape the informality trap, or other factors mitigated the negative implications of informality.

This relates to a more general question about implications of patrimonialism (and informality in particular) for development goals, that could not be addressed in this dissertation. It appears that certain levels of patrimonialism are detrimental for economic development as it may compromise property rights, decrease predictability and hamper investment. However, successful examples of highly patrimonial countries such as China or the so-called Asian Tigers suggest that patrimonialism may co-exist with economic development. In some ways informality may even facilitate economic processes and compensate for the shortcomings of the formal system, for instance if it helps companies to overcome red tape. More comparative research is needed to establish 'thresholds' of 'facilitating' and 'detrimental' patrimonialism and to understand which factors (such as governance type, resource dependence, small firms' strategies, presence of international capital) mitigate the negative impact of patrimonialism on development.

I would like to offer several hunches based on the existing literature and to be explored in future research. One regards different cultural roots of informality. A survey of managers of 35 countries finds that informal practices in Russia are rooted in an individualistic culture (understood as a prime orientation to the self) and tend to be exclusive, opportunistic and exploitative. Conversely, in Brazil, India and China informal practices are rooted in a communitarian culture (understood as a prime orientation to common goals) and are therefore less instrumental and less prone to manipulation (Trompenaars and Hampden-Turner 1998 cited in Ledeneva 2008: 130). For example, the Chinese practice of *guanxi* is based on kinship ethics and Confucian tradition with its emphasis on individual as part of a bigger system, long-term relationships and avoidance of 'losing one's face'. This makes *guanxi* more predictable and less prone to manipulation as compared to the Russian use of personal connections (Ledeneva 2008: 127-30, McNally 2012).

Another factor that may be partly responsible for the differences in the extent and impact of patrimonialism in the BRICs regards different incentives of state officials. Michael Rochlitz and colleagues find that while regional officials in China are promoted based on the economic performance of their region, and thus have a stake in its economic development, the most important promotion criterion for Russian regional

officials is political loyalty in the form of election outcomes for the ruling party (Rochlitz et al. 2015). The highly centralised tax system in Russia (only a small percentage of taxes collected locally remain in the region) may be a further disincentive for Russian governors to show initiative in economic affairs of their region.

Finally, external pressures and developments on the global market may matter, too, particularly in highly patrimonial rent-dependent economies like Russia or Brazil. The decrease of prices for natural commodities may prompt competition for dwindling resources among the elites and promote predatory behaviour and detrimental aspects of patrimonialism. Massive corruption scandals that engulfed Brazilian politics and lead to the displacement of President Dilma Rousseff in 2016 as well as the tightening of bureaucratic pressure on business in Russia since the onset of the economic slump in 2014 may be indicative in this respect. However, legal institutions, which are stronger in Brazil than in Russia, may play a mitigating role.

Against this backdrop the question of long-term stability and change of highly patrimonial systems is intriguing. What are the conditions and impediments for reform? The ambiguous nature of patrimonialism may offer a clue. For instance, for modernising its economy Russia faces a challenge to reform its highly informal network-based system of governance that Ledeneva (2013) calls 'sistema'. However, reforming 'sistema' and curbing its dysfunctional implications is hard without losing its functional potential and weakening 'various kinds of social cohesion that enable Russian society to function' (Ledeneva 2013: 2). Just like the reproduction of patrimonialism, discussed in the third chapter of the dissertation, its reform appears to be a matter of the will and capacity of the political elites but also of the bottom-up forces of society at large. These issues will be taken up in the following policy recommendations.

In any case, more research needs to be done to better grasp patrimonialism in empirical terms. We need quantitative data beyond corruption proxies or the residual category used in this dissertation in order to be more precise in quantifying the extent of patrimonialism. We also need more qualitative data to understand the specificities of each case. For instance, interviews with state bureaucrats and with more

companies, including larger ones, would be desirable in future comparative research.

As for the Russian case, this dissertation was preoccupied with providing a distinct perspective on its development and thus presented only a few - so far largely overlooked - pieces of a larger puzzle. To give a comprehensive answer to the question of why a statist-patrimonial politico-economic form got entrenched in Russia, further studies need to incorporate more factors, among them the failure of the rule of law, the role of big companies, and the impact of oil wealth. How have large companies contributed to the rise of statist-patrimonial capitalism? Are they involved in informal activity similar to small firms, and does the mechanism of the informality trap apply to them too? Moreover, further research is required to analyse the impact of natural resource wealth and large resource corporations on Russia's capitalism, a topic treated only cursory in the dissertation. Mechanisms such as resource curse and Dutch disease may have played an important role in the origins of statist-patrimonial capitalism and need to be accounted for in future studies.

