Evangelisches
Studienwerk e.V. Villigst

UNIVERSITÄT HOHENHEIM
1818

CARL VON OSSIETZKY universität OLDENBURG

Schriftenreihe des Promotionsschwerpunkts
Globalisierung und Beschäftigung

Nr. 34/2011

Economic Growth in the Post-Socialist Russian Federation after 1991: The Role of Institutions

by

Constanze Dobler* and Harald Hagemann**

Stuttgart-Hohenheim
ISSN 1618-5358

* Dr. Constanze Dobler
University of Hohenheim
Department of Economics (520)
D-70593 Stuttgart
constanze.dobler@uni-hohenheim.de

** Prof. Dr. Harald Hagemann
University of Hohenheim
Department of Economics (520)
D-70593 Stuttgart
harald.hagemann@uni-hohenheim.de

Unemployment is persistently high in many European countries. It is frequently attributed to 'functional deficiencies of labor markets', even though to a large extent caused by demand and supply shifts in goods markets and financial markets. The PhD program *Globalization and Employment* therefore focuses on the employment effects of structural change and macroeconomic developments and encourages research by granting scholarships. The dissertation projects address topics such as new technologies, processes of internationalization and system transformation, endogenous finance constraints and various strategies of fiscal and monetary policy.

Work and supervision in the PhD program follows the structures of a standard graduate school. Coordinators and *editors of the discussion paper series* are the following professors:

Prof. Dr. Harald Hagemann hagemann@uni-hohenheim.de
Department of Economics (520H)
University of Hohenheim
D-70593 Stuttgart

Prof. Dr. Heinz-Peter Spahn spahn@uni-hohenheim.de
Department of Economics (520A)
University of Hohenheim
D-70593 Stuttgart

Prof. Dr. Hans-Michael Trautwein michael.trautwein@uni-oldenburg.de
Department of Economics and Statistics
Carl von Ossietzky University Oldenburg
D-26111 Oldenburg

PhD projects in the program can be funded by grants of the *Evangelisches Studienwerk e.V. Villigst*. Application forms can be ordered from:

Evangelisches Studienwerk e.V.
Promotionsförderung
Iserlohner Str. 25
D-58239 Schwerte Phone: +49 (2304) 755-215, Fax: +49 (2304) 755-250

For further information about the PhD program *Globalization and Employment* as well as the PDF-files of the discussion papers see:

http://www.globalization-and-employment.de

Economic Growth in the Post-Socialist Russian Federation after 1991: The Role of Institutions

Constanze Dobler and Harald Hagemann

December 2011

Abstract

The paper emphasizes the transition in Russia and the role institutions played before and during the process. In Russia, a "big bang" approach was applied. That is to say, transition was conducted all of a sudden, omitting important underlying reforms. This practice should function as a shock therapy. Hence, the approach should leave no other chance than an abrupt adaption to the new free-market rules. These rules would then lead to fast economic growth and development, as they did in other places. However, since Russian GDP per capita and thereby living standards deteriorated dramatically in the years after the collapse of the Soviet Union, the plan did not work. At any rate, since then Russian economic indicators recovered and partly achieved their pre-1991 levels at the end of the last decade. The paper depicts Russia's reform efforts and the subsequent developments. The close ties among the political elite, the banking sector and the old nomenklatura are demonstrated. The patrimonial system that persisted for centuries is still observable at the state level. At any rate, Russia can neither evade its historical and institutional development path nor its societal structures that are based on networks and nepotism. Russia's systemic lack of the rule of law and therewith of secure property, the character of the Russian political system with the patriarch as the head of state and the resulting necessity of corruption and bribes inhibit the realization of its full growth potential.

Keywords: country studies, economic systems, formerly centrally planned economies, growth, institutions, transition economies

JEL classification: N14, N24, N44, O43, O52, P20, P30

This paper is part of the research project *Social Capability, Economic Growth and Structural Change in Russia* within the research network *Institutions and Institutional Change in Postsocialism: Between History and Global Adaptation Pressures (KomPost).*

1. Introduction

Alberto Quadrio-Curzio is well known internationally for his life work on the structural and long-term features of distribution, accumulation and economic dynamics in the presence of bottlenecks due to scarcities of different types. In particular the analysis of the multi-sectoral, resource-constrained economy in which material and technological linkages are key factors explaining the structural economic dynamics has been at the focus of his interest (see, e.g., Quadrio-Curzio, 1986, and Quadrio-Curzio and Pellizzari, 1999). However, his analysis has never been limited to a purely technical analysis, as is best indicated by his directorship of the international scholarly journal *Economia Politica. Journal of Analytical and Institutional Economics*.

