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Institutions, Business and the State in Russia

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THIS ARTICLE LOOKS AT LINKS between firms' behaviour and the institutional set-up in Russia. It seeks to achieve two objectives. The first is to demonstrate that an institutional approach may achieve what the neoclassical approach has largely failed to accomplish, i.e. explain the factors that forced a great number of firms in Russia to delay restructuring and other anticipated responses following privatisation and price liberalisation. The second objective is to show that the intentional weakening of the economic and administrative role of the state in the early stages of reforms has deepened the institutional crisis and increased the economic and social cost of transition.

There is growing consensus that one of the main causes of the shortage of market-type response is the frailty of market-based incentives. The new institutional economics proposes to view the inadequacies of the domestic system of institutions (which may be defined as the rules of the game in the society or, more formally, the humanly devised constraints that shape human interactions) as a factor that does not allow market incentives to reveal their strength. In fact, one of the reasons for some of the idiosyncratic practices of Russian companies is the fear that under present conditions market-type behaviour may bring losses rather than rewards. Accordingly, this article argues that the central issue of the current stage of reforms is to secure a move from an interim institutional system that emerged spontaneously in the early 1990s to an up-to-date system that can help consolidate the achievements of reforms and bring Russian capitalism into the modern age.

Currently institutions in Russia maintain features that came into being as a reaction to some very specific challenges of post-communist reconstruction. As a result the evidence that the current institutional environment has ceased to help the progress of the Russian economy should not come as a surprise. As this article will demonstrate, the present institutional arrangements in Russia reflect the drawbacks and weaknesses associated with a period of systemic change, such as domination of short-term interests, poor access to business information, lack of trust, collapse of traditional business ties, parallel existence of incompatible business cultures etc. These features made inevitable the introduction of makeshift solutions, in particular because the state as an active force in creating an institutional set-up had been weakened and was reticent during this period. However, the article aims to demonstrate that these arrangements have reached the limits of their efficiency and have become a barrier to further development as they fail to institutionalise economic conflict and provide a solid and cost-effective foundation for market transactions. The institutional framework in Russia has to be modernised and this leads to the difficult question of how this should be done. It is only natural to look at the dichotomy of evolution and deliberate action. Can economic growth on its own change institutional set-up? What should be the force behind institutional reforms? As a contribution to the transition debate this article will specifically address the issue of whether and to what degree the state may be trusted with this task in Russia.

Institutional collapse and the crisis of economic confidence

Ten years into transition, the results of dramatic large-scale market reforms in Russia have been at best controversial. While changes are notable, the expected rapid passage towards a functional market economy providing equally shared benefits has largely failed to materialise. Consequently, there has been a noticeable drive towards the re-evaluation of the experience and outcomes of reforms in the country. The major criticism is that the 'Washington consensus' and the 'shock therapy' approach to reforms have ignored some specific conditions in Russia and allowed no space for alternative strategies (Stiglitz, 1999, 2002; Hedlund, 1999). Dissatisfaction with neoclassical recipes prompted interest in institutional aspects of transition in the wake of the influential work by North (1990). Developments in Russia proved to be strikingly in line with ideas expressed by North on how an economy can get itself into trouble. However, the full scale of the insight into issues of transitional economics that the institutional approach was able to offer did not become obvious at once. Initially the attention of researchers was drawn to the heavy economic and social cost being borne by countries in transition following the surges of corruption and poor contract enforcement that were widely seen as a consequence of institutional deficiency (Blanchard & Kremer, 1997; Black et al., 1999).

Indeed, if we use the spread of corruption as a proxy for institutional efficiency (i.e. low levels of corruption indicate high efficiency of institutions), there is an obvious positive correlation between the development of institutions and economic growth (see Fig. 1). Modern Russia consistently appears among the most corrupt countries of the world according to surveys measuring the degree of corruption as perceived by businessmen and the general public. This evidence may be illuminating but there are other features that should be seen as symptoms indicating the significance of the institutional framework, or rather of its absence, for the development of business and economy in Russia. These include capital flight, the high share of the shadow economy in GDP, slow growth of small business, immense income inequality etc. This article, however, focuses on an aspect of institutional crisis that remains, according to some experts, largely unexplored (Hellman et al., 2000a).

