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**Interaction of Interest Groups and
Their Impact on Economic Reform in Contemporary Russia**

By Andrei Yakovlev

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Introduction

Russian President Vladimir Putin's first term in office is drawing to its close. Few people seriously question his chances for re-election. At the same time, the upcoming elections are a good time to look at the results of economic development over the last four years.

We have clearly seen significant positive change in Russia since 1999. This change is especially obvious when compared to the crisis-ridden 1990ies. Strong GDP growth and a stable budget surplus, repayment of arrears in the social sphere, growing real household incomes and regular sovereign debt payments are all features of the relative economic stability we have seen over the last few years. Many experts admit, however, that this success can be attributed to the 1998 devaluation of the rouble and high oil prices rather than to an intelligent and focused approach adopted by the government. Commodity industries have maintained and even increased their share in the GDP and export structure, which inevitably led to an extreme dependence of the Russian economy on world oil prices. As a result, the weakening devaluation effect and an abrupt, though temporary, decline in oil prices caused the economic growth to slow down substantially by the end of 2001.¹ These negative trends were superimposed on the general feeling of a hiatus in institutional reform and of an approaching stagnation.²

Under these circumstances, the government's attempt to include the declining GDP growth rate in the mid-term economic development forecast in spring 2002 triggered public criticism by the President's Administration and by President Putin personally. It also generated a new wave of discussions among economists on the future of the Russian economy.³ The fact that such discussions take place indicates that the expert community has a sound evaluation of the current situation. It can be regarded as a positive step forward – nothing of the kind was happening before the 1998 devaluation and default. The President indirectly reacted to these discussions in his address to the Federal Assembly in May 2003 by stating the need to double the GDP during the next 10 years and to carry out administrative reform. In addition, the need to 'diversify the economy' was declared in the new short-term program developed by the government.

The problem both with expert discussions of late 2002 – early 2003 and with new government documents is a focus on *old* questions of what kind of reform Russia really needs. In our opinion, this topic has been exhausted – almost all possible recipes have already been formulated.⁴ Since President Putin took office, we have seen clearly that we need to find out not only *what* is to be done but also *who* can support and carry out the proposed reforms and *how* they can be implemented. This paper focuses on the question of *who* can support reforms.

It consists of two sections. The first section analyses the main findings of previous studies; it highlights the questions that have not been answered and looks at the trends that, in our view, have not been properly explained. The second section discusses the evolution of interests of influential social groups in the post-reform period, shows the positive influence of the 1998 financial crisis on economic agents' motivation and explains why the key players subsequently

¹ According to Goskomstat, the Russian State Committee for Statistics, in the first six months of 2003 industrial production again grew at 6.8% per annum (as compared to the first six months of 2002). This, however, just postpones the problems without actually resolving them since there are still no stable sources of economic growth.

² This is reflected in people's deteriorating expectations with regard to economic development – for more information see changes in the VTsIOM 'social attitude index' (ISN) and the behaviour of some of its components since spring 2002.

³ See Expert Institute report 'Burden of the State', Egor Gaidar's presentation at IET Scientific Council meeting in February 2003, HSE report 'Russia: Creation of New Economy Institutions', etc.

⁴ As concluded by E.G. Yasin in his article "State Burden and Economic Policy (Liberal Alternative)" in *Voprosy Ekonomiki*, issue 11 of 2002: "Most of the proposed measures are not new. They were proposed at different stages of market transformation but were never implemented for different reasons".

lost development incentives. In the conclusion some groups are identified on this basis that are able to support a policy of reforms under the present conditions aimed at implementing competitive institutions and mechanisms in the economic and political spheres. The conclusion also describes some approaches to generating a positive influence on the motivation of those groups.

Who needs reform: analysis techniques and current state of research

It must be pointed out that this topic is not new for Russian or foreign researchers. Analysis of the social basis of reform is an interdisciplinary problem that involves economists, political and social scientists.

We believe two major areas are important in studies of the social basis for reform. In the first area we look at activities and policies of those social groups that really win or lose as a result of the reform. Here we have room both for political economy-related theoretical speculation and for empiric sociological research. The second area looks more at who really manages the reform process, how the composition of the top social layers changes during transition to the market. Normally, such elite studies are done in between political science and sociology.

In the next two sub-sections we will briefly describe the main results for both areas in the 1990s; in the closing sub-section of this section we will discuss the recent trends identified in Russian and foreign literature.

The winners and the losers

The goal to identify the winners and the losers in the reform process has been set in many sociological studies.⁵ The estimates were based both on the respondents' answers to direct questions on reform advantages and disadvantages for them and on their answers to indirect questions characterizing changes in respondents' living standards, in their attitudes to politics, etc. In some cases one can even talk about sufficiently long timelines devoted to this topic. Empiric data is, of course, very important; however, we believe that to understand the processes that took place it is more important to look at the models on which explanations of social interactions in transitional economies were based in different periods and which sometimes had a very significant impact on reform policy.

For a long time, the so-called J-curve model was one of the most popular models in political science literature.⁶ According to this model (see Figure 1), such benefits as a lower inflation, higher efficiency and competitiveness of organizations, etc. are postponed in time and dispersed in space. All members of a society benefit from macroeconomic stability and better economic performance. For this reason, it is difficult to identify those who would be most interested in reform effectiveness. The positive effect of the reforms becomes visible only after the decline related to transformation. The disadvantages, on the contrary, predominantly affect certain social groups (employees of former state-owned organizations, old *nomenklatura*, pensioners, the unemployed) concurrently with the reforms.

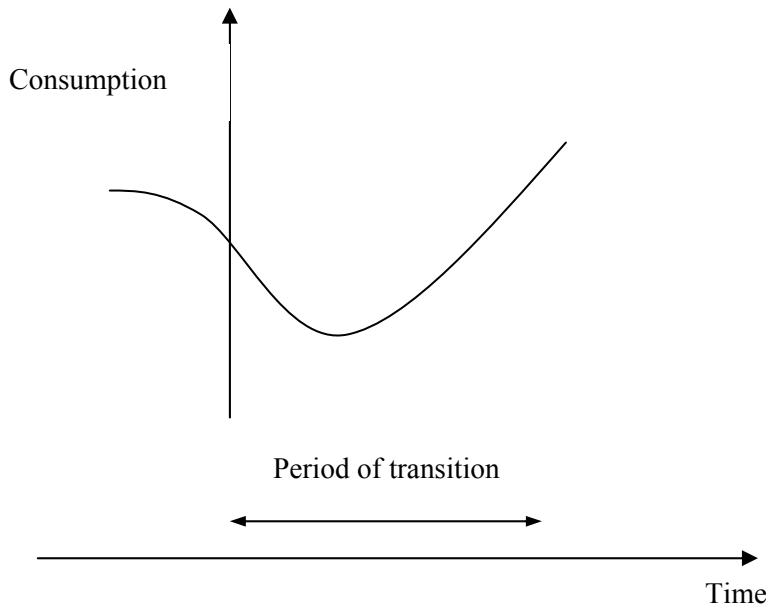
The J-curve model is based on the assumption that in a democracy, social groups likely to be affected by the upcoming reform may try to hamper the reform process and cause the reformist government to withdraw from power. It was believed, therefore, that in practice radical reforms can only be carried out by an 'autonomous' government which does not depend on its voters in the short term and is supported by international financial institutions. Since any 'autonomy' of

⁵ See VTsIOM, RNISiPN and other think tanks' projects.

⁶ See Williamson (1994), Nelson (1990), and other papers.

this kind is inevitably limited in time, the key reforms need to be carried out as quickly as possible to make sure that the process is irreversible even after a new government takes office. This concept formed to a large extent the basis of the ‘shock therapy’ policy implemented in many economies in transition in the early 1990ies.

Figure 1: J-curve.



Actual development, however, was significantly different from what was predicted by this model. As Joel Hellman showed in his well-known paper,⁷ economic reform was most successful in countries where the governments depended more on the voters. Countries with ‘autonomous’ governments, on the contrary, showed either lack of real reform or inconsistent, ‘partial’ reforms. And it was in the case of ‘partial’ reforms that there were high transformation-related costs (expressed in faster GDP decline, lower living standards, and social stratification) on the one hand, and no anticipated positive results able to stimulate economic activity on the other. Some economies would freeze in the state of ‘partial’, incomplete reform. And even countries where no reform had been carried out would be better off.

Joel Hellman tried to explain this phenomenon with his ‘partial reform’ model. He proposed that reforms in the short term can provide both disadvantages and advantages to certain social groups. The fact that in the beginning different reforms produced results at different points in time and were not implemented consistently can increase further the structural deformations typical of a command economy. As a result, it becomes possible for some social groups (such as managers of old state-owned enterprises, managers of new commercial banks, trade companies, etc.) to perform efficient arbitration transactions between the regulated and market-driven sectors of the economy.

The higher the distortion caused by inconsistency and lack of integrity in the implementation of reforms, the more benefits influential social groups can gain from such arbitration transactions and, consequently, the higher their ability to obstruct the reform process in the future and to

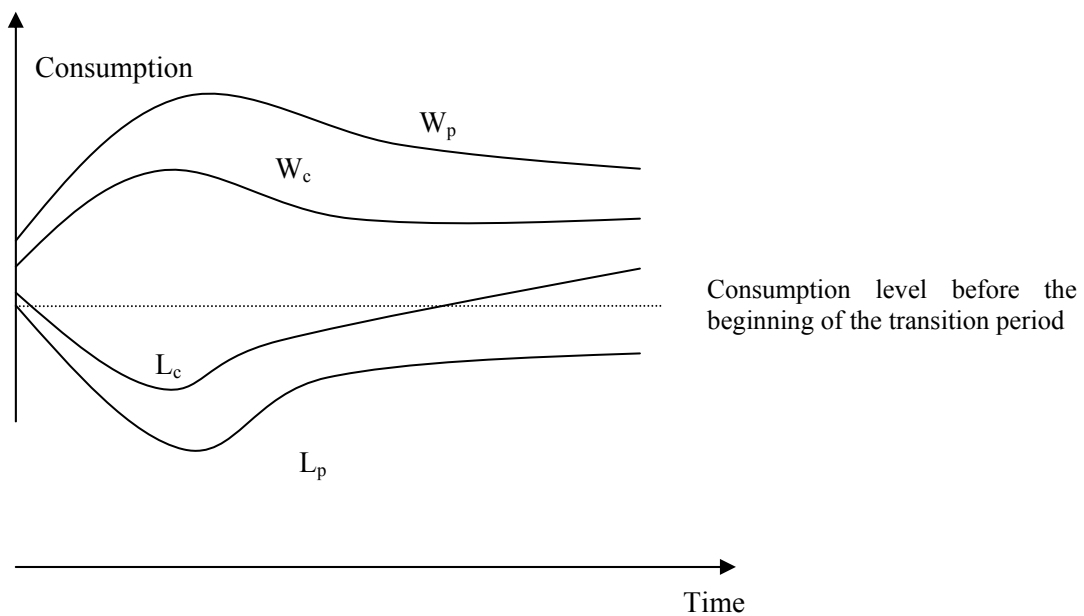
⁷ See Hellman (1998).

preserve their rent sources. As a result we can see the partial reform ‘trap’ effect.⁸ The above said is illustrated in Figure 2.

Hellman’s main conclusion is that the problem is not to protect the reformist government from the influence of the ‘losing’ social groups but to limit the ability of the influential ‘winning’ groups to put pressure on the government in an attempt to keep their rent sources. According to Hellman, one of the main solutions to this problem is development of a political democracy that takes into account the ‘losers’ opinion and contains pressure exerted by the ‘winning’ social groups.

Hellman’s paper was logically extended by a presentation on the phenomenon of privatization or state capture presented at the ABCDE conference in April 2000.⁹ By state capture the authors of the presentation mean the possibility for companies to influence the basic rules of the game expressed in laws, regulations, decrees and resolutions by making informal payments to officials or policy-makers. The paper based on a survey of 3,000 enterprises in 20 economies in transition conducted in 1999 showed the scale of state capture, the negative impact of this phenomenon on economic development, and its close relation with ‘partial’ reforms.

Figure 2: Benefits of the ‘winners’ and losses of the ‘losers’ in the conditions of partial and comprehensive reforms.



W_p – the ‘winners’ curve in the conditions of partial reform

W_c – the ‘winners’ curve in the conditions of comprehensive reform

L_c – the ‘losers’ curve in the conditions of comprehensive reform

L_p – the ‘losers’ curve in the conditions of partial reform

⁸ In Russian literature the ‘institutional trap’ problem was considered in details by Polterovich (1998).

⁹ See Hellman, Jones & Kaufman, 2000, and Hellman, Jones, Kaufman & Schankerman, 2000.