Broader theoretical implications

The finding about the bottom-up contribution of firms to the functioning and origins of Russian political economy may affect the way we think about capitalism: it is not just about what governments do and how institutions work (i.e., the focus of the traditional Varieties of Capitalism framework) but also about business and their myriad choices, which may shape the variety of capitalism. Business is one important pillar and its behaviour matters.

This connects to the discussion of drivers of social change. The findings imply that the bottom-up agency of actors can be viewed as a complementary factor to top-down forces of the state. Socio-cultural factors guiding these actors' decisions are important in this regard too, as the examination of the 'normality of informality' suggests. Furthermore, an important yet overlooked source of social change may be the unintended consequences of action, as certain behaviour choices sometimes have an impact beyond the initial intentions. Thus Russian

firms using informal shortcuts and 'navigation strategies' in the hostile business environment actually acted to their own detriment: securing property rights informally undermined them in the long run. Generally, unintended consequences of action matter because of collective action problems, the lack of foresight and vicious circles that are hard to escape.

To be sure, structural constraints and institutional contexts also play an important role in the process of societal change along with actors' agency. In this respect the findings of this dissertation connect to the broader state-society debate in social sciences. While I do not attempt to establish the relative importance of structural or actor-related factors and thus cannot resolve the perennial debate, I make a strong case that both structure and agency matter. This contribution comes at a time when the focus of the debate has shifted towards the analysis of institutions and state-related factors (Schmidt 2009, Evans et al. 1985), and is made on the example of a case – Russia - that has been traditionally analysed from the state- and legacy-centred perspective given its long history of state domination over society. Having found that the Russian citizenry has been not only a passive bystander of developments shaped by the state and large oligarchic companies, but also actively contributed to these developments, this dissertation provides a conceptual counterbalance to a debate which is typically tilted towards institutions and the state. Even if we adopt a more sceptical view of the impact of agency, seeing it merely as an effect of the pre-existing politico-economic order rather than its cause, the activity of economic agents can be seen nevertheless as one link in the causal chain that has a recursive effect on the stability and origins of a political-economic form.

In conceptual terms the dissertation contributes to the Varieties of Capitalism literature by presenting patrimonialism as a competing logic of socio-economic organisation and including it as an additional ideal type of capitalism rather than treating it as a mere aberration. This allows us to better understand political economies of emerging countries (and, given Trump's election, perhaps some industrialised, too) and provide a more fine-grained analysis of continuity and change. Viewed from a normative perspective, this approach may make us question the negative connotation often automatically attached to informal aspects of economic interactions (the laden notion of 'corruption' exemplifies this stance).

Policy implications

Viewed from a practical policy perspective, harnessing 'facilitating' aspects of informality and containing the 'detrimental' ones becomes a pertinent political task, in which both active state policies and firms' behaviour matter. The following policy recommendations target conditions for getting out of the informality trap in Russia against the background of current government policies towards the SME sector. Some of the recommendations may be relevant for other emerging economies like Brazil, which might be at risk of succumbing to 'detrimental' aspects of patrimonialism, like indicated by the recent revelation of a grand corruption scheme around the oil giant Petrobras involving top political elites.

Current situation

On paper, development of small and medium-sized firms and elimination of bureaucratic pressure on them is a priority of the Russian government. However, reality often looks different. Many of the recently introduced policies to support SMEs are of questionable effectiveness due to their limited scope, sabotage at the local level or contradictions with other restrictive policies. For example, the welcome three-year ban on inspections for firms that have a clean record concerns only planned but not unplanned inspections. The adopted tax freeze 2015-2018 and tax breaks for new companies do not compensate for the strong rise of the tax burden in 2013-2014, given the increase of social security contributions, the introduction of a retail levy in large cities and a reassessment of the land tax, which implies much higher costs for owning or renting premises, as well as numerous possibilities for bureaucratic manipulation. Moreover, regional governments seldom grant tax breaks, being not interested in losing revenue. The new simplified taxation regimes for small companies are routinely misused by larger firms that artificially break up their companies into several smaller ones. Through a similar technique, big companies or firms affiliated with the bureaucrats exploit the public procurement benefits intended for small firms (Nikitin 2015).

The measures to improve entrepreneurs' rights, such as creation of the office of a federal Business Ombudsman (2012), appear as mere window-dressing and expose the weakness of the rule of law. The office of the

Business Ombudsman deals with property rights abuses in the familiar mode of 'manual steering', making the flaws of the legal protection of property rights obvious. The same regards the new high-profile Working Group on Monitoring and Analysis of Law Enforcement in the Area of Entrepreneurship, which President Putin established as a consultative body in the presidential administration in 2016 to reduce violent pressure on business (Kornya 2015). Due to its consultative character the Working Group can be viewed as at best an informal alternative to the dysfunctional legal control over the *siloviki*.

