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# Russian transformative state capacity : a comparative study of corporate law reform.

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RUSSIAN TRANSFORMATIVE STATE CAPACITY  
A COMPARATIVE STUDY OF CORPORATE LAW REFORM

A Thesis Presented

by

WALTER P. THÖRNER

Submitted to the Graduate School of the  
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Political Science

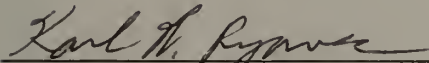
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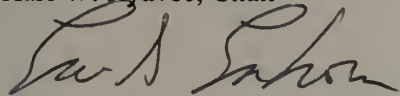
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## CHAPTER 1

### INTRODUCTION

As the New Russia proceeds on its post-communist path towards the attainment of liberal order, Western-style legal institutions increasingly replace their communist predecessors. The changes made to the Russian legal system during the past decade have been both fundamental and far-reaching. They include the passage of legislation and provide a framework for the creation of private legal entities and for the carrying out of commercial transactions. Institutions commonplace in Western industrialized market economies have been created, such as commissions dealing with antitrust, bankruptcy and securities. To be sure, a full listing of the reforms thus undertaken would be prohibitively long. As these developments continue, the Russian government is taking up the role of chief reformer pushing the agenda of *restructuring* by proposing sets of norms premised on liberal values. However, even though major steps have been undertaken towards the building of a modern institutional infrastructure, deficiencies in created devices are pervasive. Indicative is the tendency for Russian entrepreneurs to exercise conspicuous restraint towards recently legislated concepts. Entrepreneurs cling to defensive business strategies that circumvent official policy beyond the reach of legal accountability.<sup>1</sup> Appropriated strategies range from the revitalization of Soviet trading networks to straightforward criminal activities. An emerging anti-legal subculture is attested, which

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<sup>1</sup> See, for example, Hendley, Kathryn and Cheryl Gray. 1997. "Developing Commercial Law in Transition Economies: Examples from Hungary and Russia," in *The Rule of Law and Economic Reform in Russia*, pp.139-165.

supplants official policy with illicit business practice.<sup>2</sup> The formation of shadowy control structures antithetical to free market institutions calls into question the capacity of the Russian polity to undergo transformation in the direction of a democratic and law-governed market economy.

What are the institutional reasons for this type of apparently low transformative state capacity? The range of possible explication ranges from technical approaches focusing on the dysfunctional state of law enforcement agencies to more comprehensive accounts of state-societal relations.<sup>3</sup> Within the latter stream of theorizing, a popular approach is to characterize transitional processes in terms of traditional Russian state authority.<sup>4</sup> In these accounts, deficiencies in outcome optimization have been ascribed to the autocratic style of politics under President Boris Yeltsin. It is the goal of the present study to examine the latter suggestion by inquiring into the institutional bases of Russian reform politics. Accordingly, the question is raised as to what extent the Yeltsin Presidency did in effect duplicate culturally established patterns of autocratic governance in the coordination and control of economic reform policy? In addition, the question of how autocratic-style governance would infringe upon the principled purpose of reform, namely to design and implement liberal types of economic order is addressed. In this respect, the present study proceeds along the hypothetical base line that there is in fact a

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<sup>2</sup> See, for example, Volkov, Vadim. 1999. "Violent Entrepreneurship in Post-Communist Russia," *Europe-Asia Studies*, Vol.51, No.5, pp.741-754.

<sup>3</sup> See, for example, Brovkin, Vladimir. 1998. "Fragmentation of Authority and Privatization of the State: From Gorbachev to Yeltsin," *Demokratizatsiya*, Summer, pp.504-517.

<sup>4</sup> See, for example, Shevtsova, Lilia. 1999. *Yeltsin's Russia: Myths and Reality*. Washington, DC: Brookings; Fish, M. Steven. 2000. "The Executive Deception: Superpresidentialism and the Degradation of Russian Politics," in *Building the Russian State*, pp.177-192.



structural correlation between the variables of institutional arrangement and the capacity to transform embedded social behaviors.

To examine these issues this study engages in a comparative analysis of the two regimes in question, the Romanov dynasty, on the one hand, and the Yeltsin Presidency, on the other. To analyze the extent of convergence, the study focuses on institutional variables governing participation in policy choice. Structural features deemed relevant to this process extend to both organizational dimensions of government, inter-branch and interface. In this way specified categories emerge more clearly within the process of analyzing corporate law reform. As the ensuing discussion will make clear, both periods encountered in this context substantial obstacles to formulating and conveying a coherent corporate governance regime upon the sociological field of transformation. The discourse will begin by discussing the theoretical underpinnings of institutional development. Utilizing an engineer-like perspective, inquiry is made into the strands of institutional theory. Particular attention is paid to the issues of participation and interaction in order to present an ideal-typical model of institutional development on the basis of which the analysis of the Russian case will be pursued.

## CHAPTER 2

### INSTITUTIONS: THE THEORETICAL DISCOURSE

Making an inquiry into the concept of institutions might be best described in terms of the metaphorical undertaking of opening the "black box." By examining the pertaining research literature, it becomes obvious that multiple theoretical styles have been designed to provide answers to the question of what institutions are, what institutions do, and how they originate and change. So far, it appears that the project of disclosing the "locked up" subject matter is still unfolding since new variables and theoretical styles surface along the process. Accordingly, much of the academic debate focuses on the meta-question of which methodological approach might unveil the tectonic laws of institutions. Neo-traditional or "soft" styles contend in this way with behavioral or "hard" styles of theorizing.<sup>5</sup> The behavioral approach, however, somewhat dominates the scenery. Neo-traditional approaches are dismissed as "soft story-telling" while behavioral styles of theorizing, utilizing the methodological basis of rational choice theory, claim to provide institutional analysis with universal laws. The universalistic ambition of behavioral styles derives from its distinctive methodological approach that, as such, is widely considered incompatible with previous modes of inquiry. While "traditional" studies usually presumed an order based on macro-level processes as culture, history, the political system, or the like; contending behavioral styles put an emphasis on micro-level

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<sup>5</sup> For a critical overview, see Green, Donald P. and Ian Shapiro. 1994. *Pathologies of Rational Choice Theory: A Critique of Applications in Political Science*. New Haven: Yale University Press; Rothstein, Bo. 1996. "Political Institutions: An Overview," in *A New Handbook of Political Science*, pp.133-166; Taylor, Rosemary C. and Peter A. Hall. 1996. "Political Science and the Three New Institutionalisms," *Political Studies*, Vol. XLIV, pp.936-957.

processes of strategic action. As a result, distinctive and eventually mutually exclusive aspects of institutional "realities" get specified ranging from descriptive to explanatory levels of analysis. The academic community, so it seems, has been more successful in laying out a variety of methodological routes leading to the study of institutional phenomena, rather than producing an empirically validated outcome. In contemplating the logic of contending theoretical styles, the question, which approach might deliver the better key regarding the description, explanation, or even prediction of modern institutions, is still open.

The following discourse aims to shed some light onto the dominant strands of institutional analysis. The inquiry differentiates, following the suggestion of Taylor and Hall,<sup>6</sup> into rational-calculative, normative-cultural, and eclectic styles of institutional analysis. The study concentrates in this respect on the latter theoretical stream that is commonly referred to as the historical variant of institutional analysis. This theoretical style will be examined according to its capacity to provide definitions, descriptions of institutional effects, and explanations of institutional origin and change. Definitions and schemes of institutional effects, it is noted, often fall into the same category since institutions are usually defined in terms of their effects on human behavior.

### Eclectic Styles

One of the seminal texts striving to bridge interdisciplinary barriers has in this respect been rendered by Douglass North's (1990) *Institutions, Institutional Change, and Economic Performance*, a distinguished student of economic history, which integrates

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<sup>6</sup> Taylor & Hall, 1996.

culturally conditioned modes of behavior into a framework of rational decision-making. The reconstruction of this approach will be amended with insights deriving from another seminal text concerning commercial law institutions, as rendered by Max Weber's (1954) *Economy and Society*.<sup>7</sup>

The starting point of this style of theorizing represents the modification of the micro-foundations of rational choice theory.<sup>8</sup> This step occurs on the basis of empirical data provided by cognitive psychology, whereby it is demonstrated that the behavioral context of strategic action underlies the impact of incomplete knowledge and limited computational capacities. Strategic actors, contrary to rational choice assumptions, are described as computing information pertinent to choice incompletely and normatively biased, instead of reaching decisions instantaneously. Consequently, a gap, labeled "CD gap" in the technical jargon, is found to penetrate the field of human action, which discriminates between the competence [C] of the agent in deciphering problems, and the difficulty [D] in selecting the most preferred alternative.<sup>9</sup> The epistemological dilemma unfolds that the objective situation of choice and its subjective representation in the

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<sup>7</sup> This study utilizes the annotated and selective version of Max Weber's *Economy and Society* edited by Max Rheinstein who focuses on the legal aspects of Weber's text. The title of the edited version accordingly reads: *Max Weber on Law in Economy and Society*. 1954. Edited with introduction and annotations by Max Rheinstein. NY: Simon and Schuster. Rather than list the name of the editor (Rheinstein), this paper quotes the original author (Weber) in order to simplify the quotation process.

<sup>8</sup> Rational choice theory pictures human actors as strategic agents who structure their agency according to the overwhelming imperative of self-interested utility maximization. Utility functions are defined in terms of individually perceived preferences, which are presumed to be stable, transitive, exogenous to choice, and egoistic in bias. -- Picturing human nature as intrinsically egoistic has sparked off a flurry of critical literature showing discomfort with these kinds of "reductionist" (Peters, 1996, pp.216f) assumptions. The specific variations of these critics are, however, beyond the scope of this inquiry. For further details concerning the debate about the behavioralist assumptions of rational choice theories see D. Green and Shapiro (1994).

<sup>9</sup> See Ronald Heiner. 1983. "The Origins of Predictable Behavior," *American Economic Review*, Vol.73, pp.560-595, quoted in North 1990, pp.23f.

decision-maker's mind are not identical. Accordingly, the proposition is made that "we" have to distinguish between the real world and the decision-maker's perception of it.<sup>10</sup>

Culture is entering the equation by providing a language-based conceptual framework for encoding and interpreting the information that the senses are presenting to the brain. By drawing upon evolutionary theories, it is posited that the organization of knowledge, values and other factors influencing behavior is contingent upon cultural inheritance. Culture itself is defined as the "transmission from one generation to the next, via teaching and imitation, of knowledge, values, and other factors that influence behavior."<sup>11</sup> Within this context, "culture" denotes a multifaceted composite of procedural and normative concepts that become effective in the framework of institutional analysis. Procedural concepts include the notion of "cultural processing" and "social transmission;" whereas "behavioral norms" and "internal codes" describe normative aspects of "culture."<sup>12</sup>

Due to the theoretical challenge posed by the event of CD gaps, the inquiry focuses on procedural concepts of culture and particularly the concept of "cultural processing"<sup>13</sup> in order to design an integrative approach towards institutional analysis. Cultural processing of information signifies the central modus operandi for encoding and

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<sup>10</sup> North, 1990, pp.23ff.

<sup>11</sup> R. Boyd and P.J. Richerson. 1985. *Culture and the Evolutionary Process*. Chicago: University of Chicago Press, p.2, quoted in North, 1990, p.37.

<sup>12</sup> Normative concepts of culture comprise a composite of culturally embedded "informal rules" and abstract value-sets. Informal rules consist of "modifications" of formal rules, socially sanctioned "behavioral norms" and internally enforced "codes of conduct" (see definition below in section "formal and informal rules"). As a result, informal rules, like abstract values, constitute an integral part of a society's cultural heritage, whereas culture itself does not merely consist of informal rules.

<sup>13</sup> North, 1990, p.44.

interpreting information in the human brain and thus renders the constitutive momentum in the creation of mental constructs. Culture endows the individual agent with a language-based conceptual framework within which to organize, utilize, and process information. The capacity to communicate with the world and to participate in exchange situation is related to cultural endowments. The formula of "cultural processing" subsumes the condition that decision-making proceeds on the basis of subjective mental constructs, which are subject to culturally derived scripts. Cultural processing of information then influences the structure of institutional entities since institutions are constructs of the human mind. In this way, it is concluded, "culture defines the way individuals process and utilize information and hence may affect the way institutional constraints get specified."<sup>14</sup>

It is noticed that this perspective on institutional development aligns cultural styles of institutional analysis by emphasizing procedural aspects of human existence in the description and explanation of institutional constraints. The common denominator is that meaning and identity are conditioned by procedural concepts of information. To be sure, cultural styles of analysis put primacy on the political that manages meanings and identities through "the symbolism of the decision-making process,"<sup>15</sup> whereas North puts primacy on cultural processing of information. Both approaches, however, utilize procedural concepts of information to provide contending accounts of the

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<sup>14</sup> North, 1990, p.42.

<sup>15</sup> March, James G. and Johan P Olsen. 1984. "The New Institutionalism: Organizational Factors in Political Life," *American Political Science Review*, Vol.78, pp.734-749, here at page 49.

interrelationship of mental constructs, preferences, and institutional constraints. The cultural pattern of causation, however, is more sympathetic towards the ideals of individual freedom since it does not consider cultural homogeneity or the technique of political indoctrination as imperative. On the contrary, North renders a less rigid pattern of causation by leaving the exact nature of the transmission mechanism that links cultural macro-level processes with micro-level mental constructs inconclusive. As North concedes: "We still are a long way from having any neat models of cultural evolution."<sup>16</sup>

The inquiry, however, aligns the perspective of rational-calculative styles by demonstrating that institutions are the product of utility-maximizing strategies. Strategic actors, confronting the event of CD gaps, are pictured as designing institutions as a rational and utility-maximizing strategy in response to both: "the complexity of the problems to be solved and the problem-solving software (to use a computer analogy) possessed by the individual."<sup>17</sup> Rules and procedures evolve to simplify the uncertainties involved in human interaction. Institutions exist to reduce complexity of human cooperation by limiting the choice sets of the actors. As a result, a way out is managed to verify the basic behavioral postulate of rational choice theory, namely, that human actors act in a rational-calculative manner and that institutions are the product of strategic interaction. Social agents are understood to act strategically because they realize the need to devise institutional constraints in order to avoid the costliness of information deriving from latent existing CD gaps.

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<sup>16</sup> For "some interesting attempts," North (1990) refers to the works of Cavalli-Sforza and Feldman, 1981; Boyd and Richerson, 1985.

<sup>17</sup> North, 1990, p.25.

Formal and informal constraints. Institutions, due to the culture-integrative approach, are differentiated into patterns of constraints that are "informal" and "formal" in character. Before getting into details, caution is advised regarding the domain of the "informal" since, deriving from North's text, the "informal" renders a network of conceptual linkages that, as such, escape strictly linear-causal modes of thought. As the following will testify, the "informal" is approached via the concepts of "culture," "mental constructs," and "behavior." It is emphasized that North does not provide a simple formula for ways to convey these concepts into a transparent order.

North defines "informal rules" in terms of (1) extensions, elaborations, and modifications of formal rules, (2) socially sanctioned norms of behavior, and (3) internally enforced codes of conduct.<sup>18</sup> (Formal constraints, on the other hand, provide order by means of formal-legal structures.) Each aspect of informal rules is elaborated with the aid of empirical examples.

1. According to the first definition, informal rules denote "extensions, elaborations, and modifications of formal rules." To provide an example, North invokes the case of congressional committee power that evolved from its constitutionally specified task to deal with specific problems of exchange. Committee chairs and members became endowed with a degree of bargaining power over legislation that cannot be derived from the formal-legal structure alone but denotes an integral underpinning of unwritten and customized rules. These unwritten rules, however, did evolve as a complementary structure in support of the constitutionally specified task.

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<sup>18</sup> For details, see North, 1990, p. 40.



2. To illustrate socially sanctioned norms of behavior, North provides the example of Alexander Hamilton's decision to engage in a duel. As North vividly describes: "The night before he was to engage in the duel with Aaron Burr, Alexander Hamilton sat down and wrote out all the reasons why he should not accept this challenge; a crucial one, of course, was that he was likely to get killed. Yet, in spite of the overwhelming rational basis for not dueling, he felt that his effectiveness in the public arena would be significantly diminished by such a decision because dueling was the accepted way to settle disputes among gentlemen. Social norms dictated the choice, not formal ones."<sup>19</sup>

3. The first two types of informal constraints, that North describes, can be modeled in the context of wealth-maximizing strategies and lend themselves to treatment in game theory frameworks. Accordingly, rational-calculative styles of theorizing are singled out as providing a viable basis for inquiring into the first two cases of informal rules, since rule compliance and institutional design are deducible from wealth-maximizing strategies. Internally enforced codes of conduct, on the other hand, describe situations "when the individual gives up wealth or income for some other value in his or her utility function."<sup>20</sup> In this context North points to the example of legislator's voting behavior, which is not sufficiently explained by interest group models. The analysis of voting behavior by legislators is deemed to recommend the inclusion of subjective preferences and value-systems into the research agenda. Within the class of informal rules, internally enforced codes of conduct, motivations that represent a distinctive

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<sup>19</sup> Ibid.

<sup>20</sup> Ibid.

category, approximates the universal foundation of cultural values by transcending the narrow margins of economic self-interest and strategic interaction.<sup>21</sup>

Approaching informal rules within the context of strategic interaction raises the question of what might render the distinctive quality of the class of informal constraints. Formal and empirical informal rules, concerning the class of behavioral norms and so-called "extensions" of formal rules, follow the same path of origination.<sup>22</sup> Behavioral norms, as integral elements of a society's cultural heritage, are seen as emerging from micro-level interactions.<sup>23</sup> Rational decisions of strategic actors transform over time into habituated forms and stabilized attitudinal matrices. Both types of rules, as previously mentioned, are deducible from wealth-maximizing strategies that, like formal rules, mirror the action-specific context of power and interest. Some confusion results from the behavioral approach to informal rules since the theorem of strategic interaction was formerly reserved for "hard" types of theorizing that denounced the significance of cultural variables. As North indicates himself: "The difference between informal and formal constraints is one of degree. Envision a continuum from taboos, customs, and traditions at one end to written constitutions at the other."<sup>24</sup> Both types of constraint

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<sup>21</sup> North (1990, p.40) refers at this instance to the article of Kalt, Joseph P. and Mark A. Zupan. 1984. "Capture and Ideology in the Economic Theory of Politics." *American Economic Review*, Vol.74, pp. 279-300.

<sup>22</sup> This argument spares the category of internally enforced codes of conduct, as more transcendental values in general, whose path of origination is insufficiently clarified from an empiricist standpoint. North focuses in his inquiry on the category of behavioral norms since they are more conducive to empirical observation and therefore rational-calculative modulation, whereas non-wealth-maximizing values are difficult to analyze.

<sup>23</sup> North, 1990, p.87; Weber, 1954, p.68.

<sup>24</sup> North, 1990, p.46.

derive (to a certain extent) from utility-maximizing strategies and serve equally (at the empirical level) the function to reduce complexity in human interaction.

Informal rules, it is suggested, differ from formal ones with respect to their origination and transmission. "Where do informal constraints come from?" asks North.<sup>25</sup> He himself gives the answer: "They come from socially transmitted information and are part of the heritage we call culture."<sup>26</sup> The central qualification of informal rules is that they are part of a society's cultural heritage and that they have been socially transmitted. What, however, is North referring to when he mentions that informal rules are socially transmitted information? The term "informal" within this equation signifies the transmission mechanism by means of which norms are learned and disseminated. This qualification emerges more clearly from Weber's text where "conventional" (in the sense of socially sanctioned norms of behavior) become specified with respect to the "sociological structure of coercion."<sup>27</sup> While the modern state apparatus has the capacity to ensure the systematic transmission of legal norms by force of its bureaucratic support structure, social transmission characterizes the absence of this very transmission mechanism. Freedom from bureaucratic coercion, however, does not obliterate social control. As Weber emphasizes, informal rule derogation is sanctioned by the social context, even though a permanently staffed organization to implement coercion is absent. As a result, it is mainly with respect to the means of coercion that the normative realms of

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<sup>25</sup> North, 1990, p.37.

<sup>26</sup> Ibid.

<sup>27</sup> Weber, 1954, pp.20-33.

society and state-bureaucracy differ. Instead of guaranteeing rule transmission by the threat of coercive force, social transmission of rules follows the imperative of cultural inheritance.

### Institutional Effects

Lowering transaction costs. The effect of institutions on human behavior describes the concept of transaction costs.<sup>28</sup> Institutions (formal and informal) lower transaction costs because they provide a mechanism for enforcing contractual agreements. Due to the eclectic structure of the approach, institutional effects are sorted out between formal and informal constraints.