Hellman clearly shows in his papers the reformers' dependence on the economic and political environment and, therefore, convincingly criticizes the 'autonomous government' concept which was an important condition for implementing a policy based on the 'Washington consensus' principles. It can be pointed out that a detailed and thorough analysis of this concept based on Russian data was done by S. Afontsev.¹⁰ One of his conclusions is the need to choose the most economically efficient option out of a number of politically acceptable reform scenarios – rather than orientation towards an 'economically ideal' course of reforms.

Hellman, in our view, lacks this realism when he formulates political recommendations. He suggests that democratic development is one of the main ways to overcome dependence on those influential groups that benefit from 'partial' reforms. With all their differences from the J-curve, Hellman's arguments point out the need for accelerated and comprehensive reform since this results in smaller initial distortions which can be eliminated much faster. We do not know, however, why some countries choose more comprehensive and consistent reform programs while others only carry out partial reforms from the very beginning (pressure from the 'winning' social groups can explain why one cannot get out of the partial reform trap but not why one got into it). Besides, it is not clear who and why is going to support the development of political democracy and make sure the reforms are consistent in the post-privatization environment.

Another model that explains the differences in results obtained in different economies in transition was proposed by Timothy Frye.¹¹ What makes this model different is that it uses GDP changes (the ultimate output of reforms), and not implementation or pace of reform, as the dependent variable.

Frye's final conclusion is that the degree of *polarization* of the political elite has a significant impact on economic development. By polarization he means strong opposition of anticommunists and ex-communists,¹² which does not give any group the ability to shift transformation costs completely to their opponents and to wholly implement their reform scenario. This affects the economic environment. At the same time polarization generates expectations of government reshuffle and changes in political course, including possible revision by the new government of decisions made by their predecessors and political opponents with regard to distribution of property rights. Therefore, polarization undermines confidence in emerging institutions and policies pursued by the government and limits the horizon of business projects.

This approach complements Joel Hellman's model by suggesting political polarization as one of the reasons why a specific country may find itself in the unstable equilibrium of 'partial reforms'. Besides, this model explains political business cycles in economies in transition where, unlike in most democratic countries, economic growth slows down before elections.¹³ Frye's model, however, does not show why political polarization takes place in some countries but is not observed in others. Nor does it show how to handle this polarization.

Transformation of the elites

Increased attention (especially in the early 1990s) to the problem discussed in this sub-section was caused by the fact that it is elites that build new institutions. A number of empiric studies

¹⁰ See Afontsev, 2000a.

¹¹ See Frye, 2002a.

¹² T. Frye measures the polarization degree by the proportion of ex-communist parties in parliament when an anti-communist government is at power and vice-versa.

¹³ According to T. Frye, this is caused by increasing political risks which affect business activity.

were devoted to the structure and composition of elites. The results of those studies were presented at conferences in Prague, Warsaw and Cambridge in 1993–1996.

Within the large range of studies carried out at that time one can identify two approaches to analyzing the evolution of elites in economies in transition. The first approach looks at elite transformation processes from the perspective of their ‘reproduction’ or ‘circulation’.¹⁴ By ‘reproduction’ they mean close relations and consistency between the old communist elite and the new ‘ruling class’. The ‘circulation’ model, on the contrary, suggests significant social transformations and the emergence of new people with new basic values on the top of the social hierarchy.¹⁵

According to the results of a broad comparative study of national elites carried out in 1990–1994 in six countries covering approximately 7,000 respondents,¹⁶ Russian elites showed a significant level of succession – 51% representatives of 1993 elite groups already had top managerial positions in the late 1980s. On the contrary, in Poland and Hungary the proportion was somewhat lower – 41% and 33% respectively. With a more thorough approach, the proportion of old top managers in Hungary and Poland turns out to be even lower – 25% and 15% – while Russia shows the same figures as indicated above. Finally, almost 80% of the new Russian elite were members of the Communist Party back in 1988. This figure was less than 30% in Hungary and slightly above 20% in Poland.¹⁷

All this allowed for conclusions on the presence of the elite reproduction model in Russia and on trends towards elite circulation in Poland and Hungary. Besides, elite reproduction was regarded as detrimental to reform implementation in Russia and CIS.

The second approach presented in Higley, Pakulski and Weselowsky, 1998 offers a more complicated analytical model. These authors look at elite transformation in two dimensions – analysing the degree of unity and differentiation of the elite.

By unity of the elite they mean common values shared by the majority of the elite in a specific country. Unity can be based on some ideological, religious or national doctrines or on adoption by representatives of the elite of the same agreed rules of the game under which it would be possible to resolve conflicts between different elite groups without violence. By differentiation they mean the degree of independence (autonomy) of the elite of the other larger social groups as well as heterogeneity of the elite, availability in its composition of elite sub-groups offering different values to the society and competing with one another in political decision-making.

Different types of elites can appear in different countries depending on the combination of these two factors. The classification of these types is given in Table 1.

According to John Higley and his colleagues, an ideocratic elite is characteristic for communist and fascist regimes. However, it is never completely monolithic and its unity is always under pressure exerted by various opposition, intellectual, religious and political groups. Nevertheless, the ‘ideocratic’ elite configuration prevailed in the Soviet Union and Eastern Europe until the 1980s.

¹⁴ See, e.g., Szelenyi & Szelenyi, 1995. In this paper the models are contrasted as two different approaches. In our opinion, however, the authors interpret elite transformation as changes in elite structure in the same dimension. This is why we classify papers like this as one type of paper.

¹⁵ Empiric studies show that pure elite circulation or reproduction almost never took place. Rather, these models can be regarded as certain conditional poles towards which real elite processes in some EE and ex-USSR countries are oriented.

¹⁶ The surveys were carried out in Bulgaria, Hungary, Poland, Russia, Slovakia, and the Czech Republic. The results of the project for Hungary, Poland and Russia were partially presented in 1995 in a special issue of *Theory and Society*. For more information see Szelenyi & Szelenyi, 1995; Hanley, Yershova & Anderson, 1995; Fodor, Wnuk-Lipinsky & Yershova, 1995.

¹⁷ See Fodor, Wnuk-Lipinsky & Yershova, 1995.

Table 1: Configurations of national elites and associated regime types (*)

		Elite unity	
		Strong	Weak
Elite differentiation	Wide	Consensus elite (stable democracy)	Fragmented elite (unstable democracy)
	Narrow	Ideocratic elite (totalitarian regime)	Divided elite (authoritarian regime)

(*) This table is reproduced from Higley, Pakulski & Weselowsky, 1998, p. 5.

Weakening ideological and political pressure from Moscow after M. Gorbachev took office unveiled opportunities for the nationalistic and liberal/democratic opposition, which became one of the reasons why the communist regimes collapsed in Eastern Europe and why the Soviet Union broke apart later on. It was then that a transition began from the ideocratic to other types of elite.

The trajectory of this evolution was different depending on the previous history and the level of advancement of the communist regime itself. According to J. Higley and his coauthors, in Hungary, Poland and Czech Republic there were preconditions for a ‘consensus’ elite based on the broader recognition of democratic values and the willingness to “return to Europe”.¹⁸ Movement towards a fragmented elite (with interelite groups breaking away without accepting new uniting values) was characteristic of Slovakia and Bulgaria. The ‘divided’ elite phenomenon – lack of uniting values with weak internal differentiation of the elite and its dependence on the other social groups – emerged in Romania and Ukraine. Finally, according to J. Higley and his colleagues, in Russia one could observe a complex combination of ‘divided’ and ‘fragmented’ elites with some weak conditions for creating a ‘consensus’ elite.

On the whole, many researchers believe this multi-dimensional approach to be quite interesting.¹⁹ It is however difficult to verify this approach with quantitative data. This is why most results of empiric studies were analyzed within the framework of the first approach interpreting transformation of the elites in terms of their ‘reproduction’ or ‘circulation’.

Olga Kryshantovskaya applied this approach in full to the situation in Russia.²⁰ Her opinion is that power was exchanged for property in Russia, which allowed the old Soviet elite – which in this case was identical to the *nomenklatura* – to retain most of its positions (see Figure 3 on the following page).

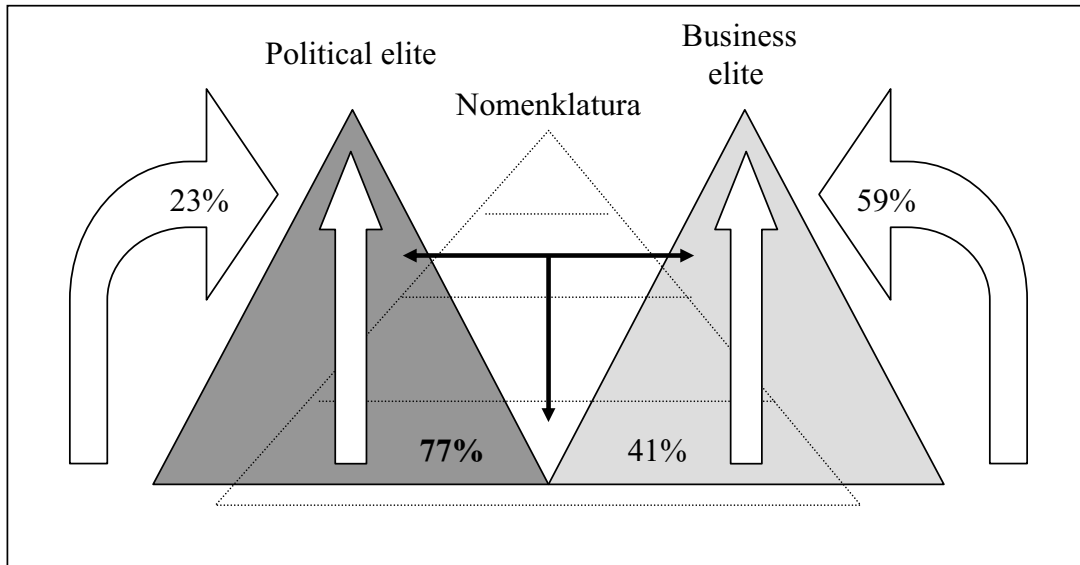
According to Kryshantovskaya, a major role in elite reproduction during the transition to the market was played by the phenomenon of the ‘Komsomol economy’ of the late 1980ies comprising several hundreds of Young People’s Scientific and Technical Creativity Centers (NTTM’s), Youth Housing Cooperatives (MZhK’s), etc. It was through the ‘Komsomol economy’ that the assets of state-owned enterprises were redistributed in favour of those individuals who then managed to grow their capital significantly in export/import and financial transactions and became the backbone of the business elite due to their active participation in the privatization process.

¹⁸ In Hungary and Poland, these values were shared by reform-oriented representatives of the former ruling party, which enabled them to get back to power during the 1993–1994 parliamentary elections.

¹⁹ See, for example, Frane & Tomšič (2002), p.438–439.

²⁰ See Kryshantovskaya (1996), Kryshantovskaya & White (1996), Kryshantovskaya (1999), Kryshantovskaya (2002a), etc.

Figure 3: Origin of the Russian political and business elites (based on the results of ‘Transformation of Russian Business Elite’ survey carried out by the elite research division of the RAS (Russian Academy of Sciences) Institute of Sociology in 2001).



Reproduced from Kryshtanovskaya (2002a), p. 38.

Kryshtanovskaya resolves the problem of clear age differences between the contemporary Russian business elite and the Soviet *nomenklatura* by introducing the concept of ‘the authorized’ (*‘upolnomochennyye’*): ‘...As the *nomenklatura* exchanged power for property it did not necessarily get involved in risky commercial undertakings. Young ‘authorized’ people were selected for risky undertakings and to operate the state money ... This was an attractive domain for people of a different generation – active Komsomol functionaries, officials in the lowest positions of the middle range’.²¹

The commercial and financial business elite nurtured by the *nomenklatura* did not immediately take control over major enterprises in the real sector of the economy. According to Kryshtanovskaya, it was only by 1996 that the business elite began to control about 50% of large business and it was at that time that the Russian oligarchy emerged.

Kryshtanovskaya underlines the consistency between the old Soviet and the new Russian elites in her papers as well as the big overlap and close interaction between the business and political elites in the post-reform period. Kryshtanovskaya’s assumption that reproduction of the elite played a major role in Russia in the 1990ies is shared by many other researchers (see Ershova, 1994; Shevtsova, 1995; Schröder, 1999, etc.). Some researchers, however, disagree with this point of view.

For example, according to David Lane and Cameron Ross,²² the Russian political elite are rooted in the Soviet *intelligentsia* (intellectuals & professionals) rather than in the *nomenklatura*. Lane and Ross make this assumption based on a detailed analysis of 470 biographies of representatives of Russia’s top political elite as of January 1995.²³ The data they provide show

²¹ Kryshtanovskaya (2002a), p. 6.

²² See Lane & Ross (1998).

