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

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Abstract

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

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

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

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

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

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

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

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

Table 1
The role of the central state in the economy and corresponding economic performance during 1928—2008.

Regime	Degree of central state control in corporations	Major corporate ownership and residual claims to profit	Economic performance
1928–1985 Soviet Union Gosplan (1)	Mandated: input and output prices; investment and output targets	None	2 periods: 1. 1928–1970: GNP growth rate is 4.53 2. 1970–1985: GNP growth rate is 2.15
1985–1991 Perestroika (2)	Binding output quotas on enterprises. Imposed under market-clearing prices on critical products	None	GNP growth ≈ 1.3% (total factor productivity is negative)
1991–2000 Yeltsin's tenure (3)	Binding output quotas on state enterprises. Binding under market-clearing prices on critical products	Quasi-managerial ownership. Surreptitious share trading and firm asset trading	GDP declines by 50% (industry and agricultural sectors decreases by more than twice)
2000–2008 Putin's first tenure (4)	Binding output quotas on state enterprises. Binding under market-clearing prices on critical products	Residual outside-investor ownership. Firm asset trading	GDP growth = 6.9% (productivity growth is 70%)

Source: Economic performance data is from Kurtzweg (1987, pp. 126–165), Noren and Kurtzweg (1993, pp. 8–33) and Kudrin and Gurvich (2015).

resulting in a dramatic fall in production (Stiglitz, 2002; Hoff and Stiglitz, 2004; Ross, 2004). In the 1990s, the regions also gained *de facto* power and the period saw the emergence of regional bureaucrats (Robinson, 2002). They exploited the existing regional differences in new policy proposals, such as public spending, as well as assigned region "property rights" in many enterprises to pursue their own wealth tunneling objectives. At the same time, shock therapy led to hyperinflation and wiped-out savings of the Russian citizenry, leading to extreme poverty and political instability (Freeland, 2000; Hoffman, 2002; Libman and Feld, 2007).

As Russia's briefly adopted market reforms were short-lived due to their failure to generate economic growth, it was unsurprising for the incoming political regime (period 4), to re-introduce a significant role for the state in directing the economy. Oligarchs' wealth diversion practices were diminished (Goldman, 2003; Tompson, 2005), while regional officials' opportunistic behavior was also restrained (Goldman, 2003; Gregory and Schrettl, 2004; Bahry, 2005; Dininio and Orttung, 2005; Ivanenko, 2005). Interestingly, the new policies did not completely abolish the free market approach in that all prices and output quantities, except that in a few strategic industries, were allowed to be determined by the market. However, an important aspect of the new regime was that the state re-engaged directly with Russia's main industries (Boussena and Locatelli, 2010; Kalyuzhnova and Nygaard, 2008), but instead of pursuing the re-nationalisation initiative, it opted to form co-partnerships with private investors.

This paper examines the mechanisms employed during Putin's first tenure to restore the state's governing status, while also promoting a certain degree of price discovery, competition and private ownership. Section 2 alludes to the motivation behind government's continuous intervention in Russian

economy, highlighting its inability to create a suitable environment for a free market. Section 3 outlines two policies, adopted by the state in the early 2000s in order to accomplish its self-professed goal of long-term growth. One policy consisted in introducing a "punishment" strategy, which was implemented when private decision-makers, such as firm managers or lower-level bureaucrats, engaged in predatory behavior. The second policy focused on introducing a co-partnership system between the state and private investors. I argue that the second policy was likely to be favored if the "punishment" strategy in itself was not sufficient and too costly, as in the case of diverted large lump-sum investment funds in the natural resources sectors, which resulted in international scandals and loss of future investment. Finally, Section 4 concludes.

2. State intervention and corporate growth

2.1. The role of institutions

The role of the state in the economy has been a topic of great interest. Some follow the Hobbesian view and trust the responsibility of the state to play an active part, creating supporting institutions and providing effective regulation. Others adopt Locke's approach and consider government interference to be harmful in that it reduces economic efficiency achieved by private players, who call for a natural evolution of property rights. In this paper, I argue that the function of the state is highly dependent on the country's entrenched customs and traditions, political rule, and subsequently, its legal developments.

