

The elites' demand for law: "Overcrowded streetcar (tram) effect"

Grigoryev, Leonid M.

Veröffentlichungsversion / Published Version

Zeitschriftenartikel / journal article

Empfohlene Zitierung / Suggested Citation:

Grigoryev, L. M. (2015). The elites' demand for law: "Overcrowded streetcar (tram) effect". *Russian Journal of Economics*, 1(3), 313-327. <https://doi.org/10.1016/j.ruje.2015.12.003>

Nutzungsbedingungen:

Dieser Text wird unter einer CC BY-NC-ND Lizenz (Namensnennung-Nicht-kommerziell-Keine Bearbeitung) zur Verfügung gestellt. Nähere Auskünfte zu den CC-Lizenzen finden Sie hier:

<https://creativecommons.org/licenses/by-nc-nd/4.0/deed.de>

Terms of use:

This document is made available under a CC BY-NC-ND Licence (Attribution-Non Commercial-NoDerivatives). For more information see:

<https://creativecommons.org/licenses/by-nc-nd/4.0>

The elites' demand for law: “Overcrowded streetcar (tram) effect”[☆]

Leonid Grigoryev

National Research University Higher School of Economics, Moscow, Russia

Abstract

The demand for law on the part of the society (business, middle class, civil society) is not sufficient at the transformation stage—the reciprocal demand for law from the power elite is necessary. Contemporary theory states that in the contrary case the pressure on elites would require a more open regime of participation. In order to strengthen the positions of the power elite in the long-run it is necessary to limit endless redistribution of assets and introduce the common rule for all.

© 2015 Non-profit partnership “Voprosy Ekonomiki”. Hosting by Elsevier B.V. All rights reserved.

JEL classification: P26, P48.

Keywords: elite, demand for law, rule of law.

1. Introduction

Under the “overcrowded streetcar (tram) effect” in everyday life, we understand the well-known rush hour situation: a crowd of passengers is attempting to delay the departing tram and squeeze through the doors. However, as soon as a passenger is inside, the lucky rider’s objective and subjective perception of it change dramatically. Now, he is impatient for the doors to close and the tram to depart the station. In certain cases, the passengers begin to hurry the driver: do not wait for all to board; close the doors and drive off.¹ These diverging interests of the very same actors defined on location, either inside or outside the streetcar,

[☆] The updated English version of the article published in Russian in *Voprosy Ekonomiki*, 2012, No. 6, pp. 33–47. The journal version of the report at the 13th Leontieff Readings (St. Petersburg, February 2012).

E-mail address: lgrigor1@yandex.ru.

Peer review under responsibility of *Voprosy Ekonomiki*.

¹ This picture can be viewed at any streetcar stop in Moscow.

appear to be a possible model for how interest groups, including the new elite, evaluate their own position and the elites' demand for law.

Generally, for centuries, the demand for law was formed through the practical actions of humanity. In this work, we shall not consider how social relationships are formed or how the social contract is implemented through a complex evolution of laws, informal relations, violations and reorganizations. It is sufficient to state that for a developed democratic society, the rule of law is natural and enforced by the entire system of coercion. In these circumstances, the law is changed in the political competitive process, and the winner is the one who is able to gain the upper hand in an election or in a court of law. The lawbreaker, particularly the one who breaks basic laws, is effectively punished when exposed and caught. One example is the recent Bernard Madoff affair; Madoff oversaw the largest Ponzi scheme in the U.S. history, which resulted in a total loss of over 50 billion dollars.

In a democratic discussion of the legislation, the dispute usually unfolds over changes that are beneficial to certain interest groups. The winners' solution includes the creation of rules for everyone, including themselves. In other words, the winners' victory in this competitive situation is acceptable to the others as a general rule. In Muslim societies, for example, violations of normal democratic 'constitutions and corruption' triggered the demand by broad masses of the poor for sharia law, which provides hope for justice.

This occurrence highlights the importance of the question: who generates the demand for law? Which social class? There is minimal doubt that the demand for effective criminal laws is universal; however, the interpretations of the approaches to law by the bureaucracy and businesses in Russia are highly different (see Zhuikov et al., 2010). Different interests determine the demand for specific legal provisions. Additionally, in an established, stable system of institutions (both formal and informal), we are confronted not with demand in general but with demand by interest groups for specific elements.

These general provisions are the starting point of any analysis of law, including its compliance with the public interest, that is, as evaluated by the actual bargaining power of various interest groups. Our task is at the intersection of the two problems, each of which is difficult to solve. First, we investigate the role of elites in the demand for law, and second, we examine the formation of such a demand in periods of profound social transformation.

2. The elites and demand for law

In considering the demand of the elites for law, we maintain that this issue is not a question of politics but a fundamental problem of political economy. Narrowing the scope of analysis, the actor in need of law, to the elite does not simplify our task for several reasons.

First, the composition of a particular elite is not always clear; therefore, the question is relevant when there is consensus among its groups. Second, the interests of the elite are not necessarily stable and may (as with those of other groups and strata) evolve over time. Third, how the process of reproduction of elites in various conditions works is often unclear, which is particularly important for the "overcrowded streetcar effect."