²³ Lane and Ross identified three elite subgroups – parliamentary, governmental, and regional elite. The parliamentary elite include top State Duma and Federation Council leaders as well as chairmen of committees of both chambers and their deputies. The governmental elite include federal ministers and their deputies. The regional elite include heads of Russian Federation constituencies, chairmen of legislative assemblies, and the president’s envoys in their

that the proportion of party bosses in important positions in the Soviet era was significant (52%) only in the regional elite. In 1995, many representatives of the Russian governmental elite (60%) had experience working at Soviet ministries and agencies but the positions they had had were normally not higher than heads of departments. As regards the parliamentary elite, those with experience in the Communist Party or government apparatus accounted for 19% and 22% respectively. These groups, however, show a partial overlap and approximately 2/3 of the parliamentary elite had no relation whatsoever to Soviet government structures.

Based on their data Lane and Ross argue that a significant renovation of the Russian political elite took place as early as the beginning of the 1990's and that it is not quite correct to speak about the 'reproduction' of this elite from the Soviet one. The authors explain the differences between their and other researchers' results by the fact that the concepts of 'elite' and '*nomenklatura*' were not identical in the Soviet Union. Lower *nomenklatura* positions did not provide significant leverage and did not mean that the person belonged to the elite. Moreover, in the 1970–1980s the *nomenklatura* itself was no longer a uniform and united 'political class'. The Soviet system at the later stages of its development can rather be regarded as a network of bureaucratic elites where each elite had a relative autonomy and was pursuing its own interests.²⁴

Apart from *nomenklatura* and bureaucratic elites there was such a social group as *intelligentsia*. The *intelligentsia* could partially overlap with the *nomenklatura* (when people from science and culture were included in party committees of different levels and the appointments of directors of academic institutes were agreed in the Central Committee of the Communist Party). Nevertheless, the *intelligentsia* was normally better educated, more free-thinking and could, to a certain extent, compete with the *nomenklatura* elites – without turning into a counter-elite, though. In this connection Lane and Ross define the *intelligentsia* as an ascendant class, something similar to the category of 'professionals' in Western democracies, and argue that it is representatives of this very social group who came to power in the key areas of the Russian political system as a result of the transformation of the early 1990ies.

Lane and Ross thus challenge the assumption of the 'reproduction' of the Russian political elite. At the same time they point out its substantial heterogeneity and qualitative differences between the parliamentary and governmental elites, on the one hand, and the regional elite on the other. These differences are expressed not only in a bigger amount of former party functionaries on the regional level but also in the quality of education. For example, graduates of local agricultural, economic and polytechnic colleges as well as party schools prevail among the 'regional' people, while representatives of the parliamentary and governmental elites received at least one education at Moscow or Leningrad universities.

According to Lane and Ross, one can generalize that the federal elite is more cosmopolitan and has a stronger market orientation, as contrasted with parameters and values of regional elite more traditional for the Soviet period. At the same time, the federal elite turns out to be more heterogeneous and fragmented.

respective regions. The sample, however, does not include the highest-ranking officials from the Presidential Administration which plays an important role in the political process. Besides, the coverage of the regional and governmental elites was incomplete. In the first case Lane and Ross' sample contains 195 people instead of at least 267 (3 representatives for each of 89 RF subjects). In the second case the sample is even less representative since big federal ministries (Ministry of Economy, Ministry of Finance, Ministry of Education, Ministry of Internal Affairs, Ministry of Defense, etc.) have 10 and more deputy ministers. On top of that, there has always been quite a big government apparatus, where heads of departments match deputy federal ministers in terms of influence and authority. However, in Lane and Ross' sample the entire governmental elite are represented by only 108 people.

²⁴ See Lane & Ross (1994), p.20. Similar opinions on the Soviet system are also expressed within the framework of the 'administrative market' concept – see Kordonsky (2000).

Post-crisis development trends

The crisis of 1998 demonstrated the internal instability of the system having evolved under Boris Yeltsin featuring many decision-making centres and strong competition for resources and instruments of influence between various financial and political groups. In those conditions and given Boris Yeltsin's ailing health as well as oncoming presidential elections one of the most urgent tasks for the Russian ruling elite was to ensure *continuity*.

The task had been fulfilled by the beginning of 2000 when it took just four months for Vladimir Putin to be transformed from a new prime minister and then an acting president, a person who was hardly even known to experts, into a political figure enjoying the support of 40 per cent of the electorate. Concurrently, due to the success of the Unity Party and the Union of the Right Forces in the parliamentary elections a legislature controlled on the whole by the Presidential Administration and the government was formed for the first time in the whole period of reform.

The appearance of the new president who had virtually no face of his own but received unprecedented popular support as well as the success of the new 'mainstream party' without any program in parliament was viewed by political scientists as a vivid demonstration of the immaturity of the civil society and of broad opportunities to manipulate public opinion in contemporary Russia.²⁵

At the same time the emergence of a popular president along with the end of the chronic confrontation with the parliament created prerequisites for change in relationships between various groups of the Russian elite. In that connection one can single out the following key trends characteristic of the post-crisis period:

A. Re-distribution of power between the federal centre and regions.

Strong 'centrifugal' trends inherited from the period of the USSR's disintegration made up one of the characteristic features of the 1990s. They can be described as relative economic and political autonomy of the regions. The objective prerequisites for this phenomenon were the failure on the part of the federal centre to collect taxes, comply with their own financial obligations and prevent autonomous fiscal activities by regional authorities.²⁶ The fragmentation of the economic space was facilitated by severe destruction of former economic ties and a drastic rise in transportation tariffs.

As for political aspects the positions of the federal centre were significantly damaged by the outcome of the 1993 parliamentary elections.²⁷ Subsequently, the power and influence of governors were getting stronger as the popularity of the president and the federal government was shrinking. As a result, it was only through the delegation of the broadest self-governance authority that Boris Yeltsin was able to win support of regional and local administrations' heads during the presidential elections of 1996.

Following the 1998 crisis and Vladimir Putin's ascension to power in particular a reverse movement was started. A. Zudin (2003) describes the trend in general terms as a transition from a "polycentric" model of the political regime to a "monocentric" one. The new president, who unlike his predecessor enjoyed the support of the electorate, declared a policy aimed at strengthening 'the vertical line of power'. It resulted in noticeable limitations on the governors' freedoms that materialized in the form of a greater share of tax revenues for the federal centre, the introduction of federal districts headed by authorized representatives of the president and the

²⁵ See Schroeder (2003) and other papers.

²⁶ David Woodruff saw this 'feudalization' of economic and political relations between the centre and the regions as one of the key reasons for the creation and dissemination of 'monetary surrogates' (see Woodruff, 1999).

²⁷ For a detailed overview of studies dedicated to Russian elections of the early to mid 1990ies see Gel'man (2000).

Federation Council reform.²⁸ Under pressure from the Prosecutor's Office the provisions of regional regulations conflicting with federal legislation began to be annulled. A review of terms and a gradual departure from "separate" bilateral agreements between the federal government and subjects of the Federation was initiated.

Attempts made by governors to oppose the trend leading to centralization (particularly through the "Motherland – All Russia" bloc) were of little success. In general, summarizing the assessments of developments made by experts it is possible to point out the federal centre's stronger positions in its relationship with regional authorities.²⁹

B. Relative reduction of the direct impact of big business on politics

From the mid-1990ies onwards, much attention has traditionally been paid in publications to the processes of the business-elite evolution and the study of its impact on political decision-making.³⁰ The reason is the role big business played in Boris Yeltsin's re-election as president in 1996 and the actions by Russian oligarchs in the political arena that followed. However, in the post-crisis period the role of big business in politics and social life changed drastically.

One of the objective reasons for the change was the weakening of most of the banking oligarch groups as a result of the devaluation and default of August 1998. Some of them totally disappeared from the scene (such as Inkobank and SBS-Agro) while others managed to restore their positions in business only with the help of their industrial assets and their transfer to affiliated companies, although it took them quite some time to do so.

At the same time the economic growth triggered by the steep fall of the rouble and subsequent expansion of the taxation base in the budget brought about further preconditions for the authorities to distance themselves from big business. During that time all attempts by Boris Berezovsky and Vladimir Gusinsky, seeking to return to the previous model of relationships, to exert pressure on the authorities through the mass media under their control were suppressed rather roughly.

Therefore, if in the mid-1990ies big business could to some extent dictate its terms to the authorities, under President Putin, who declared the principle of equidistance for the oligarchs, it, according to Kryshtanovskaya, was faced with the following choice: to support the president or leave the scene.³¹ However, big business retained certain instruments to influence political decision-making – first and foremost, through the presence of their people in the state executive power structures and the legislature.³² The instruments, however, are being used not so much for the direct lobbying of interests of individual companies as for influencing the shaping of the general rules of the game. For the same ends, the promotion of the collective interests of big business, major associations of entrepreneurs were set up with much support of the government in 2000–2001, namely the 'renewed' Russian Union of Industrialists and Entrepreneurs (*RSPP*) headed by the leading oligarchs, Business Russia (*Delovaya Rossiya*), the Chamber of Commerce and Industry (*TPP*) headed by E. Primakov, and some others.

²⁸ Before 2000, the Federation Council included the governors and the heads of regional legislative assemblies (which gave the regional policy-makers the ability to influence political decisions on the federal level). Under the new arrangement, a representative of the governor and a representative of the head of the legislative assembly are sent to the Federation Council instead of level one leaders.

²⁹ The question, in our view, is to what extent the federal centre can really control the governors claiming to be loyal to the current president.

³⁰ See Kryshtanovskaya (1996), Schroeder (1999), Pappé (2000), Pleines (2003a), etc.

³¹ See Kryshtanovskaya (2002a), p.58.

³² Some examples: there are a number of regions where the government is directly controlled by big business (R. Abramovich in Chukotka Autonomous Okrug, A. Khloponin in Krasnoyarsk Krai, etc.), the Presidential Administration employs a whole range of Alfa Group people, and the State Duma with the new Federation Council where we can see many business people.

C. Shifts inside the federal elite

The changes in the relationships between the federal centre and regions as well as between big business and the state led to certain shifts in the Russian elite's structure. As was shown by Hans-Henning Schroeder in his publication based on the study of most influential politicians' ratings published by *Nezavisimaya Gazeta* on a regular basis,³³ in the post-crisis period the positions of the Presidential Administration and the government improved in the ratings; those of representatives of the regions, parliament and political parties decreased, while big business, following some fluctuations, generally retained and from 2001 even strengthened its positions.

According to Zudin, the policy pursued by President Putin resulted in a noticeable reduction of influence by regional leaders, 'oligarchs' and the Moscow elite at the federal level. Similarly, the role of mass media and judges, who in the mid-1990ies had acted as go-betweens in conflicts between other elite groups, diminished. The beneficiaries, according to Zudin, were only those who represented the so-called 'power ministries' and 'St. Petersburg people' who were in secondary positions in the 1990ies.³⁴

It is also stressed by Kryshtanovskaya that the security services and the military strengthened their role while the people who President Putin had been associated with when he worked in St. Petersburg were mostly nominated within the framework of new appointments. According to her (see Table 2), every fourth representative of the Putin elite had a military background. Here, the large share of people representing the military, the FSB (Federal Security Service), the MVD (Ministry of Interior) and other 'power agencies' is typical for the offices of the authorized presidential representatives in the federal districts. For example, 'people in uniform' made up 35 per cent of all chief federal inspectors in 2000–2002.³⁵ Among other structural shifts one can point out a much lower share of holders of a second degree (*kandidat* or *doktor*, approximately equivalent to PhD and professor, respectively) as well as graduates of the elite Moscow universities and a rise in numbers of 'big business appointees'.

According to Kryshtanovskaya, the fact that President Putin is placing his hopes on 'siloviki' (representatives of the 'power ministries', the state security organs and the armed forces) is explained by the fact that during Boris Yeltsin's rule the state institutes were greatly weakened, the political system lost its stability, and traditional links between the social subjects were damaged, making their roles uncertain. The hierarchies of bureaucracy and military suffered the least during this period. However, the bureaucracy was infamous for its high level of corruption, making it easier for President Putin to start strengthening the state by restoring the network of the 'power ministries and agencies' that would later serve as the pillar for his personal power and authority and the foundation for the enhancement of the state functions of control and repressions.³⁶ These changes are generally described by Kryshtanovskaya as the emergence of 'a liberal militocracy', showing a trend of restoring the hierarchical structures and institutions characteristic of the Soviet period.

Based on the analysis of interaction between big business and the state, a number of authors³⁷ also stress the trend toward the development of state-corporate capitalism. Within this framework the 'power privatization' model typical of the 1990ies is being substituted by a regime of regular, both formal and informal, coordination of interests between the state structures and the biggest corporations that form various unions and associations. Here, some researchers who predicted the trend several years previously are viewing it as positive and, at any rate, more

³³ See Schroeder (2003), pp. 189–190.

³⁴ See Zudin (2003), pp.71–73.

³⁵ See Kryshtanovskaya (2002b), p.163.

³⁶ See Kryshtanovskaya (2002b), p.174.