For a long time now there has been a debate concerning the reasons for some intriguing strategic and tactical choices by Russian managers that blatantly contradict expectations based on Western experience and mainstream Western theories. Most

Note: The Corruption Perception Index (CPI) is published by Transparency International, an international non-government organisation. It is a composite index, drawing on surveys of business people, the general public and country analysts. No country is included in the CPI unless there are results from a minimum of three surveys.
1—10 European countries with the lowest efficacy of institutions according to CPI score.
2—10 European countries with the highest efficacy of institutions according to CPI score.
Source: Transparency International; World Bank.
FIGURE 1. INSTITUTIONS AND ECONOMIC GROWTH.

noticeable are the propensity to barter transactions, low level of investment, labour hoarding and the importance attributed to networks and unorthodox forms of corporate governance.

There have been attempts to explain the unorthodox business behaviour in Russia from a variety of perspectives, ranging from microeconomics to business culture (Gaddy & Ickes, 1998; Kuznetsov & Kuznetsova, 1998). They provided some elements of the puzzle but we believe that the solution will be incomplete unless an institutional dimension is included in the equation.

The institutional nature of certain behavioural patterns and business arrangements observed in Russia can be deduced from the obvious fact that they bring rewards in

Russia although they should be a ticket to failure in a market economy as contradicting its rules and institutions. It is reasonable to allege that the 'irrational' behaviour of economic agents in Russia in an attempt to by-pass a 'legal' market economy is in fact a rational reaction to the uncertainty and challenges caused by institutional distortions. For example, interviews with managers of companies importing white goods into Russia, a sector where the presence of 'grey' practices is very noticeable, revealed in 2001 that the choice between 'grey', semi-legal schemes and fully legal procedures was entirely determined by the consideration of comparative cost (Radaev, 2002). The high perceived cost of legalisation was found to be a fundamental impediment to eliminating the 'grey' economy.

Underdeveloped institutions manifest themselves by allowing relations between economic players to remain erratic and subject to undue uncertainty and insecurity. In other words, a poorly institutionalised economy lacks the infrastructure that is necessary to promote, support and simplify market exchanges and to provide them with stability and continuity. Institutional constraints, therefore, together with constraints identified by traditional economic theory, define the potential wealth-maximising opportunities of economic agents (North, 1997). It is true that the poor quality of institutions in countries like Russia should be expected. Institutions are likely to conform to the grade of maturity of the economy they serve and Russia, it may be argued, is not yet a fully-fledged market economy. However, there is little comfort in acknowledging the normality of this situation. Institutional failings represent a further stumbling block in the way of economic development as institutional immaturity reveals itself in the form of loose ties and missing links between economic players and poor quality of economic information that often lacks sufficient transparency even in the most basic business matters. This is a very serious drawback in as much as more efficient handling of economic information has always been considered to be an inherent advantage of the market mechanism over planning. Informational asymmetry may lead to such negative consequences as adverse selection and monopoly, resulting in a wasteful pattern of allocation of resources and income within a society, as opposed to productivity growth and increase in the national product. In this context one of the major rewards the market system can provide is the wide diversity of information flows and open access to them.

To maximise the benefit of the wealth of information to business users, a degree of institutional co-ordination is required in order to maintain standards that make this information usable. Market-type response may only be induced by market-based incentives that need a particular institutional infrastructure to develop. If the institutional system is weak, inconsistent or incomplete, as is the case in Russia and some other CIS countries, businesses have to cope with the detrimental consequences of a co-ordination vacuum that make it very difficult for market signals first to evolve and find their way to addressees and then to stimulate adequate reactions. This creates a particular situation of crisis of economic confidence when improvements in market efficiency have to rely heavily on non-market methods, pushing the issue of institution building to the forefront.

Whose responsibility are institutions?

While pointing out the weaknesses of the institutional set-up in modern Russia, it is important to realise that they have objective as well as subjective roots. The former may be traced back to the fact that the economic system that was the starting point of transition, the Soviet centrally planned economy, was comparatively advanced and therefore structurally and functionally complex. Because of this complexity the post-communist transitional economic system faces enormous difficulty in absorbing and integrating properties of a different type of highly complex economic system like the modern market.