Informal constraints. Informal constraints are modeled to lower transaction costs when self-interested agents perceive subjectively felt incentives to live up to the terms of contract. Integral to this approach is the notion of contractual self-enforcement. Informal rules are pictured as substituting for a system of bureaucratic coercion when the parties to the exchange share the belief or perception that it is in their interest to impose informal constraints on their conduct, regardless of the absence of a sophisticated (third-party) enforcement structure. Thus, contracts are self-enforcing when human actors are convinced that informal rules render a viable framework for contract performance. Consequently, the question arises, under what conditions are strategic actors likely to

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<sup>28</sup> Transaction costs are understood to represent the composite of information and enforcement costs. Information costs result from the measurement of valuable attributes of exchanged goods, while enforcement costs arise from the implementation of reached agreements. While the above already discussed the utility of institutions based on the occurrence of information-related contingencies, the ensuing discussion emphasizes the costs of enforcing transactions.

accept the viability of informal rules for structuring incentives in social, economic, and political exchanges.<sup>29</sup>

Informal rules are likely to structure incentives in human exchanges when the context of action rewards such agency. North focuses on the number of the parties to the exchange and the evolution of a dense network of social interaction. He postulates that incentives for cooperative behavior most likely derive from the circumstance in which the parties to the exchange have a great deal of knowledge about each other and are involved in multiple transactions. The development of the Law Merchant renders a paradigmatic example of economic history for such a system of self-enforcing norms.<sup>30</sup> This process started out in medieval Western Europe when merchants from the Mediterranean, the Germanic and Baltic region were meeting at the great international fairs along the main routes through Europe. Through evolving business practice, the mercantile community then devised a cosmopolitan body of rules governing transactions outside the official jurisdiction of the kings. Leading in this development were Italian merchants who spread the technology and pertinent rules of credit, including the techniques of negotiable

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<sup>29</sup> To be sure, "contracts" and "informal rules" are not the same. The term contract (North, 1990, p.53) stands here for the different (empirical) ways exchanges get organized, "whether through firms, franchising, or other more complex forms of agreement that extend in a continuum from straightforward market exchange to vertically integrated." Informal rules, on the other hand, stand for a heterogeneous set of normative constraints ranging from empirical phenomena as "habits" to internally enforced codes of conduct that involve transcendental qualities (see definitions above). In this way, it is possible for informal rules to deliver an endogenous support structure for contract performance without necessarily specifying the concrete form of conduct. However, the issue remains somewhat ambiguous since North employs both terms simultaneously without drawing a clear distinction.

<sup>30</sup> The "Law Merchant," according to W. Mitchell (1969) characterizes "a body of rules and principles relating to merchants and mercantile transactions, distinct from the ordinary law of the land. Possessed of a certain uniformity in its essential features, it yet differed on minor points from place to place." Additional features are its evolutionary character, based on evolving patterns of business practice - creating his "laws out of his own needs and views," its emphasis on "speedy justice" and "equity" in social relations, as well as its international scope (Mitchell 1969, pp.10ff.). See also Harold J. Berman (1983, pp.332-356) and James M. Murray (1999).

instruments, bills of exchange and promissory notes throughout Western Europe. Enforceability appeared to have its beginnings in the development of internal codes of conduct in fraternal orders of guild merchants; those who did not live up to them were threatened with ostracism. The conception that dense social networking provided for contractual self-enforcement in the case of medieval merchant practice is re-stated within other discourses of economic history. Lowry, for instance, argues that formerly, it was the "protective shell" of a close-knit fraternity of international merchants that mobilized the necessary quantum of trust and cooperation in order to secure the development of advanced forms of credit.<sup>31</sup>

By invoking conceptions of "internal codes," "fraternal orders," and lastly the image of "protective shell," the previously described action context involves both behavioral and transcendental elements. As a consequence, one may question to what extent the behavioral structure of exchange might actually be shaped in the image of overarching belief-systems, or vice versa. The hypothetical case has to be accounted for that the group of economic actors may actually constitute a "community of believers" that emulate (by intentional design or accidentally) certain transcendental principles in the organization of exchange. Besides North, other accounts of economic history are more explicit on this point by demonstrating that certain belief-systems exerted a positive influence on economic development and the flourishing of commerce in particular. Thus, the case is presented that certain hard-to-measure beliefs might eventually be the central criterion for making informal rules effective and contracts self-enforcing. Evidence for

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<sup>31</sup> Lowry, 1979, pp. 246ff.

such type of reasoning accrues from Weber who demonstrates that merchants were formerly associated in so-called "cult-communities"<sup>32</sup> that operated under the protection of their special patron god. Merchants of early Republican Rome, for instance, recognized Mercury as their patron god. Characteristic of such fraternally organized societies was the obligation to come to mutual aid in emergencies and the observance of cult meals. Berman, on the other hand, emphasizes that only the firm belief in the future of the mercantile community made it possible to circulate various forms of credit in the absence of legal guarantees.<sup>33</sup> Trade in negotiable instruments without guaranteed state enforcement is seen to reveal a strong belief in both the integrity and future of the community to which all debtors and creditors belonged. Within this action context, individual self-interests merge into a transcendental super-structure that makes informal norms effective. Contracts are self-enforcing because certain beliefs play an important role in the incentive structure of human actors.

Leaning towards "hard" types of theorizing, North subsumes "interest" and "incentive" for contract performance under the umbrella of wealth-maximizing strategies.<sup>34</sup> Clearly, North abrogates any ambition that would undermine the micro-foundations of rational choice theory. In contrast to the previously hypothesized institutional scheme, North argues that beliefs and internally enforced codes "function" as strategic devices to lower transaction costs. Belief-systems, instead of representing values

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<sup>32</sup> Weber, 1954, p.171; See also *The Protestant Ethic and the Spirit of Capitalism*. 1992. Translated by T. Parsons. London and New York: Routledge.

<sup>33</sup> See, for example, Berman, 1983, pp.338-51.

<sup>34</sup> North, 1990, p.56f.

in their own right, become operational because they are perceived as rendering enforcement mechanisms in a wealth-maximizing action context. The notion that human actors embrace certain beliefs out of instrumental utility in order to maximize individual wealth is central to this perspective.<sup>35</sup> Internal codes and beliefs are thus understood to derive ultimately from material interests in the service of personal material wealth-maximization, as expressed in the following statements: "Frequently the exchange is set within a context of elaborate rituals and religious precepts to constrain the participants."<sup>36</sup>

Under what conditions will contracts tend to be self-enforcing? In a wealth-maximizing world, the answer can be stated very simply. Contracts will be self-enforcing when it pays the parties to live up to them..."<sup>37</sup> To stipulate whether "it pays" to make informal rules effective, North calls special attention to the behavioral factor of "iteration." The foundations of this type of reasoning are rendered by game theoretic research and in particular the seminal text of Robert Axelrod (1984) *The Evolution of Cooperation*, which emphasizes the concept of iteration for inducing cooperative strategies. The prospect of iterated "games," it is argued, projects a "shadow of the future" on uncooperative strategies. Gains from iterated cooperation exceed the profitability of "running off with the profits." As a result, it depends on the utility-maximizing calculus

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<sup>35</sup> It is noted, however, that this conception of the transcendental or what was formerly referred to as cultural endowments contradicts North's assumption (see 3<sup>rd</sup> definition of "informal rules") that internal codes may not be modeled by means of wealth-maximizing or game theoretic strategies. In addition, North seems to vacillate between two diverging conceptions of internally enforced codes of conduct. At one instance he emphasizes the "importance of self-imposed codes of behavior in constraining maximizing behavior in many contexts is also evident (1990, p.43)." On the other hand, he emphasizes that it would be "prohibitive" to rely on a "purely voluntary system of third-party enforcement" in an environment marred by the uncertainties of impersonal exchange characteristics (1990, p.58).

<sup>36</sup> North, 1990, p.35.

<sup>37</sup> North, 1990, p.55.



of the individual entrepreneur and his perception of the strategic action context in order to stipulate whether contracts will be self-enforcing.

Formal constraints. Formal constraints are modeled to lower transaction costs when economic actors are in the position to resort to bureaucratic coercion to ensure contract enforcement. North applies in this context the formula of *impersonal exchange* in order to discuss a type of economic interaction where contracts are obviously not self-enforcing.<sup>38</sup> According to this model, it is very unlikely that the parties to the exchange perceive incentives to live up to the terms of contract with respect to both the strategic and cultural contexts of action.

The strategic action context of impersonal exchange advises the introduction of bureaucratic coercion into contractual relations in order to ensure contract enforcement. Impersonal exchange describes an action context where iteration rates of exchange are uncertain and where the parties to the exchange have only incomplete and asymmetric access to information. This includes the attitudinal matrix of the exchanging parties and the valuable attributes of exchanged goods, as well. Exchanges are complex and highly contractual.<sup>39</sup> The level of contracts, on the other hand, correlates with the degree of specialization to be met in an economy. The greater the specialization and the number and variability of valuable attributes, the more crucial is the availability of institutions that

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<sup>38</sup> North, 1990, pp.12, 34, 55-58.

<sup>39</sup> The significance of contract is echoed in S. Todd Lowry's account. He argues that contractual agreements denote "the" device structuring future economic activities. Lowry contends that contracts are "individualized systems of economic planning" that create future rights disassociated from the necessary present existence of either the goods or money as the substance of exchange (S. Todd Lowry, 1979, pp.243-60). Lowry further argues: "In this very real sense, contract is an instrument of economic planning which permits individuals to organize the enforceable commitments (raw materials, labor, marketing) requisite for complex economic undertakings. Without the legal sanction of private contract, economic planning would be limited to the patterns structured by custom ... or independently controlled resources" (Ibid., p.253).

allow individuals to engage in complex contracting. Thus, the higher the degree of complexity in economic exchange measured in terms of contractual settings, the greater the imperative to devise formal constraints becomes. As a result, it obviously does "not pay" to make informal rules effective within the strategic action context of impersonal exchange. In the context of a wealth-maximizing world, where there are high costs of measurement and where it is ambiguous whether economic actors feel the subjective incentive to live up to their contractual agreements, the gains from cheating and renegeing are likely to exceed the gains from cooperative behavior. Impersonal exchange, then, anticipates the availability of coercive enforcement, usually denoted in the person of the state, in order to ensure contract fulfillment. As a result, the concern for the probability of third-party enforcement in business affairs, as Weber acknowledges, is "considerable."<sup>40</sup>

Weber's text, providing a contrasting scheme to strictly behavioral modes of analysis, opens a cultural perspective on the action context of modern exchange relations. Underlying is the conception that legal development is conditioned upon power and perception. In the modern context of strategic action, formal rules, according to Weber's ideal-typical study, represent legitimate stimuli for business practice when they have been derived from abstract principles via formally correct and logically consistent interpretation. The focus rests on formal-rational processes of reasoning. Relevant key words denote the Weberian concepts of "formal legal rationality" and "bureaucratic domination." The vision field of socio-political actors is pictured to converge around a common set of basic understandings, which emphasize the rational capacity of the

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<sup>40</sup> Weber, 1954, p.71.

individual as epitomized by categories of calculability and self-interest.<sup>41</sup> The ultimate belief in the "legality" of abstract rules and the appropriateness of "rational" conduct in human exchange anticipates that human life has entered a stage of cultural development where social actors (in an ideal-Weberian sense) recognize the "sanctity" of legal-rational rules of conduct. Expanding contractual relations represent the increase of anonymity and the breakdown of former traditions of fraternal standards of performance and enforcement.<sup>42</sup> It is understood that disintegration of former standards of performance, evolving from the realm of commerce, prompted the need for an integrated system of legally enforceable norms.

Both authors, however, acknowledge that the real world situation of exchange might deviate somewhat from the described categories. "Looking only at the formal rules themselves, therefore, gives us an inadequate and frequently misleading notion about the relationship between formal constraints and performance."<sup>43</sup> On the contrary, as North elaborates: "I have stated, of course, an extreme form of impersonal exchange, because in the real world, whether present or past (where impersonal exchange did occur to a degree), we find all kinds of mitigating circumstances by which parties attempt to assure compliance."<sup>44</sup> One of those mitigating "circumstances" render voluntary organizations that make informal rules effective by lowering information costs about market participants as, for instance, better business bureaus, credit, and insurance rating agencies.

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<sup>41</sup> See Weber, 1954, pp.65-86, 145f, 301-21.

<sup>42</sup> Weber, 1954, pp.39f, 145f, 158-167.

<sup>43</sup> North, 1990, p.53.

<sup>44</sup> North, 1990, p.55.

Institutions, hence, unfold ultimate efficacy in lowering transaction costs when both formal and informal constraints merge into one coherent institutional framework. This special case of institutional interplay is considered to matter in Western societies where it is "taken for granted" that informal codes of conduct and state enforced rules coincide in the mind-set of individual agents. As North put it, "when economists talk about efficient markets, they have simply taken for granted an elaborate framework of constraints. [...]"<sup>45</sup> The institutional constraints that define the opportunity set of individuals are a complex of formal and informal constraints. They make up an interconnected web that in various combinations shapes choice sets in various contexts.<sup>45</sup> How does such interplay evolve? North does not provide a definite formula, but touches on this problem in his analysis of institutional change, discussed in the next section.

### Institutional Origin and Change

Intentional design deriving from calculated self-interest denotes the central momentum directing institutional change, since it is posited that institutions are the product of strategic interaction. Institutions change because economic, social, and political entrepreneurs share the perception that the "re-negotiation" of institutional constraints maximizes individual utility functions.<sup>46</sup> The gains from cooperation are measured in terms of alternative pay-off matrices. Entrepreneurs may change the rules of the game either directly, by devoting resources to new profitable opportunities or

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<sup>45</sup> North, 1990, pp.66f.

<sup>46</sup> North, 1990, p.86.

indirectly, by estimating the costs and benefits of devoting resources to alter the rules or enforcement of rules. The amount of resources devoted to institutional change depends in this way on the latitude of expected pay-offs. The analysis, by focusing on cost-benefit scenarios, then, verifies the behavioral micro-foundations of rational choice by demonstrating that institutional change is the outcome of strategic interaction.<sup>47</sup>

This "simple" model of institutional change, however, appears in a more sophisticated version in North's text where he constructs a more complex chain of causation. The analysis then integrates macro-level phenomena of political life by demonstrating that initial input for change derives from evolutionary variables, like population dynamics and technological innovation. These variables become operational via his concept of "relative prices."<sup>48</sup> Changes in relative prices include changes in the ratio of factor prices (i.e., changes in the ratio of land to labor, labor to capital, or capital to land), changes in the cost of information, and changes in technology (including significantly, military technology). In the mind of the rational and utility-maximizing individual, structural changes of the human environment are deciphered and computed in the shape of price variations. Price changes, then, affect human behavior by determining whether it is in the interest of strategic agents to re-negotiate existing rules. Evolution (as a macro-level process) thus enters the equation of rational-calculative styles via the route of relative prices. An example of changing "relative prices" presents the demise of serfdom. North points out that the late-medieval plague minimized the number of serfs

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<sup>47</sup> Max Weber, likewise, emphasized the significance of strategic and thus self-interested behavior in the creation of new economic rules. "Individual invention" and "purposive agreements" circumscribe the primary sources for new legal norms (1954, pp.68-75).

<sup>48</sup> North, 1990, p.84.

and thus changed the ratio of land and labor in such a way that the parties involved perceived the usefulness of re-negotiating the contractual framework. Because lords, in the aftermath of the plague, became more dependent on the subalterns they were forced to yield in a sequence of "re-negotiations" of the terms of "contract" governing the feudal relationship. The end result of these re-negotiations, then, ultimately brought about the liberation of the serfs.

Ideological Change. Another source of institutional change is rendered by cognitive endowments. On the mental plane of rational decision-makers surface certain ideas, meanings, and visions, which lead to the re-definition of individual preferences concerning the desirability of certain actions. The transformation of individual preferences, however, might result in discrimination against previous practice at the macro-level. North refers in this context to the abolition of slavery in the U.S. as an indicator for the force of ideas. "A major institutional change that by itself cannot be entirely accounted for by a change in relative prices and in which ideas mattered was the consequence of the growing abhorrence on the part of civilized human beings of one person owing another and therefore the rise of the antislavery movement throughout the world."<sup>49</sup>

The attempt to describe and explain the impact of ideas on human behavior via cost-benefit-models, however, leaves a bitter aftertaste because it does not keep its promise to provide a convincing formula for the significance of ideological concepts. Why should 19<sup>th</sup> century U.S. cotton farmer feel compelled to envision the critique of

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<sup>49</sup> North, 1990, p.85.

their liberal-minded fellow citizens as something exacting a high price? North does not account for the case that slave owners did not share the same feelings and beliefs as members of the antislavery movement. On the contrary, North implicitly presumes the condition of cultural homogeneity, so that both parties, regardless of their self-interests, share the same vision concerning slavery. This presumption, however, is counterproductive to North's general rational-calculative focus. Ideological heterogeneity instead of cultural homogeneity actually corresponds with strictly wealth-maximizing strategies. Ignorance of antislavery sentiments on the part of cotton farmers actually signifies the rational strategy to avoid the high (moral) costs for employing slaves. On the basis of a game-theoretic context of action, cotton farmers would have been better off to deliberately ignore the argument of the enlightened critics in order to maximize "utility."

Thus, the provision of a simple mechanism for linking ideological phenomena with situations of market exchange seems precarious. As North concedes: "...we are still at something of a loss to define, in very precise terms, the interplay between changes in relative prices, the ideas and ideologies that form people's perceptions, and the roles that the two play in inducing changes in institutions."<sup>50</sup> It is unclear how ideas, meanings, and visions emerge within the social context. The usual way out is to derive behavioral norms from game-theoretic models, which, however, are biased towards wealth-maximizing strategies. Consequently, it is acknowledged that ideas and visions exert a formative impact on institutional development without, however, being able to provide "neat models" of cultural development and interplay.<sup>51</sup>

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<sup>50</sup> North, 1990, p.86.

<sup>51</sup> North, 1990, pp.42, 44f.

Bargaining. In addition to factors of self-interest and culture, the concept of bargaining power delivers a crucial analytical tool towards the study of institutional change. "Moreover, it is the bargaining strength of the individuals and organizations that counts. Hence, only when it is in the interest of those with sufficient bargaining strength to alter the formal rules will there be major changes in the formal institutional framework."<sup>52</sup> This perspective on institutional change corresponds with more recent styles of rational-calculative analysis that emphasize the power differentials of negotiating parties.<sup>53</sup> Power is measured in terms of "threat points," which denote the option to threaten the other parties to withdraw from the negotiations and to leave the status quo unchanged, while the costs of non-cooperation would be inflicted on the latter. According to game theoretical analysis the party with more threat points can be modeled to claim a "Rambo-position." To the party who finds itself in a Rambo-position, the continuance of the status quo is a viable option, while the other parties face a dilemma of providing the "Rambo" with sufficient incentives for invoking cooperative behavior. Under these circumstances, the attainment of cooperation seems unlikely since institutional change depends on the consent of that player, whose utility function identifies uncooperative strategies as a viable "game" option.

Historically, it was the state, and the political elite in particular, which found itself in a so-called Rambo position vis-à-vis economic agents. Economic history is full of instances where the political elite made use of its power to advance their self-interests to the disadvantage of individual entrepreneurship. Weber demonstrates, for instance, that

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<sup>52</sup> North, 1990, p.68.

<sup>53</sup> See, for example, Knight 1992 & 1994.



the development of the legal concept of the modern business corporation was delayed in England because of the domestic power structure.

Generally it appears, however, that the development of the legal structure of organizations has by no means been predominantly determined by economic factors. This fact is provided primarily by the sharp contrast between medieval and also modern English developments, on the one hand, and the continental, especially the German, development, on the other. In English law [...] no concept of corporation of the continental type was developed until modern times. Apart from rudimentary beginnings, there was no group autonomy in the sense and scope in which it was taken for granted in medieval Germany [...] The real reasons for the developments both in England on the one side and on the Continent, specifically Germany, on the other, were primarily political ones. This statement applies to the Middle Ages as well as to the early modern period. The essential difference was this: In England royal power was strong and centralized and, under the Plantagenets and their successors, disposed highly developed technical means of administration. In Germany, on the other hand, no political center was in existence.<sup>54</sup>

In England, the establishment of a corporation then depended on special grant and the concept of limited purpose while being under constant supervision of the state bureaucracy. The formation of modern commercial law, however, was conditioned upon the transformation of hierarchical and politicized power structures, which traditionally subjugated the demands of economic entrepreneurs.