³⁷ See Zudin (2001), Peregudov (2003), and others.

adequate for the Russian ‘institutional landscape’ as opposed to the liberal experiments of the 1990s.³⁸

Table 2: Changes in the characteristics of the elite in the first two years of Yeltsin’s and Putin’s terms in office, in percent.

Characteristics of the elite*	Yeltsin’s Elite (1993)	Putin’s Elite (2002)
Average age (years)	51.3	51.5
Women	2.9	1.7
Persons with origins in rural areas	23.1	31.0
University graduates (one degree)	99.0	100.0
University graduates with more than one degree (e.g., PhD)	52.5	20.9
Persons with a military education	6.7	26.6
Persons with an education in economics and law	24.5	25.7
Elite universities’ graduates**	35.4	23.4
Natives of St. Petersburg	13.2	21.3
Big business appointees	1.6	11.3
Military	11.2	25.1

Source: The table is reproduced from Kryshstanovskaya (2002b), p. 161 and is based on data collected by a study of the Russian elite conducted by the elite research division of the RAS (Russian Academy of Sciences) Institute of Sociology starting from 1989.

(*) The term “elite” applies to Security Council members, deputies of both houses of the Federal Assembly, members of the government and heads of the Federation subjects.

(**) The notion of elite universities applies to MGU (Moscow State University) the MGIMO (Moscow State Institute for Foreign Relations), the Institute of Foreign Languages, the VPSH (Party Higher School), the VKSh (Komsomol Higher School), the ANKh (National Economy Academy under the USSR Council of Ministers), the AON (Academy for Social Sciences at the CPSU Central Committee), the MFI (Moscow Institute of Finance), the Academy for Foreign Trade and the Diplomatic Academy.

At the same time, according to other experts,³⁹ despite the significant strengthening of the state actors’ positions (primarily on the federal level) the evolving structure is characterized by being unstable to a certain degree. Under the circumstances, support of the ‘power ministries’ requires bigger budgets for the Ministry of Defence, FSB, and the Ministry of Interior. The interests of big business are still far from being homogeneous⁴⁰ while some of its representatives from time to time begin to demonstrate political ambitions of their own (during recent months, references were made most frequently to M. Khodorkovsky in this respect).

Under the circumstances the key resource for President Putin to keep the situation under control remains *broad electoral support*. The idea was very clearly formulated by Zudin: “*Putin’s unusually high rating* at the beginning of the second Chechen war in the autumn of 1999 has become the initial component of the new political regime. From that time on a stable bond between the Kremlin and the people has existed... If the [Yeltsin] polycentric system was based

³⁸ See, e.g., Lane (2000).

³⁹ See Schroeder (2003).

⁴⁰ The discussions on Russia’s accession to the WTO, banking reform, currency regulation, etc. are very indicative in this respect.

on the union of the Kremlin and the elites then the foundation of the [Putin] monocentric system is founded on *an informal 'social contract' circumventing the elites*".⁴¹

However, with due regard to the social problems yet to be resolved and gradually growing sceptical attitudes of the people to the concrete steps and reforms initiated by President Putin broad popular support can only be secured through a steady growth of living standards. And, therefore, as pointed out by Schroeder, the key prerequisite for a success of President Putin's policy is a continuous improvement of the country's economic situation.⁴² That was the reason why the president and his administration showed such a painful reaction to the slowdown in the pace of growth in late 2001 as well as to the cautious mid-term forecast by the government published in the spring of 2002. This was also the reason for Putin's aim, declared in May 2003, to double the GDP over the next decade. However, as was pointed out in the Introduction to the present paper, it is still unclear how and on the basis of which mechanisms this objective can be achieved and what influential social groups can contribute to it in real life.

Social basis of reforms in Russia: interaction and evolution of interests

In the previous section we tried to show the basic approaches towards the analysis of the social basis of reforms given in the research done so far. In our opinion, it is possible, on the basis of the conclusions of this review, to outline a range of questions that have not yet been answered.

As far as the reviewed models of social collaboration in an economy in transition are concerned, the grounds for transition of a specific country (or a group of countries) to a certain trend of reforms, as well as the ways out of the traps of 'partial reforms' and 'political polarization' are not completely clear. In this respect the initial differences in the social and institutional structure of different countries are of great importance, and in the first part of this section we will focus on this issue. At this point we do not aim at confirming the correctness of the path dependence idea. Such an analysis seems crucial to us because the above-mentioned differences influence the behaviour of participants of social interactions and must be taken into account when reviewing the evolution of interests of the main groups of players on the economic and political scene.

As for analysis of elite evolution, we will try to give our explanation of the structural changes which took place at the beginning of the 1990ies and which are interpreted differently by experts. However, the question of succession or renewal of the elites is in our opinion not so important today. Of greater importance are the tools of collaboration between business and government (and political and business elites, accordingly) because, bearing in mind the weakness of political democracy and civil institutions in Russia, it is the government and big business that are the key players which define the development prospects of the economy and society.

In this context, the problem of the previous studies is, in our view, a certain absolutization of the dominant trends or strategies of behaviour as well as a lack of delimitation of interests inside influential social groups.⁴³ In this respect, we proceed from the idea that at any moment of time along with the dominant strategy other strategies are also possible, which can form the basis for alternative ways of development. Such strategies are always connected with certain interests. Besides, in business, as a rule, there is a direct correlation between strategies and interests, which lay in their ground. As for the state, on the contrary, such a correlation is not definitely

⁴¹ See Zudin (2003), p.70.

⁴² Schroeder (2003), p.175.

⁴³ For example, we think that Pleines in a quite interesting paper (2003b) incorrectly equals the interests of the state to the interests of consolidated 'state actors', while possible substantial differences in the interests of the 'state actors' themselves are ignored.

expressed because there can be considerable discrepancies between the individual interests of specific public officials or politicians, their group (corporate) interests and interests of the state or society in general.

Taking into account such discrepancies in the interests of both business and the state, we can answer the most important question: which social groups are able to support reforms or a policy of economic growth in the conditions of an established 'bad equilibrium' in the form of 'privatization of the state' and 'political polarization'. Below we will concentrate specifically on this question.

Initial differences in social and institutional structures of transition countries

In our opinion, the initial differences in the social structure of society have to a great extent shaped the different results of social and economic developments currently evident in Central and Eastern Europe, the Baltic States and China, on the one hand, and Russia along with CIS countries, on the other hand. In this respect it is also interesting to trace the comparisons with post-war Germany, which, like Russia at the beginning of the 1990ies, underwent a radical change of the regime and faced a serious ideological crisis. However, despite all this, Western Germany as early as the late 1950ies showed powerful economic growth, which so far is not the case in Russia.

In general, we think that unlike Central and Eastern Europe and the Baltic States, Russia and other republics of the former USSR at the end of the 1980's *did not have a social basis for a policy aimed at forming a competitive market economy and a competitive (i.e. democratic) political system.*

This notion at first sight does is at odds with the wide social support for the democratic and market reforms of Mikhail Gorbachev and Boris Yeltsin in the late 1980ies – early 1990ies. However, in this regard it is necessary to distinguish between political declarations and objective interests of the influential social groups which stood behind the reformers. In this respect there were two crucial differences between Russia and Central/Eastern Europe.

First, in Russia there was no historical experience of living in a market economy and a democratic system. Therefore, the absolute majority of the population did not realize that market and democracy stood not only for freedom, but also for responsibility.

Second, the social and political structure in Russia was qualitatively different. In Eastern Europe, a substantial part of the social elite, the *intelligentsia*, was not incorporated into the government structures. Such people worked in enterprises and research institutes, gave lectures at universities, but they were not members of the Communist Party and were not present in the party and economic apparatus. In fact, such people were *holders of an alternative ideology*, which latently existed in the society and expressed itself during the 1956 events in Hungary, during the 'Prague Spring' of 1968, in the actions of the independent Solidarity trade union in Poland, etc. Due to this fact, by the time the Communist regime broke down at the end of the 1980ies it was possible to replace the people in the government structures, i.e. *new people with other values* could come to power.

Besides, the idea of European integration was without any doubt of great importance for the nations of Central and Eastern Europe and the Baltic states. The notions of 'market' and 'democracy' were regarded as symbols of Europe, which these nations wanted to belong to. That is why such common European values acted as a kind of external anchor ensuring the coordination of numerous and different conflicting individual interests.

This is a very important circumstance, because without common values society loses its guidelines and cannot shape the prospects of its own development. An obvious illustration of the

above remarks is, in our opinion, the difficult experience of the decade of reforms in Russia, when a deep crisis of the old ideology was not accompanied by the adoption of new values and ideals by society.

We see the main reason for this in the fact that in the USSR there was no real internal opposition and the number of alternative ideology bearers was rather limited. The policy of restriction of any alternative thinking in the USSR, which was consistently implemented for 70 years, resulted in either physical extermination of potential opposition in the period of repressions, or expulsion from the country, or integration into government structures. A transition from the Stalinist totalitarian regime to the authoritarian model of the 1950ies–1980ies was manifested, in particular, in a reduction of the scale of direct repressions. Nevertheless, the mainstream party and economic elite turned a blind eye to expressions of alternative ideas among scientific and art *intelligentsia* as long as they did not appear to be in opposition to the regime and was not shown publicly. As a result, only very small groups of dissidents voicing radical criticism of the system, who, as a rule, were not able to propose any constructive reform program, continued to be free from association with the regime.

We believe that specifically at this point it is worth returning to the discussion of the role, which the *intelligentsia* plays in the continuity and renewal of the elites described in the section “Transformation of the elites”. In our opinion, as far as political and economic reforms in the late 1980ies–early 1990ies are concerned, we can talk about interaction of four conventional groups of interests in the Russian elite. These are the older and younger generation within the ‘*nomenklatura*’, as well as the older, more idealistic, and the younger, more pragmatic and cynical, generations of the *intelligentsia*. The *nomenklatura*’s social status as a real ‘ruling class’ was undoubtedly higher, however, the upper tiers of the Soviet *intelligentsia* in one way or another always collaborated with the ‘*nomenklatura*’ and in this sense were close to the state.

In the first years of perestroika the struggle for power was going on inside the ‘*nomenklatura*’ and its younger generation actively used the democratic and market slogans in order to push out the older comrades. The *intelligentsia* at that time in general supported the younger generation of the ‘*nomenklatura*’, feeding it with new ideas. But, while the older generation of the *intelligentsia* in this case was rather oriented towards reforming the existing system and construction of ‘socialism with a human face’, the younger generation which was represented mostly by young Komsomol leaders⁴⁴ was mostly striving to achieve *personal benefits* from the situation and from personal proximity to power.

It was on this foundation, in our view, that the so-called ‘komsomol economy’ emphasized so much by Kryshantovskaya came into being. However, supporting such entrepreneurial initiatives, the top party officials never thought that in such a manner they gave away their power or created ‘backup airfields’ for themselves. They believed that the leverage would remain in their hands as it was during the NEP (New Economic Policy) period in the 1920ies. They needed the ‘komsomol’ economy as a way of paying off the younger colleagues because in the Soviet system there was no normal mechanism for change of generations in the ‘*nomenklatura*’. Members of the top level of the *nomenklatura* elite, being busy with their corporate infighting or just lacking sufficient knowledge, did not understand the real consequences of the actions and steps which the komsomol entrepreneurs convinced them to authorize.

⁴⁴ Here it is necessary to emphasize that by the 1980ies komsomol was a *mass* organization and all socially active young people passed through it if they were not in direct opposition to the regime. This fully applies to the young art, scientific and technical intelligentsia, for whom successful komsomol activity was not necessarily connected with a future successful career in the party *nomenklatura* or governmental bodies. Such a tendency could be related to a general expansion of komsomol establishment influence within the Soviet administrative hierarchy, because many initiatives of young members of the scientific and art intelligentsia before had been authorized by the party bodies without bypassing the komsomol committees. For example, according to Yakov Pappé, the School of Economics and Mathematics at the Faculty of Economics of the Moscow State University in the 1970ies was supervised directly by one of the members of the faculty party committee.

By 1989–1990 the administration of the country had passed mainly into the hands of the younger generation of the *'nomenklatura'*. At the same time idealistic representatives of the older generation of the *intelligentsia* entered government bodies. Since then in our opinion a certain competition for control over the Soviet legacy began between the younger generation of the *'nomenklatura'* and the younger members of the *intelligentsia* who were close to government structures.