Subjective factors have to do with the deliberate policy of weakening the position of the state in the aftermath of the collapse of the Soviet Union, justified by the low standard of government in Russia and the necessity to dismantle the basics of state paternalism typical of the Soviet-type economy in order to make space for market forces. These arguments have some force but there is no doubt that 'early retirement' by the state in the precarious circumstances of transition has its downside. Thus Russian firms soon found themselves deprived of basic public goods such as law and order.1

In the immediate aftermath of the collapse of communism in Russia both objective and subjective factors had the same effect, hampering the appearance of new institutions that would provide economic actors with universal and explicit rules that allocate responsibility and set up behavioural boundaries. These are the key fundamentals of 'social capital' (Coleman, 1988)—the ability of people to work together for common purpose—and 'social trust' (Fukuyama, 1995)—the willingness of individuals to deal fairly with each other and expect similar willingness from others to do likewise—without which the transaction costs of market exchange cannot be minimised.

With trust being a rare commodity, long-term commitments discouraged and good business practice pointers conflicting or missing altogether, the picture of the business climate in Russia cannot be further away from the social capital/social trust concept. To make matters worse, the still primitive capital market of transition economies cannot be relied on as the judge of economic performance of firms, impeding the capacity of the economy for self-regulation. Therefore, it is clear that institution building in Russia has to be revitalised, while institutions introduced in the early years of reforms may need reappraisal. Of the two groups of obstructing factors described earlier, changes on the subjective side appear to be an easier target as they may be achieved more readily if the required political will were present.

This brings in the sensitive question of the scale and intensity of the involvement of the state and its responsibilities as an agency that sets up benchmarks for the development and re-development of institutions. Under normal conditions institutions are as much a matter of evolution as of a structured effort. The state is expected to supervise the operation of the existing elements of the economic system, while gradually letting them be replaced by new entrants (Arrow, 1995). The Russian situation is hardly normal though: because Russia cannot return to the point in its development at which the evolution of capitalism was interrupted by the socialist revolution, its leap to 'modern' capitalism can only be achieved through a consistent effort of a committed state.

The 'natural' evolution of institutions is not an option as this would mean ignoring available international experience and wasting time and resources rediscovering institutions that have already proven their worth in countries with greater market experience. It is, however, established knowledge that an effective and effectively acting state makes a huge difference in the quality of development all over the world (Fuhr, 1997). The theoretical advantage of the state acting in a creative capacity is that it enjoys a crucial economy-wide and society-wide perspective that no other institution or entity can enjoy. It can address issues of great importance that are too general to become a major concern for individual economic actors but are of great consequence for the society and the business community alike.

One such issue of particular relevance to transition economies is related to the implementation of the principle of corporate social responsibility that goes beyond the standard conception of shareholder wealth. It has been established that if a society wants corporate decisions to reflect something more than just what is best for shareholders it has to rely on government to define a corporation's responsibilities to society through laws and regulations (Reich, 1998), i.e. through institution building. This concept has taken a long time to develop in the West and, it would seem, has hardly ever been seriously contemplated in modern Russia. Yet for Russia this is a particularly significant area, considering the socio-economic tradition of the previous 70 years that gave a lot of importance to social obligations of big enterprises. This heritage came into conflict with the objectives of mass privatisation in the 1990s and was one of the reasons for both mass impoverishment and poor enterprise performance.

It appears to be a sign of our time that academics and practitioners alike have started to agree that extreme forms of state involvement in the economy, i.e. absolute dirigisme versus full absenteeism, exist only in theory, while reality offers the choice of only imperfect versions of the two (Abalkin, 1997; Dallago, 1996; Holmes, 1997; Kornai, 1992; Stiglitz, 1998). No matter what approach the state seeks to pursue, the economy will suffer if the state does not succeed in rendering the economic environment transparent and 'readable'. The issue for the Russian state is to engage itself in playing the roles expected from the state in a market economy, including the critical task of defining the socially acceptable boundaries for business rationality. However, it is not altogether clear how to achieve this. Among the complications involved are prejudices fuelled by the Soviet model of overwhelming interventionism, the absence of readily available or universally applicable schemes for guiding the transitional process, and the implications of the state being a prominent shareholder already engaged in entrepreneurial activities (for details see Kuznetsova & Kuznetsov, 1999).