For instance, one of the most widely accepted arguments against state's involvement in economic affairs is that delegation of power to the government is often not matched by its credible commitments to other players. In their famous work, North and Weingast (1989) provide an example of 17th century England, where the revenue-seeking Crown continually dishonored its contractual conformities, and was subsequently stripped of its monopoly decision-making power to allocate funds. The ruling power of the Crown was replaced by political institutions, which enforced *ex post* contractual agreements. The new redistribution of control resulted in the emergence of greater political and civil freedom, as well as the ability of the sovereign to credibly commit to protecting private property rights. The success of these new institutions is linked to England's economic development.

Yet, at the same time, the authors point out that the reforms did not arise naturally—it is unlikely that the present governing institutions in England would exist had the Crown had an army to suppress the opposition. More importantly, the new hierarchies (the Parliament, the Whigs, etc.) did not operate in a country without a—although somewhat weak—legal system. Magna Carta, an English legal charter, which was originally issued in 1215, revealed certain individual rights which were bounded by law.

> No Freeman shall be taken or imprisoned, or be disseised of his Freehold, or Liberties, or the free Customs, or be outlawed, or exiled, or any other wise destroyed… We will sell to no man, we will not deny or defer to any man either Justice or Right.
>
> (Clause 29, Magna Carta 1215)

In other words, the concept of private property rights was not unfamiliar to England before the Glorious Revolution. Economic agents identified substantial gains to be made from long-term commitment, and wealth expropriation by the Crown was seen as a hindrance to achieving economic prosperity.

Similarly, Weingast (1995) attributed the success of the US common market, characterized by strong protection of property rights, to the federalism system, which allowed the states to have the power to supply their citizens with public goods, but limiting these powers to a particular region. However, the author states that such restrictions were made credible by a combination of formal institutions and informal norms that regulated the behavior of economic agents.

> Market-preserving federalism was the product of a historical process resulting in a strong consensus supporting these limits…and rested on the fact that the vast majority of the population consistently favored policies and parties limiting the federal government and protecting economic rights.
>
> (Weingast, 1995, p. 26)

By examining the innovations that focused on lowering transaction costs in mercantile early modern Europe, North (1991) drew attention to the evolution of capital markets, an important component of which was well-defined property rights, facilitating trade and investment. North believed that the increasing enforceability of contracts, a process which was aided by an improving legal system, was the product of "the long evolution of merchant law from its voluntary beginnings and the differences in resolutions that it had with both the common and the Roman law are a part of the story" (North, 1991, p. 107).

However, not all countries followed institutional development course of England, the US and Europe. Russia's political and institutional evolution can be contrasted to that of the above. In Russia, traditional authoritarian rule continuously impeded the development of a strong legal system.

> Lawyers! What is the use of so many? I have only two in my whole empire, and I mean to hang one of them as soon as I return.
>
> (Peter the Great on his travels to London in 1698.
> Quoted in: Smith, 1996, p. 1)

Ill-defined property rights hampered the formation of business strata in Russia, reducing the necessity for appropriate market infrastructure. The persistent absence of the necessary prerequisites for a market economy also implied that if Russia's political and economic system had more than one competing hierarchy, such as truculent members of the lower classes of bureaucracy, the objective of the elites would not have entailed long-term economic growth, for the gains from short-term wealth siphoning would have been much larger. Indeed, for early as the mid-16th century, the ruling dynasty believed that the oligarchy was undermining Russia's economic progress, subsequently implementing an extremely autocratic regime (Yanov, 1981). Later, under the "enlightened" Peter the Great, the centralized authoritarianism directed Russian industry to "westernize" (Pipes, 2004). One of Peter's rationales for centrally directing his "modernization" was his need to overcome the truculence of many members