Some recent policies have been in outright contradiction with the proclaimed goal to make life of small business easier. For example, the period during which back taxes can be demanded was recently extended from one to three years, expanding the authority of law enforcers to probe firms (Vinokurov 2015). Recent amendments to the Code of Administrative Offences tightened penalties for firms (up to liquidation of the business) and increased fines by several orders of magnitude, for instance for violations concerning security standards, sanitary norms and consumer rights. The latter measure affects the majority of SMEs, 40% of which are in retail trade and 35% in services (Rosstat 2012).

Last but not least, the formal 'tightening of the screws' is exacerbated by the reinforcement of informal bureaucratic pressure, palpable since the advent of the economic downturn that has been unfolding in Russia since the end of 2014, when the global oil price lost half of its value and caused the Russian GDP to contract 3.7% the following year. While previously bureaucrats had expected to draw 'dividends' from their informal control over cash flow from private property for many years, in crisis they seem to have been trying to extract maximum resources as quickly as possible and 'fleece entrepreneurs as if it was their last chance'. Under these circumstances the well-established informal practice of 'coming to an arrangement' does not seem to work as reciprocally as previously. For instance, law enforcement agents are extorting increasing sums of money from 'grey' businesses without providing protection or services in return (author's private correspondence; cf. Yakovlev 2014). As a result, businesses is pushed further into informality: the share of the shadow economy grew from 18% of employment in 2006 to 19% in 2012 and 20.5% in 2015. In absolute terms this means that about 2 million people

entered informal employment just in the past five years (Rosstat 2016: 94). Going into the shadows may be viewed as a tried and tested crisis adaptation mechanism that helps firms to weather the storm, but at the same time may push firms into the informality trap and ultimately render property rights insecure.

Recommendations

Escaping the informality trap and curbing predatory aspects of patrimonialism such as state threats to property rights is difficult in practice. Both state actors and business actors should be involved in the process. Provided the Russian state is committed to changing the situation, it should try to tackle the structural drivers of patrimonialism and make the business environment less hostile and more predictable, as well as provide incentives for business for going out of the shadows. Such reform is essential given Russia's bleak economic situation, with low oil prices, unlikely to rise in the near future, sluggish GDP growth, decreased living standard, low investment and Western economic sanctions. Conversely, business should try to opt for legal compliance whenever possible and thus escape situations leading into the informality trap. Here are specific recommendations for a better state policy:

First, the state should reduce the regulatory burden on firms and streamline the contradictory regulations. Cutting red tape will reduce inadvertent non-compliance and perhaps violations and help release at least some companies from the informality trap. For example, if contradictory regulations are eliminated and some unrealisable Soviet-era technical standards are scrapped, more firms will be able to be in legal compliance and will not face 'suspended punishment'. The government should also decriminalise economic law and soften the Criminal Code (chapter on economic crimes) in accordance with the principle 'economic penalties for economic offences'. This measure may help to empty state prisons and bring money into state coffers. Additionally, the disproportionate increases in fines in the amended Code on Administrative Offences should be reversed because these are likely to increase corruption rather than discourage violations, unless the overall regulatory burden on firms is reduced radically.

Second, the state should try to tackle informal bureaucratic pressure on firms by a combination of incentives for lawful conduct (for example, promotional, monetary) and tougher controls and sanctions. To this end, corruption and its concrete manifestations should be specified in the Criminal Code beyond bribery. Extortionists should be suspended from service and face high fines. It is further advisable to bridge the gap between on-paper initiatives and their actual implementation. Good policies (for example, an inspections break for 'prudent' SMEs) may work in practice by pushing back the covert resistance at middle and low levels of bureaucratic hierarchy, for instance by changing promotion criteria from loyalty-oriented to economic performance-oriented.

Third, the state is well-advised to decrease the influence of those factions in the political elite who are keen to toughen regulations and promote firmer control and supervision, in particular the *siloviki*. To this end, the state should genuinely commit to developing business beyond lip service and strengthen the role of the 'economic block' of the government through appointments, for example in high-level bodies such as the Working Group on Monitoring and Analysis of Law Enforcement in the Area of Entrepreneurship. The Minister of Economic Affairs, as well as the Business Ombudsman are conspicuously missing from the Group, whereas they should be crucial actors in matters of entrepreneurs' rights. At the same time, performance assessment criteria for inspection bodies could be changed from the purely quantitative ones that prevail today (for example, number of inspections and fines) to effectiveness-oriented ones (for example, the monetary value of collected fines as a proportion of the cost of the inspection bureaucracy).

