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Russian Journal of Economics 2 (2016) 41–55
Russian Journal of Economics
www.rujec.org

In the absence of private property rights: Political control and state corporatism during Putin's first tenure

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Abstract

This paper argues that Russia's choice of economic organization, which is based on the renewed role of the state, is a response to the existence of severe transaction costs, and subsequent mitigation of contractual incompleteness in the absence of a strong property rights system. Ill-defined property rights have historically hampered formation of business classes in Russia, reducing the necessity for appropriate market infrastructure. This also implied that if Russia's political and economic system had more than one competing hierarchy, the objective of the elites would not have entailed long-term economic growth, as gains from short-term wealth tunneling would have been much larger. As in the early 2000s Russian investment projects were generally defined by large sunk costs and long-term to maturity, under a weak legal system a new substitute governing mechanism, which took form of the state–private co-partnership system, has arisen in order to reduce hold-up costs leading to high levels of underinvestment.

JEL classification: P21, P26, P37
Keywords: state corporatism, industry growth, property rights, Russia.

1. Introduction

A sharp turnaround in *laissez-faire* policies of the 1990s under the new regime in the beginning of the new millennium resulted in a renewed political control of the central state. The decision-making power of regional offices was transferred back to the federal government under the "vertical flow of power" rule

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Peer review under responsibility of Voprosy Ekonomiki.

http://dx.doi.org/10.1016/j.ruje.2016.04.003
2405-4739/

(Bahry, 2005; Tompson, 2005), while political influence of the quasi manager-owner group, also known as the oligarchs, was significantly curbed (Goldman, 2003). Recently emerged political party competition, which thrived under Putin's predecessor's administration, was reduced to a handful of participants, where the central government's party, United Russia, secured an overwhelmingly dominant position (Gel'man, 2008; Reuter and Remington, 2009).

One of the most noteworthy effects of the strengthened role of the central state was its renewed governing presence in major Russian corporations (Chernykh, 2011; Vanteeva and Hickson, 2016). However, the idea of "Russian state corporatism," a development often associated with the new political regime of the 2000s (Lane, 2000; Hanson and Teague, 2005), can be persistently found throughout Russia's long-standing tradition of autocratic rule. For example, Gerschenkron's catch-up theory stresses the important role of the government in channelling investment funds to targeted industries towards the end of the 19th to early 20th century, when tsarist Russia exhibited a higher degree of economic backwardness compared to that of its European counterparts (Gerschenkron, 1962). In the absence of vital prerequisites, such as advancement of technology, skilled labor and availability of domestic capital, the new finance minister, Sergei Witte, advocated a policy which focused on direct state intervention (Willis, 1897; Tompkins, 1933; Drummond, 1976; Gatrell, 1994).

More recently, one can observe the degree of state involvement in Russia's economy during the last century summarized in Table 1. In period 1 the otherwise revolutionary Soviet regime adopted a centralized state economy through its successive five-year plan, organizing the economy on a strict hierarchal system, abolishing private property and introducing central planning (Ericson, 1991). The strategy was somewhat successful in promoting capital and total factor productivity growth (the latter having an average growth rate of 1.15 over the 1928–1970 period[1]), until the final phase of the regime witnessed product shortages attributable to managerial and local bureaucratic corruption (Kramer, 1988).

The perestroika (period 2) experimented with market-oriented policies, in order to reduce inefficiencies associated with central planning, thus allocating discretionary decision-making power to regional officials. The government also hoped to generate an incipient privately owned sector. In 1988, the Law on Cooperatives allowed private ownership in non-strategic economic sectors such as services, manufacturing and foreign trade, but the expected increase in private firm formation proved unsuccessful due to the predatory behavior of local bureaucrats. As is generally known, Mikhail Gorbachev's initiatives led to economic disaster due to the loss of central government control over economic conditions (Boettke, 1995).

The privatization program, introduced under Boris Yeltsin (period 3), resulted in the *de facto* ownership of shares by former state enterprise insiders (Alexeev, 1999; Filatotchev et al., 1999; Black et al., 2000), who were able to trade and liquidate firms' assets. The period was thus characterized by extensive wealth diversion through asset-stripping, leading to disinvestment and ultimate capital flight,

[1] The mature Soviet central-state system (between 1928 and 1985) mandated the mix and quantity of all manufactured goods, and all output was allocated by fiat, when the state was directing the available resources to where it considered they were most needed (as predicted by Trotsky, 1925). The regime also set all managerial salaries (Leeman, 1963).