of the lower state bureaucracy, many of whom were known as *boyars* (Raeff, 1962). The latter remained locked in protecting their feudal privileges, and therefore opposed the introduction of western-style, commercially dominated cities, while suspecting that new economic reforms were incompatible with the survival of the old empire. The tradition of centrally imposing commercial revolutions was reaffirmed during the reign of Nicholas II at the end of the nineteenth century, when the Stolypin and Witte reforms served to spark Russia's incipient industrialization. Once again, modernizing reforms were rigorously opposed by the overwhelming mass of the conservative bureaucracy of the period (Holzer and Illiash, 2009).

Similarly, Russian privatization process can be described as a recent example of several competing hierarchies operating in an environment without clearly-defined property rights, where private economic agents became free to acquire state's assets without any regulatory framework (Stiglitz, 2002). As previously mentioned, several elite groups, such as new "businessmen," or oligarchs, and regional government officials were formed, and they did not find it profitable to make long-term commitments and invest into their corporations. In the absence of supporting institutions, it was far more lucrative to engage in asset-stripping (Black et al., 2000; Sonin, 2000). Each of the hierarchies, having attained considerable political and economic power, competed rigorously with each other for resources, eroding the nation's wealth at an even faster rate (for example, Ponzi schemes carried out by the newly formed Russian banks, see Pistor and Spicer, 1997; Laeven, 2001). It is therefore unsurprising that the Putin administration reverted back to the traditional "top-down" control strategy and forced oligarch quasi-owners and regional bureaucrats to give up their power (Goldman, 2003; Tompson, 2005).

2.2. The political regime of the 2000s

With Vladimir Putin coming to power, the central government focused on taking control of the commanding heights. The "day of the oligarchs" was truly over, and regional officials no longer controlled parts of Russia's economy. Any remaining 1990s business elites were expected to fully cooperate with the state's economic objectives and assist in Kremlin's domestic and foreign policy initiatives (Aris and Marshall, 2004). At that time, many scholars drew attention to the rise of the new elite. *Siloviki*, who were seen as Putin's trusted men and represented security service and law enforcement veterans, became the pillar of the new administration. They were placed on company boards, particularly in industries of national importance, in order to enforce the regime's policies and to safeguard company assets. In contrast to the oligarchs, *siloviki* exercised their power through managerial positions rather than ownership. They saw their role as to reverse problems created by the oligarchs, reintroduce hierarchical loyalty, and, above all, protect national interests (Treisman, 2007). Similarly, trusted government officers were put in charge of the seven "super-regions," which were created to reverse the leakage of power to regional bureaucrats (Rutland, 2000; Orttung, 2001; Hashim, 2005).

This paper adopts the view that *siloviki* did not represent a separate elite — they merely served as a conduit for the central government, through which the new

policies were channelled. In addition, I highlight the fact that although after a brief experiment with *laissez-faire* policies Russia was once again drawn to its long-standing tradition of authoritarian rule, the new regime did not revert back to state-controlled economy; instead, the government aspired to become an effective partner with private investors. It aimed to promote long-run economic growth, which was to be financed through a mixture of state subsidies and private investment funds. The government recognized that in the absence of efficient Western-type institutions, investors faced significant transaction costs that would result in underinvestment, if the state did not introduce some effective substitute.

The next section introduces two related hypotheses. First, it is proposed that given a persistently weak legal environment, the central state did not allow competing hierarchies to exert influence on the economy and it implemented its strategy by positioning itself as the leader in a Stackelberg game, whereby it promoted corporate growth by encouraging private agents' operations through a combination of free-market and state-mandated policies, but also induced severe punishment for contractual non-compliance. The Stackelberg model shows that the incoming regime did not aim to rebuild old Soviet institutions, but focused on restoring order and protecting national economy from the elites' concentrated economic and political power.