As far as business is concerned, a transformation of the dominant entrepreneurial culture and deep-seated perceptions that underpin it is required. In this context it is crucial that entrepreneurs cease seeing formal and informal costs of doing business (and solving arising problems) as comparable expenses. Instead, business should treat legal compliance not merely as an option, but as default behaviour - at least in cases when there is a choice. To be sure, many circumstances under the current legal and political conditions dictate informal adaptation strategies unless the company wants to go bust. However, in many other cases, when firms choose informal practices out of expediency, there are

alternatives to cutting corners and thus ways to evade the long-term negative effects of informality. Entrepreneurs should stop evading taxes, cease bribing state officials or fighting competitors through instrumentalisation of the judiciary. Bearing obstacles related to collective action problem in mind, in this way formal behaviour may become a new norm in the long run. Results of my fieldwork in Russia provide a serious underpinning for this vision: the overwhelming majority of the respondents lamented the current situation and wished they could conduct 'honest business'.

However, it is illusionary to expect entrepreneurs to switch to legal compliance if the tax burden remains unsustainably high or bureaucrats continue to extort bribes. We need to be aware that the informality trap can be avoided only if the best efforts by entrepreneurs are supplemented by broad comprehensive political and economic reforms, which may tackle the very foundations of the current Russian regime, including diversification of the economy away from oil, an effort to keep the *siloviki* at bay and the attainment of the rule of law. The prospect of such reforms is very uncertain under current political and economic conditions.

The least the state can and indeed should do in this situation is to make legal compliance more expedient than beating the system. The predominant coercive approach based on stricter laws and tougher controls has not proven successful so far; instead, provision of opportunities and incentives for leaving the shadow economy is lacking. Specifically, the state can provide such opportunities and incentives by creating sound financial conditions, which is overdue in the context of the current economic slump. This measure comprises two components: taxation and credit.

First, the Russian state should decrease the overall tax burden on SMEs and thus give them maximum incentives and a real possibility to conduct 'white' business. It should revise the new land tax and the retail levy that impose a disproportionately high burden on small firms. Additionally, a stimulus programme to support the SME sector in the current economic slump is advisable, similar to the stimulus programme for big business in the 2008-2009 crisis. Given the current constraints on the state budget the stimulus can be in form of tax breaks or tax exemptions for companies

that plan to invest. In addition, regional governments should be incentivised to introduce tax holidays or other support measures for local SMEs by increasing the tax share from SMEs allocated to municipal budgets.

Second, the state should provide access to credit, which remains among the biggest problems for Russian SMEs. The volume of credits to SMEs fell by 6.5% in 2015 compared with 2014, while the share of overdue loans doubled to 14%, according to data from the Central Bank (Seryogin et al. 2016) Almost half of SME loan applications are still rejected across the banking system. Interest rates on loans remain very high, at about 17–20%, and banks commonly seek marketable collateral of up to 200% of the loan amount (OECD 2013: 21). Additionally, a system of low-interest micro-loans for the smallest firms can be created, which does not require cumbersome paperwork and collateral. Affordable credit will not eliminate all problems, but it will allow entrepreneurs to invest, develop and grow and thus in the long run hopefully become the foundation of economic development in Russia.

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Appendix

List of interviews conducted by the author

Note: Entrepreneur = owner of small- (/S) or medium-sized (/M) business. * = CEO.

Small business: 1-50 employees; medium-sized business: 51-100 employees

Location indicates the physical location of the business. All 34 interviews were conducted and recorded in Moscow and St. Petersburg (B17 and B18)

Position	Code	White or grey	Date of interview
Entrepreneur/M, sewing factory, Moscow Oblast	B1	White?	4.04.2014
Entrepreneur/S, publishing house, Moscow	B2	White	4.04.2014
Entrepreneur/S, retail, Moscow	B3	White?	6.04.2014
Entrepreneur/S, PR agency, Moscow	B4	White	8.04.2014
Entrepreneur/S, street food, Moscow	B5	Grey	8.04.2014
Entrepreneur/S, medical clinic, Moscow	B6	Grey	9.04.2014
Entrepreneur/S, construction company, Moscow	B7	Grey	10.04.2014
Entrepreneur/S, private kindergarten, Moscow	B8	White?	10.04.2014
Entrepreneur/S, legal services, Moscow	B9	Grey	10.04.2014