Weak institutions and business growth

Sub-optimal institutions

A link between sustainable economic growth and a stable flow of information connecting economic actors has been well established since the pioneering work by Hart (1942). Following these findings it is easy to accept that all economic agents would be affected, although to varying degrees, if the state abstained from building institutions that provide a framework for business negotiations as well as rules for exchanging and verifying information. Without them market levers cannot be fully functional, yet commercial activities cannot be suspended until necessary institutions are in place. Consequently, business people find themselves forced to accept sub-optimal choices. These may take different forms, of which we explore the impact on the learning ability of economic agents and networking.

Agent-based computer simulations (Moss & Kuznetsova, 1996; Edmonds, 1999) demonstrate that under conditions of institutional uncertainty even those economic agents who are willing to learn from their experience and develop new behavioural patterns may fail because learning agents are likely to get 'locked' into inferior behavioural models for a considerable length of time and perform at a lower equilibrium level as a result. These inferior models may well be the most successful of previously tried behavioural models. Nonetheless, they are bound to result in failure when recycled in the next set of actions taken by economic players under transformed conditions.

An intelligent agent will be inclined to stick to previously winning tactics if he is unaware that they represent an inferior course of action in a new time period. This inferior choice is made because the agent does not enjoy the feedback that would allow him to re-evaluate and correct his behaviour without delay. In other words, market participants depend in their judgment about the relative efficiency of a particular business performance, action, transaction etc. on signals generated and distributed with the assistance of institutional settings and institutional agencies.

If existing institutions are inadequate the necessity to compensate for such inadequacy inspires the emergence of makeshift substitutes that often present themselves as anomalies in comparison with what is believed to be appropriate for a modern market economy. Some of these anomalies are highly conspicuous in modern Russia, shaping an economy that is very much dominated by informal sectors and quasi-economic mechanisms that attempt to provide a structure for exchange.

Barter transactions offer a valid example. In the wake of market reforms they have become a striking feature of the Russian economy. In some periods barter accounted for as much as 73% of the business of many Russian firms, including the largest. The spread of barter has attracted much attention and is mostly seen as a significant drawback hampering the progress of reforms. In fact, barter is not a purely Russian phenomenon. In the last 25 years there has been a noticeable increase in the level of barter activities throughout the market economies. In the United States the number of firms regularly involved in barter transactions rose 23 times, from 17,000 to 400,000, during the 1976–96 period (Marvasti & Smyth, 1999). It is true, however, that there are fundamental differences between barter operations in these countries and Russia. In the former the growth of barter is limited to smaller companies and has become possible following the emergence of specialised barter exchanges that have reduced the information inefficiency of barter trade. In other words, the success of barter has been based on greater institutionalisation of this activity. By contrast, the barter system in Russia is not formally institutionalised and is not built around barter exchanges. At the same time, in terms of turnover it is possibly the largest in the entire human history.

Barter in Russia was spurred by the absence or inadequacy of minimal institutional provisions normally attributed to a market economy. This revealed itself in the situation in which suppliers and buyers had difficulty establishing a relationship based on long-term strategy and price information. Instead they had to rely on networks and non-contractual dealings. This could have helped Russia to limit the decline in production from the pre-reform level to 50% rather than 75% as some experts allege (Aukutsionek, 2001), but this arrangement bears a price that cannot be tolerated much longer. There is evidence that firms may easily cut the cost of their supplies by as much as 25% by replacing barter with monetary transactions (Varshavskaya, 2002).

The additional cost of barterisation gives some idea of the price tag of institutional deficiency.

The proliferation of informal networks affects the character of market relations. On one hand, they imply long-term relations with suppliers and customers that create zones of trust within the general environment of distrust that help to reduce transaction costs. Trust also forms a basis for committing resources and mutual development and co-ordination of activities (Popova & Sørensen, 2001). On the other hand, by their nature networks, in particular informal ones, seek to maintain exclusiveness. In the Russian context networking does not mean getting better knowledge of business partners and their needs but rather pursuing the goal of conspiring against outsiders and avoiding legal control over financial and other transactions. Radaev (1998) reports on the growth of 'negative solidarity' that consolidates entrepreneurs against 'outsiders', including the authorities. Business networks strive to resolve any 'problems' internally, which provides more flexibility and more chances to reach a mutually satisfactory solution than available formal methods do but often at a considerable social cost, for example poor collection of taxes and price fixing.