The Law Merchant, as the "continental" type of doing business, owes its official recognition to the circumstance that the political elite abandoned particularistic modes of governance (autocratic, patrimonial etc.). To attract foreign merchants to the fairs, the politically established class was frequently ready to abandon the status quo and to broaden the legal basis of international commercial law. In this sense, a "community of interest" evolved serving the perceived self-interest at both ends of the political spectrum since the emergence of capital markets also benefited the state's financial needs.<sup>55</sup> As the

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<sup>54</sup> Weber, 1954, pp.169-188.

<sup>55</sup> Murray, 1999, p.78.

expanding mercantile community contributed to the economic growth of urbanized regions, merchants were subsequently granted special rights to administer commercial law independently. Foreign merchants were allowed to choose mercantile councils and judges from among their own fellow citizens and to governing themselves under their own laws. Privileges of "participatory adjudication" were first granted at great international fairs and markets, which were thereupon extended into permanently instituted organs of administration at the city-state level.<sup>56</sup> "Consuls of merchants" were elected to sit on commercial cases that gradually extended their jurisdiction over all mercantile cases within the city. The northern city-states, assuming the vanguard role within these developments, at that time, integrated these mechanisms into the permanent legal framework of their town charters and spread this recipe throughout Europe. Other European cities adopted the Italian institution of the merchant counsel or else developed similar institutions for adjudication of commercial cases by merchant judges. The Freiburg charter of 1120, for instance, stipulated that cases of commercial dispute-resolution should not be decided on the basis of rules of political authority "but by the customary and legitimate law of all merchants and especially by the law of the merchants of Cologne."<sup>57</sup> As a result, the development of mercantile law was largely left to the merchants themselves, so that the process of institutionalizing the rules of the game began in a bottom-up fashion. The standards for fulfillment and enforcement of contracts emerged out of custom and practice which, over time, took on regularity. Compliance stemmed from the legitimacy of the rules and the fact that businessmen had actively

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<sup>56</sup> Berman, 1983, pp.346ff.

<sup>57</sup> Mitchell, 1969, p.28.

participated in their development.<sup>58</sup> Conditional for this development, however, was decentralization of political power that provided the mercantile community the opportunity to formalize their exchange practices.

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<sup>58</sup> Berman, 1983, p.340.

## CHAPTER 3

### IMPERIAL STATE CAPACITY

Under the imperial regime, state capacity materialized in the prerogative of Russian officialdom to exercise, among other things, an effective veto right over corporate development in the Russian lands and to resist business demands to enact a competitive type of corporate governance modeled on European standards of business conduct. To better understand this episode of bureaucratic empowerment, the following section inquires into the institutional bases of the imperial regime. As a consequence, the question is asked what institutional reasons might have existed to empower Russian officialdom against the interest structure of society? In addition, the question is raised by means of what institutional arrangement was the imperial bureaucracy able to resist societal pressures for change? It is therefore the aim of this chapter to shed some light on the institutional bases underlying imperial Russian state capacity. As a preliminary thought, it would seem that the imperial regime was relying on state-centered hierarchical structuring of interest organization and stratification in order to fashion policy. This should emerge more clearly from the case study of corporate law reform in 1858-1874. Prior to discussing such structural concerns, however, it appears logical to inquire into the affairs of Russian business life in order to give a lively picture of the historical frame of reference.

## Corporate Entrepreneurship in Imperial Russia

Under the imperial regime, corporate entrepreneurship had to deal with a curious mix of formal legality and informal procedures that, as such, were counterproductive to the needs of corporate Russia. To observers of the Russian field, it is a familiar narrative that entrepreneurial initiative was discouraged by means of bureaucratic regimentation that, in the final analysis, would hinder the evolution of a decent code of conduct. The condition of bureaucratic tutelage was in this respect especially to the detriment of smaller and medium-sized businesses that could not afford to go all the way through the bureaucratic process. In his assessment of the Russian business climate, Professor Ivan Ozerov noticed in 1916:

The old regime, with all its restrictions and prohibitions, hindered and discouraged all initiative by making success depend on the authorization of the governing officials. It annihilated all energies, smothered all humane feelings with the masses, and although industrial energies abounded in Russia they remained unexploited and of no benefit to anyone, like our forests and mineral wealth. [...The czarist regime] does not allow a free field of activity to individuals; it imposes restrictions and hindrances. Without an ukaz a Russian does not dare do anything. This ukaz is so discouraging that it incapacitates him. ...[Bureaucrats] employ all their energies, all their intellectual efforts in creating hindrances, obstacles, and restrictions.<sup>59</sup>

Of particular significance was the design of entry rules since they were instrumental for the imposition of bureaucratic tutelage over business affairs. According to the letter of the law, the so-called concession system mandated that every corporate charter had to undergo a screening process that would involve the relevant Ministries, the Committee of Ministers, and ultimately Czar himself who would put his signature under the corporate

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<sup>59</sup> Ozerov, Ivan. *Problemes economiques et financiers de la Russie moderne*, Lausanne 1916, pp.45f. Quoted in T.C. Owen. 1991. *The Corporation under Russian Law, 1800-1917: A Study in tsarist economic policy*, Cambridge: University Press.

charter. In addition, it was required that every change in the corporate charter had to be confirmed by the appropriate ministry. The general assembly of stockholders, for instance, was not allowed to change the terms of economic conduct on their own authority. It was stipulated that no appeal procedure was available to corporate founders in case of denied concessions. In addition, the formal-legal basis providing for increased bureaucratic tutelage over corporate entrepreneurship was enlarged within the course of the conservative reaction (1881 to 1905). Additional restrictions for corporate business became effective when influential conservative groups considered it particularly worrisome that foreigners and Jewish minorities could take control of economic enterprises in strategically sensitive areas. Obviously operating from a position of power, the conservative stratum of Russian officialdom succeeded in bringing about legislation that would increasingly bar foreign investors, and in especially Jewish minorities, from owning means of production.<sup>60</sup>

However, in contravention of the official policy a second set of rules emerged since it was recognized that foreign participation was urgently needed to sponsor corporate development in the Russian lands. Parallel to the growing body of restrictive laws governing joint-stock corporations, the regime established an administrative procedure that would make it possible for foreigners and Jewish minorities to acquire real estate in so-called sensitive areas. A legal basis for this kind of rule-derogatory behavior arose with a decree dating from November 1893. Its substance stipulated that "exceptions" could be granted on a case-by-case basis. For this purpose, the corporate

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<sup>60</sup> For a more detailed account see T.C. Owen, 1991; and in particular pp.118-132 (*Restrictions on foreigners, Jews, and Poles*) and pp.171-180 (*the reactionary counteroffensive*).

charter would have to receive the signature of the Committee of Ministers and the Czar himself.

A political consequence of these processes was that a gulf between official policy and informal legal practice began to emerge under the stewardship of the Czarist regime. The described legal discrepancies then coincided with a situation where most enterprises operated in contradiction to the general laws. As Professor Ivan T. Tarasov observed in 1878:

The development of corporations in Russia in recent years has taken place, as it were, outside the legislation in force, or even despite it, because it is difficult to find among the charters of joint-stock companies accepted and confirmed in the past decade a single charter that does not consist entirely of a systematic collection of exceptions [to the law].<sup>61</sup>

In addition, both incorporation procedures, the official concession system and its unofficial counterpart, underlined the discretionary powers of the imperial bureaucracy to influence corporate development at will. In this way, Russian entrepreneurs were exposed to relatively high levels of uncertainty since the imperial bureaucracy, which vacillated between benevolent neglect and decisive repression, controlled the entry barriers into business life. In the absence of a consistent system of formal-legal norms, the stakes for Russian entrepreneurship were high. From the business point of view, it was difficult to foresee how the autocratic modus operandi would play out in the next moment. Corporate founders responded to the situation by lobbying for special favors from the imperial bureaucracy.

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<sup>61</sup> Ivan T. Tarasov. *Uchenie ob aktsionernykh kompaniiakh*. Kiev 1878; quoted in T.C. Owen, 1991, p.77.

A good example describing the administrative contingencies of the concession system emerges from the memoirs of Baron Nikolai E. Wrangel, dated 1899.<sup>62</sup> An official turned businessman, Wrangel took the lead in negotiating the incorporation of an electric power company to be erected in the Caucasus region. Due to the size of the project, it was planned to give the enterprise the form of a limited liability joint stock venture. The value of the enterprise was an estimated 7 million rubles of stock to be distributed to leading petroleum producers and managers of electricity companies. Initial financing was safeguarded through a loan of the International Bank, headquartered in St. Petersburg. As stipulated by the 1836 code, the project initiating party, Wrangel and his fellow entrepreneurs, had to draw up a corporate charter to be presented to the appropriate administrative organs for approval. Even though the charter received initially a positive response from the Minister of Finance, Count Witte, the project seemed to come to nothing since the charter also required the signature of the governor-general of the Caucasus region, Prince Grigorii S. Golitsyn.<sup>63</sup> To the dismay of the entrepreneurs, this "crazy petty tyrant [malyi samodur], with whom it was difficult to deal," delayed giving his permission. Wrangel then resorted to the strategy to win the sympathy of the Caucasus autocrat by approaching him as a benevolent patron rather than as a rational decision-

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<sup>62</sup> As reproduced by T.C. Owen, 1991, pp.130f.

<sup>63</sup> To explicate the legal specifics of the situation, it should be mentioned that certain additional restrictions applied for incorporation in the Caucasus region. A decree dating from November 1893 stipulated that corporations could purchase real estate in the Caucasus region only if their charters restricted the ownership of stock to Christian Russian subjects, to non-Christian natives of Turkestan, or to natives of the Central Asian states immediately bordering the area. Moreover, in each case the corporation was required to submit a petition for permission to purchase land, via the governor-general, to the minister of war, who had the power to reject the request or to grant it upon approval of the minister of finance. Three powerful officials thus were endowed with a significant potential to put their mark on evolving corporate initiatives according to their personal whims.



maker. Accordingly, Wrangel awaited the winter social season when the members of the Russian aristocracy used to gather in St. Petersburg. On this occasion, the Prince seemed inclined to give his blessings to the project because he recognized the relative advantage of electrical power lines that posed less of a fire hazard than steam engines in the oil fields. Golitsyn also seemed pleased that the shares had already been subscribed. However, his mood changed abruptly when he learned the identity of the potential stockholders. Wrangel recounts that the Prince could reluctantly accept the idea of shares being distributed to other corporate enterprises, such as the Siemens and Halske, of which Wrangel was vice-president. However, Golitsyn lost his temper when Wrangel mentioned the role of the International Bank and the fact that it was unknown who else would acquire the remaining shares:

- Golitsyn: "What do you mean, unknown? Does that mean that they could fall into the hands of Jews and foreigners? I won't agree to that. I will not permit shares to the bearer. How the foreigners are fleecing Russia!"
- Wrangel: "The minister of finance has already allowed them."
- Golitsyn: "Witte is a Mason and has been bought by foreigners."
- Wrangel: "Perhaps, Prince, you have not read his speech in Moscow. He declared that Russia cannot do without foreign capital. He of course would not have said this if the Czar refused to allow foreign capital [into the country]."
- Golitsyn: "What do you mean, the Czar! He doesn't know what he wants and dances to Witte's tune. He's a milksop [*Triapka*]!"
- Wrangel: "Of course [...] you, Prince, as an adjutant general know the Czar's character better than I do."
- Golitsyn: [angrily] "I won't allow it; I won't, I absolutely will not allow it!"<sup>64</sup>

In the end, Golitsyn's resistance was finally overcome when the Czar himself signed the corporate charter, which listed two Russians, Nikolai E. Wrangel and Viktor F. Golubev, as founding parties. From the short anecdote some useful data emerges concerning the

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<sup>64</sup> Baron Nikolai E. 1924. Wrangel, *Vospominaniia*. Berlin, pp. 158f; quoted in T.C. Owen, 1991, pp.130f.

uncertainty level that Russian entrepreneurship was exposed to. Certainly, the more obvious theme in the narrative of Baron Wrangel denotes the spread of xenophobic sentiments among the Russian gentry. In this particular case, the incorporation of an enterprise with a potential for high rates of return almost failed because of the governor-general's attitudinal preoccupation. Instead of contemplating analytical aspects of the business scheme, and acknowledging the economic benefits of the project under consideration as indicated by Wrangel's devoted talk, Golitsyn's decision hinged essentially upon his subjectively felt fear of "selling out" to non-orthodox minorities and foreigners. In addition to cultural interpretations, the narrative also underlines the institutional deficiencies of the existing system of incorporation. To be sure, it strikes the observer to realize the scope of action that Golitsyn was provided by force of the governing system. Accordingly, the Caucasus autocrat was endowed with the discretionary powers to impose on business what seemed to eclipse with the reality of his personal sentiments. While Golitsyn's initial response bore the connotations of active involvement in favor of his subjects, the second and decisive impulse advises otherwise. Driven by xenophobic fears, Golitsyn neither cared for the bodily security of his subjects nor the eventual economic benefits associated with the project. In the end, it was the personal will of the autocratic decision-maker that counted, whose decisions seem to evolve along contingent streams of consciousness. In imperial Russia, economic agents thus faced the bizarre situation that, in addition to pervasive problems of bureaucratic self-interest, relevant decisions were delayed or even ignored because the emotional, inflating a tendency towards unpredictability and spontaneity, subdued the rational criterion in governmental decision-making.

## Institutional Arrangement

The ensuing inquiry argues that the evolution of an effective corporate governance regime was compromised because the Russian political input structure restricted policy-making competency to an asymmetric-hierarchical format of participatory entitlements. Asymmetries depict in this respect certain influence configurations over policy choice. Scales of influence are specified on the basis of institutionally determined rules. Participation, on the other hand, is understood to represent a special kind of political action that bears the imprint of its institutional environment. Action fields of participation emerge within the government system or along the state-society interface. Within the sphere of government activity, the study focuses on constitutionally specified organs of legislative authority and bureaucratic action channels in order to assess the inner-governmental configuration of influence. Thereupon, the analysis inquires into the design of state-societal exchanges in order to clarify to what extent societal actors do have access to rule-making authority. Within this overall analytical context, the picture of the politically fashioned input structures should emerge.

## Constitutional Constraints

The analysis of constitutional structures delivers an ambiguous message in determining state capacity. This situation is largely due to the delicate position that constitutional concepts are placed within the Russian context. In cultural studies, it is observed that the realities of a relatively arbitrary operating regime appear to prejudice

notions of constitutional constraint.<sup>65</sup> Under the imperial regime, the executive branch had the discretion to decide whether and to what extent constitutional structures might constrain government operations. In principle, even the institutional structure of government itself was conditional upon autocratic will power. According to tradition, the autocratic ruler was above the law, not bound by it, nor responsible to anyone or anything beyond himself. Emphasizing autocratic prerogative, cultural analysis frequently refers to Article 1 of the Complete Collection of law, which stipulates that: "The All-Russian Emperor is an autocratic and unlimited monarch. Obedience to his supreme power not only from fear but also from conscience is ordained by God Himself."<sup>66</sup> In this manner, the autocratic ruler was endowed with a rightful claim for unlimited legal authority.

In practical terms, the autocrat had discretionary powers to change the format of legislative procedure at any time. Definition of policy instruments, as well as the selection of decision-making arena was conditional upon autocratic consent. As established by Article 53 of the fundamental laws, executive authority could choose from a large range of possible legislative procedures. Available alternatives according to which a law could be formulated included codes [*ulozheniia*], statutes [*ustavy*], establishments [*uchrezhdeniia*], charters [*gramoty*], ordinances [*polozheniia*], instructions [*nakazy*], manifestos [*manifesty*], ukazes, opinions of the State Council [*mneniia Gosudarstvennogo soveta*], and reports [*doklady*] vouchsafed in the emperor's

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<sup>65</sup> The classical texts are Berman (1963) who gives an extensive account of the judicial system; Brzezinski (1962) who focuses on the dominant position of executive authority in governmental inter-branch relations; and Pipes (1974) who provides an interesting study of increasing violence in judicial affairs.

<sup>66</sup> Berman, 1963, p.211.

confirmation.<sup>67</sup> In addition, the autocratic ruler was endowed with the discretion to freely determine the playing field for policy-making. Standing at the center of the political arena, the Czar had the freedom of choice from which of the various government organs to receive advice in legislative affairs. Even though the State Council took on a central role in the coordination of legislative activity (see below), Article 53 clearly implies that it was far from obligatory to process legal projects through the State Council. As confirmed by an imperial order of November 1851, the possibility was acknowledged to circumvent State Council procedures by means of ministerial reports. Ministers with the Czar's approval issued administrative rulings with the force and scope of law. Procedural requirement for such action was that the issue under consideration touched simultaneously upon several ministries. Not surprisingly, as Whelan indicates, few projects failed to meet this criterion.<sup>68</sup> The Czar could, at his pleasure, have laws processed through organs other than the State Council. During the reign of Alexander III, for instance, various ordinances concerned with state security, the press, and Jews were confirmed and enacted after having been pushed through the Committee of Ministers. Another procedure to avoid Council scrutiny, it was customary for the autocratic ruler to make use of one or another agency of his personal bureaucracy to work out crucial pieces of legislation. Thus, a good many legal issues were handled by the ever-proliferating divisions of His Imperial Majesty's Own Chancery or by one of his specially created secret committees and commissions.

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<sup>67</sup> Whelan, Heide W. 1982. *Alexander III & the State Council: Bureaucracy and Counter-Reform in Late Imperial Russia*. New Brunswick, NJ: Rutgers University Press, here at p.49.

<sup>68</sup> Whelan himself refers [footnote 19] at this instance to A. S. Alekseev, *Russkoe gosudarstvenno pravo*, p.261.

In the exercise of their consultative function, government organs, however, could never go beyond the outer limits set by any given Czar. The scope of institutional autonomy of legislative procedure therefore varied widely, not only between but also within reigns. The government organ of the State Council provides in this respect an interesting case since its significance for legal matters oscillated between high priority and remote meaninglessness for the affairs of the central administration. Created in 1811, the Council was to serve as the central consultative body for legislative matters. Its primary function was the consideration of legislative projects before presentation to the Supreme Power. Official Council policy prescribed that the Czar had to involve the Council into policy-making. This procedural requirement was expressed in Article 53 of the fundamental laws (1832) according to which "intended implementation" of legal projects would include the provision "after having heard the opinion of the State Council."<sup>69</sup> In addition, Article 50 stipulated the principle of overriding autocratic decision-making power: "All legal projects are to be examined in the State Council and submitted to the emperor's discretion; only by the action of the autocratic power can they be given the intended implementation." However, neither in practice nor in theory did the wording of the formula in any way restrict the autocrat's prerogative to pay no attention to the advice or opinions given him. Even the observation of such minimal procedural requirements came in conflict with imperial sense of authority. Whelan delivers in this context an enlightening example of the basic situation. Expressing his aversion towards regularized institutional procedures, Nicholas I uttered: "Really, when I decide something

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<sup>69</sup> Quoted in Whelan, 1982, p.48.

is useful and beneficial, do I first have to ask without fail for the agreement of the Council?"<sup>70</sup>

For his choice of affairs, the autocratic ruler was, in effect, not accountable to anybody beyond himself. On the contrary, legal accountability was the prerogative of the Czar. Legislative bodies, whose members were hand-picked by the Sovereign Power, performed only advisory functions. The Council had no power either to initiate or to promulgate legislative projects; its function was purely advisory, and the Czar remained free to accept, reject, or modify at will the Council's recommendations. The delimited scope of institutional autonomy in Council activities emerges clearly from the first three articles of the Establishment:

1. In the hierarchy of state institutions, the Council is the body [*soslovie*] in which all parts of the administration are ordered in their principal relations to legislation, and through it they rise up to the Supreme Imperial Power.
2. Therefore, the preliminary drafts of all laws, statutes, and institutions are submitted to and considered by the State Council and then, by act of the Sovereign Power, forwarded for implementation.
3. No law, statute, or institution may issue from the Council and be implemented without confirmation by the Sovereign Power.<sup>71</sup>

As a result, a whole series of conflicting and contradictory norms and procedures governed the legislative process. Political issues tended to be decided by shifting procedures and by the interplay of various bodies and certain favorites or persons revolving around a formally supreme sovereign. The proliferation of legislative organs ultimately evolved into a diffuse network of competency. A clear demarcation of spheres of influence, as characteristic for constitutionally delimited government, was absent.