This period is marked by the selective take-over of big enterprises in the form of joint-stock companies, authorization of the so-called lease with subsequent buyout for medium-sized and small enterprises, as well as transformation of ministries and institutions into concerns and associations, which in fact reflected the attempts by the *'nomenklatura'* to keep the real power in their hands by obtaining control over property. However, only in very few cases such joint-stock companies, concerns and associations turned into really functioning big business structures, just because the majority of the Soviet *'nomenklatura'* (including its younger generation) were not trained managers or skilled businessmen.⁴⁵ Very typical in this respect is the destiny of the majority of 'red directors' who at the first stage of privatization usually managed to retain control over their enterprises but lost it afterwards because of their inability to manage enterprises under the new market conditions.⁴⁶

Therefore, the younger generation of the *'nomenklatura'* was rather oriented towards a gradual, 'creeping' transformation of the old system. On the contrary, the more educated and energetic younger generation of the *intelligentsia* placed their bets on a radical destruction of the existing regime in order to achieve their objectives. For that purpose this elite group, relying on their proximity to the Russian authorities, managed to use new opportunities for the benefit of their business, and afterwards for the strengthening of their political positions. And while the August 1991 coup may be regarded as the last attempt of resistance on the part of the older generation of the *'nomenklatura'*, the shelling of the Russian 'White House' and dissolution of the RSFSR Supreme Soviet in autumn 1993 meant removal of the Soviet *'nomenklatura'* as an influential social group from real political power at the federal level. Such a thing did not happen, however, in the majority of the regions because the top intellectuals were traditionally concentrated in Moscow and other big cities. In the regions, in many cases power still remained in the hands of the old party and economic elite.

However, it is important that both in the centre and in the regions the new people who came to power in the early 1990ies under the slogans of democratic and market reform were in fact guided by their own, private interests. The drastic weakening of the state in that period did not happen by mere chance. It enabled the new governing elite to remove the old centralized control mechanisms, which had restricted the freedom of action of the old Soviet *'nomenklatura'* to a certain extent, and at the same time to strengthen its positions institutionally (within the privatization process). With all the differences in opinions on the reform policy, in this respect the positions of the younger generation of the Soviet *intelligentsia* and the younger generation of the Soviet *'nomenklatura'* coincided completely: both groups wished to obtain control as quickly as possible over the property earlier managed by the old Soviet bureaucratic establishment. And the state was not to be an obstacle for them.⁴⁷

⁴⁵ A certain exception in this regard may be the enterprises which underwent the procedure of lease with subsequent buyout. In many cases they proved to be more stable and viable. It is possible that their relative success is due to the fact that this option in late 1980ies was chosen by very well equipped enterprises led by energetic and market-oriented directors.

⁴⁶ This fact, by the way, did not change the Russian corporate management model. It has been and it is of insider nature, but in the majority of cases control passed over into the hands of new private owners who can interact with old managers as with minor partners.

⁴⁷ These assumptions were confirmed in the framework of the discussions regarding demand for law. Katarina Pistor notes that at the time of property redistribution there will be no demand for a law, because it imposes undesirable

Therefore, unlike in Central and Eastern Europe and the Baltic states⁴⁸ the *intelligentsia* in Russia were not a counter-elite which could replace the party and economic *nomenklatura* and bring in new values and ideals.⁴⁹ In contrast to China, Russia at the period of radical political and economic changes already had no capable old elite.

By the time economic reforms began in China in the late 1970ies Communist rule had existed for less than 30 years. There was no such crisis of ideology and internal corrosion of the state and demoralization of the elite which were observed in the USSR in late 1970ies – early 1980ies, and which, to our mind, were some of the reasons for the precipitous collapse of the Soviet system. In addition, despite growing corruption and increasing social differentiation of the society, the Chinese party and governmental elite remained quite consolidated and considerably oriented towards promoting their national interests.⁵⁰ This may also be the result of a different cultural inheritance, and distinctive cultural self-sufficiency of China. Unlike Russia, which for several centuries strived to catch up with developed countries, China always regarded Europe and the USA as ‘another world’ with their own values and ideals which could not be rooted in the Chinese soil. Above all, the feeling of its cultural superiority enabled China to easily and comfortably adopt from other nations any technical achievements along with organizational and administrative know-how.⁵¹

We think that in general parallels with China could have been possible if the market transformations had begun in the USSR during Khrushchev’s rule, when the state was much stronger and the top levels of elite were able to be guided not only by their private interests, but also by the interests of the society. But even at that time the probability of following the current trend of ‘Chinese reforms’ was, in our opinion, very low.

A. Fedorovski notes that by the end of the 1970ies internal political troubles and disorganization of economic life in China caused by the “cultural revolution”, had led to a situation where administrative and state institutions were equally unable to perform efficiently traditional command and distribution functions or to oppose reforms. In addition, some of the Communist Party of China leaders headed by Deng Xiaoping were still represented by revolutionaries of the first wave, who had long political experience and were flexible in their reaction to the events, rejecting, if necessary, ideological dogmas.⁵² The USSR, on the contrary, emerged from the Second World War with a stronger bureaucracy, which had been transformed into a self-contained force. Above all, the repressions of the late 1930ies followed by the ‘negative selection’ of party functionaries resulted in domination of poorly educated dogmatists in the Soviet administration in the 1950ies.

The last comparison is worth relating to post-war Germany. Similar to Russia today, it experienced a profound transformation of the regime and a radical reform of political institutions. The country was in a deep economic crisis. At the same time, the first post-war years were marked

restrictions on the participants of the ‘big fight’ (see Pistor, 1999). And if such players can prevent formation of a regulatory framework, they will do so.

⁴⁸ The Baltic republics are in general a special case. They are close to Central and Eastern Europe in terms of their democratic experience, a shorter term of living in the socialistic system, a high level of national self-consciousness, and perception of the Soviet regime as occupational. However, we can hardly talk about the existence of a manifest counter-elite in the Baltic republics. It is more probable, as Pappé thinks, that the old elite was ideally placed to saddle the national horse.

⁴⁹ Many researchers (see, for instance, Frane & Tomšič (2002)) consider the existence of an active counter-elite relying on different social values as the key condition of successful reforms in a number of East European countries.

⁵⁰ One indirect confirmation of this notion is the ‘planned’ change of top leaders in China in November 2002 at the XVI. Congress of the Communist Party of China, with a preservation of the previous political course. For more details about Chinese social and economic development trends see Gel’bras, Kuznetsova (2003).

⁵¹ Such peculiarities of China were demonstrated by Pappé during the discussion of the first brief version of this article.

⁵² See Fedorovski (2003), p. 77.

by a deep ideological crisis.⁵³ Although the old elite had discredited itself, the government was for a long time dominated by officials who had worked during the Nazi rule. Nevertheless, by the end of the 1950ies Germany had overcome the crisis, and the 1960ies became the decade of the German ‘economic miracle’. What was the basis for this, and what is the difference between Russia of the 1990ies and post-war Germany?

We believe that these questions as well as a more general subject of understanding the history of post-war Germany are worth a much more detailed discussion which has only begun in the Russian-language literature.⁵⁴ Notwithstanding, without going into a detailed discussion, we would like, along with traditional discourse about the role of the occupational administration in restoration of democratic institutions and the importance of US economic aid, to define a range of other parameters in which the situation in post-war Germany considerably differed from the reform period in Russia:⁵⁵

- *Time factor and nature of the regime.* The Nazi regime in Germany existed for 12 years only and it was preceded by a period of democratic development. Correspondingly, the majority of the population had experience of living in a democracy, and many of them had voted against Hitler in 1933. Besides, in Germany there was a transition from totalitarian to democratic regime. And the ‘negative side’ of the totalitarian regime in that case was much more evident. In the USSR, on the contrary, a totalitarian system was replaced in the 1950–60ies by an authoritarian regime which gave much less sufferings to people. That is why in Russia of the 1990ies the contrast was not so pronounced and the advantages of the democratic system were not so evident for many ordinary people, especially against the backgrounds of falling living standards.
- *Political transformations and economic crisis.* The Nazi regime was unable to achieve a serious transformation of the economic relations. Besides, as a result of the war the national economy of Germany went bankrupt and political reforms started in the conditions of a dramatic economic slump which had already reached its lowest point. Economic growth which took place later and was somewhat inevitable stimulated confidence in the revived democratic institutes. As for Eastern Europe and especially the Soviet Union, where economic disproportions were much deeper, introduction of democratic institutions began simultaneously with the economic crisis, which was certainly far from inspiring confidence in the new institutes.
- *Institutional environment.* In Germany there was no need for radical transformation of all the institutions. Democratic institutions were destroyed, but they were conserved in the memory of the majority of the population. The rest of the institutions (primarily legal ones) continued to function. In the Nazi period they worked on the basis of the Nazi laws, and they had to be filled with different content, but it was not necessary to revive and build the institutions anew. The same is true in regard to market institutions. Under the Nazis the state influenced them to a large extent, but they still existed and had not been destroyed.

The latter difference is also important in the context of discussions about the reasons for “political polarization” and a concrete country being trapped in ‘partial reforms’. Along with a lack of legal and market institutions, the Russian economy in comparison with other socialist economies was characterized by a greater degree of *structural distortion*.⁵⁶ The share of the military-

⁵³ The crisis was preconditioned by the fact that at the end of the 1930ies the majority of the German population supported Hitler. As was mentioned by Professor Udo Wengst at a seminar in the Institute of Modern History in Munich on March 19, 2003, according to sociological survey data up to 2/3 of the older respondents regarded 1936–1939 as the most comfortable years of their life until the mid 1950ies.

⁵⁴ See Schtolting (2000), Margolina (2002), Nolte, Polyan (2003).

⁵⁵ The author expresses his gratitude to Professors Horst Möller and Udo Wengst for a number of interesting judgments expressed in the course of the seminar in the Institute of Modern History in Munich on March 19, 2003.

⁵⁶ The mechanisms of reproduction and accumulation of structural distortions in the Soviet economy at the beginning of the 1980ies were analyzed in detail by Yaremenko (1997), volume 1, chapters I–III. The logic of such distortions

industrial complex and the gap between the domestic and world prices for raw materials, investment and consumer products can serve as indicators. The latter parameter depended considerably on how closed the economy was and on how long the command system had existed in the country, since price distortions were accumulated, reproduced and grew as time passed.

Such large-scale structural deformations along with a profound institutional vacuum created more possibilities in Russia than in other countries for arbitration between the market and non-market (regulated) sectors of the economy, and generated a bigger potential rent. That is why the stakes in the game of 'social heritage' distribution were many times higher, likewise the motivation to break the rules and norms.⁵⁷ In our opinion, this was the reason for a shift towards 'partial reforms', which made it possible to obtain a rent and became a prerequisite for 'political polarization', because in a situation where rules were missing or were broken on a large scale, the results of distribution of property and resources were perceived as unjust.⁵⁸

Returning to the analysis of developments in post-war Germany we can say that direct analogies with modern Russia can hardly be drawn. Nevertheless, it is possible to learn certain lessons from the German experience. As Schroeder noted, a major role in the social and political development of the FRG was played by the perception of the USA as a good example along with the existence of the USSR and GDR as the 'enemies'. There is no such ideological 'anchor' in today's Russia, which may hinder the reform process. Studies of the transformation of elites in post-war Germany are also of interest. As shown in the works of many German authors,⁵⁹ during the first post-war years removal of people who had collaborated with the Nazi regime from the political elite and return of the ideological opponents of Nazism to politics were combined with a high degree of succession in the bureaucratic and business elite. A real renewal of such elite groups together with a considerable change of the mindset of the society and a new look at German history took place only in the 1960ies.

In this context it is rather interesting to look at the comparative analysis of changes in the German elite in the periods after 1945 and after 1989 done by Ursula Hoffmann-Lange.⁶⁰ Her data allows for assumptions that non-acceptance of changes by the citizens of the former GDR, despite multibillion investments and social aid programs, was, among other things, caused by East German elite groups who had suddenly lost their positions. For instance, people from West Germany dominated the majority of social and economic spheres even in East German states (*Land*), to say nothing of the federal level.

To sum up the comparison between different countries, we can identify two factors which, in our opinion, were of crucial importance for the success of economic and political transformations:

1. *Retention of functioning institutes.* In this respect, the conclusions made in the book by a well-known Polish economist, deputy prime minister and minister of finance of Poland in 1994–1997 Grzegorz Kolodko appear to be very accurate.⁶¹ His detailed analysis of development in

was also shown by Kornai (1990). The influence of structural deformations inherited from the Soviet period upon economic reform in Russia is discussed in Yakovlev (2001).

⁵⁷ That is why, for example, expansion and acuteness of corporate conflicts are determined not only by the severity of the law enforcement system, but also by the scale of potential benefits related to violation of shareholders' rights. This assumption is substantiated in great detail in the article by Woodruff (2003) on the basis of a comparative analysis of data for Russia and Poland.

⁵⁸ It is characteristic that until now, according to data of different sociological surveys, about 2/3 of respondents usually support proposals to review the privatization results.

⁵⁹ Issues of social and political transformation and reintegration of the Nazi elite in postwar Germany are discussed in great detail in the works by Norbert Frei and his colleagues (see Frei (1999), Frei (2002)).

⁶⁰ Hoffmann-Lange (1998).