Emphasis on informal arrangement contradicts the idea of competition as a fundamental quality of an efficient market. It promotes exclusivity as a feature of business relations, which is of course counterproductive considering that the assumption of the equality of all economic agents is a major condition of an efficient market.

Institutions and business culture

The national pattern of entrepreneurial and managerial behaviour relies heavily upon past experience and stereotyping. Managerial decisions are essentially selective filtering of input against certain criteria. If some of them become vague the efficiency of decision making may suffer. Cultural conventions occupy a prominent position among these criteria as they are related to both institutional and consciousness aspects of business. In their established form such conventions constitute a national business culture. They make it easier for decision makers to choose routinely those responses to signals coming from the economic environment and the society that have a proven record of being adequate and successful.

The radical transformation of the economic set-up in post-communist Russia urges economic agents to produce responses that are entirely new to them. Importantly, these responses have to be based on a set of values and a type of rationality that differ from those that were significant before the reforms and, owing to social inertia, still constitute a notable part of the national cultural tradition. At the same time information coming from the economic environment is likely to be distorted, confusing and incomplete because transitional institutions are not sufficiently equipped to transmit market signals.

Because in Russia cultural values are in the process of being redefined, there is no consistent and comprehensive 'system of cultural values' but rather an often uneasy coexistence of conflicting values that adds uncertainty to information flows and decision making (Kuznetsov & Kuznetsova, 2000). Yet we cannot expect that modern Russian managers would be able to liberate themselves entirely from any social experience gained under socialism. This is not only impossible but also impracticable as long as common social experience provides the framework for the meaningful exchange of information without which no business activities are feasible. Institutional theory predicts that, in the absence of a developed institutional infrastructure, informal constraints, including those rooted in a common cultural background, become crucial in resolving basic exchange problems among economic agents.

In the context of a transitional economy this solution brings about particular complications following a contradiction between the origins of informal constraints applied (a centrally planned economy) and the circumstances in which they are put to use (a proto-market economy). This implies a fair possibility of a conflict between informal rules in use and formal rules introduced in the course of reforms to facilitate transition to the market. Economic agents are likely to be forced to comply with informal constraints until a functional institutional framework is in place but by doing so they make the installation of such a framework more difficult and prolonged.

Another aspect of this problem is that reliance on a transient set of rules brings to life a specific type of short term-oriented rationality that precludes businesses in Russia from strategic commitments, which has a negative effect on economic growth in the country.

Understandably, the selection of norms of behaviour and experiences carried over from the past by managers and entrepreneurs in modern Russia reflects the realities of the present set-up. What makes this choice bear important social and cultural consequences is that almost everything that was praised under the old system appears to be irrelevant or even counterproductive under current circumstances, while behavioural patterns that were anathematised or seen as improper acquire importance. The shift in perspective puts the first generation of Russian entrepreneurs, in terms of culture, in the rather uneasy position of being at odds with historically endorsed cultural values. They are forced to challenge and contradict some of the values which for millions of Russians are still synonymous with a socially responsible model of behaviour, for the sake of practices that were stigmatised during the lifetime of several generations. The paradox here is that new entrepreneurs act objectively as propagators of new cultural norms and values that, however, in the minds of many of their compatriots bear a strong resemblance to something old and well known, something they grew accustomed to regard as vicious on moral grounds.

The antagonism of the new set of business values and the previous social experience provides only a partial explanation of the negative attitude towards business people in Russian society. The realities of post-communist transition are at least as much responsible for the misrepresentation of these values. The Russian variant of capitalism is widely perceived as brutal and unfair.2 Consequently, free market values get a perverse interpretation within the Russian context. Public attitudes are influenced not by the idealised concepts of new values but by the way they reveal themselves in the activities of the people who are popularly seen as the standard bearers of a new society. These latter, however, cannot inspire sympathy towards the

Source: The Russian Economic Barometer, XI, 1, Winter 2002, p. 76.
FIGURE 2. PROPORTION OF MANAGERS NOT COMPREHENDING THE GOVERNMENT ECONOMIC POLICY OF THE PREVIOUS 3–4 MONTHS (%)

values they allegedly represent (or rather misrepresent) because, in the absence of institutional safeguards, they are not encouraged to behave fairly.