For the purposes of this paper, we shall limit the task of research to issues of ownership and demand (by the governing (ruling) elite) for sustainable law in this area (see Higley and Burton, 2006). We understand this elite in the manner that W. Mills did: as an association of political and financial elites. The latter, in our view, is the top tier of the upper class, which makes the most important economic decisions and retains direct or indirect control over key assets (with allowances for collective forms of ownership and the dispersion of ownership).

With these simplifications, the primary issue is the unity of the elite in formulating the problem of law and its stability, quality, and supremacy. A divided elite cannot effectively implement positive programs because (in the form of separate groups) it is in a state of fight for survival or existence. In this study, we proceed from the simple idea that the elites, in contrast to all (or most) other groups, not only have a positive program but, at the same time, are concerned with the preservation of their status; elites analyze the impact of changes within institutions and politics on their dominant position and the interrelation among the elite groups' positions.

The most important practical conclusion in connection with such duality is the following: the elites, in principle, do not operate on the basis of pure rationality. The elites are forced to constantly monitor (or are interested in doing so) the impact of events and the proposed laws on their position. Changes in the position of other strata in a volatile legal environment are impersonal in nature and are often not entirely obvious to the objects of law. Many social strata are unable to adequately analyze the dynamics of the situation to anticipate events and their consequences. Conversely, the elites are perfectly aware (not in terms of the accuracy of estimates, but of attention to and perception of the context) of the situation and have the means to monitor, analyze, influence and prevent adverse effects.

Let us note an important aspect of the evolution of the elite's interests, that of consolidating control and preventing conflicts over the fundamental issues of property rights. The struggle for property is one thing, and its legitimization is something entirely different. The rules governing elite's reproduction are the key question in any community. In established democracies, this problem was not always as easily solved as in the recent past. Roosevelt's amendments to the law on inheritance led to huge changes in the reproduction of the financial elite. In the last decade in countries with developed market economies, criticism of corporate management, excessive bonuses, and lack of company owners' and management's responsibility led to lawsuits, as well as to a drastic tightening of regulation and supervision. Under pressures from the political elite and civil society, the position of the financial elite has been changing notably (although not radically). However, the rules of inheritance, bankruptcy, mergers and acquisitions, control and change of control are not undergoing systemic changes, not as of yet.

Regarding history, which has been popular with the economists in recent years, we can state that if the ruling elite loses its control of society and property (as a result of lost wars and revolutions), the question arises regarding the rules governing the redistribution (seizure) of property and the recognition of control and management rights that opens the way for its use and possession. Historical examples and M. Olson's approach point to the importance of a transition from

the initial chaos of ownership relations, the instability of forms, and the scope and rates of skimming the producers' current incomes to a stationary operation of resources.² Apparently, one can single out the recurrence (with great actual diversity) of several interrelated steps: seizure of the ownership of a resource (in the case of a "roving bandit", this is the sole and sufficient condition for its use), assertion of the control over ownership of the resource, legitimization of control (ownership), transition to stationary control and management on the basis of a legitimate ownership of the resource.

Before turning to more specific research on contemporary transformation problems, we should note the thorough analysis conducted by D. North, D. Wallis and B. Weingast (2009), regarding what a "stationary bandit" actually is. Indeed, the elites should be interested in achieving stable public order; however, as politicians state, they need to achieve a "preliminary arrangement." North et al. (2009) call this arrangement defining (recognizing) their privileges with respect to one another: "...Initially these privileges are fluid, resulting from the dynamics of the coalition... Legal systems initially develop to enforce unique and personal elite privileges". A few challenging issues remain in the societal transformation process, particularly from a practical perspective. First, one challenging question is whether the elites realize the need for the mutual recognition of privileges, a certain compromise that allows them to predict their partners' behavior, reducing the costs of confrontation or an "arms race", with the goal being to achieve general stability for the elites. Given that the seizure of property is usually accompanied by the violation of certain (old) legal norms, a problem arises with the "legal amnesty of the elite with respect to itself" needed to make the transition to new legal norms. Moreover, a change in legal norms is generally easier to legitimize than a massive redistribution of property that affects the interests of certain social strata, or at least, those strata believe their interests will be affected. Finally, when speaking of recognizing the mutual privileges of the elites, we imply that the elites realize very well who they should and should not admit into a coalition. In reality, our assertions follow from the multiplicity of the elites. The elites find it difficult to define laws at any given moment (resulting in the importance of an individual leader), whereas the process of mutual recognition may be complex, interruptive, unstable, and accompanied by coalitions; this compels elites to achieve equilibrium at a given point in time.

3. Institution building in periods of deep social change

Historically, we know large-scale examples of legal systems that have been transferred into new states and continents from the outside. The Norman conquest of England in the XI century changed the system of law, causing an enormous impact on the world. The Mongolian and Turkish conquests were accompanied by the establishment of new legal codes; the colonization of America and territories on other continents was accompanied by the introduction of English and

² "Under anarchy, uncoordinated competitive theft by "roving bandits" destroys the incentive to invest and produce, leaving minimal for either the population or the bandits. Both can be better off if a bandit sets himself up as a dictator—a "stationary bandit" who monopolizes and rationalizes theft in the form of taxes." (Olson, 1993, p. 567).

