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## **Chapter 1: Continuity and Change in Russian Capitalism<sup>1</sup>**

### **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.

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<sup>1</sup> 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 led 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.<sup>2</sup>

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.<sup>3</sup> 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

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<sup>2</sup> 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.).

<sup>3</sup> 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,<sup>4</sup> 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

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<sup>4</sup> 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.<sup>5</sup> 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

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<sup>5</sup> 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.<sup>6</sup> 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

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<sup>6</sup> 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.<sup>7</sup> 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).<sup>8</sup>

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

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<sup>7</sup> 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).

<sup>8</sup> 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.<sup>9</sup> 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).

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<sup>9</sup> 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).<sup>10</sup>

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

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<sup>10</sup> 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.<sup>11</sup> 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

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<sup>11</sup> 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.