Entrepreneur/M*, manufacturing (chemicals), Moscow	B10	White	11.04.2014
Entrepreneur/S, translation agency, Moscow	B11	Grey/black	11.04.2014
Entrepreneur/S, construction company, Moscow	B12	Grey	14.04.2014
Entrepreneur/S, retail, Moscow	B13	Grey?	15.04.2014
Entrepreneur/M, manufacturing (metal), Vishniy Volochek (Tver Oblast)	B14	Grey	15.04.2014
Entrepreneur/M, IT services, Moscow	B15	White?	15.04.2014
Entrepreneur/M, manufacturing (furniture), Kaluga (Kaluga Oblast)	B16	White?	16.04.2014
Entrepreneur/M*, manufacturing (plastic), St. Petersburg	B17	White?	17.04.2014
Entrepreneur/M*, manufacturing (metal), St. Petersburg	B18	Grey?	17.04.2014
Entrepreneur/S, retail, Moscow + assistant of a Duma deputy	B19	Grey?	18.04.2014
Entrepreneur/M, retail, Moscow	B20	Grey	21.04.2014
Entrepreneur/M, confectionary production, Moscow	B21	Grey	21.04.2014
Entrepreneur/S, manufacturing (industrial fans), Zelenograd (Moscow Oblast)	B22	Grey	22.04.2014
(former) Entrepreneur/S, car retail,	B23	Grey	23.04.2014

Moscow			
Business association executive, Moscow	A1		3.04.2014
Business association executive, Moscow	A2		7.04.2014
Business association executive, Moscow	A3		8.04.2014
Corporate Lawyer (Centre 'Business Against Corruption'), Moscow	L1		7.04.2014
Corporate Lawyer, private legal company, Moscow	L2		7.04.2014
Academic, Moscow	E1		9.04.2014
Academic, Moscow	E2		14.04.2014
Academic, Moscow	E3		21.04.2014
Academic, Moscow	E4		22.04.2014
Journalist, 'Kommersant Dengi', Moscow	J1		8.04.2014
Journalist, 'Forbes Russia', Moscow	J2		11.04.2014

Dutch summary

Nederlandse samenvatting proefschrift Alexandra Vasileva
“Verandering, continuïteit en macht in de Russische politieke economie in vergelijkend BRICs-perspectief”

In dit proefschrift wordt de ontwikkeling van de Russische politieke economie van de afgelopen 25 jaar in een vergelijkend BRICs (Brazilië, Rusland, India en China) perspectief onderzocht. Het concentreert zich op de belangrijkste eigenschap van het Russische kapitalisme, genaamd 'patrimonialisme', waarbij de relatie tussen de staat en (voornamelijk kleine) bedrijven, met name de informele aspecten, worden onderzocht. Deze dissertatie is op artikelen gebaseerd en stelt zichzelf de volgende doelstellingen:

- het beschrijven van het duidelijke onderscheid van het Russisch kapitalisme (hoofdstuk 1);
- het vergelijken van de Russische kapitalistische evolutie en variëteit met die van de andere BRIC-landen (hoofdstuk 2)s
- kennis verschaffen over hoe het Russisch kapitalisme functioneert en zich staande houdt (hoofdstuk 3);
- een analyse bieden over waarom het Russisch kapitalisme zich op deze manier ontwikkeld heeft (hoofdstuk 4).

Kortom, de hoofdstukken richten zich op de beschrijving, de vergelijking, het functioneren en de geschiedschrijving van de kenmerkende Russische vorm van kapitalisme. Daarbij richten zij zich op de beantwoording van de vier fundamentele vragen in de sociale wetenschappen: ‘wat?’, ‘in vergelijking met?’, ‘hoe?’ en ‘waarom?’.

In conceptueel opzicht, verschuift de dissertatie vanuit een macro-perspectief van de algehele politieke economie (hoofdstukken 1 en 2) naar een micro-onderzoek van haar functioneren op het niveau van het midden- en kleinbedrijf (MKB) (hoofdstuk 3), en gaat vervolgens weer terug naar het macroniveau, wat zich er daarna op richt de bredere implicaties van de bedrijfsactiviteiten op het oorspronkelijke systeem weer te geven (hoofdstuk 4). Deze drie-stappen analyse vereist een conceptuele ‘*gear shift*’. De theoretische instrumenten van de ‘*Varieties of Capitalism*’ (VOC)-beurs worden in de eerste helft van het proefschrift gebruikt om de specificiteit van de politiek-economische vorm van

Rusland te beschrijven en weer te geven hoe het in de loop van de tijd in een vergelijkend BRICs-perspectief is ontwikkeld. De resterende helft van het proefschrift kijkt naar het buitengewone patrimoniale Russisch kapitalisme, en richt zich erop het gedrag van de MKB en haar interactie met lokale overheidsdiensten op basis van inzichten die verkregen zijn middels diepte-interviews weer te geven.