Spanish law. These examples are, of course, simpler in certain ways: the winner establishes its own rules. The emancipation of the serfs in Russia in 1861 was also a part of the historical experience. We observed something similar, although with smaller changes to the basic institutions, after the end of World War II in Japan and Germany and later in South Korea. These people experienced large-scale transplantation of Anglo-Saxon elements and a fragmentation of ownership. Nevertheless, the Japanese and German cultures, coupled with historically inherited institutions, led to hybrids that were adapted to the conditions of these countries. Hence, the system of large Japanese and Korean (paternalistic) companies, which are conquering the world; hence the special funds to support political parties (Stiftung) in Germany. Hybridization occurs, apparently through the interaction of two “strong” systems of institutions. An example of creating anew the institution of property in the radical form was shown, perhaps, by the Soviet regime, with its planned economy during the socialist experiment; this began with the 1917 October Revolution and lasted until the collapse of the Soviet Union in 1991. The socialization of income in China had deep historical roots and was not very different from the previous regime.

In all these cases, new systems were designed by the “reformer,” which we understand to be a group of persons or a body (usually, informal) that produces a system of new institutions on behalf of new authorities. The latter, logically, are either a colonial administration plus certain figures that ensure the previous local institutions are accounted for, or representatives of a new elite, who form for themselves and for the society a system of new formal institutions. To a certain degree, the “reformer” discards the old institutions, forms new ones and attempts to entice them to match the system, deliberately (at best) or unconsciously.³ It is noteworthy that the “reformer” as a group of people working on the content of the reforms belongs mostly to the intellectual elite. The “reformer” rarely has the legitimacy of decision-making in choosing institutions (although such short periods may occur and have occurred in different countries); this is the prerogative of the new power elite, emerging “from the foam of transformation.” However, the “reformer” cannot by itself solve the complex issue of institutions; in our view, it is split into the proxy of the “reformer”, who is visible and transparent, and the “principal”, who is an actor or a group participating in the decision making process. At the start of the reforms, the initial decisions (regarding the nature of institutions, privatization, and liberalization) are of arbitrary character. There is yet no law that enables making legitimate decisions. Revolutionaries (or winners in the war) take “forcible” (not in terms of methods but in fact) decisions regarding what society will be like and how property will be transformed.

The problem of institutional design in the process of transformation is an important element of any reform. To an outsider, it may appear haphazard, which raises its social costs, causes fluctuations in formulating goals, breaks methods, and results in discrepancy between the expected and actual results

³ The degree of the reformers’ awareness of the essence and the final goal of their activity, the essence of institutional design, its tools, social costs and social responsibility is a subject matter of separate research, both historical and theoretical. This boils down to answering to the question: had the “reformer” had prior knowledge of the social costs and the side effects of his activity, and the risk of failure, and if not, what were his actions based on?

(see Tambovtsev, 1997). In periods of transformation, institutions emerge under the influence of both the practical commercial activity of economic agents and of the activity of the “reformer.” We have previously stated that there is no vacuum in the institutional design from below, or absorption (refer to the perspective later expressed by S. Pejovich) of experience by institutions; that is, there can be no pause between the creation of institutions and their consolidation in legal acts (Grigoryev, 2013).

In his book “Elements of the theory of reforms” academician V. M. Polterovich rightly states that “the accumulation of seemingly positive changes can lead to inefficient institutional structures... The second type of trajectory is the result of deliberate institution-building, it is typical for the reforms carried out by organizations and, in particular, by the state.” It would be useful to once again discuss the question of how the organizations can know the preferred approach to designing. However, as the author concludes, “natural selection and reforms complement each other” (Polterovich, 2007, pp. 54–55). Let us note that the doer of the reform remains slightly vague, but very benevolent.

We offer a fairly simple thesis. The final choice (selection) of institutions in real life, to be chosen for the legal system during the transformation and for a yet-to-be planned reform, is made by the “reformer.” Regardless of the form of organization, whether it is a constitutional commission, a think tank, or a group of advisers, such a body filters all knowledge (of its own) regarding the institutions in the surrounding world, generates solutions and presents them to the “principal” as the representative of the real power at the moment of the decision-making.

From our perspective, “the seizure of power” by this or that elite occurs sufficiently early (the manner in which foreign invasions occurred in history); therefore, the design work, the selection of external experience, and the analysis of their own practices can be conducted with due regard for the “tastes and interests” of the new ruling elite. The latter may be weak and ignorant, or very strong and purposeful (both have occurred), but usually are sufficiently smart to assess its interests and preferences in the short term. Of course, the new government (elite) portrays them as public goods and development goals, regardless of whether it believes this (which the contemporaries find very difficult to verify) and whether it truly knows the means to achieve such significant and long-term goals. The elite always understands its interests!