Second, as such games were more costly across industries with large sunk costs and high asset specificity, where firms were not only characterized by high hold-up costs, but also bigger international scandals, the state chose to form state-private co-partnership systems with private investors. In this partnership, the state played a major role in firm corporate governance and could therefore avert rent-seeking behavior from the outset, thus minimizing misappropriation of both government and private investors" funds in the absence of well-defined property rights.

3. The punishment strategy and the state-private co-partnership system

3.1. The Stackelberg game between the central state and private decision-makers

This section outlines a model adopted by the central state in order to enforce contractual compliance of private decision-makers. The model can discourage short-term rent-seeking behavior by allowing the state to execute punishment if a decision-maker chooses to pursue wealth tunneling objectives. It is argued that the model was developed in response to the legacy of previous regime's reforms, which empowered the rising elite to take advantage of an open but weak political system and use their ill-gotten wealth to buy media coverage, as well as state officials, in order to further their interests and to strip the nation's assets.

The state, which acts as the Stackelberg leader, passes laws that address protection of investment funds. It knows that, due to a poor legal system, the laws may not be effectively enforced. The government also acknowledges that a private decision-maker (for example, firm manager) can be non-cooperative and ignore the law if the expected return from short-term wealth tunneling is higher than that from a long-term investment commitment strategy. Therefore, the state

develops a punishment strategy, which it imposes on private decision-makers if they do not conform to the implemented policy. If the penalty is severe, it is in the best interests of a private decision-maker to conform.

Fig. 1 shows the state acting as the Stackelberg leader. The maximum payoff the state can achieve is represented by π, while the corresponding payoff to a private decision-maker is $(1-s)\pi/n$. However, π is also unattainable, as it can only be accomplished by not inducing a punishment mechanism, with private agents still credibly committing to honor their contractual obligations and not adopting short-term investor expropriation strategy. However, one can see that given the no-penalty option, agents can obtain a larger profit of $m((1-s)\pi/n)$, where m corresponds to a positive coefficient obtained by not conforming to the state's policy and cheating, leaving the state with a smaller profit of $\alpha\pi$. The state anticipates such opportunistic behavior, and introduces a punishment strategy at cost c in the initial period. The cost of punishment leaves the state with a reduced profit of $\pi-c$, yet one can see that the outcome $\pi-c$, $((1-s)(\pi-c))/n$ is the only equilibrium in this game, because by choosing the "not to conform" option with a punishment strategy already in place, private agents will create an even smaller profit for themselves, as well as the state.

Perhaps the most apparent example of this game was the prosecution of the head of Yukos oil company, Mikhail Khodorkovsky. In 2003, the richest oligarch was accused of engaging in extensive asset-stripping, as well as using his position to bribe local bureaucrats. The federal government placed Khodorkovsky under arrest for tax evasion and Yukos assets were subsequently sold to the state-owned company Rosneft. By executing such punishment the state sent a clear message that Kremlin will not be challenged by the elite, who became accustomed to fusing their political and economic power (practice that western institutions vetoed since the 1920s). Other oligarchs, who were subjected to similar fate included