Qua methode, combineert de dissertatie een historisch onderzoek met een statistieke analyse; een casus met een vergelijkend onderzoek; een macroanalyse van belangrijke instellingen in een politieke economie die draait op een *micro treatment* van zakelijke actoren; het gebruik van beschrijvende en verklarende benaderingen, evenals *deskresearch* en data verkregen uit persoonlijk veldonderzoek. Het tijdsschema van de analyse begint bij de ineenstorting van het communisme eind 1991 en eindigt in 2014 – het jaar van de laatst beschikbare gegevens.

Kwalitatieve gegevens verkregen uit diepte-interviews vormen het empirisch fundament en bieden een methodologische bijdrage aan dit proefschrift. De interviews werden afgegeven tijdens het veldonderzoek wat in het voorjaar van 2014 in Rusland ondernomen is. Onder de 34 respondenten bevinden zich ondernemers, bedrijfsverenigingen, advocaten, academici en journalisten. Daarnaast zijn in deze studie *cross-sectoral* en *cross-national* kwantitatieve data gebruikt, evenals secundaire literatuur, krantenartikelen en historische analyses van collega-wetenschappers.

Hieronder volgt een overzicht van de belangrijkste bevindingen van de vier artikelen (hoofdstukken) van het proefschrift:

Hoofdstuk 1, getiteld ‘**Continuity and Change in Russian Capitalism**’ (gepubliceerd als hoofdstuk in een *edited volume*), is een historisch onderzoek naar de evolutie van Russische *state-business* relaties en kapitaal-arbeidsverhoudingen sinds de ineenstorting van de Sovjetunie langs drie dimensies. De politieke dimensie omvat de staatscapaciteit en de samenstelling van de dominante politieke elites; de juridische dimensie heeft betrekking op de rechtsstaat en de waarborging van privaat eigendom; en de economische dimensie beslaat het economisch staatsbeleid ten opzichte van het bedrijfsleven. Tegen de achtergrond van de ideaaltypische staatsgeleide, liberale en patrimoniale vormen van

kapitalisme bekeken, wordt duidelijk dat de belangrijkste verandering van richting in de Russische politieke economie uitgedrukt wordt in het proportionele aandeel van liberale en staatsgeleide elementen. Terwijl tussen 1992 en 2002 het Russisch kapitalisme grotendeels kan worden gekenmerkt als liberaal, verschuift die trend naar een uitgesproken staatsgeleide kapitalisme na 2003. De nationalisering van het Russisch kapitalisme uit zich in een gedeeltelijke toename van de staatscapaciteit, alsook in de overgang van liberale naar conservatieve politieke elites, en de gedeeltelijke nationalisering van de strategisch economische activa, wat ook gekoppeld is aan een algehele toename van de staatsbetrokkenheid in de economie en de bestaande arbeidsverhoudingen.

De belangrijkste continuïteit in de ontwikkeling van het Russisch kapitalisme bevindt zich in het aanhoudende patrimonialisme, wat zich manifesteert in de doordringende zwakte van de rechtsstaat; in de onverbiddelijke corruptie, in de gedeeltelijke fusie van de staat en het bedrijfsleven en in de ontplooiing van de informele verhoudingen tussen de staat en het bedrijfsleven en de kapitaal-arbeidsrelaties – wat aanvankelijke allemaal in strijd was met de formele regelgeving omtrent dit soort betrekkingen. Een ander opmerkelijk kenmerk van het Russisch patrimonialisme is te vinden in de informele bureaucratische controle van het privaateigendom (genaamd ‘power-ownership’), en de van daaruit onttrokken zogenoemde administrative rents, wat nader wordt onderzocht in de volgende hoofdstukken. Dit hoofdstuk geeft geen antwoord op de reikwijdte van het Russisch patrimonialisme, de uiteindelijke verschillen tussen de jaren negentig en het nieuwe millennium, of haar mechanismen, aangezien deze in de komende hoofdstukken van deze dissertatie aan de orde komen.