The “reformer” in our case is a function (largely constant until the completion of reforms), which is performed by an agent of the authorities, not the authorities themselves (it conducts the process of decision-making, largely determines the choice of the type of institutions to be created, and corrects the current policy and evaluates its results.) The decisive choice is to be made by those who represent real power, the “principal,” such as Emperor Alexander II, who was behind the commission for the reform of serfdom (see Gaman-Golutvina, 2006). In our opinion, this aspect is often overlooked in analyzing the transformation of the former Soviet Union, in which the reformers are said to have acted for the sake of certain (fairly abstract) public interest and the formation of a market economy and democracy. This aspect is precisely what the slogans in all post-Soviet countries proclaimed; however, very different things were undertaken there, different institutions were formed, and often, the final results were the opposite.

The adoption of various provisions by a society's elite in the transformation phase is a complex process. Looking ahead, we should recall that every elite is comprised of clans and groups. The relationship between the political and financial (owners) elites are rarely simple. Jane Austen's Mr. Darcy is most likely the sole exception. The conflicts between the elites greatly complicate the task of formulating the objectives and methods of reform, the creation of a system of political checks and balances, and the accommodation of the interests of property owners in the long run (see Gaman-Golutvina, 2001). This problem was recently (in the 1980s) termed in the scientific literature as "elite settlements" (Burton and Higley, 1987).

4. On the legitimacy of ownership

The legitimacy of ownership provides a basis for investment and sustainable economic development. The question of legitimacy of control and ownership can be considered key in terms of the completion of any large-scale transformational process involving a fundamental change of the entire ownership system or the systemic replacement of owners. The task of transformation is to create political and economic institutions that ensure not only a type of economic growth, but dynamic development and the competitiveness of institutions in today's highly competitive world. Of course, in general, the elite will seek to legitimize and assert in practice and in law a system of institutions that satisfies it at the moment; however, it can both stimulate and inhibit growth. Additionally, this behavior is due to the possible opportunistic behavior of elites (or clans of the ruling elite) defending their position.

The double-vectored interests of the elites, who implement a positive program and maintain their dominant position, can manifest themselves as a direct conflict or as a threat of such conflict in the future. Consequently, delays occur in implementing reforms because of attempts by clans to calculate or adjust the measures or laws under discussion to minimize or remove future threats. Delays in making decisions to reform institutions may create additional problems for the institutional system and affect the country's development potential.

Substantive revision of property relations through revolutions and transformations is another difficult problem that hampers the sustainability of elites' rights and support for the rule of law. Enormous benefits from the seizure of property outweigh both the moral code and the development interests. The coincidence of the elites' interests and of economic development in the early transformation stages must be proved separately, at each stage. The reason is this transformation is not a long historical process of forming relations of property and distribution; instead, now the actors are well informed, understand their objectives and, more importantly, the brevity of the "open assets" period, that is, of the time span when there are wide opportunities for property seizure.

J. Buchanan outlined the formation of the initial problem of property rights as follows: "It is appropriate to call this a genuine basis for the emergence of property rights. Both parties agree to and accept the assignment, which carries with it the complementary agreement that they will not behave to violate the terms. Therefore, both parties can reduce their private investment in attack and defense; at the limit, the full value of X can be realized without cost. The agreement on

rights of the two parties represents a contractual internalization of an externality relationship that existed in the pre-contract state of nature. The specific distribution of rights that comes in the initial leap from anarchy is directly linked to the relative commands over goods and the relative freedom of behavior enjoyed by the separate persons in the previously existing natural state” (Buchanan, 1975, Ch. 2). Of course, the transformation of the property institution and of the property itself appears very different. Moreover, it is difficult to distinguish between social elements that created the rules and those which used them for privatization.⁴

D. Bromley (1989) introduced the concepts of commodity and institutional transactions. The latter involves actions aimed at changing the “rules of the game” and not at the exchange of goods under the existing rules. It appears productive to explore (in future) the formation of market institutions and private property from that perspective. The new relations of property and its distribution in our time cannot emerge from simple relationships, by trial and error, or from legitimization of a leap from chaos. Here, we are discussing the “reformer”, which expresses the interests of the “principal,” who is capable of authorizing the establishment of the rules of transfer and use of property. It can be assumed that neither was aware of the consequences of their introduction in the long term; however, this problem has two aspects.

First, in Russia, the “principal” (who dictated the direction of reforms when power changed hands) was fully aware of the original objective, which was to form an elite group of owners, and authorized the establishment of rules with priority accorded to that objective (in other countries, different purposes were formulated).⁵ Second, both the “reformer” and the “principal” had all the resources necessary to be aware at every step of the consequences of their activities and to make adjustments whenever they wanted and believed it necessary to do so. Relevant topics of the demand for law are considered in a number of interesting works (see, for instance: Pistor, 2002; Hendley, 1999).

