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# Russian modernization: Between the need for new players and the fear of losing control of rent sources

Andrei Yakovlev\*

Institute for Industrial and Market Studies at HSE, 20, Myasnitskaya Street, Moscow 101000, Russia

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## ABSTRACT

This paper considers current contradictions in state–business relations in Russia. On one hand, the Russian political elite needs economic growth to keep social stability in the country and to limit mass protesting in big cities. Economic growth is impossible without investment, which explains Russian leaders' increased interest in improving Russia's business climate. On the other hand, influential interest groups (represented first of all by security and law enforcement agencies) try to expand their control on rent sources in the economy. These groups of interests could strengthen their positions due to fear of political protests. This strong conflict among different groups in the Russian elite creates additional uncertainty for investors and the business community, and can lead to economic recession independent of the level of oil prices and dynamics of global markets. Reversing these negative trends in economic development will be possible only with collective actions of different economic and political actors (including technocrats in federal and regional governments, representatives of large and successful middle-sized business and top-managers of public sector organizations) in the search for pragmatic solutions to the challenges faced by Russian economy and society.

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## 1. Introduction

Modernization of economy and society is a problem that Russia has been trying to resolve for many centuries. Moreover, there is a certain cyclic recurrence of the projects of modernization, which the Russian elite has been implementing in intervals of several decades: a regular

interchange of the policy of “modernization from above” in attempt to prepare conditions for “modernization from below”.

The Soviet experiment of 1917–1991, undoubtedly, was a large-scale project of modernization from above. Centralization and huge redistribution of human, physical, and financial resources in the framework of planned economy enabled the Soviet Union to create well-developed heavy industry, to win a victory over Nazi Germany in World War II, to make significant achievements in science and technology, and to ensure a strategic military parity with the United States. However, it became evident in the mid-1950s that the Soviet planned economy was losing competition with market economy by the criterion of living conditions of its common citizens.

The Soviet elite, constrained by ideological dogmas, found in the mid-1960s that it was unable to give adequate

\* Tel.: +7 495 628 86 49; fax: +7 495 621 76 69.

E-mail address: [ayakovlev@hse.ru](mailto:ayakovlev@hse.ru).

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answers to new challenges and preferred to postpone solutions of imminent problems. Exploration of oil and gas fields in Western Siberia in the late 1960s and a surge of oil prices in 1974 made it easy to do: the Soviet elite was able to lessen internal social pressure in the country using massive importation of consumer goods and foods, bought with proceedings from oil and gas exports.

The Gorbachev reforms in the second half of the 1980s (introduction of *glasnost*, expansion of the scale of independent decision-making at state enterprises) can be regarded as a new attempt of modernization, counting on initiative from below. However, moral degradation of the elite and deep structural imbalances, which had accumulated in preceding decades, resulted in the Gorbachev reforms actually contributing to the disintegration of the USSR and to the deepening of its economic crisis (Robinson, 1995; Sakwa, 2013).

Further reforms, implemented under Boris Yeltsin in the 1990s, led to the establishment of a market economy (although with distorted structure and stimuli). However, these reforms did not resolve the problems and gave no answer to the challenges that the country (now Russia, not the Soviet Union) had faced as early as the 1970–1980s: lack of sufficient incentives for innovation and lagging behind developed countries in terms of labor productivity and living standards.

Against this background, the economic policy of the 2000s, as I believe following some other scholars (Lane, 2008; Malle, 2013), was a new attempt of “modernization from above”, oriented towards construction of a specific Russian model of state capitalism. The concept of “vertical of power” was one of the key features of this model. It presumed centralization of management and concentration of financial resources in the hands of the Kremlin and the Federal Government. Substantial restriction of regional powers and reduction in the influence of big business on politics were logical outcomes of this policy (contrary to the situation of state capture, which had been typical of the 1990s and was analyzed in Hellman, Geraint, and Kaufmann (2003), Slinko, Yakovlev, and Zhuravskaya (2005) and other papers). This approach to modernization, perhaps, was based on inner conviction of the new Russian leaders, as well as, in a certain sense, representing a reaction to the failures of “modernization from below” that had been attempted in the time of Gorbachev and Yeltsin. David Lane defined this process as transition ‘from chaotic to state-led capitalism’ and considered it mostly positive (Lane, 2008).

However, weak points of this model became evident as soon as the mid-2000s. In particular, construction of the “vertical of power” resulted in consolidation of positions of the bureaucratic machine, which became the main social foundation of the regime after the Yukos affair (Yakovlev, 2006). Nevertheless, the interests of expanded federal bureaucracy did not coincide with the interests and goals of the top political elite. In my opinion, the economic and social development of the country became, along with satisfaction of private interests, a part of the top political leaders’ priorities. “National projects” designed for the development of education, public health, and housing, as well as infrastructure projects related to the 2012 APEC

Summit in Vladivostok and the 2014 Olympics in Sochi are examples. However, the interests of bureaucrats in the middle and lower tiers of the state machine, which was out of social control in the absence of political competition, were more focused on receiving rent from informal control over flows of financial resources.

This conflict between interests of top political elite and rent-seeking elitist groups was most apparently displayed after the global financial crisis of 2008–2009. To overcome this crisis, the Government resorted to large-scale expansion of social commitments (Simachev et al, 2009). As a result, the amount available for distribution of natural rent substantially decreased. This aggravated internal conflicts in the Russian elite,<sup>1</sup> which further increased uncertainty, a decline in capital investment, and intensive capital outflow. In other words, it became evident that the model of governance established in the 2000s was inadequate for the situation of the post-crisis world.

Recognition of this fact incentivized a search for a new model of economic development. This search was made by experts representing different flanks of the ideological and political spectrum. The new version of the “Strategy 2020”, prepared in 2011 (<http://2020strategy.ru/>), can be regarded as a collective product of the liberal part of the expert community and a reflection of views of liberally oriented elitist groups. On the contrary, policy declarations of the Izborsk Club, which was established in 2012 (<http://www.dynacon.ru/>), are a reflection of views of the conservative wing of the Russian elite.

It is worth pointing out that the choice in favor of one or another model has not yet been made in the real economic policy. In her recent papers Silvana Malle (2012, 2013) provided very detailed analysis of the main features and contradictions of Russian economic policy after the global financial crisis of 2008–2009. We are going to try to supplement this analysis, using new approaches of institutional economics and centering on a single, although very important, aspect: the change in relationship between the state and business after the crisis of 2008–2009, particularly since 2011.

## 2. New business climate policy and concept of ‘limited access orders’

The fact that business conditions in Russia are unfavorable has been discussed for a long time (see Golikova, Gonchar, Kuznetsov, & Yakovlev, 2007; Hellman et al., 2003; Kuznetsov & Kuznetsova, 2003; Puffer, McCarthy, & Zhuplev, 1998; Yasin, Grigoriev, Kuznetsov, Danilov, & Kosygina, 2006, etc.). However, Russian authorities recently began to make visible efforts to change the investment climate. Thus, in February 2012, Vladimir Putin announced the 100 steps program, which is aimed at

<sup>1</sup> A striking example of such a conflict was a “public discussion” between Vladislav Surkov, vice-premier of the Government of the RF, and General Vladimir Markin, spokesman of the Investigative Committee, related to an investigation of financial improprieties in the innovation center “Skolkovo” – see <http://www2.lse.ac.uk/newsAndMedia/videoAndAudio/channels/publicLecturesAndEvents/player.aspx?id=1880> and <http://izvestia.ru/news/549923#ixzz2SZZv1O2z>.

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