Under these circumstances the ability of entrepreneurs and managers to take decisions and develop long-term strategies is hampered. Academic literature suggests that economic agents should react by attempting to obtain greater knowledge or redefine their decision problem so that uncertainty is no longer critical (Cohen & Cyert, 1965). They need a lead that should be provided by an institutional structure. Instead, the government's own behaviour did little to reinforce respect for rules of fair business: it made itself particularly noticeable for not paying its own bills to companies that provided it with goods and services (Black et al., 1999). Little was done to create a competitive environment or to help newly privatised enterprises to become socially responsible economic players. Overall, it has been a characteristic of the transition period that signals coming from formal institutions remain confusing. Surveys by the Russian Economic Barometer, for example, persistently indicate that the proportion of industrial managers who fail to comprehend the current government economic policy remained quite high throughout the last decade (see Fig. 2). These data are open to various interpretations. Our aim is not to establish whether it is managers who are at fault or the policy is incomprehensible. In the context of this research what matters is that these results indicate a failure of one of the more important formal institutions (economic policy), for whatever reason, to achieve what institutions are designed for, i.e. to increase the confidence of economic actors through achieving transparency and 'readability' of the business environment.

Can we trust institutions created by the state?

In what are now advanced capitalist countries, market transactions and institutions built up with state participation to regulate and sustain these transactions usually developed together and in support of one another. The reason why this did not lead to a situation in which the government and bureaucracy were able to abuse their powers was that such parallel development of the market and its institutional framework guaranteed that the norms the state used to guide bureaucratic behaviour were subject to comprehensive social pressure (Robinson, 2000). In transition countries the situation is usually different: the forces of society are split and the state is administratively weak. As a result certain interest groups can acquire disproportionate influence that they may try to exploit to their own benefit at the expense of broader strata of economic interest. This raises a serious concern regarding the quality of institutions introduced under such circumstances. In modern Russia the process of institution building may indeed look seriously compromised following the role played by two such groups: the state bureaucracy and powerful oligarchs.

The Soviet state was notoriously over-bureaucratised and post-communist reforms have achieved little in restraining bureaucratic supremacy. In fact the powers of bureaucracy have increased following the decentralisation of the state that gave increasing clout to local and regional authorities. The economic side of these greater powers has expressed itself in persistent growth in the salaries of the state bureaucracy at all levels, in particular over the second half of the 1990s. This is in stark contrast to the trend of value added per employee in all major industries in Russia, which was continuously falling throughout the reform period. Growth in wages was accompanied by increase in numbers employed against the background of a dramatic fall in employment in the productive sphere, research and development.

The economic powers of state bureaucrats are based on a number of premises of political, legal and economic nature. To name but a few, it is the continuous dependence of a great number of enterprises, including privatised ones, on various forms of state subsidies and the fact that in many locations firms have to carry on providing residents with social and communal services, such as heat and water supply, schools and medical care etc, that create openings for bureaucratic infringements on the liberties and initiatives of economic agents. It is not surprising then that bureaucrats seek to exploit the process of institution building, or rather its deficiencies, to sustain their domination. Weak and inefficient institutions form an ideal setting for arbitrariness that may be readily cashed in. A good example was the situation with the licensing of business activities that existed in the country until recently. The law included 215 business activities that required licensing; bureaucrats issued instructions 'explaining' the law and the list of such activities had increased to 2,000, turning licensing into a major barrier to business growth and a money-making machine for unscrupulous civil servants.3

There is an inherent conflict between institution building and the self-serving instincts that drive bureaucrats in a corrupt society. Institutions are the tools for regulating conflicts and defining socially acceptable borders of economic behaviour.

Institutions introduce transparency that seriously restricts the ability of bureaucrats to gain wealth or power or both by regulating conflicts and setting behavioural boundaries at will. Therefore, if bureaucrats are an influential cast, as is the case in modern Russia, this is a serious reason to mistrust institutions that have been forged in the recent period.