The most important event for the contemporaries is the post-socialist transformation of property (and of the market economy and society as a whole). S. Pejovich (1994) in his article analyzed innovations in the institutional changes in the transformation process on the basis of competition among different rules. From the voluntary efforts and arrangements examples of “successes” and “failures” emerge. The former (successes) are copied by other individuals and eventually institutionalized. Apparently, this behavior is characteristic of the optimistic period of transformation. However, first, for the natural process of selection, it is necessary to clarify the ability of the market institutions to distinguish (very rapidly) between the successful arrangements and failures; second, there is no certainty a priori that the correct institutions will be selected for the purposes of long-term economic development.

⁴ In Russia, in contrast to what one observes in Central and Eastern Europe, debates continue regarding the political nature of privatization; however, there have been practically no court trials over cases of abuse of its rules, conflicts of interest, or manipulations of value or other typical problems of privatization, although 50,000–60,000 enterprises have been privatized.

⁵ We are aware that we use the term “principal”, which we borrowed from a neighboring field of knowledge; in theory, rules reflect the characteristics of actors from the perspective of awareness and powers (including the right to the first move).

In the natural selection of institutions' process, certain actors who will introduce innovations in contracts and arrangements must be present; next, they or their likes will copy this or that arrangement. Finally, these actors will consolidate the preferable types or interact solely through these, which the arrangement merely puts on record. The process of selection inevitably involves additional aspects: the interests of individuals who are active in innovation and in their copying and consolidation; the criterion (and horizon) of assessing the success or failure. One must consider two important factors: the factor of the evolution of groups' and individuals' interests at different stages of the process; and the gradual emergence of influential individuals or groups, who are apparently "winners" of the first stage of transformation.

This approach puts us in front of a chain of related events, in which the "winner" of the just-ended stage is likely to attempt to consolidate the rules that allowed him to win with the objective to continually win repeatedly. However, it is possible that, if the gain is sufficiently large (which may also be difficult to retain), the "winner" may opt for opportunistic behavior and may attempt to change the rules, to weaken competition with the objective to consolidate the gains and prevent the risk of losses and of ceding positions. The selection of institutional arrangements can proceed in accordance with the general rule of success; however, this is not necessarily the best institution from the perspective of democracy and effective markets. Therefore, the natural selection of arrangements does not always ensure success for the society or for the formation of an efficient market system.

Interference by the "reformer" substantially alters the situation, but this requires explanation. First, he must act in general long-term interests, which may not be observed in reality. Second, he is to be very knowledgeable and visionary, including the ability to predict the formation of institutions and their interaction (which is not very easy). Instead, we shall assume that the "reformer" either imports an institution from the outside, attempts to find it in the voluntary chaotic attempts and transactions, or has one's own explicit or hidden agenda.

In the latter case, the selection of institutions may be an artifact. The "reformer's" domain also includes the issue of timing—before, simultaneously or after the beginning of massive transactions and contracts in the renewed institutional environment, and the problem of interests that are material or prestigious (power and glory) pushing him towards opportunism. Next, there must follow the classification of individuals engaged in transactions and arrangements within the framework of "further" action or those who start from scratch. Finally, the transformation raises the question of social interests, the stratification of reformers (including their transition to the group of owners), and changes in the interests of players at each step.

5. Double-sector model of capital import–export

In their article D. Acemoglu et al. (2008) concluded that the economic crisis (a significant decline in the GDP over five years) would undermine dictatorships, rather than democracies. Of course, this result was obtained on the basis of post-war period data, mainly reflecting the realities of Latin America and the collapse of the socialist system. Of course, the protection of property rights must

be capable of maintaining sustainable investment opportunities over time. Weak protection of property generates huge “day-to-day protection” costs, and capital flight is a natural reaction to threats.

We proceed from the rational behavior of a capitalist in a relatively open economy (import–export of capital). When the investment climate changes, he attempts to support (maximize) the income while minimizing the risks. However, the risk of property seizure by the state or by a raider, of a sudden change in the “rules of the game,” and of court prosecution is not reflected by a simple linear function. We believe that a businessman attempts to simultaneously maximize profits in Russia (at home) and to save money for the family and to conduct business abroad; that is, he creates a double-sector (dual-country) company. A portion of the company’s assets remain in Russia to maximize profit amid high risks, and the other portion is exported abroad as low-risk capital for the sake of “better buoyancy.” In our opinion, such a pattern of behavior is notably widespread in Russia, including the foreign bank accounts of individuals and the purchases of low-income property in Spain and Bulgaria. Having embarked on the path of risk diversification, the businessman will automatically reduce the amount of investment at home, thereby increasing the cost of credit domestically and transferring savings from the country in the form of long-term, usually direct (partially liquid) investment.

This form of risk optimization and asset management is essential for any macroeconomic model because firms and individuals make judgments on their own and are capable of making decisions (sufficiently effective) that may coincide or run counter to the intentions of the national monetary authorities. Of course, the point at issue is the magnitude of the problem; however, all capital export indicators point to its large size. In this case, it is necessary to consider the gross capital outflow in the model at the micro level. The import of capital (although it is performed by the same actors) is conducted to extract high profits under completely different (speculative) rules, although it may be part of the actors’ same strategy of balancing risks and benefits.