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<sup>70</sup> Whelan, 1982, p.53.

<sup>71</sup> PSZRI [*Polnoe sobranie zakonov rossiiskoi imperii*], 1<sup>st</sup> ser., 31 (1810-1811), No.24064, quoted in Whelan, 1982, p.41.

Under conditions of procedural uncertainty, it was difficult to perceive which of the involved parties had a rightful claim to policy-making competency. To be sure, as long as legislative authority depended upon the temporary will of the autocrat, it was always within executive discretion to select the format of participation in policy-making on an ad-hoc basis. Once again, the old regime undermines institutional development by interfering with the ground rules of the political game. This tendency manifested itself most clearly within the domain of legislative activity. Within legislative procedure, the autocratic *modus operandi* nullifies notions of genuine participation. Components of participation, as they emerge from legislative procedure, were usually removed from the public, lacking transparency, and certainly allocative efficiency. Accessible only to a small number of favorites and bureaucratic staff, the structure of social input chances hinged upon the personal discretion of the autocratic ruler.

### Action Channels

Administrative practice differed substantially from the proclaimed ideal of autocratic omnipotence. Far from being involved in all kinds of political transactions, the capacity of the autocrat to cope with the flood of legal projects awaiting his decision turned out to be rather limited. To be sure, under the old regime thousands of singular legal issues were propelled to the highest echelons of government swamping the office of the autocrat. The Czar, however, exercising his discretionary powers on a rather tight schedule, could not possibly manage all of the political affairs awaiting imperial action.<sup>72</sup> The empire had become too complicated for one man to run, even with the help of any

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<sup>72</sup> For a detailed description of Nicholas II working day schedule, see Verner, 1990.



number of favorite assistants; too many questions demanded expert opinion, too many matters required not just consent or denial, but informed consent.

To remedy the situation, Alexander I created the State Council. Its purpose was to service the informational needs of imperial decision-making. However, as previously indicated, the Council was not to trespass the limits set by autocratic discretion. As a rule, the Council should operate only as a regular consultative body to the Czar. Its official role was to assist the Czar in legislative affairs by submitting informed recommendations for imperial action. In this consultative function, the Council had de jure discretion to work as the central coordination mechanism linking the Czar with the other parts of government. However, even the State Council itself gave rise to organizational deficiencies, which it was supposed to cure. Circumstantial evidence for such difficulties emerges from a note of a Council member written in 1884. Expressing his dissatisfaction with the organizational inefficiency of the system, B.P. Mansurov complained: "if a member of the State Council does his business as he should, it is impossible for him either to search out allies or foresee on his own everything that he should - nor, for that matter, can he even read everything through properly."<sup>73</sup>

The void separating official intent from de facto reality, then, was increasingly filled by bureaucratic support structures. As supreme government bodies had to wrestle with overload, auxiliary organs emerged to take increasingly control of "business." Of central significance in this respect was the State Chancery (*Gosudarstvennaia kantseliariia*) that transacted all kinds of Council business. All informational materials

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<sup>73</sup> Whelan (1982, p.43) characterizes the author of the quote, B. P. Mansurov, as one of the "most diligent" and "conscientious" Council members.

going in or out of the Council passed through the Chancery and its pertinent subdivisions. The Chancery functioned in this respect as a resource center for the so-called supreme organs (*verkhovnye organy*) of government.

The significance of Chancery staff emerges clearly in connection with Council procedures. Even though the Chancery served as an auxiliary organ, it is significant to point out that its organizational infrastructure was distinct from that of the Council. The Chancery was managed by a functionary called the state secretary (*Gosudarstvennyi sekretar'*), a direct appointee of the Czar. The state secretary was not a Council member, and his position was independent of the Council. He had the discretion to appoint divisional staff, which by the 1880s numbered more than double that of the Council itself. As mentioned above, Chancery staff operated all business transactions going in and out of the Council. Informally established procedure was that proposals for policy-making would be dealt with on a preliminary basis by Council divisional staff. After due deliberations, Chancery staff, versed in adequate legalese, then would go on to transcribe the preliminary results for presentation to the General Assembly (*obshchee sobranie*) of the Council. Within the course of Council procedures, Chancery staff was responsible in keeping track of pending deliberations and for recording them in journals (*zhurnaly*). From the journals, a so-called memorandum (*memoriia*) would be extracted to submit to the Czar the project under consideration. The memorandum would include an outline of the project, a report on the debate it had occasioned, and any changes resulting from that debate. According to the channels of political action, the information provided in memoranda delivered the final stage of input for imperial decision-making.

Influence by Chancery staff on the processing of legal issues had enormous potential. Council members, and even the Czar himself, received necessary information on pending projects through the Chancery. Such influence was all the greater since it was literally impossible for individual members of the decision-making arena to deal responsibly with the ever-growing volume of business presented for informed consent. The official policy-making organs, coming down to the nitty-gritty of legal drafting and policy-coordination, increasingly relied on Chancery expertise because its staff was versed in the techniques of legal transcription and interpretation. As a result, the Chancery's importance as a power base grew steadily over the course of the nineteenth century since it functioned as the central coordination mechanism that moved the points of legislative affairs through the state apparatus.<sup>74</sup> The crux of the matter, however, was that increased reliance on bureaucratic expert opinion promoted the cause of bureaucratic tutelage by deflecting government attention from informed consent within the State Council towards secluded areas of executive decision. Of course, such political tendencies undermined the already fragile basis of quasi-parliamentary structures. Bureaucratic influence over policy-making reinforced in this regard already existing trends of political inequality and procedural uncertainty.

### Interface Linkages

As indicated above, this section of the analysis inquires into institutionally determined structure of state-societal exchanges. In particular, an effort is made to clarify to what extent societal actors are provided with the opportunity to deliver input in the

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<sup>74</sup> Whelan, 1982, p.46.

policy-making process. Or, to put it differently, it is questionable by what organizational rules the state might have delimited chances for societal input?

To the informed observer the assumption probably appears puzzling that there is something like an interface in Russian politics. To be sure, within state-societal relations, the term implies the concept of a political arena where both types of actors meet, state and societal, to engage in political exchanges. The democratic concept of state-society interface usually involves a two-way communication model conditioned on such qualities as formal equality and voluntary cooperation. Based on democratic political traditions, it is assumed that the parties to the exchange meet on a somewhat equal footing in order to arrive at a mutually beneficial agreement, or contract.

The Russian experience differs from this concept substantially because it is based on a one-way model of political communication. According to the study of basic state-society communications, the image of a self-centered state apparatus emerges that actively restricts the spectrum of chances for societal input. Central to the study of interface communications then is the theme of an enduring state-society antagonism: the image of dual Russia. The classical texts are Herzen (1853) and Tucker (1979). Both authors share the concept of a culturally entrenched state-society cleavage. Alexander Herzen created the formula of the "two Russias" by arguing that:

One the one hand, there was governmental, imperial, aristocratic Russia, rich in money, armed not only with bayonets but with the bureaucratic and police techniques taken from Germany. On the other hand, there was the Russia of the dark people, poor, agricultural, communal, democratic, helpless, taken by surprise, conquered, as it were, without battle.<sup>75</sup>

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<sup>75</sup> Alexander Herzen quoted in Tucker, Robert C. 1971. *Soviet Political Mind: Stalinism and Post-Stalin Change*, revised edition. New York: Norton, here at p.124.

Introducing the formula of "dual Russia" into a larger analytical context, Tucker creates the metaphor of "the image of dual Russia" by observing:

Far from developing as a dependent political 'superstructure' over the social-economic 'base,' the Russian state organism took shape as an autonomous force acting to create or recreate its own social base, to shape and reshape the institutional pattern of society, in a series of revolutions from above. [...] The exploitative relation of the state to the society brought an extension of coercive controls and the hypertrophy of the centralized governmental system.<sup>76</sup>

Similar to Herzen, Tucker conceives likewise high levels of violence in state-society exchanges. The state is pictured as maintaining an exploitative relation vis-à-vis society. It is understood that the state took control of society in a manner of an occupying power dealing with a conquered populace. To be sure, it is historical fact that Russian non-state actors were in a position of extreme disadvantage vis-à-vis state actors. The same pattern persists with regard to policy choice. Rule-making authority traditionally was considered the sole privilege of the state. State-centered legal authority was exerted as "top-down" approaches towards legislation. Based on a hierarchical understanding of political organization, the autocratic regime engaged in a conscious effort to diminish societal access to policy-making bodies. Thus, it is probably fair to argue that the dominant game strategy was to maximize control over state-society interactions, and to forestall the emergence of a two-way playing field for political exchanges. To put it differently, control over interface communications and top-down approaches of legislation belong to the same game plan.

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<sup>76</sup> Tucker, 1971, p.123.

By what organizational rules did the state delimit chances for societal input?

Judging on the basis of cultural studies, it would appear that Russian regimes managed to exert a controlling influence over interface exchanges by implementing a certain social program. The consequence of social reforms would be the forceful binding of social strata into a state-centered hierarchy of rank. Intermediate steps included the establishment of status-defined privileges and duties towards the state. High positions within this system were then rewarded with special privileges and rights vis-à-vis lower-positioned class members. Notables and favorites were provided with exploitative rights vis-à-vis lower strata and authoritative protection of those rights in exchange for absolute loyalty of the nobility to the power center. The introduction of the Table of Ranks by Peter the Great in 1722, designed to establish a strict official hierarchy based on service to the state rather than on ancestry, belongs to this category.

An especially effective instrument for establishing hierarchies and exploitative social relations proved to be status-defined property rights.<sup>77</sup> The autocratic government abolished by means of "reforms" the principle of previous private property rights in land ownership, and granted them thereafter on a conditional basis only to loyal military officers and members of the aristocracy. The aristocracy, encountering the infringement of their customary rights, in turn, gained certain exploitative rights vis-à-vis the peasantry, accomplished through the enslavement of the peasantry as enacted by the 1649 Law Code (*Ulozhenie*). The 1649 Code stipulated that peasants occupying lands granted to loyal members of the aristocracy and military became bound to the land as well as to

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<sup>77</sup> For an overview concerning data and "The Structure of the Peasantry," see White, Stephen. 1979. *Political Culture and Soviet Politics*. New York: St. Martin's Press, here at pp.55-63.

the landlord and the Czar. The Russian autocracy thus succeeded in binding the societal strata into state-centered hierarchies through the authoritative allocation of land. Although Catherine the Great attenuated the concept of conditional property rights in land in 1782 by establishing the concept of absolute ownership, the law was restricted to the nobility. Whereas the gentry gained independence from service obligations to the czar, the peasants remained bound to the land and to the landlord for another century, compounding the injustice against them. Property rights thus depended on access to executive power and the momentary will of the ruler, in contrast to the kind of stable contractual agreements between monarch and social constituents that occurred in Western Europe at this time.<sup>78</sup>

Similar tendencies prevailed in the domain of corporate activity where scholarly refined competence concerning the management and governance of corporations was confined to the military-bureaucratic elite. Since new forms of business operations demanded an input of technological know-how, it was a natural consequence that the bureaucratic elite would play a crucial role in Russia's corporate development. The emerging banking and corporate sector then had little to choose but to hire a large number of czarist bureaucrats. From the Ministry of Finance, 225 bureaucrats held 251 posts in corporations, mutual credit societies, and other enterprises; thirteen were presidents of Boards, fifteen were members of Boards, twenty sat on audit commissions, and twenty served as bookkeepers and other technical personnel.<sup>79</sup> Evgenii I. Lamanskii, for instance, was vice-director of the State Bank and its director (1866-81) after the retirement of

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<sup>78</sup> White, 1979, pp.41ff.

<sup>79</sup> Owen, 1991, p.91.

Baron Stieglitz. He also occupied the presidency of the Volga-Kama Bank council, the Russian Bank for Foreign Trade council and was also a stockholder of the Moscow Merchant Bank and a member of the Petersburg Mutual Credit Society. By virtue of holding these prestigious offices, Lamanskii was able to influence significantly the design of emerging corporations, especially in the railway business.

Executive decisions, how to go about corporate business affairs and the like, was concentrated in the hands of the imperial bureaucratic elite. A major cause for this state of affairs was the technological backwardness of the broad mass of the Russian mercantile class. In 1873, Babst, a representative of the "enlightened" stratum of Merchant Moscow, addresses this issue expressively by complaining: "Of commercial and industrial men with a comprehensive knowledge and understanding of contemporary forms of trade and of banking in particular, there are almost none in Russia."<sup>80</sup> To be sure, the stratum of 'enlightened' entrepreneurs that was open towards Western forms of education and technological advance was quite small at the turn of the century. Alfred Rieber estimates the numerical strength of this group to approximately 100 families. The bulk of merchants remained loyal to traditional customs and beliefs that, as such, were antithetical to Westernization.<sup>81</sup>

Owen demonstrates the natural distrust of innovation typical of the traditional Moscow Merchant of the period by relating two anecdotes, which are reproduced here to

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<sup>80</sup> Quoted in T.C. Owen, 1991, p.87.

<sup>81</sup> Rieber, Alfred J. 1982. *Merchants and Entrepreneurs in Imperial Russia*. Chapel Hill: University of North Carolina Press, here at p.421.



give a lively image of the situation.<sup>82</sup> It is reported that Moscow Merchants were reluctant to make use of the newly established stock exchange building, erected in November 1839. They preferred instead to trade outside the new building. This situation was even more amazing since the temperatures were clearly below freezing point causing them actually to stand and converse in the snow. It then required police action to compel them to enter the new building. However, the merchants moved only to its terrace and steps, but not to the interior of the stock exchange building! Likewise, Moscow Merchants are reported to have shunned the new railroad built between St. Petersburg and Moscow (1842-51). Vladimir Alekseev (1795-1862) and several other prominent merchants were summoned to St. Petersburg to thank the Czar for the newly built railroad. The Czar then asked them how they enjoyed the trip by train and the much shorter travel period of 14 hours. However, the merchants remained mute and embarrassed to give an answer. After some irritation the autocrat left the room. The merchants then confessed to an aide that out of fear of the train they had all traveled by stagecoach. This was reported to the monarch, who made them promise to return to Moscow by rail. The next day, Alekseev boarded the train alone. In Bologoe station at midpoint, where the southbound and northbound trains stopped simultaneously to refuel, Alekseev went off to take some refreshments. Spending too much time at the buffet, he rushed out at the third bell, but used the wrong door and so boarded the northbound train by mistake. In conversation, he soon learned of his neighbor's destination. "How marvellous!" he exclaimed. "The same train that is taking you to Petersburg is taking me to Moscow. Devilishly clever, these Germans!" Confused

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<sup>82</sup> Owen, Thomas C. 1981. *Capitalism and politics in Russia: A social history of the Moscow merchants, 1855-1905*. Cambridge, MA: Cambridge University Press, here at p. 15.

and humiliated because of his blunder, Alekseev cursed the "gadget", left the Petersburg railroad station, and rode back to Moscow on the stagecoach.

In the final analysis, asymmetric patterned allocation of technological know-how produced two side effects. First, the emergence of a genuine business class strong enough to develop a coherent group identity and socio-political interests independent of the state bureaucracy and foreign involvement seemed unlikely. Second, hierarchically patterned socio-political organization under the stewardship of the Czarist regime continued to play a crucial role in determining the course of business activities. As a result, the chance of bottom-up codification of best practice rules seemed unlikely. The formation of normative prescriptions governing business activities as well as the decisive impetus for economic development had to emanate from the top of the political hierarchy. Against this background, it becomes clear why the building of social consensus on economic policies, and institution-building in particular, turned out to be such a delicate adventure. The state apparatus, functioning as energizer for economic development, was provided with extensive powers to direct and spur social activities, which, on the other hand, proved counterproductive to the building of commercial law institutions. Even though, or exactly because the top executive could dictate the rules of the game, the project of institution-building (assuming that there was such an intention at all) vanished from the political agenda since both entities, state and society, did not feel compelled to observe the official policy. The fallacy being that the state apparatus made extensive use of its discretionary power to manipulate existing legislation, while the social base of Russian merchants and entrepreneurs was not able to emerge from the long shadow of the state to breathe life into the autocratic prescribed rules.

## Corporate Law Reform, 1858 - 1874

This section will focus on how the rules of the game played out. Of particular interest is whether the asymmetric format of participatory components in effect prejudiced institutional development. Intermediate analytical steps involve a process study of corporate law reform, as it became visible within the reign of Alexander II. To see how the imperial regime determined business-level preferences is of vital interest. The analysis then proceeds to an assessment of de facto participation. On the basis of the data, the study comes to the tentative conclusion that the hypothetical base line of the argument will be verified because participatory components appeared to have an effective impact on organizational behavior.

### Agenda-Setting

In 1858, Alexander II exercised his discretion to delegate the issue of corporate law reform to Finance Minister Reutern. By force of imperial discretion, Reutern was commissioned the task to serve as chairman in the process of reviewing existing legislation on joint-stock corporations. Thus, it was made official that corporate law reform was part of the regime's agenda. In the interest of this research paper, the question then arises concerning the kind of inputs that might have affected the decision of the autocrat. Or, to put it differently, what was the constellation of forces that appeared to move the autocrat to initiate the pertinent policy-making process?

On the basis of available data, it would seem that the course of events leading to the autocratic decision followed an established procedure of ministerial consultations. In accordance with established procedures, the decisive impetus for putting corporate law

reform on the agenda came from Finance Minister Reutern. To be sure, jurisdictional competence and economic self-interest were sufficient motivation for the Finance Minister to push the agenda of corporate law reform. Reform was of immediate interest to him since an expanding company sector would enhance the tax extraction facility of his ministry and therefore underline the utility and prestige of his bureaucratic domain. It is significant to point out, however, that such calculus played a rather limited role in this particular case. According to available data, it seems that the personal features of the Finance Minister, especially his initiative and standing power, exerted a determining influence on the course of events.

Societal support for this cause, to the surprise of the unsuspecting observer, came from the intelligentsia rather than from business groups. Looking towards Western Europe, members of the intelligentsia came to appreciate the liberal political ideas in general and the role of a law-based state in particular. To be sure, such ideas were very appealing to an audience that was accustomed to the vacillations of an arbitrary operating imperial bureaucracy. With the solemn intent to put an end to arbitrary government a new consciousness was advocated. In the field of company organization, such ambition translated into advocacy for the abolition of the concession system. To outline the essential points of criticism that were alive within the intelligentsia, Owen refers to an "important speech" of Semen Pakhman (Pachmann).<sup>83</sup> A leading proponent for reform, Pakhman demanded the abolition of the many "formalities" of the 1836 legislation. Speaking at Kharkov University, Pakhman emphasized in particular the benefits of "the

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<sup>83</sup> Owen, 1991, p.57.

principle of freedom for joint-stock activity." In the same spirit, Pakhman criticized the ubiquitous tendency of the bureaucracy to function as a "yoke" to the Russian people. Particularly disturbing, criticized Pakhman, was the state tutelage because of its adverse effect on the capacity of economic actors to take care of business. State tutelage over industry, in the words of Pakhman, "teaches the people to hope, to expect, and to demand everything from the government, while the people remain inactive, having lost the ability to think about itself."<sup>84</sup> Progress in the affairs of corporate governance, he suggested, should be attained through "open discussion" (*glasnost*) and "responsibility" (*otvetstvennost*).<sup>85</sup>

As it turned out, Finance Minister Reutern himself showed interest in the new ideas of *glasnost*. Reutern, consulting regularly with the enlightened stratum of Russian society, then took the initiative to push the reform agenda. To be sure, within government only a relatively small circle of proponents supported the ideal of *glasnost*, which, in the following decades of reform and counter-reform, were steam-rolled by the more conservative majority. The policy exchanges between Reutern and members of the intelligentsia represented a situation-related derogation from overall system characteristics. To show an open-minded attitude towards liberal segments of society was certainly not the dominant game strategy of the imperial bureaucracy. Thus, it was largely within Reutern's discretion to decide how to deal with societal inputs because there was no systemic pressure for top bureaucrats to embrace societal concerns.

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<sup>84</sup> Quoted in T.C. Owen, 1991, p.57.

<sup>85</sup> Ibid.

## Policy-Formulation

In February 1861, the Ministry of Finance initiated the process of policy-making, presenting a bill one hundred paragraphs long ready for inter-ministerial discussion. It mainly consisted of a somewhat balanced approach towards reform. Greater economic freedoms were promised through the abandonment of restriction on future contracts and unnamed shares, while the concession system, the genuine bone of contention, was to remain in force. In addition, it stipulated that a sworn statement indicating that one-fifth of the necessary capital had already been raised was to accompany each corporate charter submitted for ministerial approval. The official justification for continuing such restrictive measures was to protect the public from the unpleasant side effects of unguided economic self-interest.