Hoofdstuk 2, getiteld ‘Russia’s political economy re-conceptualised: a changing hybrid of liberalism, statism and patrimonialism’ (gepubliceerd in co-auteurschap met Uwe Becker in het *Journal of Eurasian Studies*), is een onderzoek naar de evolutie van het Russisch kapitalisme in vergelijkend BRICs-perspectief. Het is gebaseerd op een analyse van zowel historische als statistische data, en geeft antwoord op de vragen die in het voorgaande hoofdstuk open zijn gebleven. Het benadert, in het bijzonder, de reikwijdte van het Russisch

patrimonialisme en hoe deze zich ontwikkelde in de jaren negentig en in het eerste decennium van de eenentwintigste eeuw.

Dit hoofdstuk legt een conceptueel kader voor met de bedoeling de invloed van het patrimonialisme op het landelijke veranderingstraject te evalueren, door het patrimonialisme systematisch als een derde dimensie toe te voegen aan het beter bekende liberalisme en statisme. In dit hoofdstuk wordt het Russisch veranderingstraject geconceptualiseerd ten opzichte van ideaaltypische liberalisme, statisme en patrimonialisme. De belangrijkste bevindingen van het eerste historische gedeelte van dit hoofdstuk is dat het Russisch patrimonialisme de opkomst van het economisch gefaciliteerde staatscapaciteit belemmerde, en zowel de liberalisering in de jaren negentig als de her-nationalisering na 2000 ondermijnde. Het tweede gedeelte geeft een kwantitatieve evaluatie van deze ontwikkelingen die gebaseerd zijn op statistieke data, en voegt een vergelijkend BRICs-perspectief toe aan de analyse, die de eigenaardigheid van de Russische ontwikkeling verduidelijkt. De onderzoeks-data bevestigen de de-liberalisering van Rusland en vertonen een toename van patrimonialistische gebruiken in het eerste decennium van de eenentwintigste eeuw ten opzichte van het decennium ervoor. Een volgende bevinding is dat Rusland het enige BRIC-land was dat de-liberaliseerde en steeg in niveau van patrimonialisme in de onderzochte periode.

De overige twee hoofdstukken van het proefschrift richten zich op de Russische casus en haar staatsgeleide patrimoniale versie van het kapitalisme, met de bedoeling haar werkwijze en haar origine – door zich op de economische activiteiten van het MKB te concentreren – nader te belichten. **Hoofdstuk 3**, getiteld ‘**Trapped in informality: The big role of small firms in Russia’s statist-patrimonial capitalism**’ (gepubliceerd in *New Political Economy*), omvat een studie naar de werking van het Russisch kapitalisme en de mechanismen die haar stabiel houden. Het beantwoordt een volgende vraag die in het eerste hoofdstuk open is gebleven, namelijk wat de mechanismen achter het Russisch patrimonialisme zijn en welke factoren en omstandigheden de bureaucraten in staat stellen om onder hun indirecte controle *administrative rents* uit privaat eigendom te halen.

Terwijl de voornaamste toelichtingen zich richten op het gebrek aan institutionele beperkingen om staatspredatie te verklaren, wordt in dit hoofdstuk de veerkracht en handhaving van het Russisch staatsgeleide patrimoniale kapitalisme uitgelegd door middel van de vaak nagelaten bijdrage van het MKB nader te onderzoeken. Op basis van statistieke data, blijkt in dit hoofdstuk dat de MKB-sector, ondanks de toenemende staatspredatie, gestaag steeg in het eerste decennium van de eenentwintigste eeuw, waaruit kan worden opgemaakt dat het MKB niet alleen aan de werking van de staat onderworpen is. Uit diepte-interviews met Russische ondernemers blijkt verder dat het bedrijfsleven een bijdrage levert aan de handhaving en het functioneren van het staatsgeleide patrimonialisme door middel van het ‘*informality trap*’-mechanisme: bedrijven die voor een informele strategie kiezen, vinden het moeilijk om terug te keren naar de juridische sfeer en blijven vervolgens vastzitten in de informele economie.

In dit hoofdstuk wordt geconcludeerd dat de bestuurders die de informaliteit aansturen de institutionele beperkingen omvatten, zoals over-regulatie en bureaucratische afpersing, wat betekent dat het een machtsbron aan de kant van de overheid representeert, en waarmee bedrijven gedwongen kunnen worden voor informeel gedrag te kiezen. Informaliteit wordt echter ook aangedreven door enkele bedrijfsspecifieke factoren. Ten eerste, afhankelijk van de bedrijfskenmerken (zoals omvang en sector), kan een kleine onderneming geprikkeld worden tot informeel gedrag. Ten tweede, sociaal-culturele factoren, ook wel 'normaliteit van informaliteit' genaamd, spelen in dit verband ook een rol: het beschouwen van formele zakelijke kosten en informele uitgaven zoals steekpenningen als vergelijkbare kosten, kan – om subjectieve redenen – sommige midden- en kleinbedrijven ertoe doen kiezen half werk te leveren in het naleven van wettelijke normen. Hoewel deze minimale machtsvorm om het systeem te ondermijnen deze bedrijven kan helpen in hun doen en laten en in de bescherming van hun belangen, heeft het vaak een onbedoeld langdurig negatief effect op de waarborging van privaat eigendomsrecht en kunnen deze bedrijven komen vast te zitten in informaliteit. Kortom, het ‘*informality trap*’-mechanisme markeert het agentschap van het MKB in de Russische politieke economie en hun bijdrage aan het functioneren ervan.