⁶¹ Kolodko (2000).

the former socialist countries in 1980–1990 shows that the depth of the ‘transitional’ crisis and further economic development was conditioned by the retention of capable institutions in some countries and catastrophic incapability of the government in others. It is evident that such *functioning institutions* should have been mostly inherited from the preceding regime. In our opinion, it is not so important what the nature and contents of such institutions were (see the example of China). The substantial thing is to what extent they supported the transformation processes ensuring the ongoing activity of economic agents and performance of routine functions by the state.

In Russia, unfortunately, the old institutions were already destroyed in 1991–1992, while the system of new institutions only started to take shape and function by the end of the 1990ies. As we tried to show above, the elite groups in general were interested in such an institutional vacuum, because without any rules it was easier for them to divide the former state property.

2. *Existence of a strong elite able to offer common values to society and to adhere to those values.* As mentioned above, in the opinion of some authors, success of economic and political transformations in Eastern Europe was connected to the existence of counter-elites. The Chinese experience shows that reforms are possible even if the old elite is dominant. A more important thing is, in our view, that the elite should have the values, which unite it with the rest of society. Erosion of values inside the ruling Soviet elite in the period of stagnation without existence of any considerable counter-elites resulted in a situation where the beginning of the 1990ies there were no influential social groups in Russia able to take into account and promote the interests of the society along with their own private interests.⁶²

Therefore, we believe that the course Russia took in the 1990ies was to a great extent inevitable: in 1990–1991 Russia did not have enough prerequisites to opt for any other way of reforms. Now the situation is different. First, big private business practically non-existent in the 1980ies started to play an active role in economic and political life.⁶³ Second, after Putin came to power, considerable strengthening of institutes set up in the middle of the 1990ies has been observed. Thus, it is necessary to understand the role being played by the new elite groups. How are their interests changing? And to what degree will the new institutional environment promote or hinder the future transformation processes? We will try to answer these questions in the following subsections.

Evolution of business strategies and impact of the 1998 crisis

A sceptical attitude towards the Soviet *nomenklatura* was typical of the perestroika period.⁶⁴ However, most expectations related to market players were optimistic at that time. It was supposed that unlike the *nomenklatura*, the emerging ‘new business’ would actively support the reforms and promote the new market ideology. In this respect it is worth mentioning that in the 1990ies many studies by the World Bank paid a lot of attention to the differences in the behaviour of state, privatized, and newly created private companies.

⁶² It is worth noting that recently not only social scientists who have long studied this problem have paid attention to the influence the value system has on economic development (see papers by N.I. Lapin, O.I. Shkaratan etc.), but also economists involved in economic policy development (see Yasin (2003)).

⁶³ Representatives of the director corps also formed a very influential group in the Soviet period (see Zaslavskaya, 1988; Lane & Ross, 1994 etc.). However, heads of economic entities were officially subordinated to the top party *nomenklatura*.

⁶⁴ See Zaslavskaya (1988), Migranyan (1988) and other papers published in the well-known collection of articles “No other way” edited by Yu.N. Afanasiev.

These expectations never came true. In the papers by Joel Hellmann and colleagues⁶⁵ already mentioned earlier it was convincingly shown that it is the 'winning' social groups represented, in particular, by new banking and trade business that become objectively interested in 'partial reforms'. Incompleteness of reforms enabled them to retain their rent sources, despite the damage caused to the economy and society. Above all, search for rent is the prevailing business strategy both for privatized and newly created private companies.

Besides, our own experience as well as research by V. Radaev⁶⁶ confirms the existence of two alternative business development strategies in the 1990ies. The first was aimed at keeping the maximum possible distance from the state, when business solved its problems itself and had to survive in a competitive environment. The second strategy assumed close integration with the state represented by concrete persons in governmental bodies or legislative structures which supported business in its competitive struggle much better than any criminal 'protectors'.

In the short term the second strategy was more successful because in comparison with the volumes of budget flows channelled into the required direction by certain officials and politicians their personal compensation was very modest. As a result, investments into 'contractual relations' with the government proved much more efficient than investments into real business. Above all, it is worth mentioning that the prevalence of the second, opportunistic strategy in the business environment was objectively the result of the weak state and a degradation of its institutions.

It is evident that such a 'market' economy could not be competitive. The reasons were direct or indirect restrictions imposed by the state on new businesses, very high costs of keeping up 'contractual relations' between business and government, and retention of less efficient enterprises that base their market strategy on such 'contractual relations'. However, with all the damage to the society and large-scale misappropriation of the national resources, this model was very profitable for individual persons and generally for the top social groups formed mostly in Soviet times.

As a result, by the second half of the 1990ies a certain 'negative equilibrium' had been created in the Russian society and, despite the inefficiency of the existing system, there were no influential economic or political actors interested in its transformation. The stability of such a 'negative equilibrium' even generated some pessimistic hypotheses about a 'stationary transitional' condition of the contemporary Russian economy.⁶⁷

Along with all that, the economic system, which in its formal part consumed more resources than the value produced and which operated at the cost of net debt only,⁶⁸ could not exist for a long period of time. Sooner or later it was to come to an end, which happened in August 1998. Above all, it was even possible to expect that such a *system* crisis would have resulted in substantial changes in the elite and emergence of new influential players.

But this did not happen: in spite of certain shifts inside the Russian elite, its present top representatives were already at power at that time and on the eve of the crisis. In fact it is possible to talk about a mere 'removal' of some figures of the Yeltsin era and the promotion of certain players of the second echelon to the first rows.⁶⁹ Therefore, we can talk about appearance of *new persons* and, at the same time, about *new interests*.

⁶⁵ Hellman (1998), Hellman et al (2000).

⁶⁶ See Yakovlev (1993), Radaev (1998).

⁶⁷ For more details see Kapelushnikov (2001).

⁶⁸ See Gaddy & Ickes (1998), Yakovlev (1999), Ericson & Ickes (2000).

⁶⁹ Here it is worth mentioning S.M. Ignatiev, M.M. Kasianov, A.A. Kudrin and I.S. Ivanov who, several years before the crisis, held offices of deputies and first deputies at federal ministers. We can also mention Vladimir Putin, who in July 1998 became FSB Director with the rank of federal minister, and German Gref, who in 1997 was Vice-governor of St. Petersburg and Head of the State Property Management Committee.

A change of interests on the side of the business was related to the end of large-scale privatization and the beginning of a post-privatization property redistribution (the Law on Bankruptcy of 1998 was very actively applied for such purposes). Such a trend was not directly related to the crisis and only coincided with it in time. However, the incentives for property redistribution were strengthened by the effect of devaluation, which increased the profitability of Russian companies and raised the value of their assets. As a result, business started to realize that it really *possessed property* (not just control over cash flows) and if it followed a very short-sighted policy only aimed at withdrawing liquid assets, it could lose both. Such a situation resulted in a substantial *extension of the time horizon of business interests*.

At the same time, the crisis provided an impetus for self-organization of business in order to influence its environment. More and more representatives of the business circles realized that even absolutely successful business independent of the state could crash if the system of relations in the society is not changed. A fact that serves to illustrate this point is the creation of the Club 2015 at the end of 1998 and the active work of this association in 1999–2000 in the “Scenarios for Russia” project.⁷⁰

On the part of the state, the change of interests was related to a reevaluation of the situation by the political elite and new bureaucracy, which had benefited from the reforms of the 1990ies. These groups began to realize the necessity of *consolidation of power and strengthening of the state* in order to turn the anarchy and chaos of the previous decade into a kind of ‘order’, because there was a real possibility that the next crisis similar to that of August 1998 would lead to the ousting of the political elite. Such strengthening of the state required streamlining the budgeting process, changing the relationships between the federal centre and the regions, as well as a ‘longer-sighted’ view at economic and social development.

On the whole, the 1998 crisis had a cold shower effect on the Russian elite. The crisis hit not so much the top tier but the middle class in big cities.⁷¹ Nevertheless, the crisis became the milestone that made the elite realize it *could lose* its property or status (there were several examples of this in politics and business). Such an extended horizon of interests along with the understanding of the system risks became a basis for the drafting of a new reform program (the well-known ‘Gref Program’) as well as for a search for new values and variants of the ‘social contract’ which had not been even mentioned since the beginning of the 1990ies.

Alongside the change of interests both on the side of business and on the side of the state there were, in our opinion, certain shifts in the composition of the elite. The crisis did not result in its radical renewal, but, as we already said earlier, it enabled a number of players, who occupied less important positions, to come forward. In 1999–2000 the place of the former ‘oligarchs’ was taken in several cases by second echelon companies which, having no access to the budget sinecures, had to invest more in the development of their business, in restructuring of assets and penetration into new markets. Exactly this kind of business turned out to be more competitive during the crisis and received a strong impetus for development in 1999–2000.

Similar trends were observed to a certain extent in the government. After the crisis, a wide range of young mid-level officials advanced their careers. In many cases they were more professional than their predecessors but did not have prospects of fast advance under the old system, because

⁷⁰ For more details see the web site of the Club <www.club2015.ru>. The difference of Club 2015 from other public associations which became more active at this period (like the Council for Foreign and Defense Policy) was that it was composed mostly of businessmen and managers not involved directly in political activities. Unlike business associations, Club 2015 did not directly lobby the interests of any branches of economy or business groups.

⁷¹ However, here it is necessary to stress that the term ‘middle class’ as applied to the Russian reality needs to be clarified. There are studies of Tatyana Maleva and her colleagues supported by Bureau of Economic Analysis and Carnegie Foundation on this subject (see Avraamova 2000 and Avraamova 2003). That is why we shall only note, without going into a detailed discussion, that according to Pappe, the 1998 crisis enabled some of the traditional groups of Soviet *intelligentsia* to return to the middle class (at least to its lower tiers).

it was based not on the evaluation and recognition of personal achievements, but rather on close informal interrelations between governmental bodies and business. Not bound by the old system of relations, which imposed rather strict obligations upon its members, such public officials were more willing to be guided by their own long-term career interests. Thereby they were more willing to promote public interests not only by words but by deeds. Above all, having real competitive advantages, such officials were generally interested in more transparent and competitive 'rules of the game' inside the governmental establishment during the crisis and in the period immediately after the crisis, because this could advance their careers further.

As a result, several trends coincided by the end of 1999–2000. The 'cleaning of the field' for more efficient business players along with the devaluation effects served as a prerequisite for post-crisis economic growth. By the time of the parliamentary and presidential elections such economic growth had already brought about a real increase of household incomes, primarily in the regions. At the same time, the extension of the horizon of interests, both in business and in the government, was manifest in the readiness to play *by the rules* instead of *with the rules*, which was typical of the 1990ies. On top of that, a new young president appeared on the scene, who not only started to voice the 'super power' aspirations of the electorate but also initiated, for the first time in a decade, a long-term program of social and economic development.⁷²

A combination of such trends for the first time since 1991 produced an upsurge of positive expectations in society. In particular, in the period from September 1999 till May 2000 the 'social attitude index' (ISN) calculated by VTsIOM increased almost 1.5 times and for the first time exceeded the 100-point level. But after a rather long period of stability,⁷³ the ISN started to decrease from May 2002 slowly but steadily. Such a trend, in our opinion, reflects the common feeling of a new slowdown of social and economic development which is manifest not only in the deceleration of economic growth rates. In the next paragraph we will try to look into the reasons for such 'stagnation'.

New deceleration and its reasons

In addition to decreasing living standards, skyrocketing inflation, devaluation and default, the 1998 crisis discredited in the minds of the people those neoliberal values and approaches which determined the policy of the 1990ies (to the extent it was consistent). The neoliberal doctrine in Russia in the 1990ies to a certain degree was the official ideology in the field of economic policy. A failure of this policy resulted in an ideological crisis inside the ruling elite and compelled it to search for new approaches.

Such a situation in autumn 1998 – spring 1999 gave birth to a *demand for new ideas* on the part of the government structures, while there was a dearth of such ideas in the expert and analyst community. In that period one of the key platforms where the process of elaboration and discussion of such ideas took place was the Council for Foreign and Defence Policy (SVOP) close to Evgeny Primakov. The SVOP was the first place for public expert discussions between representatives of very different elite groups – from Kakha Bendukidze and Irina Khakamada to Sergei Glaziev. However, the nature of the discussions remained informal. Despite Primakov's presence at several SVOP meetings, the government did not participate directly in the dialogue.

When Vladimir Putin came to power, further advances were made in this direction. In order to elaborate the long-term program of social and economic development declared by Putin, the

⁷² Before that, all government programs starting with the famous "500 days" program had a horizon of no more than two years. It increased investment risks, because implementation of large business projects requires much more time, and political uncertainty grows dramatically over a time period of two years.

⁷³ The only considerable fall of ISN at that time was observed at the end of the summer (sinking of the Kursk atomic submarine and fire in Ostankino TV-tower).

Centre for Strategic Research (CSR) was set up. From the very beginning it was headed by German Gref, who became Minister of Economic Development and Trade in May 2000. Representatives of leading research and analytical centres were officially invited to participate in activities of CSR. On the basis of the reports presented by them a series of public seminars was held at CSR in February–March 2000 devoted to a wide range of questions – from modernization of the economy to public administration reform and formation of a new social contract.