Quadrio-Curzio has well understood the classical theme in the analysis of structural change, i.e. the relationship between changes in the economic structure and the adjustment of an existing institutional set-up compatible with such changes. Historical processes of structural change illuminate the importance of the relationship between the structural composition of the economy, the distribution of agents among different institutional clusters and the overall growth performance of the economy, Institutions are the "Carriers of History" (David, 1994), i.e. institutions are a decisive constraint upon growth and structural change. This has been an important insight in development economics where economists such as Albert Hirschman have identified the connection between political and economic progress and emphasized that certain institutional changes are clearly favorable to a process of sustained economic growth. The work of North and others has shown the importance of institutions and institutional changes for economic performance. This holds in particular also for post-socialist transition economies where a radical shock therapy neglecting the existing institutions and the importance of search and evolution of the right institutions for the completely different reality of everyday life, have proven a failure (Rodrik, 2000). Initially, authors such as Przeworski and Limongi (1993) have pointed out that there is no simple answer to the question whether democracy fosters or hinders economic growth and that a credible commitment to economic growth may be difficult to achieve under autocratic rule, in which there is a high probability that the society will be plundered, as well as with democratic institutions in which too much weight may be given to a more egalitarian distribution of income and wealth with possibly detrimental effects on growth.

From an institutional economist's point of view the countries of the former Soviet Union depict one lucky accident that allows special research possibilities. The often discussed matter of institutional transformation with all its perils can be observed by means of Russia and its cohorts. There, we have a dramatic systemic change from one of the dominating socio-political directions of the 20th century – Communism – to the other – capitalism. Hence what is often discussed in theory did actually happen on the ground of the former Soviet Union: the shift of a complete system, that is, the transition from a centrally planned to a market economy. This systemic change is interesting for institutional economics in several ways. Institutions as the rules of the game are thought to influence a country's economic development path (North, 1990; North, 2005). Now, countries differ regarding their level of economic development and regarding their institutional environments. Hence, the crucial question is whether certain institutions are generally more growth-supportive than others and thus yield higher growth rates and higher development levels in the long run. The crux is that a country's institutional environment depicts a complex entity with myriad of institutions and other factors influencing each other. Hence, the political and economic institutions of an economically successful country might not cause the same results in another country. Institutions depend on history, culture, religion, geography, and reverse causalities. To really examine certain institutions and their emergence one usually has to go far back in a society's history and for general conclusions disciplines like anthropology, neurology, and evolutionary theory have to be considered. Therefore, different opinions exist regarding institutional transformation. During the time of Soviet transition, mainstream economic opinion was that institutional transformation is possible. Hence, free-enterprise institutions could be implemented in every country and would then lead to economic growth and development. The necessary modifications were summarized in the 'Washington Consensus'. The complex dependencies that exist between institutions and other exogenous and endogenous factors were ignored.

Empirical evidence, however, proved that things were not so easy. It looks as if many institutions cannot just be transplanted into certain societies, although they might support efficient outcomes in other economies. Whether the transformation of institutions is possible or not seems to depend on a country's history and culture, that is, on its roots and established moral, worldview, and traditions (Boettke et al., 2008; Landes, 1998; North, 2005; Roland, 2005). Hence, the rule of law cannot be easily installed in a country that has no tradition of law and property. And these countries do exist. The fact that a certain understanding of law, state, society and property rights did develop in Western Europe and from there spread to other societies does not necessarily mean that the same development occurred in other world regions. This becomes quite clear when we deal with the respective developments in Western

Europe that led to the implementation of these institutions (Hedlund, 2005; Huff, 2003; Jacob, 1997; Lipsey et al., 2005). Hence, different opinions exist regarding institutional change and transplantation. Therefore, the former Soviet Union depicts a kind of natural experiment where institutional economists can observe what happens if systems change and transition is conducted rapidly or gradually.*

The current paper emphasizes the transition in Russia and the role institutions played before and during the process. It broadly describes the developments of the last 20 years. In Russia, first a Big Bang approach was applied. That is to say, transition was conducted all of a sudden, omitting important underlying reforms. This practice should function as a shock therapy. Hence, the approach should leave no other chance than an abrupt adaption to the new free-market rules. These rules would then lead to fast economic growth and development, as they did in other places. However, since Russian GDP per capita and thereby living standards deteriorated dramatically in the years after the collapse of the Soviet Union in December 1991, the plan did not work. At any rate, since then Russian economic indicators recovered and partly achieved their pre-1991 levels at the end of the last decade. Therefore, we have to examine whether Russia at least made its way to a path of sustained growth (Lipsey et al., 2005).

2. Signs of structural change

Economic transition describes the process of change from a centrally planned to a free-market economy. Centrally planned or socialist economies are characterized by heavy industry, state-owned enterprises, physical management systems, and underdeveloped service and finance sectors (Ickes & Ofer, 2005). Hence, privatization and structural change are central elements of economic transition. Therefore, the current paper first demonstrates some core indicators of the Russian economy and then explores whether structural change is observable since 1991.