Tenslotte geeft hoofdstuk 4 een historische analyse van de oorsprong van het Russisch kapitalisme, getiteld ‘**Digging their own graves: how small companies contributed to the emergence of Russia’s statist-patrimonial capitalism**’ (in voorbereiding op indiening). Dit hoofdstuk traceert in historisch perspectief de verschillende redenen die ertoe hebben bijgedragen dat Russische bedrijven in de jaren negentig aan informele praktijken begonnen, en hoe ze, door in de daaropvolgende tien jaar in een ‘*informality trap*’ te vallen, de basis voor onzekere eigendomsrechten en de informele betrekkingen tussen de staat en het bedrijfsleven hebben helpen creëren.

De belangrijkste bevinding in dit hoofdstuk is dat het staatsgeleide patrimoniale kapitalisme niet alleen een resultaat is van een *topdown*-activiteit van een staatssoeverein, zijn corrupte actoren of trawanten in de *big business*, zoals dat in het algemeen gekenmerkt wordt, maar dat het systeem ook berust op een *bottom-up* activiteit van het leeuwendeel van economische actoren – het MKB. Het zijn grotendeels geen passieve slachtoffers van staatsbedreigingen op het privaat eigendomsrecht, maar hebben in veel gevallen juist bijgedragen aan de opkomst van dergelijke praktijken. Deze – vaak onbedoelde – bijdrage hangt samen met enkele informele business praktijken die door de midden- en kleinbedrijven ondernomen zijn en welke hun op de langere termijn in de ‘*informality trap*’ gevangen hebben gezet. Terug in de jaren negentig waren sommige van deze informele praktijken niet de enige opties van bedrijfsvoering, maar werd daar uit opportunistische redeneringen toch voor gekozen. Toen na 2000 de staat steeds machtiger werd, begon het informele gedrag van de MKB-sector averechts te werken, aangezien het corrupte staatsstelsel gebruik maakte van de gevestigde informaliteit en deze exploiteerde om de eigendomsrechten van vrijwel elke zakenman te schenden. Zo wordt de opkomst van het staatsgeleide patrimoniale kapitalisme in 2000 gekenmerkt door staatsbedreigingen op het private eigendomsrecht, welke mogelijk gemaakt – en feitelijk gefaciliteerd – is door o.a. de informele praktijken van zakelijke actoren in het voorafgaande decennium.

De belangrijkste bijdrage van deze dissertatie is tweeledig. In empirisch opzicht stelt het ons in staat beter te begrijpen hoe Rusland werkt, en waar haar politieke economie zich bevindt in vergelijking met de andere

BRIC-landen. Het suggereert ook waarom het Russisch staatsgeleide patrimoniale kapitalisme op haar eigen manier functioneert, en hoe het zover is gekomen. Een andere empirische bijdrage is de instrumentele suggestie voor het kwantificeren en vergelijken van de verschillende veranderingstrajecten in opkomende economieën, die ook buiten de BRIC-landen en in andere tijdvakken van toepassing zijn.

In conceptueel opzicht verfijnt dit proefschrift het *Varieties of Capitalism*-debat door systematisch een gedetailleerd onderzoek naar patrimonialisme erin op te nemen. De bevindingen in dit proefschrift bevestigen dat het patrimonialisme een veel belangrijker kenmerk is dan een incidenteel detail, zoals corruptie of een leemte in een bepaald type kapitalisme. In plaats daarvan moet het patrimonialisme gezien worden als een concurrerende logica van economische en sociale organisatie, zonder welke de politieke economieën buiten de OESO niet voldoende begrepen kunnen worden. Door de reproductie van het patrimonialisme in het Russisch voorbeeld te bestuderen, draagt dit proefschrift bij aan de kennis over de reproductie van instituties in het algemeen. Door de aandacht te vestigen op *bottom-up* praktijken die het patrimonialisme ontwikkelen en handhaven, spreken de bevindingen in dit proefschrift ook aan op het bredere *state-society* debat in de sociale wetenschappen.