The draft law then entered the stage of politico-bureaucratic debate where various ministries and agencies produced commentaries on this proposal between February 1861 and February 1865. The Ministry of Internal Affairs, for instance, sought to impose higher standards on minimum capital required for incorporating joint ventures in order to discourage the proliferation of small, "weak firms" and to "limit speculation;" so went the official justification.<sup>86</sup> Reutern, however, refused to include these provisions into the reform bill because the signs of an unbroken police mentality on the part of the Ministry of Internal Affairs emerged as all too obvious from its comments.

Societal Input I. The government, to the surprise of the "informed" observer, also solicited opinions from business organizations. Historical records of submitted opinions, however, exist only from two business organizations: the Riga Exchange Committee and

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<sup>86</sup> Owen, 1991, p.67.

the "semibureaucratic" Moscow sections of the manufacturing and commercial councils (MEC).<sup>87</sup> In its opinion, Riga criticized the one-fifth rule, while Muscovite merchants favored the issuance of preferred shares, which would carry a preferential right to dividends. The Ministry of Finance, as expected, rejected the advice from Riga; however, it considered it worthwhile to adopt the Muscovite proposal. For reasons of analytical expediency, it appears worthwhile to mention that existing bonds of political patronage might have played into the hands of the MEC. Muscovite merchants, especially under the leadership of Naidenov (1877-1905), were known to make up the more conservative stratum of corporate Russia who better appreciated their traditional place within the hierarchy of court politics. Moscow Merchants were more fortunate in playing on the diplomatic repertoire of the times by conveniently engaging in behind-the-scenes negotiations and performing the proper rituals of due respect to the dominant system of autocratic-bureaucratic rule and the like. Representatives of the Baltic region, on the other hand, were known for their rather straightforward approach towards business which, in political affairs, must have conveyed connotations of undesired provocation and opposition.<sup>88</sup>

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<sup>87</sup> For details on the MEC, see Owen, 1991, pp.66ff; Rieber, 1982, pp.103-111.

<sup>88</sup> Naidenov must have constituted the archetype of conservatism within the arena of Russian organizational business life. Owen (1991, p.102) describes him as a personality who integrated the diverse cultural and political streams of his times. As such, he was well known to be capable of demonstrating "absolute devotion" to the Czar, while, at the same time, pushing his own agenda of "prudent financial policies." At the occasion of another bureaucratically orchestrated reform conference, the Tsitovich Commission (1897-99), Naidenov rendered an infallible proof of his conservatism when he opposed, alone among the merchants in the empire, the principle of incorporation by registration. In a memorandum to Witte, the MEC warned that the introduction of the new system would lead the great banks to launch a multitude of "small companies with inexpensive, unnamed shares" (Owen 1991, p.147). Thus, what appeared to liberal segments of corporate Russia as a legitimate reform goal was perceived as a threat by the most influential organization of Russian manufacturers in the Witte era.

Bureaucratic Deliberations I. The unwished-for fate of the Baltic business opinion, however, turned out to be futile against the background of a politico-bureaucratic machine that seemed to spin endlessly. Since the process of bureaucratic deliberations took on Kafkaesque proportions, the Czar himself considered it necessary to step in repeatedly and urge the bureaucracy to process the issue swiftly. The State Council, operating as the focal point of policy coordination, however, withstood these reprimands. Instead, the Council insisted on sending the bill to the Ministry of Justice since the matter of reform was deemed particularly significant. The Minister of Justice, Count Konstantin I. Palen, and his subordinates then made a multitude of amendments and counterproposals that mostly questioned the bill in its entire form. Palen offered detailed proposals for revision of fifty-six of its ninety-nine articles. In addition, he called for a "fundamental revision" of the statutes on full and limited partnerships as well as the law of 1836 and proposed for this purpose to send the bill to all existing corporations for comments. Finance Minister Reutern, then, returned the bill to the State Council in November 1869, and signaled his readiness to accept the generality of Palen's amendments to the bill. However, the revisions made in the previous years were so sweeping that the State Council considered it necessary to open a new round of deliberations. Finally, in February 1870, bureaucratic deliberations came to a temporary halt when Alexander II gave his approval to the State Council's proposal to publish the bill and to solicit comments from the public by September 1. To the surprise of the officials, however, no significant feedback was registered. It was suggested that manufacturers and investors "had grown



dazed from watching the bureaucratic carousel of drafting, debating, and delay in the previous nine years."<sup>89</sup>

Formulations II. After the first attempt failed, a second major effort was mounted to produce a new law subsequent to the deadline of September 1870. The newly established commission composed of officials from the Ministries of Internal Affairs, Transportation, Justice, and Foreign Affairs was chaired by Aleksander I. Butovskii of the Department of Trade and Manufacturing in the Ministry of Finance. One of the commission members, the economist Fedor Gustavovich Terner (originally Thörner in German), stressed the importance of entrepreneurship and that of individual initiative for economic development. Terner was obviously taking up ideas of *glasnost* as Pakhman had aired them before. Emphasizing the capacity of self-government, as has been crucial for Western European legal-economic developments, Terner advocated the establishment of clear legal guidelines. He suggested that entrepreneurs should be endowed with a maximum of freedom in which to pursue their businesses as long as they respected the law and registered with the relevant authorities. He especially endorsed the legalization of unnamed shares in order to facilitate the free circulation of stock, deemed supportive of the extension of credit in the Russian economy. Otherwise, he argued, state interference in corporate activity would only damage the prospects for economic growth.

The bill produced by the commission was the first in Russia to advocate for a streamlined system of registration according to European standards of corporate law. Companies, according to the draft law, were considered legally incorporated once the first general assembly approved the charter; all shares were sold and at least one-tenth fully

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<sup>89</sup> Owen, 1991, p.68.

paid for, with the corporation registered at the Ministry of Finance. For potentially risk-seeking enterprises, in particular banks and brokerage businesses, and projects of national significance, such as railroad companies, the law mandated an exemption to the rule by keeping up parts of the concession system. In this way, "potentially fragile entities" had to obtain ministerial, but not imperial, approval. Apart from dismantling parts of the concession system, the reform framework included procedural safeguards to protect minority shareholders. The reform proposal stipulated that owners of only 1/10 of the company's shares could convene a special meeting of the assembly. Further, anyone owning at least 1 percent of the stock must be allowed to vote; and no individual could cast more than half of the votes. Because of these detailed and qualitatively new legal norms, the reform framework swelled in size to 194 articles. The Ministry of Finance then granted a provisional approval of the bill on April 6, 1872. The inclusion of procedural safeguards, however, certainly signaled that the carousel of bureaucratic deliberations was rotating at another level.

Societal Input II. The bill, upon its provisional approval, was submitted to the public for comments. The commission, within a half-year period, received approximately thirty commentaries on the law from newspapers, exchange committees, and other groups, each of them providing insights from the business point of view. Common to these comments was a welcoming attitude vis-à-vis the proposed principle of incorporation by registration. Surprisingly, even the Riga Exchange Committee emphasized that it valued highly the principle of registration. In its critique, the Committee focused on minor points because it hoped (in vain) to avoid a long debate that might doom the reform. The Petersburg business representatives, in the same spirit,

praised the effort of the Butovskii Commission "to remove from legislation all tutelage over the public."<sup>90</sup> However, there was also agreement among the multitude of business opinions that the reform bill was still to perpetuate various forms of bureaucratic tutelage. Owen accounts for a few critical inputs that stand out from the rest.<sup>91</sup> The newspaper *Golos* (The Voice), for instance, criticized article 52 - obviously a typical Russian stipulation - by which the finance minister was empowered to annul a company's registration certificate at any time if inaccurate statements were found in the original application. Such a procedure placed, so was the opinion, a veritable "sword of Damocles" over every corporation registered in the empire. Another sensible comment came from *Torgovyi Sbornik* (The Commercial Reporter), the newspaper of the Russian Industrial Society at that time. It criticized the lack of an appeal procedure for rejected applications.

Bureaucratic Deliberations II. The commission then proceeded to review the comments of the business organizations in thirty-six more sessions. To what extent the bureaucrats might have considered the business opinions in their periodic consultation remains uncertain on the basis of the existing database. Owen merely indicates that the Petersburg critique was not included in the final draft. Presumably, the autocratic principle of secretive deliberations remained untouched by ideas of *glasnost*. Apart from these traditional ambiguities, bureaucratic deliberations reached their preliminary conclusion when the Ministry of Finance approved the draft law in March 1874. This

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<sup>90</sup> Owen, 1991, p.73.

<sup>91</sup> Ibid.

version, 198 articles long, was forwarded to the State Council for final editing. There, the bill underwent a few changes that showed the determination of the conservative elite to ensure the principles of bureaucratic control over business activities. The most notable outcome of this process was a detailed list of punishments to be imposed on managers who violated either the general law or the corporate charter.

These efforts again turned out to be futile when Finance Minister Reutern, on the very eve of final approval, precipitously abandoned the Butovskii bill. At a time when the reform bill had approached the final stages of editing, a stock market panic broke out in Europe (1873), leaving Russian legislators in disarray concerning the cause of reform. Czarist policy makers were so alarmed by the stock-market crisis that, in December 1874, the Czar himself endorsed the repudiation of the Butovskii bill and implemented further restrictions on corporate development. The emperor wrote that new corporate charters should be approved only "with extreme caution." This policy was further highlighted in August 1877, when new companies were approved "only under exceptional circumstances."<sup>92</sup>

### Participation Levels

In contrast to the ideals of *glasnost*, it is probably fair to say that reform was eventually wrecked because a genuine political process that would have moved the totality of singular wants and preferences into the direction of coherence, or even consensus, was missing. Instead an organizational process that bespoke the incapacity of the regime to integrate diverse policy choices into a coherent legal framework existed. On

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<sup>92</sup> Owen, 1991, p.77.

the contrary, the discussed material clearly indicates that the organizing principle of reform was rarely efficient, or politically expedient. For example, to the neutral observer it must appear puzzling why, in 1870, the Butovskii commission deemed it necessary to start over, even though substantial groundwork had been done in the previous nine years of reform.

Scope of social input chances. To be sure, even though business organizations were invited to provide their input at various instances of the reform cycle, their prospects of having a decisive impact on policy tended to be marginal. As indicated above, opinions of business organizations were solicited but not accounted for by the authorities in the final draft proposal. Sheltered from the public, policy experts were meeting in endlessly seeming sessions to discuss and draft the legal framework. A common denominator of these drafting sessions was the production of legal output that would discard most of the entrepreneurial inputs. For obvious reasons, it is therefore delicate to make an accurate assessment of the situation since the available database about these quasi-secretive sessions leaves it largely uncertain what criteria the drafters utilized to discard the lot of business opinions. It remains even questionable whether business opinions were considered at all. Russian business representatives for their part showed their determination to utilize the official invitation to openly discuss their dissatisfaction with the still enforced 1836 legislation. To be sure, opinions were submitted with due respect without openly attacking the principle of autocratic governance.

One major reason for reform failure was the dominant position of the imperial bureaucratic elite within the legislative procedure, which, in the absence of parliamentary oversight, was delegated the task to come up with recommendations for policy design.

The bureaucratic elite clearly imposed a pivotal role in the organization of reform. The more obvious case involves the State Council that preserved its discretion, in contravention of the official time frame, to prolong the process of inter-ministerial deliberations and to send the Butovskii bill to Konstantin Palen. The Minister of Justice, in turn, called for a "fundamental revision" of the statutes. Although this kind of organizational behavior might appear self-defeating, one could interpret this sort of bureaucratic action as an effective indicator for the pivotal role of the bureaucracy within the policy-making process. Accordingly, bureaucratic power becomes specified by means of its discretion to make counter-reform proposals or to make amendments to the official agenda that, in the final analysis, would contravene the emergence of a politically viable solution. Equally, the discretion of the top bureaucrats to decide when to bring reform to a halt or to start over again emphasizes their controlling influence over the organization of institutional reform. In particular the decision of the Finance Minister to abandon reform after informal consultations with personages outside the official cabinet underlines his capacity to interfere, in the style of an elevated autocrat, into the legislative process as he sees fit.

Bargaining Logic. More important than to know who the main culprit of failed reform was, is the question of how the bureaucratic elite utilized its leverage to influence the political organization of reform. Within the exercise of their responsibilities, government agencies took an ambivalent role towards society that, in the final analysis, would compromise the search for a viable political solution. On the contrary, it is suggested that the imperial bureaucracy, far from organizing the "efficient allocation" of

business-level preferences, operated in a general state of detachment from societal concerns.

Indicative of this trend are the many instances in which the authorities requested business organizations to deliver input without, however, granting them significant attention afterwards. Certainly, one of the main concerns of the imperial bureaucracy was to keep intact the traditional foundations of the regime in general, and the state-centered framework of status-defined privileges in particular. To this end, it was prohibitive for government agencies to provide entrepreneurial groups with a context of action, which would have delivered effective participatory components. Instead, the overriding calculus of Russian bureaucratic politics was to impose on the political process an asymmetric order of participatory entitlements, preferentially allocated to the higher stratum of Russian officialdom. To be sure, the emergence of a strong economic base capable of independently formulating its interests would have posed a threat to the traditional system of rule. To avert this scenario, the imperial bureaucracy relied on strategies of political organization, which would prevent the public from having equal access to the policy-making process. Intermediate measures included tactics of political patronage, secrecy in decision-making, and a general preference for behind-the-scenes negotiations. The unheard-of fate of legitimate issues of business, such as, the demand for an appeal procedure appears to confirm the use of these tactics. To be sure, effective political participation was not an issue within the bureaucratic elite. Instead, it appears that the official policy of soliciting societal input was more of instrumental value for the political elite.

## Outcome

Common to these developments was the fact that the autocratic impulse and bureaucratic regimentation remained prominent within the domain of corporate governance. The Russian political elite was in the position to prescribe and delimit the scope of corporate business activities because of its dominant position within the domestic political arena. Thanks to the untouched principle of status-defined participation, the autocratic regime was in the position to hold on to the concession system for incorporation. With the aid of such a system the Russian autocracy exerted an effective veto right over corporate development and the idea of self-government in particular. When the ethnic composition of the stakeholders inspired religiously motivated counter-arguments the bureaucracy could simply refuse to pass it to the higher echelons of power. The government was therefore provided with the capacity to mold any corporation in its own image since every corporate charter had to be signed personally by the Czar. The bestowal of "favors" falls into the same category since it emphasizes the discretion of the imperial bureaucracy to intervene in favor of a particular request, or to neglect it. Under the system of autocratic favors, a particular group of individuals, the so-called "financial oligarchs" distinguished itself from the mass of Russian entrepreneurs by taking advantage of the institutional communication rules.<sup>93</sup> Their avenue to business success usually involved activities in the railroad construction business, which enjoyed a full-scale boom during the second half of the nineteenth century with (government guaranteed) high rates of return and other forms of state support. Crucial for success,

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<sup>93</sup> See, for example, Petrov, Jurij A. 1996. "Formen, Typen und Besonderheiten des russischen vorrevolutionären Unternehmertums, in *Russlands unternehmerische Vergangenheit: ein Wegweiser in die Zukunft?*, pp. 31-52.



however, was to establish close 'working relations' to the higher echelons of bureaucracy in order to receive favorable concessions, terms of contract and cheap credits. The brothers Samuil and Lazar Poljakov, descendants from a Jewish merchant, for instance, established unusually close connections with the Minister for Post and Telegraphy, Count Tolstoj, and to turn it into a favorable railroad construction concession. Using a fair amount of cunning and good business instincts Samuil succeeded in becoming the owner of several railroad corporations. It is reported that Samuil disposed over an enormous capital worth 30 billion rubles [sic?] at the time of his death in 1888.<sup>94</sup> This wealth, however, as contemporaries noted, was due to the shabby quality of railroads constructed under his control. The stakes of doing business in Russia were therefore disproportional high for individuals not connected to the imperial chancellery or any favorite of the Czar. The autocratic regime discriminated in this respect between members of upper levels of state hierarchy, and individuals outside the official hierarchy without adequate access to the political patronage.

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<sup>94</sup> Ibid., at page 43.

## CHAPTER 4

### TRANSFORMATIVE STATE CAPACITY IN THE NEW RUSSIA

To assess the transformative capacity of the Russian polity after the fall of the Soviet Union, the ensuing discourse inquires into the institutional bases of Russian reform politics. Because of its institutional orientation, the study focuses on the variables of participation and interaction. The present analysis of Russian reform politics conceives in this regard a correlation between the variables of institutional arrangement and the capacity to transform embedded social behaviors. To examine the significance of institutional variables the analysis focuses on the issue of corporate law reform. Within this context the analysis covers the time frame of the Presidency of Boris Yeltsin (1992 - 2000). In tracing Yeltsinite reform politics, the analysis concludes that the presidential apparatus did in effect duplicate elements of pre-democratic governance. The utilization of such, it is argued, would eventually infringe upon its ability to conduct an effective economic reform policy. Its low transformative capacity materializes, in this respect, in Soviet-type continuities of corporate governance caused by the resistance of Russian general directors to adapt their behaviors and orientations to the new legislation.

#### Institutional Arrangement

With the intent to insulate government agency from societal resistance, the presidential apparatus emerged to implement a series of institutional reforms that would eventually increase the scope for political maneuvering and tactical moves. Institutional reforms included a set of policy instruments and action channels that would marginalize the role of constitutional organs of legislative activity. As a related strategy, the

Presidency would take steps to disenfranchise and undercut Soviet-type organizations. The resulting alienation of communist-based groups was to be counterbalanced by a loyal network of personal friends and favorites, the new "Kremlin Oligarchy." The analysis refers in this context to the delicate web of "court politics" and extra-constitutional arrangements that, in fact, revolved around the Yeltsin family.

### Inter-Branch Relations

Within the affairs of government, entitlements to affect policy design have the tendency to cluster around the presidential apparatus. To maximize its influence, the Yeltsin Presidency made substantial efforts to institutionalize a set of policy instruments and action channels that would eventually diminish the constitutional principle of parliamentary sovereignty. Recent studies have in this respect highlighted the systemic conflict between the elective nature of the presidency, on the one hand, with the requirement of democratic legitimization for governmental power, and the autocratic character of that very power, on the other hand.<sup>95</sup>

Newly established freedoms of parliamentary sovereignty (Article 94) are diminished by tendencies of power concentration within the executive branch of government. A common point of reference delivers in this respect Article 90 of the 1993 Constitution. The presidency, according to this stipulation, has the prerogative to assume

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<sup>95</sup> Lilia Shevtsova interviewed in Trud, June 18, 1999, as translated in *The Current Digest of the Post-Soviet Press* Vol.51, No.24, p.9. See also Eugene Huskey. 1999. *Presidential Power in Russia*. Armonk, NY: Sharpe; Virginie Coulloudon. 2000. "The Divided Russian Elite: How Russia's Transition Produced a Counter-Elite," in *Building the Russian State*, pp.67-87; M. Steven Fish. 2000. "The Executive Deception: Superpresidentialism and the Degradation of Russian Politics," in *Building the Russian State*, pp.177-192.

legal authority in policy areas, which have not undergone parliamentary regulation. According to Article 90 the President is empowered to issue decrees and directives that are in force throughout the territory of the Russian Federation. The decree powers entitle the President to establish the legal basis upon which the executive branch of government may pursue its policy. Moreover, the presidency disposes over the procedural means by which he may expedite his choice of affairs in against parliamentary resistance.