* However, because of the mentioned interrelationships between institutions themselves and other factors and because of the uniqueness of every single case general conclusions can hardly be detected in institutional economics. Therefore, conclusions drawn from the Soviet case cannot be applied one-to-one regarding other regions. Nevertheless, theory can be revised and the respective case can be better understood.

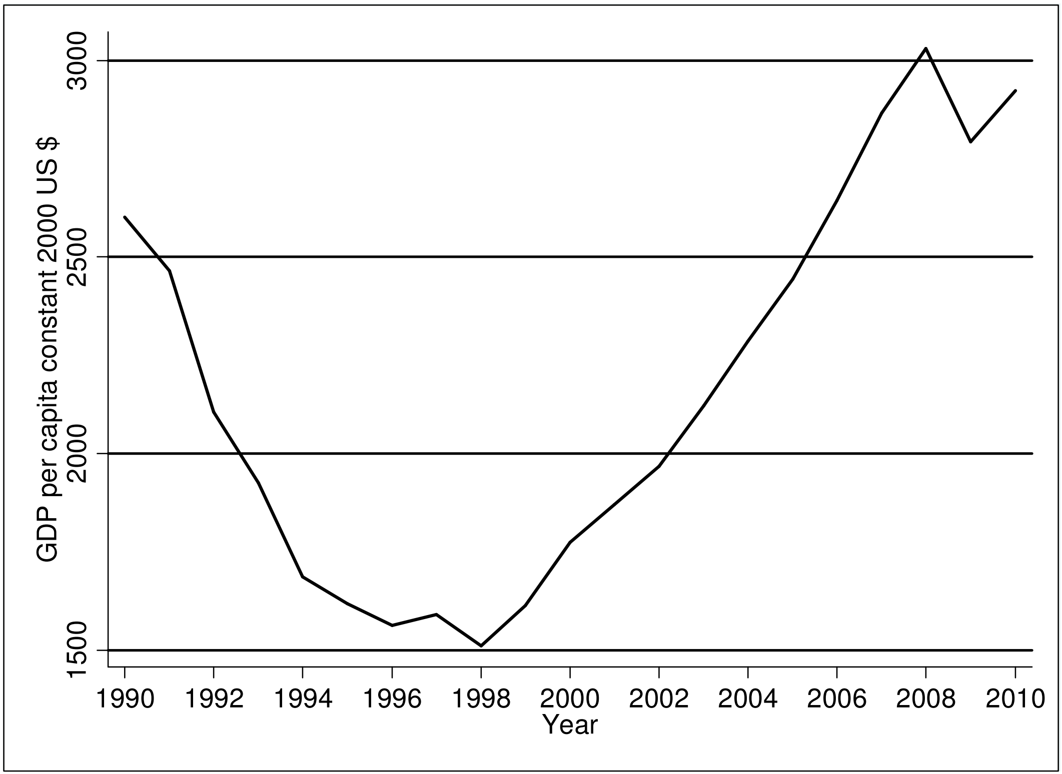

Figure 1: Russian GDP per capita in constant 2000 US dollar. Data Source: World Development Indicators.

