

Dr. O.Kuznetsova

**RELATIONS BETWEEN BUSINESS AND THE STATE IN LIBERAL THEORY, IN RUSSIA AND ELSEWHERE
(discussion notes)**

1. When Ronald Reagan was the President of the United States in the 1980s, he offered an epitome of the relations between business and the state in a simple brushstroke. He advocated that the government's view of the economy could be summed up in a few short phrases: 'If it moves, tax it.' 'If it keeps moving, regulate it.' 'If it stops moving, subsidize it.'
What I deduce from this is that there is no place for rigidity in our assessment of the economic systems: they can be more liberal at certain times and less liberal at others.
2. We have our discussion about liberal capitalism at the time when it has discredited itself once again by delivering the world economies to the steep slopes of recession. For political reasons or short-termism, when economies are on the upturn and booming, societies tend to ignore that markets fail, because under favourable conditions markets produce prosperity and growth.
3. In the gloomy times or the times of uncertainty and transformation we find it more comforting a thought of appointing an entity that can reconcile the internal conflicts and can pursue in a systematic way the agenda of rescue. In the gloomy times, we are more sensitive to the social cost of development and our inclinations are stronger towards corporatism. It becomes more desirable to appoint to rule an entity that can represent wider interests. Corporatism recognizes or 'incorporates' divergent interests better than liberal establishments. Importantly, historically, economic corporatism has been used to reduce opposition and reward political loyalty, the lesson that might be particularly relevant in the emerging societies.
4. It is believed that the governance model with a strong centre can better recognise societal aspirations and expectation based on the national tradition and embedded in national history. The liberal theory endorses the state with the supremacy in guarding law and faithfulness to established, proper procedures. In this sense, the benefits of the state are clear: like no other agency the state has a crucial economy-wide and society-wide perspective. This is a reason why we accept the state intervention.

5. One of the principles of the liberal theory is that the state ought to respect the fault principle. The state ought not to punish or inflict any detriment upon anyone except on the basis of his fault. So we appeal to the state when we want to punish the market (more professional wording, of course, would be 'to correct' the market). However, there is another principle in the liberal theory from bounce back our discontent with the state domination in the economy: it implies that the state is not superior to other institutions. The state is not an inferior institution; however, the state should generally be inferior to other institutions in the respective fields of their special competence and operational domain. The state is only one social institution amongst many; like the others, it has its designated speciality. It should not appropriate the fields that belong to other institutions. Nevertheless, we appreciate the merits of the state's intervention into economy.
6. I want to talk specifically about Russia but I have very conflicting evidence about what it is in respect of its position in between the libertarian and authoritarian extremes. The Russian modification of capitalism is widely perceived as brutal and unfair. Free market values get a perverse interpretation within the Russian context. Public attitudes are influenced by the behavior of the agents of a new society. These latter, do not inspire sympathy towards the values they allegedly represent because, in the absence of institutional safeguards, they are not encouraged to behave in accordance with a societally accepted mode, something that we call fairness. If the business and market cannot deliver perceived fairness, the society turns to the state. But, I would argue, that in the absence of the workable institutions it would be difficult for society to stick on in a consistent manner to any particular type of the developmental path. I will try to show where my assessment stumbles.
7. The main pillar of the liberal capitalism is the institute of private property. Markets only exist for resources over which someone has a defined property right. I believe that this arrangement is seriously missing in Russia and this hampers the opportunities for the development of the liberal market economy there. Equally, the establishment and operation of the capitalism with the strong state would require a clearly defined system of the property rights and relevant institutions as much as liberal economy. This implies that institutional constraints, including the

property rights issue might be an impediment for the development of both liberal and state-dominated capitalism.