The scope of this paper does not permit an analysis of the contents of such discussions (although it would certainly be of interest from the point of view of studying the public thinking in modern Russia). Nevertheless, we would like to emphasize the fact that the government initiated a public expert discussion of strategic problems of national development and made attempts to listen to alternative points of view. It is noteworthy that representatives of the business community (in particular, members of Club 2015) also took an active part in the discussion.

We believe this dialogue could have become a turning point for the formation of ‘a consensus for the sake of reforms’ which was shaped in many countries of Central and Eastern Europe in the beginning of the 1990ies and which, in the opinion of many experts, became the key factor for their successful transformation.⁷⁴ For this purpose, however, the process should have passed from the expert to the political level, but this did not happen.

The reason for the end of the process, as we think, lies in the technocratic ideas of social and economic management, which continue to dominate in the Russian political and governmental circles. In accordance with such ideas, the state had listened to potential stakeholders and after that made itself an arbitrary decision about where to go and what to do.

However, in order to implement the decisions made it was necessary to reinforce the positions of the state and, first of all, of the federal centre. It was with this purpose that the strengthening of the ‘vertical line of power’ was initiated by President Putin in 2000. It led to the noticeable limitation of the governors’ powers, reform of the Federation Council, creation of federal districts headed by president’s representatives, etc. The result of such measures was a real strengthening of the federal government’s position. But we think that the bureaucratic establishment has strengthened and consolidated even more, which nullifies all the positive results of this policy. In order to clear up this point of view it is necessary to make an excursion to the spheres related to correlation of public, state and corporate (or group) interests.

As was shown by Mansur Olson in his “Logic of Collective Actions”, *public interests* do not exist by themselves and do not have a specific carrier. They are realized through *political competition*, which is a conflict of different group or corporate interests in the political market. In our opinion, however, it is necessary to differentiate considerably depending on the existence and level of the development of democracy. In particular, we can talk about a developed or unstable democracy, as well as about non-democratic regimes.

A developed democracy acts as a tool to maintain constant public political competition. It provides the society with controls over the actions of the government and offers an opportunity and legal procedures to change the government, if its actions do not correspond with the interests of society. In this process a developed democracy can maintain a relative balance of group and corporate interests through systematic identification of public interests.

However, in a weak and unstable democracy political competition basically acts as non-public, internal struggle of the elite groups for power. This certainly assumes the possibility of subsequent use of power to suppress political opponents.

Finally, in the absence of democracy (which has been historically typical for Russia), political competition acquires, to our mind, the nature of a permanent conflict between the *state interests*

⁷⁴ For more details see Afontsev (2000b).

and the interests of separate elite groups. Such a conflict is preconditioned by the 'state nature' of the society, by a different, much bigger, role of the state in all social and economic processes. The state declares itself as *representative of the interests of society*⁷⁵ and all other interests are overridden by the interests of the state.

The carriers of such state interests are the top representatives of government structures. However, for practical implementation of the state interests shaped by the government, it needs support from a certain social class. As shown by Pivovarov and Fursov,⁷⁶ this role was played in different periods of the Russian history by the *Oprichniks*, serving noblemen, officialdom of the middle and end of the 19th century, and the Soviet *nomenklatura*. What they all have in common is that representatives of these social groups were *servicing the state* and can generally be defined as a 'service class'.⁷⁷ However, every time such a class expanded and gained influence it began promoting *its own corporate interests* which did not correspond to the interests of the state and, therefore, undermined its basis.

As a result, political competition in Russia can be likened to the swing of a pendulum between two extremes. At one end, there was the consolidation of the state and concentration of government efforts on a promotion of the 'state interests' while oppressing the interests of other social groups. At the other end, there was the absolute domination of group or corporate interests of the 'service class' to the detriment of the interests of the state.

During the period of movement from one pole to the other, a relative balance between the interests of the state and the 'service class' may be reached favouring, in particular, partial realization of public interests which are ignored at extreme points. But the problem is that such 'intermediary' states are not stable. The logic of the system always pushes it to one of the poles, and after recurrent growth of inefficiency the systems falls again into a deep crisis.

The collapse of the Soviet Union in 1991 is a vivid example of one such crisis, the basic reason for which was the transformation of the Soviet *nomenklatura* into a self-sufficient force and transformation of the state into a combination of institutional interests that interacted based on 'administrative trade' principles.⁷⁸ In the 1990ies this structure was generally reproduced under the guise of a market economy and with adjustments for the considerably increased independence of the regional elite and the emergence of the business elite.

In this context Putin's policy can be perceived as the backward swing of the 'pendulum'.⁷⁹ However, at present Russian society is in transition from a non-democratic regime to an unstable democracy. Besides, we are living in a more open society. Under such circumstances the possibilities of direct control of the state over the actions of its 'service class' turn out to be very limited.

It is for this reason that the technocratic choice in favour of 'strengthening of the vertical line of power' without creating the prerequisites for development of democratic institutions has so far benefited mainly the consolidation of the corporate interests of the 'service class' (currently represented by the federal bureaucracy) and strengthening of its positions as opposed to regional authorities and big business. Besides, the group or corporate interests of the 'service class' are more and more associated with the interests of the federal ministries, the activities of which in fact remain outside the control of society.

⁷⁵ It is evident that even in the ideal case of an 'enlightened and just monarch' such a structure means absolutization of one point of view, i.e. the idea of public interests typical of the people who are located at the top of the power hierarchy at that moment.

⁷⁶ See. Yu. Pivovarov, A. Fursov (1999) etc.

⁷⁷ The term 'service class' was suggested by K. Renner and further developed in Goldthorpe, 1995.

⁷⁸ Kordonski (2000). See also <http://www.libertarium.ru/libertarium/1_knig_knig>

⁷⁹ In particular, Yu. Zudin (2003) writes about the 'monocentrism' of Putin's rule in comparison with the 'polycentrism' of the Yeltsin regime.

The state's consolidation policy has helped governmental agencies as well as corporations of state officials to better understand their own interests and possibilities, which in practice significantly exceed the possibilities of any individual representative of the bureaucratic establishment. For illustration see Table 3, which characterizes the evolution of interaction between government and business depending on the level of its consolidation and the extent to which it is controlled by the society.

Table 3: Government and Business Interaction Model

Governmental agency		Not consolidated	Consolidated
		1	2
Not really controlled by society	A	Individual public officials play for the benefit of individual market players (situation in Russia of the 1990ies)	1) Agency plays for the benefit of individual players, or 2) Agency plays for its own benefits, bringing market players under its control (in general typical of the last 3–4 years)
Controlled by society	B	-	<i>Open political competition</i> restricts negative extremes of standard bureaucratic aspirations and therefore directs the activities of governmental agencies to promotion of social interests

In contrast to the 1990ies the majority of Russian government agencies are at present located in the A2 square. Besides, we can observe a gradual transition from the game for the benefit of separate businesses to subordination of such businesses for the purposes of internal bureaucratic interests. This happens because a consolidated agency able to substantially influence the rules of the game in a specific market is stronger than any other, however big, player in the same market. To a certain extent the model of state capture by business is being replaced by the model of informal 'subordination of business to the state', which is no more efficient than state capture.⁸⁰

In this regard it is also possible to talk about the use of expanded opportunities of the state for direct capture of business by state officials. Such a strategy, however, may come into conflict with corporate interests of government agencies. The latter are likely to aim at ensuring general control over the markets assigned to their competence, which creates possibilities for all the representatives of the agency to obtain rent in accordance with their ranks in the institutional hierarchy.

An indirect confirmation of the growing activity of state institutions and abandonment of the 'privatization of the state' model may be found in the statistical data of the Supreme Arbitration Court, according to which the 100% growth of the number of claims submitted to court in the period between 1997 and 2001 mainly resulted from the rapid increase of administrative claims.⁸¹ The state capture hypothesis for post-crisis Russia finds no confirmation in the empiric data given in one of the latest works by Frye.⁸² The results of his research based on the survey of 500 managers of enterprises in six regions at the end of 2000 are more likely to confirm the existence of a system of mutual 'exchanges' between the state and business structures close to the state.

⁸⁰ The extreme examples of this kind of policy may be the use of tax arrears of private companies in potentially attractive branches of the economy for direct transformation of these companies into state enterprises (see Kryshstanovskaya, 2002a).

⁸¹ For more details see Karev (2003).

⁸² Frye (2002b).

It is evident that the 'pressure groups' lobbying certain business interests can undoubtedly influence a specific state institution. But efficiency of such influence will substantially depend on the degree of agencies' consolidation. The higher the degree of such consolidation, the higher the costs of passing the 'required' decision through the agency, and therefore, the higher the possibility that the agency will aim at the implementation of its own internal bureaucratic interests, assigning the corresponding costs to business and society.

Such a strengthening of the bureaucratic establishment and oppression of business activities could not but provoke a counter-reaction of business. This was manifest in the development of horizontal concentration and vertical integration and in the formation of very large holdings comprising enterprises of different industries. Such large holdings are able to 'balance' separate consolidated ministries which compete for authority and control over resources. Such an economy is characterized by a shrinking space for competition in the internal market, which is manifested itself, among other things, in the stagnation of small and medium-size business.

However, there were some other factors on the side of business that hindered further development. As we have already said, the economic dynamics of 1999–2000 were ensured to a great extent by the successful advance of more efficient players of the former 'second echelon'. However, the economic structure in general has not become more competitive. New institutions and tools supporting competitiveness and stimulating new ideas and technologies have not appeared. Moreover, the pressure of competition in some sectors has possibly even become weaker because of the impact of devaluation which restricted access of imported goods to the Russian market. As a result, having gained positions in the 'first echelon', the new players are now interested in preserving the existing and creating additional non-market barriers, protecting them against potential competitors. With this purpose in view, the same 'games with the rules' can be used, the only difference being that now the relevant decisions are adopted at a higher level and consume more resources.

To sum up, we can say that although the horizon of interests has extended, the dialogue between the key stakeholders has not come into being, and the big business and the state have not realised a common understanding of the future social and economic development of the country. In addition, the state in general does not trust business and tries to override it by imposing its own policy. However, in practice the result is that governmental reformers who are not incorporated into the system of receiving the 'status rent' sink deeper and deeper in the flood of the reforms initiated by them. In this process the governmental establishment is adapting to the new conditions and is gradually converting such transformations into 'reforms for the sake of reforms' which create new sources for obtaining rent. Business realises this and distrusts the state in its turn and therefore does not have sufficient competition incentives for development.

As a result, all the influential players prefer to wait,⁸³ and not take the risk of investments into long-term political or business projects. The situation in the oil market, favourable for Russia, reinforces such a tendency even further. Thus, development is continuing at an extremely slow pace under the 'Fairy-Tale of Lost Time' scenario, which was predicted by Club 2015 as early as 1999 as one of three most probable development scenarios in Russia for the next decade.⁸⁴ According to this scenario, after ten years of such slow development Russia will find itself yet again on the brink of a profound social and economic crisis. This pessimistic forecast corresponds on the whole to E. Kuznetsov's opinion, who worked for a long time at the World Bank as an expert on Latin America, that Russia during recent years resembles Argentina during 1995–1996.

⁸³ Such a situation was called a 'waiting trap' in E. Kuznetsov's paper (2002).

⁸⁴ For more details about the project "Scenarios for Russia" please refer to <www.club2015.ru>

Instead of a conclusion: preliminary results

As compared with other former socialist countries, the Soviet Union and Russia are the countries with the longest experience of a command-line economy and a one-party political system. This resulted in deep institutional transformations because competition was consistently eradicated from all economic and social spheres for 70 years. In the economy, this was manifested in the 'one factory' model and in the struggle against 'parallelism and duplication'. In the social sphere, the fight against free-thinking either resulted in physical elimination of the potential opposition or caused this opposition to emigrate or be assimilated.

As a result of this policy, reflecting the logic of the system, incentives to development were continuously eliminated and innovation was fading away. Living on rent was gradually becoming a dominant strategy. Ultimately, there was a decline in efficiency and stagnation. It is these factors that caused the Soviet Union and its allies to lose their global fight against capitalism.

However, the collapse of the Soviet Union and implementation of market mechanisms did not change the situation. Introducing market features to the economy that had been functioning along the 'one factory' principle for decades only generated acute monopoly effects. In politics, the lack of a real counter-elite enabled representatives of the younger generation of old elite groups (party *nomenklatura* and top tiers of the *intelligentsia* close to the government) to take advantage of the collapse of the regime and to promote their own interests.

The traditional incentive and motivation system used by these groups would stimulate reproduction of new uncompetitive structures in the economy and in politics and would encourage the elite to try and obtain rent on an even bigger scale. The elimination of checks and balances limiting such patterns of behaviour within the framework of the administrative system as well as the arbitration opportunities that arose between the market and regulated sectors of the economy during the reforms also played a role in this process.