An especially effective instrument that emerged was the presidential discretion to dissolve the State Duma. Intended as a check on presidential power, the constitution prescribes that the President needs parliamentary approval for his latest choice with respect to the affairs of government. Additional features stipulate that the President has the option to dissolve the State Duma if it rejects his candidate for Prime Minister three times. Article 111 states: "After the State Duma rejects three candidates to the office of Chairman of the Government of the Russian Federation, the President of the Russian Federation shall appoint the Chairman of the Government of the Russian Federation, dissolve the State Duma, and call new elections." Designed as an unlikely exit strategy, such entitlement was utilized as a very powerful bargaining chip within the course of the Yeltsin Presidency. Yeltsin made extensive usage of the threat of parliamentary dissolution to force the deputies to submit to his will by approving his budget, confirming his latest choice for premier, and the like. Yeltsin clearly demonstrated, on the other hand, that he could change Prime Ministers four times between March 1998 and August 1999. Sacrificing unpopular ministers enabled Yeltsin to defuse the rising hostility of

Parliament and the nation. As Huskey put it: "Like a seated beast, following each sacrifice the parliament lost for a time the will to stalk the executive."<sup>96</sup>

State Duma deputies, on their turf, were not able to mount an effective impeachment procedure against the President. Despite several attempts to impeach President Boris Yeltsin, members of Parliament would eventually succumb to the complexities of the legal procedure. To be sure, according to the letter of the law it is virtually impossible to remove a Russian President from office. As established in Article 92 of the Russian Constitution, two-thirds of the State Duma must vote to charge him with high treason or "some other grave crime." These charges must be validated by the Supreme and Constitutional Courts. In addition, two-thirds of the Federation Council must vote to remove him within three months of the filing of the charges.<sup>97</sup>

By formalizing such power asymmetries, it seems reasonable to argue that the 1993 Constitution had been tailored to the persona of Boris Yeltsin. Lilia Shevtsova, for instance, contends that the constitutional framework had been designed to "ensure domination" by Boris Yeltsin and his close entourage.<sup>98</sup> The personal characteristics of Boris Yeltsin seemed conspicuously close to this rationale. That Yeltsin had an obvious weakness for presenting himself as the new Czar and the single political force able to protect democracy in the Russian lands underscores this rationale. To notice Lilia

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<sup>96</sup> Huskey, 1999, p.170.

<sup>97</sup> The most recent impeachment procedure was instituted on 15 April 1999. One of the five counts of impeachment included the charge that Yeltsin was to be held responsible for the shelling of the White House in 1993. This is the most notorious charge leveled against Yeltsin in subsequent indictments generally promoted by the Communist Party. None of the charges, however, passed the first hurdle in the State Duma to get the required 300 votes. For details see *The Current Digest of the Post-Soviet Press*, Vol.51, No.20, pp.1-5.

<sup>98</sup> Shevtsova, 1999, p.279.

Shevtsova: Yeltsin's tremendous power - and, equally important, the influence of his circle - have accentuated some of his undemocratic characteristics. Those close to him have often encouraged him to think of himself as Czar Boris (1999, p.275).<sup>99</sup> As a corollary, he may have perceived any restriction on his presidential powers as an insult. Parliamentary efforts to amend the Constitution were repudiated on a routine basis. To be sure, any type of amendment would impair his capacity to act as the patron of Russian democracy.<sup>100</sup> To quote Boris Yeltsin directly: "The Constitution is what enables us to block extremists. It stands in the way of those who are sowing hatred and ethnic discord, who cannot abide a free press, and who are trying to deny us the right to private ownership and a free market."<sup>101</sup> Boris Yeltsin considered it as politically expedient to maintain the extensive powers of the presidency in order to defend newly established freedoms. The Russian transition has in this respect been marked by the use of traditional patterns of political authority. Indicative of the implied personalism, however, is the fact that everything depended on his persona of being the President. Yeltsin resisted amendments because he apparently considered his own personality to be the central safeguard of Russian democracy. For obvious reasons, political analysis, therefore, tends to label the 1993 framework as the "Yeltsin Constitution." By the same token, what

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<sup>99</sup> Shevtsova, 1999, p.275.

<sup>100</sup> Obviously, the bones of contention were parliamentary efforts to amend the constitution. State Duma deputies, stirred up by the recurrent government reshuffles, sought to amend the constitution in order to delimit the powers of the Presidency. Yelena Mizulina (Yabloko), for instance, launched an initiative in July 1998, wherein she proposed to simplify the procedure for impeaching the President. For details, see Sergei Aksyonov. "State Duma Storms Constitution," *Kommersant-Daily*, July 1, 1998, p.3, as translated in *The Current Digest of the Post-Soviet Press*, Vol.50, No.26, p.11.

<sup>101</sup> Natalya Timakova. "Don't Hold Your Breath," *Kommersant*, December 15, 1998, pp.1f, as translated in *The Current Digest of the Post-Soviet Press*, Vol.50, No.50, p.14f.

Yeltsin did not account for is the fact that the constitutional framework could provide a Trojan horse for dictatorial ambitions. This scenario could become especially relevant if a member of an "extremist" party should win the presidential elections. In such a circumstance, the Constitution would deliver the means necessary to roll back reform by decree. Yeltsin's grasp of the situation reveals that he was very positive about himself to act as the President.

### Action Channels

The ability of the presidency to generate support for his legislative agenda in the State Duma has been further advanced by a network of bureaucratic support structures. Eugene Huskey accounts in this respect for three action channels that became regularly employed by the President.<sup>102</sup> The first is the Domestic Policy Administration, which informs the President of the correlation of political forces in Parliament while at the same time trying to convince deputies of the advantages of the legislative initiatives of the president. The second institution comprises the presidential representatives to the Duma and Federation Council. These operational units oversee the movement of a bill from its drafting in the executive to its final approval in Parliament. In addition, for important bills, the leader of the Executive Office of the President also assigns a high-ranking government official to "bulldog" the bill through the two houses.

The most crucial institutional support is delivered by the Executive Office assisting the President to manage the flow of legal documents in and out of his office.

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<sup>102</sup> Huskey, 1999, pp.172f.

Established in 1993, the Executive Office brings under one organizational roof a disparate group of presidential agencies, ranging from the State-Legal Administration and Monitoring Administration to the analytical centers serving at the discretion of the President. Huskey indicates that the organizational structure of the Executive Office defies a clear demarcation in the lines of competency. Accordingly, it is stated that the Executive Office never succeeded in establishing clear vertical lines of authority or horizontal lines of jurisdiction between offices.<sup>103</sup> In addition, its many subdivisions enjoy different degrees of autonomy and access to the President. As a result, the Executive Office developed into a massive institution with forty-three bureaus and two thousand professional staff members. Of great significance for legislative procedure is the State-Legal Administration that advises the President on legal matters. It functions as a key gatekeeper in the legislative process, whether shepherding executive bills through Parliament, advising the President on the appropriate response to legislative vetoes, or drafting and reviewing decrees for the President's signature.<sup>104</sup>

The Presidency, patterned upon traditional concepts of legal authority, presents itself as the dominant player within the Russian political realm endowed with the discretion to affect policy design and to outmaneuver parliamentary opposition. With the aid of an expansive support apparatus, the President has a wide range of options to influence policy choice. Such an arrangement seems troublesome with regard to aspects of institution-building and capacity.

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<sup>103</sup> For details, see Huskey, 1999, pp.58ff.

<sup>104</sup> For a detailed discussion of the State-Legal Administration, see Huskey, Eugene. 1995. "The State-Legal Administration and the Politics of Redundancy," *Post-Soviet Affairs*, Vol.11, No.2, pp.115-143.



## Interface Linkages

Access to "Czar Boris": Societal schemes of participation tend to follow the culturally embedded modus operandi. The analysis refers in this context to the delicate web of "court politics" and extra-constitutional arrangements that revolved around the Yeltsin family. In its pursuit of reform politics, the Yeltsin Presidency appeared to capitalize on a personalized type of entitlement that corresponds in this regard to features of volatility and procedural inequality. To provide a systemic account of the issue, however, requires some improvisation, since emerging patterns of bargaining and participation in policy design continue to be a work in progress. The absence of an institutionalized input structure may in this respect render only the most general pattern.<sup>105</sup>

A politicized account of the Yeltsin regime was tendered by former Prime Minister Yevgeny Primakov. In an open letter to the President, Primakov criticized a lack of concern on the part of the presidential apparatus for the affairs of society, to wit:

We feel compelled to write to you because we are seriously concerned about the state of affairs in Russia on the eve of the parliamentary and presidential elections. [...] The presidential staff and a group of individuals close to it have essentially been put in charge of the country, and this group is turning the state into a hostage to its interests and actions, while your political and informational isolation from the people who elected you is increasing. The Russian Federation government sometimes becomes a mere game piece in your inner circle's games.<sup>106</sup>

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<sup>105</sup> To be sure, volatility of input options is likely to continue for some time since the societal bases of civil society are still underdeveloped; see, for instance, M. Steven Fish, *Democracy from Scratch*, 1995; for studies on entrepreneurial organizations see Lohr, Eric. 1993. "Arkady Volkysy's Political Base," *Europe-Asia Studies*, Vol.45, No.5, pp.818-837; McFaul, Michael. 1993. "Russian Centrism and Revolutionary Transition," *Post-Soviet Affairs*, Vol.9, No.3, July-September, pp.196-223; Rudkin, Charles. 1996. "The Russian Union of Industrialists and Entrepreneurs: Professional Association or Political Party? The Role of Employers' Associations in Post-Soviet Russia," *Slavonic and East European Review*, Vol.74, No.4, pp.640-657.

<sup>106</sup> "A Small Group of Individuals Is Abusing its Position," Letter from Primakov, Luzhkov and Yakovlev to the President of Russia. *Kommersant*, Oct.29, 1999, p.2, as translated in *The Current Digest of the Post-Soviet Press*, Vol.51, No.43, p.14.

The underlying pretext of the open letter was the deteriorating health condition of the President and the pressing question of who would eventually replace him. The political nature of the letter may in this regard explicate the conspiracy theory involved, namely the allegation that "the state" has been turned into a "hostage." At a more general level, the letter is indicative of the problem of insularity and the formation of particularistic exchange relations.

More carefully crafted assessments of the Russian political situation confirm the latter point. Hans-Henning Schröder, for instance, argues that:

Proximity of financial and business circles to the executive and intertwining with the institutions relevant for making decisions was characteristic of the [Yeltsinite, W.T.] political system. Parties, associations or lobbies representing the will of large groups of society and giving these a political voice were still underdeveloped. Thus, society as a whole was excluded from the political process. [...] Consequently, it was not the consolidation of democracy that was the central focus of the political process in Russia but the deformation of the presidential democracy legitimated by elections and the constitution by incorporating commercial interests into the actions of the executive.<sup>107</sup>

The New Kremlin Oligarchy. The group of individuals and business circles with high proximity to the Yeltsin Presidency came to be known as the "Oligarchy" or the "Boyars."<sup>108</sup> Informal entitlement schemes are endemic features of this particular kind of

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<sup>107</sup> Schröder, Hans-Henning. 1999. "El'tsin and the Oligarchs: The Role of Financial Groups in Russian Politics Between 1993 and July 1998," *Europe-Asia Studies*, Vol.51, No.6, pp.957-988, here at pp.980f.

<sup>108</sup> The group of "boyars" includes Boris Berezovsky of LogoVaz (automobiles, television, oil); Roman Abramovich of Sibneft (protégé of Berezovsky), Mikhail Friedman of the Alfa Group (oil, tea, sugar, cement); Mikhail Khodorkovsky of Ros-Prom (banking, oil); Vladimir Gusinsky of Media-Most Group (television, newspapers, banking, real estate); Mikhail Smolensky of SBS-Agro (banking); Vladimir Potanin of Uneximbank (banking, real estate, oil and gas, media, ferrous metals); Vladimir Vinogradov of Inkombank (banking, metals, oil).

exchange relationship. The Yeltsin regime was actively involved in the creation of this type of support group.<sup>109</sup>

An essential contribution to the emergence of oligarchic structures occurred when the Kremlin turned over state budget money for commercial management. After the collapse of the Soviet Union the existing financial structures had to be rejuvenated without, however, disrupting the established networks. With the backing of the political leadership, new "private banks" mushroomed with state-provided capitalization.<sup>110</sup> In turn, the newly emerging banking elite would eventually proceed to utilize their resources to buy up Russian industry. A very effective tool was, in this respect, the so-called loans-for-shares privatization scheme. Masterminded by Potanin, the scheme advocated that large stakes in Russia's companies were to be transferred to a small group of bankers on highly favorable terms. Yeltsin instituted this privatization scheme in 1995, whereby the class of *nouveaux riches* businessmen agreed to make loans to the "cash-starved" state in return for shares. Most transactions were the result of behind-closed-doors negotiations.

The rationale underlying this reform strategy was to create a class of property owners whose self-interest would depend on the continued support of the Yeltsin regime. To secure support for his reform policies President Yeltsin granted special "exemptions"

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<sup>109</sup> Its emergence has been described as comprising three stages: commercial, banking, and industrial. See Sergei Markov. "Big Money's Origins: The Three Stages," *Izvestia*, Sept.18, 1997, p.4, as translated in *The Current Digest of the Post-Soviet Press*, Vol.49, No.38, p.9f. See also Virginie Coulloudon. 2000. "The Divided Russian Elite: How Russia's Transition Produced a Counter-Elite," in *Building the Russian State*, pp.67-87; Olga Krishtanovskaia and Stephen White. 1999. "From *Nomenklatura* to New Elite," in *The New Elite in Post-Communist Eastern Europe*, pp.27-52; Ivan Kukolev. 1999. "Formation of the Business Elite in Russia," in *The New Elite in Post-Communist Eastern Europe*, pp.279-295.

<sup>110</sup> For details, see Coulloudon, 2000, pp.69ff.

in exchange for loyalty. To make social and economic reforms irreversible Yeltsin was pleased to give out bargains to friendly bankers rather than to the provincial industrialists who are backing the Communist Party. Culturally specified codes of governance emerge in this respect through the personalized nature of entitlement. To some political observers, analogies to the late czarist period "fit perfectly well" in this context.<sup>111</sup>

*Violent Entrepreneurship.* Certain institutional details of the political exchange situation, however, call into question its cultural modus. Conspicuous in this regard is the attitudinal orientation of some of the financial-industrial elite vis-à-vis political authority and their seeming readiness to exploit every means possible, including extra-constitutional arrangements, to advance their agenda of self-enrichment. As a corollary, conflicts of interest often bear the imprints of *violent entrepreneurship*. Government officials opposed to oligarchic business interests ran the risk of becoming targets of organized violence.

Anatoly Chubais and Boris Nemtsov, two key figures of the "second-generation reforms" [see below, IMF], illustrate the violent tendencies of the post-Soviet political exchange situation. Appointed Deputy Prime Ministers in March 1997, the reformers were tasked to break with the unwritten rules of behind-the-scenes agreements. Part of the new strategy was to make sure that state assets would be privatized within a framework of (relatively) open and competitive bids. The first touchstone of this type of government action was the competitive bid for 25% shares of Svyazinvest (Communications Invest Telecommunications Company) on 25 July 1997. At the auction itself, two consortia were

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<sup>111</sup> See, for example, Dinello, Natalia. 1999. "The Russian F-Connection. Finance, Firms, Friends, Families, and Favorites," *Problems of Post-Communism*. January/February, pp.24-33.

competing, whereby the Mustcom holding (Potanin interest) emerged as the winner defeating his competitor, Berezovsky. Expectedly, the auction was surrounded by incidents of moderately belligerent exchanges. In a last-minute appeal to Chubais, Berezovsky reportedly tried hard to avert the scenario of open competition.<sup>112</sup> To this end, Berezovsky, in company with Potanin and Gusinsky, boarded a plane to meet Chubais who was vacationing in France at the time. However, in opposition to their demands, Chubais upheld the cause of the official agenda. Dissatisfied with the formula that whoever should offer the largest amount would win, Gusinsky and Berezovsky reportedly went over to threaten Chubais with "media war."<sup>113</sup> Another ploy of the Oligarchs was the possibility of taking purposeful actions to bring about the collapse of Svyazinvest. In the aftermath of the bid, the defeated competitors made real their first threat and initiated a large-scale media campaign against Chubais. Multiple "conspiracy theories" were aired involving an allegedly "strategic alliance" between Chubais, Kokh (Deputy Prime Minister and Chairman of the State Property Committee), and Potanin to outmaneuver the recalcitrant tycoons.<sup>114</sup> In the end, Yeltsin eventually stepped in and fired Kokh as "compensation" for those who lost in the auction. In addition, Yeltsin promised that ONEKSIMbank would not participate in the next Svyazinvest auction.

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<sup>112</sup> Andrei Bagrov. "Owners of ORT and NTV Lose First Battle," *Kommersant-Daily*, July 30, 1997, pp.1f, as translated in *The Current Digest of the Post-Soviet Press*, Vol.49, No.30, p.5.

<sup>113</sup> For a detailed organizational chart see "Who Controls Russia's News Media Outlets," *Sveodnya*, August 12, 1999, p.2, as translated in *The Current Digest of the Post-Soviet Press*, Vol.51, No.33, p.14.

<sup>114</sup> See, for instance, Ulyan Kerzonov. "Anatoly Chubais Seeks Complete Control Over Russia," *Nezavisimaya Gazeta* (Berezovsky interest), Sept.13, 1997, pp.1-6, as translated in *The Current Digest of the Post-Soviet Press*, Vol.49, No.37, pp.1-5; Fyodor Fyodorov. "Bankers Behind Kremlin Walls," *Kommerant-Daily*, Sept.16, 1997, p.1, as translated in *The Current Digest of the Post-Soviet Press*, Vol.49, No.37, p.5.

Another case demonstrating the violent tendencies of the new Oligarchy is provided by the Skuratov affair, in Spring of 1999. At that the time the Prosecutor General, Skuratov was ousted from office while he was looking into illegal financial transactions involving Aeroflot. The events leading to his dismissal became virulent when state-run television channels aired excerpts of videotape purporting to show Skuratov engaging in an extra-marital affair. According to Skuratov's understanding, the chain of events leading to the broadcasting of the tape is connected to the very circle of personages that he was investigating. In his statement to the Federation Council on 17 March 1999, he indicated that: "A big contribution to the process of getting me out of office was made by the oligarchs you are all familiar with, who have their own interest in criminal cases involving corruption in the highest echelons of power. The cases they are most interested in are the ones involving the Aeroflot airline company [Berezovsky interest], the AvtoVAZ [Volga Automotive Plant] joint-stock company, the Atoll private security company [Berezovsky involvement] and others."<sup>115</sup>

The more immediate circumstances surrounding the Skuratov-affair, however, reveal the uncompromising nature of the tactics of the new Kremlin Oligarchy. In the pursuit of wealth and political influence, the new class of businessmen seems inclined to utilize forward linkages to crime and corruption. To acquire incriminating evidence, the

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<sup>115</sup> Speech of the General Prosecutor in the Federation Council reprinted in *Kommersant*, March 18, 1999, p.6, as translated in *The Current Digest of the Post-Soviet Press*, Vol.51, No.11, p.1f. Investigations into the cash flows of Aeroflot have indicated that moneys from ticket sales were channeled to an off-shore bank via complicate financial schemes involving the subsidiary Andava located in Lausanne, Switzerland (*Der Spiegel*, 1999, No.35, p.144f.). The Atoll company is charged to have carried out private surveillance activities on high-ranking government officials including the Russian President's family. See Leonid Berres and Oleg Stulov. "Search is made at Sibneft for incriminating evidence against Berezovsky," *Kommersant*, Feb.3, 1999, p.1, as translated in *The Current Digest of the Post-Soviet Press*, Vol.51, No.5, p.7.

new Oligarchy, as a corollary, obviously capitalizes on the prevailing situation of dysfunctional administrative state capacity.

The most distinguishing thing about oligarchic capitalism is the "privatization of power." I know of a great many examples in which, at the wave of some magnate's hand, an army of regular policemen and prosecutors will begin working feverishly to dig up dirt on that magnate's rival or political opponent. Our law-enforcement agencies are so weak and impoverished that they are in effect at the disposal not of bodies of power but of economic and media "kings." Investigations of high-profile contract murder proceed slowly and listlessly. But when it comes to a competitive struggle among businessmen, dozens of investigators go to work, turning everything upside down to satisfy some magnate's curiosity.<sup>116</sup>

Chronic problems of underpayment in the administrative apparatus have the effect that law enforcement agents exchange their official duties with private protection money on an informal basis. It has been estimated that up to 20% of FSB (former KGB) cadres are engaged in extra-legal "roof" (*krysha*) business.<sup>117</sup> In his detailed analysis of various agencies of *violent entrepreneurship*, Volkov demonstrates that there is a growing industry of private enforcers that recruits its personnel from the power-wielding administrative branches of government, MVD and FSB.<sup>118</sup> Private security agencies are said to build "enforcement partnerships" at times with semi-legal entities or straightforward criminal groups. Criminal groups and state police cooperate to install a "combined roof." As a corollary, corrupt officials "reveal" violations of sanitary and other

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<sup>116</sup> Boris Nemtsov. "Russia's Future. -- Oligarchy or Democracy?" *Nezavisimaya gazeta*, March 17, 1998, p.8, as translated in *The Current Digest*, Vo.50, No.11, pp.1-5. See also, "I'm against a board of directors for Russia." Interview with Anatoly Chubais conducted by Yevgenia Albats, *Kommersant-Daily*, March 5, 1998, pp.1-5, as translated in *The Current Digest of the Post-Soviet Press*, Vol.50, No.11, pp.6-8.