8. Nearly 20 years ago Mario Nuti labelled Russia as an economic and political non-system. Not much has changed since. The market institutions in Russia are weak, underdeveloped, inconsistent and not omnipresent; many market infrastructures are missing; more importantly, Russia is not run as a democracy, so to have a political capacity to sustain the development of the market economy; the market mentality, which is comfortable with the idea of personal independence, self-reliance and responsibility, has not set roots yet.
9. This prompts a question: how relevant is the discussion about the establishment and the strengthening of the state-enforced capitalism in Russia if there is still a problem with the system being a capitalism. But first of all I would like to go quickly through the list of problems with the property rights in Russia that prevent its capitalism from moving in either direction, while, nevertheless, tipping the balance towards the capitalism with a strong involvement of the state. The problems listed below point out that the unresolved during transition property rights issues increase the demand for the state's presence.
 - 1) Russia still grapples with the repercussions of the *original sin of privatization* (quick and dirty), which resulted in a huge degree of mistrust on the side of the population (the society) in business and to some degree in the state. In the light of this, it is understandable that the sentiment about the need to have a conversation about the unfair privatization is still strong in Russia and the recognition of the market merits and values is not universal in the country. The business is under pressure to prove its legitimacy with society and would support the measures ensuring that it has been legitimised. All this creates demand for the increasing role of the state because it is expected to be able to act as a mediator, a redeemer, a representative of the societal interest. Big business, population and the state are interested in a strong state capable of sorting out aching problems related to the property rights;
 - 2) the Russian economy is mono-cultural. The mainstay of the Russian market economy is the energy sector, natural resources and extraction industries. This is where the wealth and grows are generated. When the Russian business elite, mainly represented by the 'carbon

- tycoons' used to come to London for its annual Economic Forum gatherings, the British press greeted them with the headlines: '60 percent of the Russian GDP came to London'!. The current owners though has not contributed revolutionary to the transformation of the Russian economy but have enriched themselves beyond comprehension. In these conditions, it is not reasonable to expect that the support for the further enrichment of the few would be in resonance with the societal aspirations. When there is only one resource on which the whole society relies, what is the point of handing it out? Petr Aven, one from these rich Russian banch, once mentioned: *we were appointed by the state to become rich*. Who wants to repeat a mistake? This situation, clearly, gives the state a moral lever to defend its position of being present in strategically important industries;
- 3) one-dimensionality of the Russian economy is its main weakness making the country a hostage: externally – to the global demand for resources and sequential economic volatility; internally – to the never-ending fights over the wealth redistribution, political instability, lack of commitment from and opportunities for investors, corruption, disincentivized entrepreneurship. Witty Russians have invented a term *распил* [ras-'pil] (carve up your piece from a whole with a saw) to describe the all-encompassing quest for the wealth split rather than wealth generation. In reality, it is much easier to *распиливать* [ras-'pi-li-vat'] rip off resources that belong to the state. Many parasitic organizations and enterprises have been created around the core entities representing the state property and not only in the extraction industries, but in science, in finance, health service and education, just everywhere, and the bloodsuckers are not necessarily the state bureaucrats but ordinary citizens. Thus, the interest in the strong and big state sector is not inconsistent with the efficient model of private enrichment that is wide-spread in Russia;
 - 4) it might be a more attractive alternative to have a state-led economy because, the economy is dominated by the big business that is hardly accountable to the society or anybody, but the government needs to be re-elected and thus has to play the 'societal interest' card from time to time;
 - 5) as for the business that is not a part of 'the big business' the Russian economy continues to operate on extremely shaky foundations: the status of property rights is even more uncertain here and high redistributive risks prevail¹. Such conditions are not encouraging for

high levels of investment, innovation, entrepreneurship and proliferation of the entrepreneurial drive, and hence, the development of the private sector in general.

10. As we can see, the current situation in Russia suggests that the business landscape is not propitious for the implementation of the liberal market model; quite opposite, there is a demand for the state. Also, in the light of the Russian historical experience and institutional configuration, it may be argued that the country is likely to be more predisposed towards the coordinated type of market arrangement despite the fact that 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. The Russian reformers were inspired by the American-style IMF-sponsored ideal of liberal capitalism, which they accepted in its entirety and at face value despite apparent contrasts in the business environment in Russia and the US. The change of the course might give an impression that Russia is turning back to the progressive marketization. While in reality, it only tries to implement a system that is compatible with the institutional set up in the country.

11. Although there are pointers, suggesting that the state-dominant capitalism might be beneficial for the current development of Russia, its presence is not evident in the country. Let us pose a number of questions to see where Russia is:

Q: is the state seriously present in the economy?

A: the fact is that the economy outside the carbon sector is not big.