The possibility of rent-seeking on a systematic basis within the framework of such arbitration transactions encouraged the elite to solidify and prolong that situation, which generated the 'partial reform' policy as described by Hellman. The arbitration opportunities were much better in Russia and CIS countries than in other economies in transition because the scale of structural distortion accumulated earlier was larger, too. Therefore, the potential benefits grew and incentives to retain the economy and society in the 'partial reform' trap were becoming more and more powerful.

However, the new system turned out to be even more inefficient when compared to the old one. The society was living on rent, as before, while the distribution of the rent became extremely disproportional. The main rent volumes were concentrated in the hands of a limited number of people, while most people's living standards were stagnating or even falling dramatically. This increasing injustice in revenue distribution can, in our opinion, explain the appearance and importance of the phenomenon that Frye calls 'political polarization'.

The growing inefficiency of the system and the fact that influential players (both in business and in the government) were not interested in finding a way out of the existing 'negative equilibrium' made a crisis (similar to the one that took place in August 1998) inevitable.

On the face of it, this crisis did not result in a dramatic transformation of the business and political elite. We believe, however, that it had a significant impact on the motivation of the existing agents, especially in 1999–2000. A major difference from the early 1990ies was that representatives of the existing business elite already had significant assets and had, therefore, something to lose. The crisis that brought the left-centrist Primakov government to power also revealed a potential threat to representatives of the Yeltsin political elite, namely, a loss of their social status should the crisis repeat itself in a more acute form.

As a result, both business and government extended their horizons of interests and, therefore, more willingness to ‘play by the rules’ – as contrasted with the systematic ‘games with the rules’ characteristic of the 1990ies. At the same time, the devaluation effect triggered economic growth which in 1999–2000 for the first time in many years resulted in a visible increase in living standards, especially in the Russian regions. Furthermore, the appearance on the political scene of a young president who started his presidency by developing a long-term social and economic development program generated a surge of positive expectations in the society in spring 2000.

Now, three years later, despite the continuing (although at a slower pace) economic growth and social stability, one can state that most of these expectations have not been met. One might feel that what we see in Russia at the moment is the restoration – although in more ‘market-oriented’ and ‘democratic’ forms – of the hierarchical system that was characteristic of the Soviet era and that would extinguish all incentives to change which did not originate at the centre or did not comply with its policy.

In our view, this can be explained by the fact that although some new players appeared on the scene after the 1991 and 1998 crises, the environment in general did not undergo any significant transformations. It has been and continues to be uncompetitive – both in the economy and in politics. The crises cleared out the field and promoted new, more active and energetic players to the frontline. As they strengthened their positions, however, they lost incentives for development and innovation.⁸⁵ But since the economic and political environments remain uncompetitive, these players, once they have taken dominant positions, can extract rent from their ‘status’ or market share; they can deny access to resources to their potential competitors; or they can even block the reforms that could break the existing equilibrium.

It must be stressed that trying to obtain rent is generally natural for market agents. Rent is normally associated with monopoly. We believe, however, that a difference should be made between innovative and political rent.

In a competitive market, the environment makes market agents search for ways to reduce costs or to find new market niches thus encouraging them to be innovative. As long as these innovations are not copied by other market players their initiators can expect to receive an innovation rent. The innovations in question are not only technological but also organizational and managerial. Studies show that such innovations are closely related to accumulation of specialized knowledge and are possible in any sector and at different stages of global value chains.⁸⁶

The phenomenon of ‘Political rent’, on the other hand, appears when one market player can use his connections in the government to influence the regulatory system, artificially limit access to markets for new players, and obtain resources that do not match his performance.

It is obvious that a prevalence of such strategies at the micro level results in a general decline in efficiency on the macro level thus making the next crisis unavoidable. And although this new crisis can provide new opportunities for promoting new, more efficient players, the odds are the system will ultimately return to the state of ‘negative equilibrium’ if the structure of relationships does not change as new players appear on the scene, if competition and innovation-oriented institutions and mechanisms are not put in place.

That competition is important for economic and social development is not a new thing. The question is where competition will come from. It was typical of Russian reformists and their

⁸⁵ It must be pointed out here that we are talking about the general trend which can be expressed in different ways on different marketplaces. It is most visible in commodity industries. On the other hand, companies from the food or mechanical industries in the post-crisis period face competition from foreign producers and this causes them to be innovative.

⁸⁶ See, e.g., Kaplinsky (2000).

Western advisors of the early 1990ies to believe that competition would be introduced together with market mechanisms and democratic institutions. These expectations did not come true. A loose coupling of an imperfect market and a weak, corrupt state extinguished the sparks of reforms coming from the top, the reforms stalled, and the reformists themselves either fitted in the existing system of relationships or disappeared from the political arena. It should be pointed out that all this is not new either. Many third world countries have been in the state of 'negative equilibrium' for decades.

In our view, the way out of this weak market/inefficient state trap is not revolutionary transformation under large-scale reforms but gradual introduction and incorporation of mechanisms and institutions that would stimulate innovations in the continuing uncompetitive environment. Dissemination of innovation and involvement of new economic agents in innovative activities would help create interest groups that would actually support competition.

An example of such mechanisms used to stimulate innovation is the Chile Foundation, which was created in the mid-1970ies under a match funding scheme between the Government of Chile and ITT Corporation. The activities of this Foundation in the 1980–90ies encouraged a dramatic growth in Chilean exports – artificially bred salmon, tomato paste, table grapes, and other products.⁸⁷ Other examples include associations of producers initiated by business people in depressed regions of South Italy and North East Brazil that managed, with support of the local authorities, to significantly improve quality, expand production, and increase exports.⁸⁸

Using traditional terminology, we can talk about mechanisms and instruments of industrial or structural policy. They do not fit in standard schemes, however, because they assume close interaction between government and business and often do not have any strict formal limits. In our opinion, it is more correct to speak about *institutional innovations* that create conditions for the appearance and dissemination of technological and organizational/managerial innovations when market competition is insufficient.

What could be the *fulcrum* for the implementation of such institutions and mechanisms?

In business, in politics, and in the state machinery there is always 'the second echelon'. Its players can perform better than the leaders but it is difficult for them to move forward. As the system is progressively consolidated and cemented, it becomes more difficult for them to develop and they face bigger hurdles and barriers. Such companies on the marketplace and such players on the side of the state (not only in the state machinery but also in the political sphere) can support efforts to put new institutions in place. But they can hardly initiate this process since they do not have enough influence to do that.

The problem is that with the current balance of power the 'first echelon' players do not need institutions and mechanisms of competition. They already have dominating positions and their rational strategy of behaviour comes down to using the existing opportunities to obtain 'political rent'. To each rule, however, there are exceptions; and 'the first echelon', too, has *atypical players* oriented towards long-term development.

Their distinct feature is that they do not just want to retain what they already have (capital, their position on the market, their social status), they want something more. They act irrationally; from the perspective of dominating strategies of behaviour; their interests can collide. And yet, it is they who can initiate institutional innovation and kick off the process. In our opinion, however, they can be successful only under certain conditions.⁸⁹

⁸⁷ For more information see Kuznetsov (2002).

⁸⁸ See Locke (2001).

⁸⁹ When identifying these conditions we use the results of Russian studies by E. Kuznetsov (2002), A. Ponomarev, and K. Gonchar (2002) as well as Richard Locke's paper on building institutions of trust in South Italy and North Brazil (see Locke, 2001).

The first hurdle they will need to overcome is gaining *minimum critical mass*. Since we are talking about atypical players, their group will by definition be very small; and the better the interaction among the players, the better their chances of success. This interaction should involve both business and government. Since the market and the state are both weak, cooperation on just one side is unlikely to bring about the expected results. Moreover, this cooperation should reflect the specific interests of the potential stakeholders and should, therefore, be aimed at implementing certain projects rather than create institutions as such. To avoid possible mimicry and search for rent in such projects, they should from the very beginning be based on long-term and common interests of the potential stakeholders.

The second hurdle has to do with *lack of trust* among potential players and with their sustainable negative expectations generated by their previous experience of the 1990s. The abovesaid is true both for possible first movers represented by atypical players of ‘the first echelon’ and for more numerous efficient players of ‘the second echelon’ who have less resources and do not believe that something can be changed in real life.

In the case of first movers, as we can see from the few successful projects of cooperation between business and government implemented in Russia in the 1990ies,⁹⁰ to establish trust among the potential participants it is better not to make project implementation conditions too formal at the initial stages of the projects. If, however, the projects are successful, the conditions need to be formalized so that they can be replicated and disseminated in the future.

The last step is very important for the *demonstration effect* because negative and pessimistic expectations of the ‘second echelon’ players can be overturned with a series of successful joint projects proving the possibility of cooperation between interested market and state actors. Best practice identification and dissemination mechanisms can be used for the same purposes (e.g. contests of already implemented projects, ‘company of the year’-type of contests, etc.).⁹¹

The third hurdle is likely to be expressed in an active *opposition of the environment*. The point is that stable interest groups have been formed around the existing inefficient institutions. These groups include both businessmen and officials. Because of these institutions and because some players have better access to them these players can obtain political rent. This is why they are going to hinder any reform of such institutions or turn this process into ‘partial reforms’. This is, in our view, the reason behind the systematic ‘slipping’ of institutional reforms in Russia.

In order to weaken this opposition of the environment, the reform vector needs to be changed, in our opinion. Instead of changing and breaking the existing institutions we need to emphasize the need to *create new institutions*. It is better to launch such institutions (or projects they are based on) in the sectors where the drawbacks and inefficiency of the old institutions are most visible. However, it is better to do this as a series of experiments or pilot projects because this gives you the ability to keep the old institutions which can at least function, albeit badly.

This approach, in our opinion, will not only weaken the opposition of the existing interest groups but will also create conditions for *competition of institutions*. The experience with the practical functioning of such somewhat parallel institutions will provide grounds for redistributing resources in favour of the most efficient ones in the future and, thus, for building new interest groups around them to strengthen those institutions.⁹² It is important, however, to understand

⁹⁰ See Ponomarev, Gonchar (2002).

⁹¹ E. Kuznetsov (2002) in his paper describes a successful implementation of such a contest mechanism in Mexico that helped develop elements of competition among the regions (states). We believe certain analogies can be offered here with the ‘socialist competition’ mechanism which created certain incentives to innovation and improved performance in the uncompetitive command-line Soviet economy in the 1930–60ies.

⁹² We believe, something similar took place in China in the 1980–90ies when the so-called town-village enterprises – TVE – emerged. The rapid growth of those enterprises belonging to local authorities took place against the background of very slow transformations in the state-owned industry. At the end of the day, TVEs turned out to be a very

that not all institutional innovations prove effective. An evolutionary approach based on competition of institutions can soften the impacts of unsuccessful experiments.

Our last comment will be about the concepts of 'first' and 'second echelons'. These concepts are very important for us but we should stress their relativity. One and the same company can be the top leader in its region and, at the same time, a minor player on the national marketplace. An energetic governor who has his own political ambitions can be lost at the federal level.

In our view, institutional innovation providing more room for competition is more likely to be initiated at the regional level because of a greater variety of initial conditions and potentially higher ambitions of the regional elite. Projects with the biggest potential could be the ones aimed at establishing cooperation between strong regional leaders and large business structures operating on the national marketplace. As opposed to many federal policy-makers and high-ranking officials, the relative advantage of regional leaders is that they still *have room for advancement*. The main advantage of national level business structures could be a larger pool of resources and a broader horizon of interests.

The main target of the policy of creating institutions in an imperfect institutional environment should, therefore, be the search for 'exceptions to the rules' among the 'first echelon' players both in business and in government, and to gain their cooperation. At the initial stage this cooperation should be relatively informal and take the shape of specific projects rather than be focused on creating new institutions as such. At the next stage, stable negative expectations in business and society will need to be broken to secure and extend support for the new institutions. This can be done using the demonstration effect of a series of successful joint projects proving the possibility of cooperation among interested players in business and in the state machinery. And finally, to contain the opposition of the environment and ensure a relative stability for the entire system, it is better to aim not at a destruction or dramatic transformation of the existing institutions (something that Russian reformists have traditionally focused on) but at a system of experiments aimed to create parallel institutions. This would provide for institutional innovation and encourage competition among the institutions. Support groups would form around the most efficient institutions with subsequent gradual redistribution of resources in favour of those institutions.

Obviously, the above is not an answer to the question HOW to implement reform. These are just some approaches that can be used to create positive incentives and motivation for potential reform supporters represented by atypical players of the 'first echelon' and more numerous efficient players of the 'second' echelon. In our next papers, however, we will use more detailed analysis of mechanisms of economic growth stimulation and transformation of market institutions in Russia in the conditions of globalization to try and provide a more complete answer to the question HOW because it is this question that is the key to successful economic and political reform.

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