Another cause for reservations regarding the effects of the state becoming more involved in the development of the institutional framework is the ongoing 'state capture'. This is a process characterised by oligarchs and selected firms gaining the ability to manipulate policy information and even shape regulations and norms to their own advantage by providing illicit private rewards to public officials (Hellman et al., 2000b). The scope of this phenomenon is evident from the remark of the Russian president during his meeting with Russia's business leaders on 28 July 2000: 'I only want to draw your attention directly to the fact that you have yourselves formed this very state to a large extent through political and quasi-political structures under your control'. 'State capture' raises a question mark over the merits of the institutions already introduced or about to be introduced from the point of view of how the new institutional framework supports such fundamental qualities of an efficient market as the equality of economic agents and competition. If institutions are tailor-made to meet the demands of a selected few, outsiders become socially excluded and have to fall back on informal networks. As a result a gap is likely to appear between formal progress in institution building and their actual performance.

'State capture' and bureaucratic dictate are just two aspects of a wider issue of whether institution building by the state necessarily pursues the general good. The most plausible answer is 'no' but this does not make the case for relying on the endogenous growth of market institutions as this process may be equally uncertain in its results, leading, according to some experts, to the real danger of transitional countries being stuck in an equilibrium of weak law enforcement, a large unofficial economy and a low tax base (Snape, 2001). Actually, a robust institutional base would provide the strongest antidote to both 'state capture' and bureaucratisation. It must be noted that these two are not unique to Russia or transition countries in general. Evidence of attempts at 'state capture', for example, regularly finds its way into the Western media, investigating the allegations of political sleaze and corruption in countries like Italy, Britain, France, Japan and others. The difference between these countries and Russia is that in the latter there are fewer barriers at the moment that will check ‘government capture’ so that it does not acquire the scale that would transform the nature of the government. These barriers are institutions themselves. Encouraging a weak state to lead the institutionalisation of economic life may be a risky strategy but encouraging it to withdraw is no risk-free option either. In other words, the contribution of the state in transition countries to institution building is likely to be controversial but cannot be avoided. As Robinson (2000) notes, the state can play a constructive role in overcoming institutional crisis as long as all capitalist groups support the restoration of order if short-term profiteering threatens the entire fabric of the system of production, especially if there is also popular agitation against the economic order.

Conclusions

In the past 2 years there has been a stream of publications that put forward arguments in favour of a bigger role for the state in Russia relying on the analysis of such diverse factors as geographical position and climate (Lynch, 2002), democratisation of society (Steen, 2001; Shevtsova, 2001) and industrial development (Carlsson et al., 2001).

The analysis of institutions in the country appears to provide further pointers in the same direction. This deduction may look controversial considering the poor record of governance in Russia in the last decade. Yet this record can be largely attributed to the fact that, as Robinson aptly put it, Russia had a government but not a state after 1993. The logic of political struggle against the threat of restoration of communism undermined the administrative capacity of central authorities and their ability to provide an institutional framework in a time of systemic changes. Poor institutional structure emasculated the state and the weak state lacked legitimacy to advance institutional reforms. Consequently, the introduction of economic liberties has proved an insufficient substitute for the provision of the most important public good the business community requires from the state: the institutionalisation of economic conflict.

The biased conceptual support that reforms had to rely upon in their initial stages has also played a role. When market reforms started in Russia, their theoretical underpinnings had to be imported wholesale from the West. This created a number of immediate and long-term problems related to adaptation and interpretation of utilisable concepts and the evaluation of the consequences of their implementation in Russia. In an ideal world we would expect the decision maker to choose the best of available models. In reality, such a choice presents an enormous challenge even in a less politically charged atmosphere than that in Russia in the 1990s. There from the outset the values of the Anglo-Saxon model of capitalism established themselves almost uncontested as an implicit benchmark. Russian reformers were inspired by the American-style IMF-sponsored ideal of liberal capitalism, which they accepted in its entirety and at face value.4 References to the Anglo-Saxon concept initially appeared in studies on privatisation and firm management in Russia sponsored by international agencies (e.g. Pohl & Claessens, 1994), despite apparent contrasts in the business environment in the US and any of the post-communist countries. In terms of institutional arrangements, however, it is an established fact that some nations adhere to a liberal market economy and others to a co-ordinated or organised market economy. In the former case firms co-ordinate their activities primarily through competitive market arrangements. In the later they rely to a greater extent on non-market relationships like network monitoring and other informal ties. In the light of the Russian historical experience it may be argued that the country is likely to be more predisposed towards the second type of market arrangement. Nonetheless, the economic policies of the Russian government for a substantial period of time were almost invariably conducted in terms and within the framework of conceptions developed with a liberal market economy in mind.