For the analysis of individual capital flight, we can propose the following model. A businessman has considerable assets, which can be placed at home or abroad. In the first case, the rate of return and risks are much higher. The question is how the businessman estimates the risk of losing the business at home over a period of T years: from pressures by the state, as a result of raiding, or from a sharp deterioration in the “rules of the game” (taxes or additional charges of “old taxes”). The businessman summarizes these probabilities into a risk variable for a given time horizon. From the profits received at home (and offshore), the businessman deducts the full amount of payments to the shadow economy, which include latent business partners, pay for patronage and corruption-related costs. Naturally, although high domestic incomes compensate for all the risks and illegitimate costs, and as long as the prospects appear more or less reliable, the businessman will continue to conduct business in Russia. However, in addition, he may seek to relocate an increasing proportion of assets into low-risk areas for the sake of his health, prosperity and family stability. Next, the sum of profits in the domestic section of the company, which is discounted for risks, will gradually decrease. One can imagine the surge of uncertainty for a business when the discount rate increases sharply

and foreign profits (at a low rate of return) become sufficient to outweigh the domestic profits.⁶

$$Outcome(T) = \sum_{i=1}^T \frac{Pf_i(h) - Costdef_i(h)}{(1+R)^i} - \sum_{i=1}^T \frac{Pf_i(off) - Costdef_i(off)}{(1+R)^i}$$

where $Outcome(T)$ is the businessman's discounted net income over a period of T years; Pf_i is the expected profit of each section of the company from assets during the i period; h is the company's domestic section; off is the company's foreign section; T is a risk assessment horizon in years; $Costdef_i$ is the expected informal payments, bribes, funding of political projects—protection costs during the i period; $R = R(risk) = R(raid, grab, taxes)$ —the discount rate, where risk is the aggregated risk parameter; $raid$, $grab$, $taxes$ are the probabilities of exposure to adverse effects including an attack by raiders, fraud/theft/extortion, or tax suits, respectively, in a given year (expressed as a decimal).

Thus, we consider the return on assets at home and abroad, minus the direct costs of protection, discounted for the risk of capital loss, lawsuits, or raiding in the foreseeable future T . We subtract the “external return” solely for convenience; one can simply compare the two parts of the equation (divide one by the other). When the $Outcome$ indicator becomes negative, foreign profits (always positive) are not sufficient to cover the expected losses at home. This finding is a major reason for shifting the proportions of capital within the company in favor of offshore assets (reducing costs at home) or simply ceasing risky domestic operations.

Of course, we are aware that for the oligarchs, such behavior is difficult simply because of the scale of capital, and many business people solve this problem highly differently. An alternative solution is individually acceptable at the micro level; however, it is not conducive to risk-taking, innovation, or the modernization of the country. We are discussing the merger of businesses with the authorities (locally and above), deriving rents from the “closeness with the authorities,” or receiving protection in exchange for financing (usually) hidden accomplices and large non-business expenses (which, incidentally, can eventually become a matter for a lawsuit). In addition, the merger with the authorities is a delicate and selective affair; most businesses, as the large-scale corruption scandals show, pay for patronage; this puts the businesses in the position of a lawbreaker. Therefore, these businesses cannot guarantee immunity from prosecution and other risks, particularly when the political regime has changed, the democracy begins to spread, or a “clean hands” crusade is launched.

6. “Overcrowded streetcar effect” and the behavior of elites

We can now return to the “overcrowded streetcar effect” and the behavior of elites. We believe that after the end of a certain period of “roving bandits and robber barons” (of course, the duration of this period depends on the specific

⁶ Naturally, in the given post-crisis period, interest rates around the world are low, as is the profit rate abroad. An upturn in Asia or a later upturn in the EU and the U.S. may cause the profitability of capital export to shift in the context of lower risks at home on the condition of a certain combination of the model's parameters.

historical and national features), the financial elite takes control of key assets (including the post-Soviet assets) and needs the protection of its domain, which is its base of regular operations, to a far greater degree than new conflicts and property seizures. More precisely, seizures can now be transferred to the stock exchange and conducted by means of collusion, which is how it is achieved in the “happy world” of legal capitalism, which is the world of XX century tycoons in developed democracies, that is, states ruled by law (see DeLong, 1997).

One can imagine how the elite, once inside an “overcrowded streetcar” closes the doors, that is, blocks admission to the elite through the state or through any apparent violations of the rules of a legal state. Renunciation of business seizures or of artificial criminalization is accompanied by both improvements in economic legislation (a better investment climate *de jure*) and a sharp improvement in the practice of law enforcement (a better investment climate *de facto*). Of course, this should also apply to large companies and holdings and to the middle and small businesses at the regional level. This is the natural outcome of the period of massive redistribution of assets of the 1990s, based on rules of the past very far removed from any justice, and, particularly, from the logic of establishing the domination of effective economic entities (see Grigoryev, 2010b). However, we believe that this transition is inevitable from the historical perspective, and the establishment of property rights protection and the creation of conditions for investment and growth in Russia depend on how quickly and how radically a ban will be imposed on undermining someone else’s business and on collecting bribes from those who remain unprotected outside the “streetcar.” We believe the passengers on the “streetcar” will be pardoned directly or indirectly by all existing means; the legitimacy of all past actions will be ensured by the former “barons” turned responsible owners and the engines of the progress and modernization of the country.