Q: does the state make an effort to create a welfare state?

A: poverty, and I mean the poverty of the middle class in particular, which is a post-communist phenomenon, is a serious problem in the country; social reforms have not been implemented at any significant scale; the decline in education, health services, financing of the research are evident; there is no middle class in the country; the living standards differ dramatically between the centre and the peripheries; the inequality gap is widening; the social safety net is in disarray. I doubt that poor people would vote for the liberal reforms.

Q: is the state in control of the economy and its economic assets?

A: from the very early days of reforms the state had chosen the self-withdrawal approach that eventually created a system allowing for private gains to be achieved at the expense of the state but not through the market.

A deliberate policy of weakening the position of the state in the aftermath of the collapse of the Soviet Union was 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 that 'early retirement' by the state in the precarious circumstances of transition has its downside. The Russian business found itself deprived of basic public goods such as law and order and the trust has become a rare commodity in economic relations.

The state has foregone responsibilities as an agency that sets up benchmarks for the development and reformation of institutions. Kenneth Arrow inferred that 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. The Russian state has distanced itself explicitly from this task. Little has been done to create a competitive environment.

Our analysis of the role of the state as a shareholder brought about the evidence that the Russian state has failed to utilize its powers to bring benefit to the firms in which it has shares, to other shareholders and the shareholding culture in general. The state showed inability to determine correctly its responsibility as a shareholder and execute associated rights. It did not contribute a bit to the development of the national pattern of the effective ownership and corporate governance.

There are many industries in the Russian economy that, according to the experts are not spoiled by the attention of the state. Financial industry is one of them, although it is clear how regulatory set up is important here. The state has not assisted in the securitization of the economy and in the elimination of the dependence of the financial markets on the hot money that determines the speculative nature of the Russian financial market, its volatility and bust and boom nature.

Q: can we trust the state with its ability to build market environment and its institutions? Has the state delivered workable institutions?

A: I have serious reservations about encouraging a weak state to lead the institutionalization of the economic life. So far, it has been 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 consistently high throughout all this years of transition.

Q: is bureaucracy a sign of the state capitalism?

A: the Soviet state was notoriously over-bureaucratized and post-communist reforms have achieved little in restraining bureaucratic supremacy. In fact, the powers of bureaucracy have increased. The persistent growth in the salaries of the state bureaucracy at all levels is evident, but it did very little in reducing state corruption and bribery. Every post has its price, the average of the bribes is on increase, and it takes only five years for a state bureaucrat to afford a flat in Moscow with a \$5mln tag.

The economic powers of state bureaucrats are based on a number of premises of political, legal and economic nature. For example, a continuous dependence of a great number of enterprises, including privatized 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 create openings for bureaucratic infringements on the liberties and initiatives of economic agents. It is not surprising then that bureaucrats seek to exploit the intuitional deficiencies, to sustain their domination. The state corruption is a warning sign and the source of the societal dissatisfaction, but is it a product of the state-led capitalism?

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 institutionalization of the economic conflict that is, the creation of the market institutions, a neglected aspect of the Russian transition.

12. Putting together practical solutions to the current developmental demands 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. Some experts have noted that 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.

13. When discussing the conceptual aspect of contriving governance model of the Russian economy the selection of criteria to measure the practical value of available options must not be overlooked. 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 governance model should support the economic growth and prevent the reproduction of aberrations in business behaviour that have made the transition to the market in Russia so slow and painful so far. Why cannot it be done outside the liberal market framework? No matter what approach the state seeks to pursue, the economy will suffer if the economic environment lacks transparency and is not 'readable'. Thus, the issue for the Russian state is to engage itself more in playing the roles expected from the state in a market economy, including the critical task of defining the societally acceptable boundaries to guide business rationality.

14. The danger is not in the state-led or state-dominated capitalism but in the impotent state that tries to build a capitalist system.

ⁱ For details see: Kapelyushnikov, R., Kuznetsov, A., Demina, N. and O. KUZNETSOVA (2012). Threats to Security of Property Rights in a Transition Economy: an Empirical Perspective. *Journal of Comparative Economics*, 41(1): 245-264. DOI 10.1016/j.jce.2012.05.002.