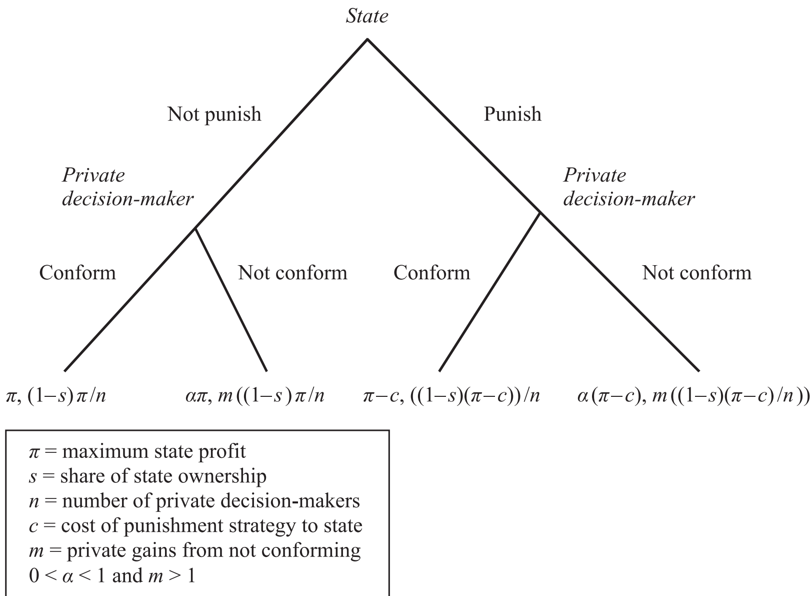

Fig. 1. The state acts as the Stackelberg leader in a two-player game between the state and a private decision-maker

Boris Berezovsky, who initially made gains from channelling money from a motor company Logovaz in the 1990s and later set his interests on Aeroflot, Sibneft and Russian Public Television. In an attempt to cement his power over the Russian economy, Berezovsky also expressed keen interest in politics, which resulted in his exile to London in 2000. Vladimir Gusinsky, who successfully created a media empire and used his position to influence politics in order to usurp further wealth, also found himself in exile (Sakwa, 2008). The punishment strategy signalled that the only way for the oligarchs to participate in economic transactions was to accept the government as the Stackelberg leader, who inevitably dictated the rules of the game. Evidence suggests that Kremlin allowed several oligarchs to maintain their empires as long as their behavior did not disrupt the state's strategy (Goldman, 2003). For example, Oleg Deripaska, Vladimir Potanin and Roman Abramovich still controlled metal mining empires, but they had to adhere to certain conditions imposed by the state (such as Abramovich selling his major ownership stake of oil company Sibneft to the government). In sum, the oligarchs had to become servants, as opposed to competitors, or opponents of the regime (Lavelle, 2004).

Now consider what happens when private decision-makers become leaders in the Stackelberg game (Fig. 2). By gaining the first-mover advantage, private agents can attain their maximum payoff of $m((1-s)\pi/n)$ by choosing the "not conform" option, knowing that if the state punishes them in this period, it receives the smallest profit generated by the game. This strategy leaves the state with a much reduced payoff of $\alpha\pi$, and represents a weakened government, which is frequently vulnerable to oligarch power wars (for example, the notorious "loans for shares" scheme of the mid 1990s).

From the outcomes produced above, one can see that in the absence of strong property rights, it is socially optimal to re-establish the state as the market leader,

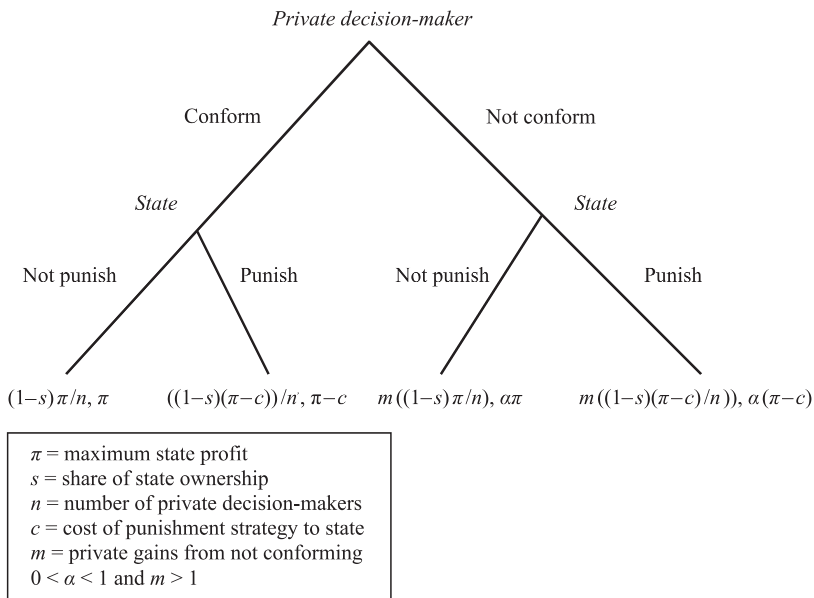

Fig. 2. A private decision-maker acts as the Stackelberg leader in a two-player game between the state and a private decision-maker.

because such organizational structure can better secure long-term investment funds. The government is able to place constraints on private decision-makers and thereby limit their abilities to engage in short-term predatory behavior by forcing them to conform to state's anti-expropriation policies. This approach enables the state to obtain its maximum attainable payoff (which also corresponds to the social optimum), and it also enables private agents to make a profit.