However, to close the doors of the “streetcar” and to establish a common legal framework, it will be necessary to solve several difficult problems:

- establish and enforce the standard for those who remain in the street and for all who would board the “streetcar”;
- achieve consensus among its passengers;
- ultimately “close the doors” and block attempts by the outsiders to make their way inside;
- sacrifice (unhook) part of the wagons “to let the streetcar finally get rolling”;
- those remaining “on the street” should be aware that: a) the “streetcar” has departed, b) there is no longer any chance to board it, and c) there are general rules of upward mobility;
- ensure that the key influential actors have accepted this final reform of the protracted process of ownership transformation (the problem of external legitimacy).

In discussing possible reforms in the cycle of 2008, A. Shastitko presented to reformers (in our interpretation of the term) a request to change institutions; in fact, he did that with consent from the elites, assuming their determination to support the country’s development. However, there are certain serious requirements for the very organization of institutional restructuring in later stages: “The choice of a technology for the systematic modernization of institutions is rather an exception than the rule. A confirmation of this is observed not only in the economic history of the past two decades, but in the relation between strategies from the perspective of

the probability of implementing them. Are probabilities exogenous?” (Shastitko, 2008). The determination of the authorities (the ruling elite) to change the “rules of the game” in spite of the inevitable violation of certain interests is an important aspect of the situation.

Regarding the role of elites in the creation of the “limited access order,” Nobel laureate D. North et al. (2012, p. 5) note: “Our paradigm pays more attention to matters of violence and organizational structures inside elites.” In fact, the issue being discussed is that of reducing violence and facilitating access for different strata of society to the political (and economic) life. What makes this approach so important is that developing societies “reduce violence through manipulations by the political system with the aim to create rents that let groups with access to violence and individuals realize the benefits of refraining from violence” (North et al., 2012, p. 8). In fact, this is the inverse problem: the offer of an amnesty and rent to the elite “passengers of the streetcar” to purchase from them the maximum freedom of access for society.

Our next remark concerns the mode of action the elites may choose to maintain their position, particularly by means of violence, including the division and extraction of higher rents as a result of an agreement between the “leaders of armed groups” (in comparison with the conflict). We must add that an external guarantor is needed to maintain the fragile political arrangements among groups that distrust each other. The elites’ leaders calculate scenarios for long periods and may consider such an agreement a truce, which is needed to gain strength before an inevitable future conflict. The high costs of survival of the elite groups and the associated risks may be more important than the rational calculation of rents of the “stationary” (so to speak) military leaders.⁷

Finally, the authors conclude: “At the level of the elites the most important result will be growing certainty that the supremacy of law for the elites will be implemented impartially and there will eventually emerge institutions where the attitude to elites will be fair and impersonal, i.e., an ever wider range of the elites will be living by the same rules” (North et al., 2012, p. 15). Thus, this is a promise of an impartial trial (in The Hague?) of certain elements of the elite.

In this paper, we have attempted to show that the ruling elites of many countries need to move to the legal solutions of problems for the country as a whole; otherwise, there is a threat both to its development and to their position in the country in the long run. We believe that the elites become “stationary” and want to maximize the time of their presence at the top of politics, finance and society. North and his colleagues address a different problem: how to persuade the “failed” (ineffective) elites to retire on the proposed terms and expand citizens’ access to political and economic life?⁸

For us, this is a great topic of research; the doors of the “streetcar” are open wide for the voluntary exit of passengers or for the freest possible flow of passengers between the crowd inside and the “queue at the stop.” We believe this behavior applies to different stages of development and to different situations:

⁷ The personal plight of the leaders, ousted in the course of the “Arab spring” of 2011–2012 is not very encouraging for potential leaders who wish to give up power (violence) in exchange for a rent and calm.

⁸ An example of an unsuccessful attempt to “persuade” the Arab elites to agree to a transformation is discussed in Perthes (2004).

in certain places, the elite may begin to disembark, and in others, in contrast, to become stronger and adapt. The ruling elite's abdication from overt control can be forcible under the pressures of public protests.

A description of sudden upcoming external changes is beyond our task; the purpose of this paper is to analyze the behavior of elites, who are already inside the "streetcar." One can offer another illustrative model of risks the elite's presence inside the "streetcar" with open doors encounters: one may fall out, as North et al. (2012) noted. It appears that many of the elements of the elite within the "streetcar" are aware of that; occasionally business and intellectual elite representatives call for establishing law and order in a particular country.