<sup>117</sup> *The Economist* (28 August, 1999, p.17) characterizes *Krysha* as a "straightforward commercial arrangement, with payments, which may typically run to 10-20% of profits, invoiced monthly by a security company. The resulting protection is a hybrid of insurance, factoring, physical security, a lawyer and a friendly civil servant: good service costs more, but is more effective."

<sup>118</sup> Vadim Volkov. 1999. "Violent Entrepreneurship in Post-Communist Russia," *Europe-Asia Studies*, Vol.51, No.5, p.741-754.

codes on order from the Mafia. Entrepreneurial entities without "roof" protection then face up to exorbitant taxes or inspection fees and the like. The joint enterprise of *violent entrepreneurship*, however, has furthered the hollowing out of the state's claim that it represents the legitimate monopoly of power. By exploiting and maintaining a vacuum, semi-legal collusion between corrupt officialdom, state police, and criminal groups have compromised any serious effort toward state-building.

In view of such violent aspects in state-business relations, it seems unlikely that the post-Soviet banking and corporate elite would fit "perfectly" well in the Romanov model of governance. Particularly troublesome in this respect has been the readiness of the financial-industrial elite to exploit almost every means possible to advance their agenda of self-enrichment, including the utilization of forward linkages to *violent entrepreneurship*. Confronted with these semi-legal aspects of Russian entrepreneurship, it seems futile to expect the new Oligarchy to proffer input for the legal conceptualization of the company. Au contraire, the situation suggests that the financial-industrial elite continues to identify and pursue its interests outside the conventional rule-of-law framework. Certainly, the sanctity-of-law concept that penetrates much of the Western business climate is alien to this kind of support group.

IMF-Cooperation. Another essential case demonstrating the institutional contingencies of the Yeltsin regime was IMF-Russian cooperation. The analysis emphasizes in this respect the proximity of the International Monetary Fund (IMF) to relevant Russian policy-making authorities. Whether this kind of cooperation evolved into a case of "intertwining" remains open to discussion since disagreement prevails



concerning the depth of IMF involvement in Russian affairs. Political inquiries vacillate in this regard between notions of technical assistance and political advocacy.

In the field of privatization, Aslund, for instance, argues that the role of foreign advisors was simply to provide technical support.<sup>119</sup> As Aslund put it: "...the leading Russian privatizers, Chubais and his deputy Dmitry Vasiliev, knew what kind of policy they wanted. They instructed their advisors about the policy framework, and the advisors were not permitted to act as an interest group. Their job was to provide the government with useful advice within the parameters of the government policy."<sup>120</sup> Political studies, on the other hand, contend that the international institution, beyond its conventional task of macro-economic stabilization, got increasingly involved into the management of the Russian economy.<sup>121</sup> To be sure, a possible source for these diverging assessments is low visibility in IMF operations.

IMF proximity, however, was conspicuous when the Yeltsin Presidency took the initiative to apply for full membership in the international institution. To expedite the application, the Russian government invited foreign advice to participate in the drafting of a detailed program on economic policy. The resulting framework conformed so well to IMF standards that it would eventually earn the grade of "an IMF shadow program without financing" from one of the foreign advisors.<sup>122</sup> Approved in late February 1992,

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<sup>119</sup> Aslund, Anders. 1995. *How Russia Became a Market Economy*. Washington, DC: The Brookings Institution.

<sup>120</sup> Aslund, 1995, p.248.

<sup>121</sup> See, for instance, Gould-Davis, Nigel & Ngaire Woods. 1999. "Russia and the IMF," *International Affairs*, Vol.75, No.1, pp.1-22.

<sup>122</sup> Aslund, 1995, p.64.

the Economic Memorandum was sent to the Fund in the hope it would expedite their application for full membership. Russian Government circles expressed their hope that the document "will make a good impression on the international economic community and that Russia will become a full member of the IMF and the International Bank for Reconstruction and Development [The World Bank]."<sup>123</sup>

Evidently, the Russian government pinned high hopes on IMF membership. Endemic to this episode was the idea that transition to a democratic market economy would essentially hinge upon the availability of foreign financial assistance.<sup>124</sup> According to this reform calculus, it became imperative to know what kind of policy would meet the sympathies of the international finance community. The Russian government would therefore invite foreign economic advice to participate in the drafting of the economic reform agenda to ensure agreement with western standards. The official presentation of the Memorandum bespeaks the delicate nature of IMF involvement. Speaking at the 1992 Annual Meeting of the Bretton Woods Committee, Michel Camdessus, at the time IMF Managing Director, was obviously taking pains to de-emphasize IMF involvement in the drafting. "The staff of the IMF has assisted the Russian authorities in preparing this memorandum. But allow me to insist on one point. It is *their* program. They will take the credit for the successes and the blame for the failures." He then went on to explain: "The

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<sup>123</sup> "Russian Government Memorandum on Economic Policy," *Izvestia*, February 28, 1992, pp.1-2, as translated in *The Current Digest of the Post-Soviet Press*, Vol.44, No.9, pp.1-4.

<sup>124</sup> Gould-Davis et al. (1999) refer in this respect to the structure of incentives deriving from IMF assistance. IMF credits, it is noticed, provide an inexpensive modus to finance the state budget by non-inflationary means. In addition, the institution's influence is highly leveraged since successful negotiations with the IMF are almost always a prerequisite for agreements with the World Bank, the London Club and the Paris Club.

program has to be *their* program, backed by *their* commitment, supported by *their* public opinion."<sup>125</sup>

Visibility of IMF proximity emerged aggressively (though not by intentional design) when the institution announced its support for "second-generation" reforms in 1995. The ultimate intent was to strengthen property rights by making financial support conditional upon thorough institutional changes. To achieve this, the IMF put a new slant on conditionality.<sup>126</sup> To strengthen its commitment towards second generation reforms, the Russian government entered into special monitoring agreements with the Fund. Monitoring of standby arrangements was to be conducted on a monthly rather than quarterly basis.<sup>127</sup> A related strategy was to institute a Temporary Extraordinary Commission on Strengthening Tax and Budget Discipline [VChK]. Under the aegis of Anatoly Chubais and Boris Nemtsov, the Commission was empowered to seize and sell off the assets of tax debtors. Such actions, and IMF support for them, provoked a furious response from the Oligarchs.

In December 1997, when the Commission decided to seize and subsequently sell off the property of two tax defaulters -- the Omsk Petroleum Refinery (Berezosky) and the Angarsk Petro-chemicals Company -- a new tide of "media war" erupted. To oppose strengthened efforts of revenue collection, the financial-industrial elite decided to orchestrate a media campaign against IMF involvement in Russian business affairs. The

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<sup>125</sup> Michel Camdessus speaking to the Conference on the Economic Future of the Former Soviet Union at the 1992 Annual Meeting of the Bretton Woods Committee, U.S. Department of State, Washington, D.C. on June 15, reprinted in *IMF Survey*, 6 July 1992, p.221.

<sup>126</sup> For details see Gould-Davis et al., 1999, pp.11ff.

<sup>127</sup> *IMF Press Release* No. 95/21, 11 April 1995.

most cynical articles came from the Berezovsky-owned newspaper *Nezavisimaya gazeta*. Its first page headline read: "Why Does Russia Need a Government of its Own?"<sup>128</sup> Excerpts of letters from IMF and World Bank to the Prime Minister Viktor Chernomyrdin were published, which convey the clear message that the Russian government would not obtain any further assistance unless Chernomyrdin would "finalize" the decisions of the VChK.<sup>129</sup> *Nezavisimaya gazeta* commented on the IMF/Worldbank initiative, to wit: "Following the IMF's logic, the Russian Federation Cabinet of Ministers could be disbanded, it could be replaced by a small staff for monitoring the implementation of Washington's decisions, and the [Russian] White House could be leased to commercial firms. Everything would be easier for the budget." Capitalizing on the theme of wounded national pride, the authors eventually went over to ridicule Chubais and Nemtsov who conducted the VChK campaign. Koshkaryova and Narzikulov made their view clear: "Under this arrangement, there would no longer be any need for the two First Deputy Prime Ministers, who deal with the economy. After all, they are essentially duplicating the work of Messrs. Camdessus and Wolfensohn."<sup>130</sup>

To be sure, Russia's new relationship with the IMF was made possible in part by the strong insulated executive, which had been created by the 1993 constitution. During

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<sup>128</sup> Koshkaryova, Tatyana & Rustam Narzikulov. "Why Does Russia Need a Government of its Own?" *Nezavisimaya gazeta*, Dec.18, 1997, pp.1f, as translated in *The Current Digest of the Post-Soviet Press*, Vol.49, No.51, pp.8f.

<sup>129</sup> Camdessus is quoted to "recommend" that: "Before the meeting of the Board of Executive Directors can be held, a number of measures in the form of preliminary conditions must be carried out. [...] I attach enormous significance to the decisions made at the VChK's meeting on Dec. 8, 1997, concerning major defaulter enterprises. Those decisions are especially important if the government intends to show major Russian taxpayers that it is serious about its efforts to collect taxes. Accordingly, the decisions should be finalized immediately, made public, and then implemented fully, following a specific timetable."

<sup>130</sup> *Ibid.*

the course of negotiations, IMF-staff could reassure itself of the feasibility of agreed-upon terms of contract since the Russian Presidency could make them legally effective by resorting to its abundant decree powers. Parliamentary opposition to IMF conditionality, on the other hand, could be simply vetoed. The elitist and essentially collusive nature of such "cooperation" sparked criticism regarding the role of IMF-sponsored economic advice, not only from among the ranks of the Oligarchy but from the academic community as well. It is criticized that economic advisors, operating on neo-classical theoretical basis, are welcoming the concentration of political power, while ignoring the long-term effects of such approach on capacity-building, and the concept of democratic legitimacy in particular.<sup>131</sup>

Assessing IMF staff involvement in Russian legal reform, Kathryn Hendley comes to the conclusion that:

Many laws related to economic development, such as banking and securities legislation, have been demanded not by Russian businessmen but by international financial institutions. In some instances, the release of money from the World Bank or the International Monetary Fund has been linked to the passage of specific laws (Camdessus, 1996). In other cases, receiving technical assistance for much-needed reforms has required the Russians indiscriminately to adopt a Western framework for these reforms, rather than allowing Russians to dictate the shape of future institutions (Aslund, 1995, p.247; Sharlet, 1997).<sup>132</sup>

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<sup>131</sup> See, also, Fish (2000, p.181), who argues that:

"For their own part, the foreign consultants who advised the Russian government on economics were, as is normally the case among neoclassical economists, convinced of the virtues of concentrating, rather than dispersing, power. Many felt that the concentration of power would fortify the forces most committed to rapid economic change, minimize the dangers of 'gridlock,' and marginalize the bothersome interference of 'politics' in restructuring a moribund economy."

<sup>132</sup> Hendley, Kathryn. 1997. "Legal Development in Post-Soviet Russia," *Post-Soviet Affairs*, Vol.13, No.3, pp. 228-251, here at pp.238-240.

The process of corporate law reform confirms the outlined contingencies of transformative state capacity. The analysis confronts in this respect the circumstance that the Yeltsin regime was able to engender popular support for the removal of Soviet-type controls, as mandated by the reform concept of "depoliticization," without, however, securing intermediary agreements on the emerging legal framework.<sup>133</sup> The principle objective of Russian privatization, as Shleifer and Vasiliev summed it up, was not to get rid of the managers, but of the ministries.<sup>134</sup> The inability of the Yeltsin regime to effectively move its reform agenda beyond the strategy of depoliticization so as to design and implement a cohesive corporate governance regime is indicative of the proposed line of reasoning.

Underlying reform failure was the predisposition of the Yeltsin Presidency to utilize various types of emergency powers. Instead of going through a lengthy process of building societal support, the Presidency would more often resort to Article 90 in order to circumvent parliamentary opposition to his reform plans. Using his decree powers, Yeltsin issued omnibus privatization decrees that would include aspects of company

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<sup>133</sup> Depoliticization, as argued by Boycko, Shleifer, and Vishny (1996) refers to the reform strategy of disenfranchising Soviet-type controls over the affairs of business and industrial management. To implement depoliticization was considered imperative according to dominant types of economic advice since political influence over business was considered the prime cause for economic inefficiency. Institutional concerns of effective corporate governance, on the other hand, and managerial discretion in particular, were considered "clearly subordinate" to depoliticization (Boycko et al., 1996, p.12). The main policy tool of depoliticization was the 1992 Privatization Program. Signed into law by Yeltsin on 11 June 1992, the Russian parliament passed a new privatization program designed to distribute most of the large state enterprises in eighteen months, beginning in January 1993.

<sup>134</sup> Andrei Shleifer and Dimitry Vasiliev. 1996. "Management Ownership and Russian Privatization," in *Corporate Governance in Central Europe and Russia*. Vol.2, pp.62-77.

law.<sup>135</sup> In addition, regulations related to corporate law materialized in the manner of flat orders or prohibitions: the President states what is or what is not to be done. As a corollary, the privatization decrees were typically lengthy, making it difficult to locate the relevant provisions. The pertaining contingencies of the legal conceptualization of the firm became clearly visible for Pistor who observes that:

From a formal point of view it is worth noting that most normative acts pertaining to privatization or corporate law, issued since the introduction of economic reforms in 1992, were presidential decrees. Their primary goal was to regulate specific aspects of the reform process, without being necessarily consistent with each other, or with underlying legislation. The latter is part of the basic dilemma of the reform process. Even if the legislature had been willing to support reform, it would have been unable to keep up with its pace. As a result, contradictions between new normative acts and old laws would have been unavoidable under more favorable conditions. [...] The lack of change in legal culture is also apparent in the style of normative acts passed. The majority of norms reveal a systemic lack of appreciation of the importance of norm clarity and consistency. This tendency is difficult to explain, unless it is seen as the continuation of a legal culture that paid little attention to a rational and predictable legal system.<sup>136</sup>

Kathryn Hendley, a distinguished field researcher of Russian company law, renders a similar account:

The technical problems of Russian law (including company law) are legion. Merely finding the law can be a struggle - to say nothing of the difficulty of interpretation. Laws are often internally contradictory or make cross-references to laws that either do not yet exist or do not say what the first law claims. The desire to make the market reforms irreversible has led to impatience with the long debates within the legislature, and to a preference for executive decrees.<sup>137</sup>

Deficiencies in norm consistency were eventually to compromise the reform agenda by erecting entry barriers to outside shareholders. Due to the 1992 privatization regime, Russian management disposed over a veto over corporate entry. As Joseph Blasi

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<sup>135</sup> For details, see Pistor, Katharina. 1997. "Company Law and Corporate Governance in Russia," in *The Rule of Law and Economic Reform in Russia*, pp.165-187.

<sup>136</sup> Pistor, 1997, pp.175f.

<sup>137</sup> Hendley & Gray, 1997, p.150.

observed: "When the enterprises were privatized, the proof of share ownership was not a share certificate but the record of the owner's name in an official book called the shareholder register. If your name was not there, you did not own stock. Period."<sup>138</sup> Thus, if an investor wanted to start accumulating shares of a particular company, the general director could make these intentions null and void by simply refusing to register new shareholders or not disclosing relevant information to interested parties. In addition, an employee who wanted to sell his own shares had to get management's approval before the transaction could be registered.

### Interim Period

During the interim period (1992-1996), incremental changes were made in company law whereby attention was largely focused on privatization (Order No. 255 and No. 2004). Despite these initiatives, the tendency for most shareholder registries to be "closely held secrets" continued.<sup>139</sup> The majority of company managers were reported to have been very reluctant to relinquish their control on shareholder registers, which further compromised the free selling and buying of shares. Preventing workers from selling, refusing or delaying registration of shares acquired by new owners, or erasing shareholders from the company register, were frequently reported.<sup>140</sup>

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<sup>138</sup> Blasi, Joseph R., Maya Kroumova, and Douglas Kruse. 1997. *Kremlin Capitalism: The Privatization of the Russian Economy*. Ithaca, NY: Cornell University Press, here at p.90.

<sup>139</sup> Ibid.

<sup>140</sup> Thirty-six percent of voucher funds surveyed in the summer of 1994 report that a major obstacle to share acquisitions on the secondary market is that shares are not registered, see Frydman et al. (1996). Moreover, the establishment of shareholder registries has often been delayed. For example, *Gazprom* completed voucher auction at the end of June 1994. By December 1994 the company had still not established its shareholder register; see Pistor, 1997, p.173.



In response to such malpractice, a Presidential Decree of October 1993 (Decree No. 1768, 27 October 1993) sought to address the problem. The decree stipulated in detail the requirements for registering shares and for providing that the refusal to register, despite the fact that all necessary documents were submitted, could be challenged by referring to the company's revision commission or filing a law suit. In addition, companies with more than 1,000 shareholders were required to transfer their register to a bank, investment company, or similar organization.

A 1995 survey of 3,400 of Russia's largest companies, however, revealed that 44 percent of the companies with more than 1,000 shareholders had not surrendered control over their shareholder registers.<sup>141</sup> Moreover, these companies controlled many of the broker or financing houses conducting shareholder registers on behalf of companies. Additional entry barriers to outside ownership arose from the extensive catalog of administrative requirements. In order to transfer shares, companies usually required a complex set of documentation to be filed, which in turn needed to be certified by a specially authorized firm with notary powers. Other requirements included, but were not limited to, the presentation of a formal application by the new shareholder to open an account, powers of attorney by the seller or buyer, as well as proof that taxes were paid on the transaction.

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<sup>141</sup> The survey was conducted by the "Gruppa monitoringy fondovogo rynka" (GMFR) attached to the Russian Securities Commission (KZB), see *Kommersant* No.7, 28 February 1995, p.42, as quoted in Pistor, 1997, p.173.

## The 1996 Company Law

A more comprehensive approach developed only with the new Civil Code and the new Law on Joint-Stock Companies. On 24 November 1995, the Russian Duma adopted the Law on Stock Companies that was put in force as of 1 January 1996, making it the first comprehensive company law in Russia's history. The law replaces most of the patchwork legal regulations on corporate law that had been enacted during the privatization process.<sup>142</sup> President Yeltsin, wary of the significance of the legal reform initiative, obviously did not utilize Article 90 to fashion policy. Government officials expressly resisted the "temptation" to put its main points into force by presidential decree.<sup>143</sup> Its drafting extended over the (likely) period of two years (1993-1995).

Societal Input. Even though available data on bargaining is limited, it appears that regionally based groups and Soviet-type organizations tried to influence policy design. In the end, the governmental proposed framework, however, should prevail over somewhat fragmented domestic group pressures.

Provincial groups, for instance, are reported to have lobbied in favor of extending the privileges of closed-type companies. Certainly, the continuation of this governance type would have played in the hands of insider domination by effectively barring outside

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<sup>142</sup> The first part of the Civil Code (*Sobranie zakonodatel'stva RF*, no. 32, art. 3301, 1994) came into effect in January 1995. The second part of the Civil Code (*Sobranie zakonodatel'stva RF*, no.5, art. 410, 1996) came into effect in March 1996.

<sup>143</sup> Karpenko, Igor. "Law for Stockholders," *Izvestia*, March 30, 1994, p.4, as translated in *The Current Digest of Post-Soviet Press*, Vol.46, No.13, p.15f. The article implicitly refers to First Vice-Chairman of the State Property Committee Pyotr Mostovoi as having been well aware of the importance not to use presidential decree powers for the enactment of the law.

ownership.<sup>144</sup> The government draft, on the other hand, proposed limiting the number of participants in closed-type joint-stock companies in order to extend the legal basis for investment and technology transfer. Within the final stages of the drafting process the region-based group demands would eventually acquiesce into government policy. Notice is taken that: "In the end, everyone agreed with the government that the number of stockholders in a closed-type company should be limited..."<sup>145</sup>

Despite such spontaneous cases of policy alignment, it would be wrong to believe that governmental discretion in designing policy was beyond reproach. To be sure, government officials would have to deal with the likely opposition of Soviet-type collectivities. Available data suggests that concessions were made regarding policy pressures from communist-based and agrarian organizations.<sup>146</sup>

Agrarian groups reportedly lobbied for special arrangements regarding the legal status of recently reorganized state and collective farms. Positioning themselves as "the most opposition-minded group," agricultural producers were looking for amendments that would allow them continued state funding. Apparently, their voices had been heard. The final draft eventually extended special jurisdiction for agricultural entities without, however, encroaching upon the main principles of corporate law reform. Similar

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<sup>144</sup> Ivanov, Viktor & Boris Boiko. "Saga of the Law on Joint-Stock Companies Has Come to an End," *Kommersant-Daily*, November 25, 1995, p.2, as translated in *The Current Digest of the Post-Soviet Press*, Vol.47, No.47, p.20. The article lists the Voronezh Province Duma as the official protagonist of this type of demand. The authors, furthermore, refer to the vested interests of the regional military-industrial complex.