3.2. The co-partnership between the state and private investors

While the Stackelberg game strategy between the state and private decision-makers ameliorates rent-seeking, one must also draw attention to *c*, or cost of implementing punishment. The government has to spend substantial resources to monitor the behavior of private decision-makers, as well as absorb the cost of investment scandals. For instance, there were numerous reports referring to continuous government interference in the operations of private companies (Buck, 2003), especially if these companies belonged to industries of national interest, such as the oil sector (Finon and Locatelli, 2008). Such practices culminated in internationally-condemned business environment, which deterred global investors from entering the Russian market (Hanson, 2007). McFaul and Stoner-Weiss (2008) argued that the regime focused on “rolling back democratic gains” in exchange for stability and growth.

Therefore, as the punishment strategy may not always be the most efficient policy, I argue that the central state often opted to create a direct partnership with private investors. By acquiring a large proportion of capital in many enterprises, the government became a major partner in firm decision-making process and had the authority to block predatory behavior (Nikonov, 2005; Tompson, 2008).

From the theoretical perspective, Russia's choice of economic organization is a response to the existence of severe transaction costs and to subsequent mitigation of contractual incompleteness in the absence of a strong property rights system. In the Russian economy, many large fixed investment projects, which have significant sunk costs and can be defined as long-term to maturity, are undertaken. In the absence of a well-defined legal code or some effective substitute, one *ex ante* expects high hold-up costs, and high hold-up costs lead to a high level of underinvestment, particularly in strategic economic sectors, which are also characterized by high asset specificity (Klein et al., 1978; Williamson, 1979). While it is believed that Russian firms have benefited from stringent corporate governance reforms (Yakovlev, 2003; Lazareva et al., 2007), one cannot expect a rapid emergence of an appropriate legal system, which can assure private investors of their expected returns. Subsequently, in more vulnerable industries a second-best corporate governance mechanism has arisen in the form of the state–private co-ownership system, which can act to monitor the behavior of corporate insiders and constrain their wealth tunneling objectives until Russia develops a secure property rights system.

Grozovskiy (2007) and Hanson (2009) showed that the political regime of the 2000s eschewed renationalization of enterprises and instead increased its stake in corporate equity from 20 percent to just under 40 percent between 2003 and 2007. Sprenger (2010) also drew attention to significantly increased government control over the country's largest enterprises. Above all, the state targeted

energy sector firms, as Russia's economic revival depended on the ability of the state to collect energy sector rents, while offering investors their expected rate of return (Butt et al., 2008). Foreign investors were also encouraged to form partnerships with the state (Erochkine and Erochkine, 2006; Hanson, 2009). It is reported that over 40 percent of the 500 points Russian stock market growth during the 2000–2006 period was attributed to two major energy companies, namely Gazprom and Rosneft, which introduced partnerships between the state and private investors (Harris, 2009). However, Tompson (2008) and Vanteeva and Hickson (2016) went a little further by showing that state participation also increased in industries such as utility, metallurgy and mining, transport and manufacturing (see Table 2 for number of co-partnerships among RTS-listed firms). These industries are associated with large sunk costs and high asset specificity and in the absence of a well-defined property rights system, are subject to significant hold-up costs. Vanteeva and Hickson (2016) also reported that the implemented state-private co-partnership had a positive effect on company long-term performance, indicating that this strategy may have been less costly and more effective than simply monitoring and punishing private decision-makers. Chernykh (2005) demonstrated similar results and argued that the state's key objective was to regain control over strategic enterprises in order to minimize wealth tunneling, and not, according to a popular belief, to "cherry pick" most profitable firms (Chernykh, 2011). In other words, under the new regime, a partnership between investors and Kremlin was successful in increasing private investment from $11 billion in 2000 to $54 billion in 2005 (Treisman, 2006), while capital inflow comprised seven percent of GDP in 2007 (Kudrin and Gurvich, 2015).