We believe that several factors can interfere with the closing of the "streetcar" doors and with introducing difficult rules (compliance with laws) for all who have remained outside, that is, for all businesses, bureaucracy, etc. First, there is continued pressure from various "friendly" sub-elites and hypo-elites, who are attempting to extend the "open season for the redistribution of assets" to catch the "streetcar" (or to attach another carriage to it) while the doors remain open. These elites and a number of passengers occasionally have an idea of laying hands on and sharing the assets of a passenger or a group outside to create their own great fortunes. Second, there are complex relationships between the financial and political elites who have not yet decided the question of the nature and composition of the ruling elite. Third, there is a continuing struggle of clans in connection with the discussion of policy issues of combining two things: the nature of the country's development and, at the same, continued control (see Grigoryev, 2010a). Fourth, there is an unresolved problem of the legitimacy of property and security, that is, mutual guarantees by the elites and society that the rule of law enjoys supremacy (in fact, an amnesty for past violations in seizing assets).

In particular, the passengers of the "elite streetcar" need the certainty that these institutional changes, which are very positive from the perspective of the country's development, are reliable and will remain as such for a long time; in addition, unexpected future changes will not affect the bulk of the passengers.⁹ Typically, the ruling elites are not prepared to accept the idea of losing control in exchange for impartiality and rent (a type of an elite retirement pension). The determination to fend off those supporters (or influential members of the competing elites) who also want to board the "streetcar" or to attach a couple of carriages to it is also a matter of political courage and wisdom of the ruling elite. The elite's expressed and enforced demand for the rule of law is a long-term choice of a course toward the stability of society and the elite's proper position.

Reference

- Acemoglu, D., Johnson, S., Robinson, J. A., & Yared, P. (2008). Income and democracy. *American Economic Review*, 98 (3), 808–842.
- Bromley, D. (1989). *Economic interests and institutions: The conceptual foundations of public policy*. N.Y.: Blackwell.
- Buchanan, J. (1975). *The limits of liberty: Between anarchy and Leviathan*. Chicago: University of Chicago Press.

⁹ In Spain, that was done with the help of the well-known Moncloa Pact.

- Burton, M. G., & Higley, J. (1987). Elite settlements. *American Sociological Review*, 52 (3), 295–307.
- DeLong, J. B. (1997). Robber barons. In A. Åslund (Ed.), *Perspectives on Russian economic development*. Moscow: Carnegie Endowment for International Peace.
- Gaman-Golutvina, O. V. (2001) Interaction of political and economic elites in Russia: Historical retrospective and modern state. *Bulletin of the Political Centrism Development Foundation: Russia in the context of transformations (historical and political seminar)*, 10, pp. 38–47 (In Russian).
- Gaman-Golutvina, O. V. (2006) *Political elites in Russia: Landmarks of historical evolution*. Moscow: ROSPEN (In Russian).
- Grigoryev, L. (2010a). Elites and the middle class. *SPERO*, 13, 87–110.
- Grigoryev, L. (2010b). Privatization programs of the 1990s (pp. 479–523). In L. Grigoryev. *The economy of transitional processes* (Vol. 1). Moscow: International University in Moscow Publ. (In Russian).
- Grigoryev, L. M. (2013). The emergence of institutions: Interests and measure of success in the transformation process (pp. 278–295). In M. G. Pugacheva, & V. P. Zharkov (Eds.), *Russia's ways. Historization of social experience* (Vol. XVIII). Moscow: Novoe literaturnoe obozrenie (In Russian).
- Hendley, K. (1999). Rewriting the rules of the game in Russia: The neglected issue of the demand for law. *East European Constitutional Review*, 8 (4), 89–95.
- Higley, J., Burton, M. (2006). *Elite foundations of liberal democracy*. N.Y.: Rowman & Littlefield.
- North, D., Wallis, J., & Weingast, B. (2009). *Violence and social orders. A conceptual framework for interpreting recorded human history*. Cambridge: Cambridge University Press.
- North, D. C., Wallis, J. J., Webb, S. B., & Weingast, B. R. (2012). *In the shadow of violence: Lessons for limited access societies*. Paper presented at the XIII International academic conference, National Research University Higher School of Economics, Moscow, April 3–5. Moscow: HSE Publ. (In Russian).
- Olson, M. (1993). Dictatorship, democracy, and development. *American Political Science Review*, 87 (3), 567–576.
- Pejovich, S. (1994). The market for institutions vs. capitalism by fiat: The case of Eastern Europe. *KYKLOS*, 47 (4), 519–529.
- Perthes, V. (Ed.). (2004). *Arab elites. Negotiating the politics of change*. London: Boulder.
- Pistor, K. (2002). The demand for constitutional law. *Constitutional Political Economy*, 13 (1), 73–87.
- Polterovich, V. M. (2007). *Elements of the theory of reforms*. Moscow: Ekonomika (In Russian)
- Shastitko, A. Ye. (2008). The institutional environment of business activity. *Obshchestvennye Nauki i Sovremennost*, 2, 24–35 (In Russian).
- Tambovtsev, V. (1997). Theoretical grounds of institutional designing. *Voprosy Ekonomiki*, 3, 82–94 (In Russian).
- Zhuikov, V. M. et al. (Eds.) (2010). *Supremacy of law and problems of ensuring it in law enforcement practices* (2nd ed.). Moscow: Statut (In Russian).