Putting together practical solutions to the current institutional crises in Russia may take a number of paths. One way forward may be in finding means to increase the powers of the state without providing more leverage for bureaucrats. This can be achieved if decision making is concentrated in the more transparent branches of the government while rules and regulations are formulated in a manner that minimises the freedom of the lower levels of the bureaucracy to give their own interpretations of the law. At the moment there is a noticeable gap between the degree of public accountability of the ministers in the central government and local administrators. This is not to say that in the case of the former the situation is exemplary. However, their activities are more in the limelight due to the mechanisms of parliamentary control and exposure in the central press, which is usually more vocal and emancipated than the regional press. At the same time, as some experts have noted (see Kapelyushnikov, 2001), the core of the 'institutional trap' in Russia is that all new formal institutions immediately acquire a superstructure of informal surrogates that undermine their impact. Therefore, although in the long run decentralisation may prove its worth, the quest for transparency and institutional efficiency may justify a shift in the balance of responsibilities towards the centre.

The importance of the conceptual aspect of contriving institutions facilitating sustainable development in transitional economies must not be overlooked. In particular this involves the selection of criteria that are employed to measure the practical value of available options. In the current situation it would be inappropriate to choose such criteria as if Russia were a market economy, even more so a liberal market economy, while in fact it is a transition economy. The state is in need of a vision of institutions required for growth and progress during a lasting period of changes and within the environment that transition provides. Using the vision of a 'proper' market modelled on the most advanced economies of the world as a point of reference for present economic policies and short-term strategies cannot always be justifiable because of the distance between Russian reality and these 'models' and uncertainty regarding the exact shape that Russian capitalism may take by the end of the transition period.

In the literature it is often accepted by implication that the government and the market are opposites. In fact, the experience of post-communist transition highlights the complementary nature of the two. By refraining from reinforcing formal institutions the state will tip the balance in favour of informal institutions that may play some positive role but equally, granting the immature, transitional character of the market, may endorse inferior business practices and culture. This will obstruct economic growth and translate into the reproduction of aberrations in business behaviour that have made the transition to the market in Russia so slow and painful so far.

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1 Not just the poor state of law enforcement is a problem but equally the poor quality of laws and regulations. Thus, the fact that more than 0.6% of Russia's labour force are employed by the Federal Tax Police Service cannot be interpreted otherwise than as an indictment of the country's system of taxation, which is obviously so unrealistic in its objectives and clumsy in their implementation that taxes can only be collected through overwhelming policing (Kommersant-Vlast', 20 November 2001).

2 The magnitude of the problem is clear from the results of the poll of 2000 Russians by the All-Russian Centre for Public Opinion (Journal of Commerce, 21 November 1997): 88% of respondents named 'connections' and 76% 'dishonesty' as the essential requisites for becoming a successful businessman in their country.

3 As a further example, here is a description of the formal registration of a company in Russia. The procedure 'looks rather complicated. As a minimum it requires passing five examinations by the registration committee. These bureaucratic complications were so powerful as to compel most

entrepreneurs to find ways of getting around the formal system. It just took some initial capital payment for the extra service of "negotiating" the registration process. Nowadays registration of a company has stopped being the serious problem … Bureaucratic procedures have not been changed but the "market for services" has became more advanced. Nowadays there are many agencies specialising in the provision of company registration (through which officials get their commission)' (Barkhatova, 2000, p. 663).

4 Then as now there were people who maintained that this was a superficial and potentially disastrous approach to reforms. For an authoritative analysis see Stiglitz (1999) and Kornai (2001).

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