<sup>145</sup> Ibid.

<sup>146</sup> See supra note; see also Natalya Samoilova. "Privatization of State Property: State Duma Tightens Control. But Cautiously," *Kommersant-Daily*, July 6, 1995, p.2, as translated in *The Current Digest of the Post-Soviet Press*, Vol.47, No.27, p.14.

tendencies prevailed regarding communist-based demands that sought to make amendments regarding issues of authorized charter capital. Encountering opposition on this issue, the government dropped the idea of introducing the principle of "fund balance" (i.e. assets minus liabilities) as advocated by western standards.

Thus, even though available data is suggestive of societal resistance, it should be noted that the particularistic nature of politically articulated interests would not amount to a broad-based opposition to government policy. Instead, their main concern was to demand exemptions to the rule, not to establish a coherent policy alternative. Indicative of state autonomy is the circumstance that legal output would conform to the principled purpose of reform, namely to introduce a corporate governance regime fashioned upon western concepts of norm consistency and legal protection of minority shareholder rights.

Foreign Economic Advice. In its push for corporate law reform, the government would eventually draw upon western sources of expertise. Legal commentary indicates that the government-sponsored reform bill represents a modified version of a draft designed by two American corporate law professors, Bernhard Black and Reiner Kraakman. The professors themselves came forward to publish an article explaining the novel approach of the law.<sup>147</sup> In their article, the authors indicate that they helped to draft a model statute for the Russian Federation, which formed "the basis for the recently adopted Russian law on joint-stock companies."<sup>148</sup> This assessment conforms to the normative substance of the law. As advocated by Black and Kraakman, the Russian

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<sup>147</sup> See Bernhard Black & Reiner Kraakman. 1996. "A Self-Enforcing Model of Corporate Law," 109 Harvard Law Review, pp.1911-1982.

<sup>148</sup> In their acknowledgments, the authors, however, make a reference to Anna Stanislavovna Tarassova as "the principal Russian drafter of the Russian company law." Black et al. 1996, p.1912.

Company Law offers legal protection of minority shareholder rights and participation in the governance of the corporation. Toward this end, major points of the law include: (1) cumulative voting by shareholders to elect the board of directors; (2) extensive procedural protections for shareholders over the board; (3) a requirement for the use of independent registrars; (4) disclosure of a company's financial records and other relevant information; and (5) mandatory board and shareholder oversight over classes of large-scale and self-interested transactions.<sup>149</sup>

Regarding entry and exit options, the 1996 corporate law guarantees the right of shareholders in an open stock company to sell their shares freely. Again, a valid transfer of shares requires registration in the company register. Furthermore, similar to previous regulations, the law attempts to reduce control by company insiders over the register by establishing that companies with more than 500 shareholders must transfer management of the register to a special registry. In view of the difficulties many newly incoming shareholders had had with registering their shares, the law provides that registration must be conducted within three days after the necessary documents are submitted. In the event that the registration requirements have not been met, the company must issue a written explanation for the rejection within five days after the request for registration is submitted. A shareholder may challenge in court a decision to refuse to register his shares.

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<sup>149</sup> For a discussion of the law, see Gregory Wolk. 1999. "Comment: Corporate Governance Reform in Russia: The Effectiveness of the 1996 Russian Company Law," *Pacific Rim Law & Policy Journal*, pp.219-240; Natasha Ziabkina. 1999. "Rights of Shareholders in Russia: Assessing Recent Legal Developments," *International Law and Politics*, Vol.30, pp.369-396.

## Corporate Governance in the New Russia

The empirical situation of corporate governance is suggestive of Soviet-type management discretion. General directors have been quite successful in holding onto their control, as against rank-and-file employees and outsider influences.<sup>150</sup> Persisting management patterns become visible in the nature of voting procedures, executive decision-making, and the resolution of ownership claims.

In the governance of entry options, managers have continued to exert tight control over who buys their shares. Circumventing the law, most companies in fact do not use independent shareholder registers; and most managers say they oppose financial disclosure and majority ownership by an outside investor with enough capital to turn the firm around. A "favorite tactic" of management to counter outside ownership consists in the dilution of stock.<sup>151</sup> Dilution of stock denotes the circumstance when shares are issued to "insiders," meaning enterprise managers and employees, at below market prices. To facilitate these insider-acquisitions, cash-starved employees and staff members are allowed to delay payment for shares until the rate of inflation has reduced the price to practically zero. The ultimate goal of this maneuver is to encroach upon the power of outside shareholders while increasing those of insiders.<sup>152</sup>

Insider domination is essential for management discretion since employee ownership is protective of the status quo. Due to organizational overlaps of the Soviet

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<sup>150</sup> See, for example, Shleifer et al., 1996; Blasi et al., 1997; Pistor, 1997; Hendley, 1997.

<sup>151</sup> *The Economist* July 24, 1999, p.64.

<sup>152</sup> Most of the surveys conducted on ownership results from privatization estimated insider shareholdings as a percentage of all shareholdings in privatized firms to be between 65% and 70%.

Trade regime, labor unions continue to be weakly organized and inexperienced in the exercise of workers rights. Another reason is fear of losing their jobs if they would attempt to vote against management in shareholders meetings. Yet another key for management discretion is the historical respect for the head official. Challenging the general director seems an unlikely insider strategy for collectivities that have been exposed to decades of Soviet-style *edinonachalie*. As Kathryn Hendley observes in her in-depth study of the Saratov Aviation Plant: "Their instinct was to obey orders, not to question their legitimacy."<sup>153</sup>

As a strategy, corporate executives capitalize on the risks associated with liberal types of entrepreneurship in order to mobilize consent from labor collectivities. Talking in front of their workers, directors have repeatedly conjured up the image of an hostile environment, composed of organized crime and foreign investors, ready to launch a hostile take-over of their business. Argumentative formulas, such as, "whether the government likes it or not, the privatization program will be beneficial only to foreign business and domestic shadow business" characterize such arguments.<sup>154</sup>

Related surveys on enterprise behavior confirm that Russian corporate directors espouse an ambivalent attitude towards the involvement of foreign investors in the conduct of business affairs.<sup>155</sup> Russian managers oppose outside minority shareholders

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<sup>153</sup> Hendley, Kathryn. 1998. "Struggling to Survive: A Case Study of Adjustment at a Russian Enterprise," *Europe-Asia Studies*, Vol.50, No.1, pp.91-119.

<sup>154</sup> Tatyana Koryagina, a former colleague of Gaidar who would later become a key economic advisor to Gennady A. Zyuganov quoted in Joseph Blasi et al., 1997, p.46.

<sup>155</sup> See Joseph Blasi et al., 1997, pp. 96-104; 1998 *Russia: Country Commercial Guide*, pp.24-27; Macmillan, Carl H. 1996. "Foreign Investment in Russia: Soviet Legacies and Post-Soviet Prospects," in *Foreign Investment in Russia and Other Soviet Successor States*, pp.41-73, here at pp. 65f.

even if they would bring an inflow of capital and technological know-how necessary to modernize enterprises: "Yes, we need investments, but we would never agree to get them in return for our shares. We don't need anything outside shareholders have to offer. We have not given our share register to an independent registrar and we're simply not going to."<sup>156</sup>

Summarizing his research on corporate governance in Russia, Joseph Blasi came to the following assessment:

In 1996 we gave all Russian corporations corporate governance scores based on the number of outsiders on their boards, cumulative voting, the use of independent shareholder registrars, the degree to which owners of concentrated blocks of stock (over 5 percent of shares) had board seats in proportion to ownership, and maneuvering to keep new share issues and stock buybacks within the firm. Thirteen percent of companies engaged in bad practices so systematically that their corporate governance was graded so horrible; 46 percent received bad corporate governance grades; and 39 percent, who engaged in only one or two questionable practices among generally good ones, were graded as good. Two percent of the companies received excellent scores. This is not encouraging news, since even those companies with reputations for good corporate governance engaged in at least one practice that might make a serious outside investor think twice.<sup>157</sup>

More recent trends in corporate Russia seem to indicate a change towards more transparency. In July 1999 *The Economist* noted that many abuses are becoming rarer thanks to more rigorous enforcement of stock market rules by Russia's securities and exchange commission (SEC). The article went on to argue that, "Russian company registrars can no longer simply delete the names of shareholders they dislike."<sup>158</sup> Especially larger companies are seen to be moving to comply with the law as a default mechanism to protect shareholder rights in the hopes of attracting foreign investment.

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<sup>156</sup> Quoted in Blasi et al., 1997, p.103.

<sup>157</sup> Blasi et al., 1997, p.101.

<sup>158</sup> *The Economist*, July 24, 1999, p.64.



Insiders at SIDANCO, a Russian oil company, for example, agreed to offer minority shareholders "equal access" to bonds that had been previously diluted. To be sure, the offer came after aggrieved shareholders called upon the SEC. Vladimir Potanin, director of SIDANCO, purportedly commented on the former deal that in Russia today "it is not possible not to respect shareholder rights."<sup>159</sup>

The convoluted style of Potanin's statement seems conspicuous in reflecting persistent features of ambiguity in the governance of Russian business affairs. Firms interested in attracting foreign direct investment are likely to comply with the 1996 company law, while smaller business entities continue to hold on to their accustomed way of doing business. As a tendency, managers seem willing to comply only when they realize they need outside money. According to field research, Corporate Russia appears to be splitting into two tiers of corporate governance. The first tier is concerned with attracting investments and exhibits "no major corporate governance challenges."

The second seeks to remain closed and works with closely affiliated "banks or trade suppliers."<sup>160</sup>

The aforementioned assessment corresponds with more general streams of development in state-business relations. Observers note that Russia is undergoing a tectonic rift in socio-political exchanges between center (Moscow & St. Petersburg) and

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<sup>159</sup> Chrysta Freeland. "Shareholders Win Russian Bond Fight," *Financial Times* (London), February 26, 1998, p.2.

<sup>160</sup> Paula Hawkins. 1997. "Salomon Gets Serious," 7 *Central Eur*, pp.44f (containing excerpts from an interview with Jim Dannis, Managing Director for Emerging Markets with Salomon Bros.), as quoted in Gregory Wolk, 1999, p.235.

periphery that seems to recapitulate culturally determined cleavage formation.<sup>161</sup> Economic entities located at the periphery, or with an ideological outlook diverging from that of the center, seem inclined to utilize Soviet-type trading regimes in order to circumvent the rules of "official" Russia. To erect entry barriers to outside control, general directors rely on personalized exchange patterns established in Soviet times. Decentralized networks of trusting business partners take the shape of financial-industrial-groups (FIGs) and barter cartels.<sup>162</sup> A 1996 survey of 1670 industrial enterprises, it has been revealed that 42 percent of trade was through non-monetary exchange, including barter and payment in various forms of negotiable instruments.<sup>163</sup> Russian CEO's prefer and adopt such trading networks, even when monetary funds are available. This business strategy seems irrational because the complexities of barter impose a 100 percent surcharge on transaction costs.<sup>164</sup> Moscow, on the other hand, with its concentration power, emerges as the new capital of Russian-style capitalism. Data on foreign direct investment (FDI) is indicative of center-periphery cleavage. The city makes up six percent of Russia's population, but attracts two-thirds of FDI. All leading Russian

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<sup>161</sup> See, for example, Hendley, Kathryn & Barry W. Ickes, Peter Murrell, and Randi Ryterman. 1997. "Observations on the Use of Law by Russian Enterprises," *Post-Soviet Affairs*, Vol.13, No.1, pp.19-41; Dinello (1999).

<sup>162</sup> Financial-industrial-Groups represent alliances among commercial and industrial enterprises that are connected through interlocking share holding and directorates organized along the lines of production chains.

<sup>163</sup> Hendley & Ickes et al., 1997.

<sup>164</sup> Some researchers estimate that barter entails 100 percent surcharge vis-à-vis money-based transactions; for details see Hendley et al., 1997, p.34.

banks, the main beneficiaries of privatization, are Moscow-based; among the thirty leading banks in January 1998 only two were located elsewhere.<sup>165</sup>

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<sup>165</sup> See, for example, Dinello, 1999, p.28.

## CHAPTER 5

### CONCLUSION

To draw a tentative conclusion, the present study demonstrates that post-Soviet reform politics have been shaped by culturally specified contingencies. To assess the degree of institutional contingency, the inquiry (1) carved out the institutional bases pertaining to coordination and control of economic reform and (2) contextualized the specified variables with empirical settings of corporate law reform. The analysis (3) established in this regard a correlation between the variables of institutional arrangement and transformative capacity. The resulting matrix of intended and unintended consequences of corporate law reform bespeaks in this context a circumstance of endemic low transformative capacity.

AD 1: In accordance with the historic model, the executive branch of government emerged to exercise tight discretion over the institutional underpinnings of reform politics. To ensure heightened autonomy in policy design, the presidential apparatus would make strategic institutional choices to insulate government agency from societal interest structure. Insularity of government agency extended over both institutional dimensions of government, inter-branch and state-societal.

Inter-branch relations. To all appearances, Boris Yeltsin stands in the current of czarist traditions, able to condition the process of constitutional politics to his personal advantage. The 1993 constitution, composed under his auspices, confers abundant powers to the Presidency, allowing for the merging of legislative and executive powers. In its push for reform, the Yeltsin regime institutionalized an operational framework that would diminish the role of democratically elected representatives to the State Duma. Recurrent

episodes of government reshuffling and the invocations of constitutional crisis bespeak the scope for political maneuvering and tactical moves of the Presidency. Reminiscent of Czarist times, furthermore, is the organizational design and status of the presidential bureaucracy. Exceeding by far the scope of other government agencies, the Executive Office is of central importance for the internal relations of coordination and control. Its operational competence has been credited to be of central importance to the coordination of legislative activity. In conjunction with the State-Legal Administration, it is considered a gatekeeper within the field of legislation. Under the Romanov dynasty, a similar role was accorded to the State Chancery working under the auspices of the Imperial State Council.

State-Societal Linkages. In addition, the presidential apparatus would ensure autonomy from societal pressures by exerting tight, if not to say manipulative, control over the organizational design of participation and societal interaction in state-business exchanges. To maximize control over policy choice, the Yeltsin Presidency disrupted the established framework of state-industrial linkages and forged new coalitions based primarily on personal discretion. To this end, Yeltsin could make use of his presidential powers to reshape and condition societal access points. Instrumental to this cause was his decision to disenfranchise and undercut Soviet-type mass-base organizations and to grant particularistic entitlements for access and bargaining to a network of personal friends and favorites. Due to Yeltsinite discretion, emerging state-business linkages manifest organizational strains of volatility, selectivity, and informality. The analysis referred in this context to the delicate web of "court politics" and extra-constitutional arrangements that revolved around the Yeltsin family.

The new Kremlin Oligarchy: Presidential discretion was instrumental in the rise of a highly leveraged group of financial-industrial entrepreneurs, the new Kremlin Oligarchy. The preceding paragraphs illustrated in this regard the political calculus of this particularistic exchange relation. Based on traditional concepts of loyalty, Yeltsin was pleased to extend bargains to friendly bankers rather than to the provincial industrialists who are backing the Communist Party. This type of political exchange peaked with the loans-for-shares privatization scheme instituted in 1995. To grant special privatization rules, and exemptions from the general laws, Yeltsin made consistent use of his presidential decree powers. The underlying rationale was to create a class of property owners whose self-interest would depend on the continued support of the Yeltsin regime. Culturally specified governance codes emerged in this respect through the personalized nature of entitlement.

The analysis, however, also tried to underline the negative aspects of this particularistic exchange modus with respect to concerns of social legitimacy and political culture. Proximity of this oligarchic type of support group to political authority turned out to be disastrous for state capacity and the conduct of an effective economic policy. In contrast to its historic predecessors, the new group of Oligarchs would not bend to the insignia of political authority when their immediate business interests were involved. Instead, the class of *nouveaux riches* businessmen made it very clear that they would exploit every means possible, including extra-constitutional arrangements, to advance their interests. Multiple series of "media wars" demonstrated their inclination not to support government policy and to openly resist authoritative action.

Resistance to government authority emerged more aggressively in its opposition to strengthened efforts of revenue collection. Under the lead of Boris Berezovsky, the new business elite would launch a media campaign to ridicule government cooperation with the international institution of the IMF. Capitalizing on the theme of wounded national pride, the published press articles would question the legitimacy of IMF involvement into the affairs of Russian reform politics. At the same time, however, the Oligarchy would ignore its commonality with the international institution, namely the basic fact that their own rise to power was made possible through the criticized institutional contingency. Both oligarchic self-enrichment and evolving patterns of IMF involvement in Russian affairs were conditional upon the institutional feature of heightened insularity. Deriving from internal system features, the Presidency had the strategic option to allocate and reshape bargaining positions based on tactical considerations.

AD 2: The organizational complexities involved in the utilization of highly insulated government agencies became clearly visible in connection with corporate law reform. When the government took the initiative to strengthen the property rights of minority shareholders, it became evident how difficult it would be to change embedded social behaviors without a set of complementary institutional arrangements. The preceding section highlighted in this respect the varieties of Soviet-type continuities in the affairs of corporate governance. Voting procedures, executive decision-making, and the resolution of ownership claims bespeak the persistence of Soviet-type management discretion. As a corollary, the current situation suggests that domestic general directors have the freedom of choice on whether or not to comply with the 1996 legislation.

According to available data, managers are willing to comply only when they realize that they need outside money. On the basis of the presented material, however, it seems fairly reasonable to argue that even the influx of outside investment capital does not guarantee compliance. Recurrent cases of share dilution have made it clear that Russian managers have been very reluctant to adapt to western standards of business conduct. Common to these developments is that general directors have quite successfully maintained the status quo. The pertinent research literature emphasizes the phenomenon of insider-domination.

In addition, emerging patterns of center-periphery cleavages provide another strong indicator of low transformative capacity. Corporate Russia appears to be undergoing a tectonic rift in socio-political exchanges. Economic entities located at the periphery, or with an ideological outlook diverging from that of the center, seem more inclined to utilize Soviet-type trading regimes. Indicative of this tendency is the structure of FDI and the mushrooming of barter cartels organized along Soviet lines of production chains. Russia, consequently, runs the risk of having two opposing realms of governance, the Moscow-based centralized economic interests involving the new Oligarchy of come-to-riches businessmen, on the one hand, and decentralized actors without access to the Kremlin's 'inner circle,' on the other. The developing patterns of two disassociated governance structures and realms of influence bears in this context a stunning resemblance to Robert Tucker's paradigmatic conception of Russia as a dual cultural entity.

AD 3: The presented materials demonstrate that regime failure to change embedded social behaviors is connected to the organizational design of state-societal relations. Low organizational density and executive branch domination of societal input



options have certainly left their mark on the sociological field of economic reform. The data of unintended consequences of reform policy bespeaks an organizational dearth of information exchanges and guidance in understanding reform policy. The fact that corporate executives are in a position to mobilize worker collectivities to act against their own self-interests by not observing their legal rights in the governance of the corporation underscores such reasoning. Particularly troublesome is the phenomenon that Russian managers are evidently able to capitalize on culturally established fears of xenophobia. Such conditions certainly underscore the issue of information dearth because the legal clause of minority shareholder protection, as stipulated under the 1996 legislation, is designed to serve equally the needs of worker collectivities and any outside investors (domestic or foreign). To be sure, under current conditions it seems fairly easy for insider-controlled firms to question the legitimacy of reform policy. The intertwining of the Presidency with a network of personal friends and favorites, the new Kremlin Oligarchy, which itself does not appear inclined to comply with the general legislation of economic reform policy, is certainly not helpful in inducing a change at the political and regional periphery. In addition, the fact that the Russian government was, to a certain extent, dependent upon foreign economic advice in shaping policy also plays into the hands of resisting sociological structures. Accordingly, business collectivities have rejected the new legislation because of culturally determined concerns, or interpret it simply as new machinations of the power center. The provision of an acceptable alternative to traditional Russian-style transformation could have lessened these concerns.

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