Table 2

State-private co-ownership across eight industrial sectors during 1998–2006 and the percentage of state-private owned enterprises relative to the overall number of firms in this industry (based on RTS-listed firms).

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Utility	1 (2%)	1 (2%)	4 (7%)	5 (9%)	5 (9%)	12 (21%)	10 (16%)	10 (10%)	19 (18%)
Energy	1 (6%)	0 (0%)	1 (5%)	2 (11%)	2 (11%)	3 (16%)	2 (11%)	3 (16%)	3 (16%)
Metallurgy & Mining	0 (0%)	1 (5%)	1 (5%)	2 (10%)	2 (10%)	2 (9%)	3 (17%)	3 (13%)	5 (21%)
Transport	2 (29%)	2 (29%)	1 (14%)	1 (14%)	1 (14%)	1 (14%)	0 (0%)	0 (0%)	1 (14%)
Manufacturing	0 (0%)	3 (8%)	7 (17%)	7 (17%)	7 (17%)	8 (19%)	7 (16%)	7 (15%)	14 (30%)
Communications	1 (8%)	1 (7%)	1 (7%)	1 (7%)	1 (7%)	1 (7%)	1 (7%)	1 (7%)	1 (7%)
Banking & Services	0 (0%)	0 (0%)	1 (11%)	1 (7%)	1 (6%)	1 (6%)	0 (0%)	1 (4%)	1 (4%)
Food & Retail	1 (20%)	1 (17%)	1 (14%)	1 (11%)	1 (10%)	1 (8%)	2 (15%)	1 (7%)	1 (7%)
Total	6	9	17	20	20	29	25	26	45

Source: Vanteeva (2012).

4. Conclusion

Russia has a long-standing tradition of authoritarian government, where its business model came to rely on a strong governing role of the state. As is often postulated, the historical tendency in Russia for central and authoritarian economic planning hampers the possibilities of any organic growth through the medium of unfettered market forces.

Evidence has shown that under a weak legal system, hierarchical groups tend to adopt a short-term wealth tunneling strategy, which leads to economic stagnation. This was reaffirmed during the privatization initiative, whereby Western-style governing institutions failed to emerge and the new elites siphoned off national resources.

The subsequent policy was a response to *laissez-faire* approach of the 1990s, which culminated in economic collapse, institutional chaos, and a weak state. The administration focused on reigning in the oligarchs and centralizing federal structure by creating super-regions and appointing personal trusted officials, to ensure that the state's interests are met. Unsurprisingly, these goals came at the expense of the development of more democratic institutions.

This paper shows how during Putin's first tenure the state implemented severe punishment strategy on private decision-makers, who sought to form competing hierarchies and use their newfound influence to usurp wealth. Significantly, it is also important to observe the formation of a substitute monitoring mechanism, where the state aspired to form a direct co-partnership with private investors to promote long-run economic growth.

Putin's strategies to rebuild the Russian state were not dissimilar to the approaches adopted in the 19th century France and Japan, which centralized power, implementing a top-down control method and displacing the elites. Furthermore, many authors (e.g., Hashim, 2005; Levitsky and Way, 2005) note that transition economies may not necessarily remain unstable until they implement democratic institutions, and that their stable state may, in fact, represent a non-democracy. However, the stability will ultimately depend on whether the state will successfully manage Russia's faltering economy in the wake of oil price decline and significant capital flight. The establishment of a secure property rights system may still be the necessary prerequisite for the country's long-term development.

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