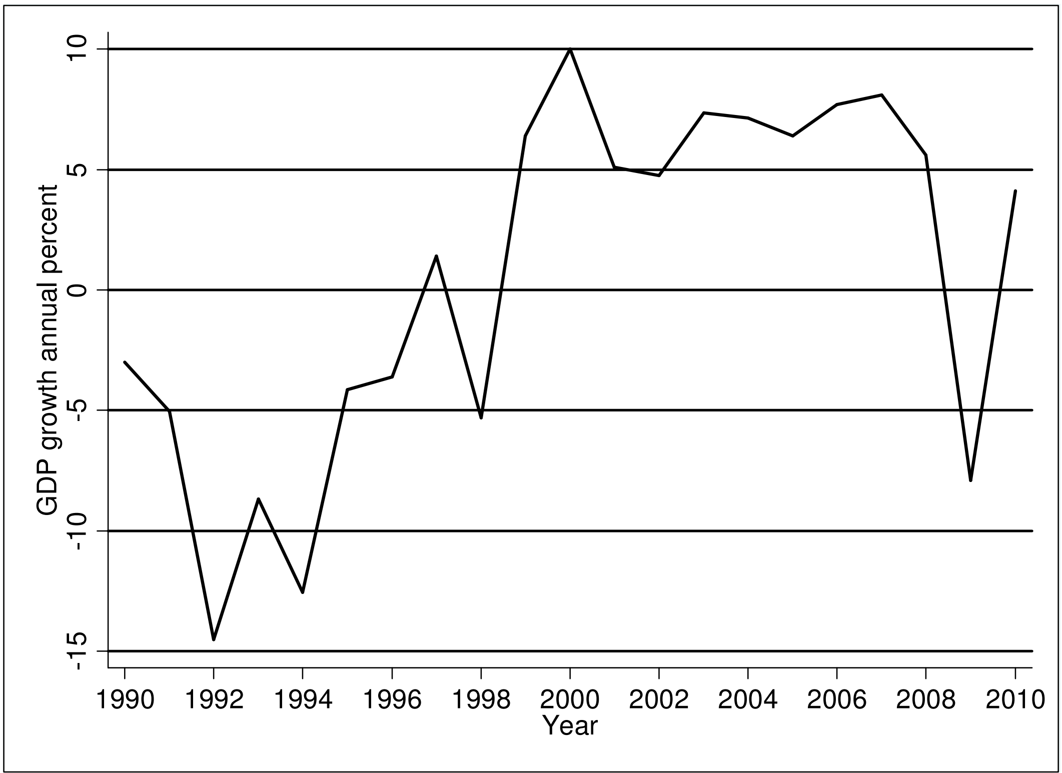

Figure 2: Russian GDP per capita growth annual percent. Data Source: World Development Indicators.

According to the World Bank classification, the Russian Federation belongs to the group of upper middle income countries.[†] Development of GDP per capita can be observed in *figure 1*. In 1990, Russian per capita GDP amounted for US$ 2,602. After the breakdown of the Soviet Union in 1991, per capita income continually decreased, reaching its lowest point in 1998 with US$ 1,511. After 1998 a recovery began. The 1990-level, however, was not reached until 2006 – that is 15 years after the end of the Soviet Union. This, however, was not the intended effect of transition. Living standards and therefore per capita GDP were thought to increase right from the start of the reforms, since the situation of the population should improve under the new system instead of worsening.[‡]

Figure 2 depicts GDP per capita growth rates. Between 1990 and 1998, GDP per capita on average fell by -6.16 percent per year. The average yearly growth rate of the period between 1999 and 2008 amounted to 6.85 percent. After the financial crisis of 2008, however, the growth rate in 2009 accounted for -7.9 percent and 4.11 percent in 2010. The average GDP per capita growth rate between 1990 and 2009, however, is merely 0.26 percent. Hence, on average, almost no growth in GDP per capita can be observed within a time span of 20 years. Russian growth until 2006/07 can be described as mere recovery. This, however, was not the original intention of economic transition.

Another critical point regarding living standards in Russia in the phase after the breakdown of the Soviet Union is the development of the GINI-index, which increased from 0.289 in 1992 to 0.422 in 2009, indicating a growing gap in income distribution.[§]

Since economic transition describes the change from a centrally planned to a free market economy, several modifications of the structure of the economy should be observable during and after the phase of transition. Employment shares, for example, are a sign for structural change. In 1990, 14 percent of total employment was registered in agriculture. The value decreased to 9 percent in 2007. In industry, employment dropped from 40 percent in 1990 to 29 percent in 2007, and in services employment increased from 46 percent in 1990 to 62 percent in 2007.[**]

Value added as percentage of GDP in agriculture decreased from 17 percent in 1990 to 5 percent in 2008. In industry, value added decreased from 48 percent in 1990 to 37 percent in

---

[†] World Bank classification: Country and Lending Groups; [online] available at: http://data.worldbank.org/about/country-classifications/country-and-lending-groups [accessed 8 January 2012].

[‡] GDP per capita is measured in constant 2000 US$; World Development Indicators, The World Bank.

[§] Data taken from Goskomstat. The World Bank measures a GINI-coefficient for the Russian Federation of 0.24 in 1988 and 0.44 in 2007; World Development Indicators.

[**] Employment as percentage of total employment, World Development Indicators, The World Bank.

2008, and in services an increase from 35 percent in 1990 to 58 percent in 2008 is observable.[††]

Net inflows of foreign direct investment (FDI) increased from 0.25 percent of GDP in 1992 to 4.5 percent in 2008. FDI then, however, dropped to 3.02 percent in 2009. These indicators indeed refer to structural change, which usually comes along with decreasing employment and value added rates in agriculture and industry and increasing shares in services.

According to World Bank data, unemployment in the Russian Federation rose from 5.3 percent in 1992 to 13.5 percent in 1999. In the 2000s, the unemployment rate fell to 6.2 percent in 2008.[‡‡]

Transition had an effect on enterprises, as can be seen in *figures 3-5*. Accordingly, the market capitalization of listed companies as percentage of GDP rose from 0.05 percent in 1991 to 115.61 percent in 2007. Afterwards it crashed to 23.82 percent in 2008 due to the financial crisis, but recovered to 69.99 percent in 2009.

The total value of stocks traded as percentage of GDP also increased from 0.07 percent in 1994 to 58.04 percent in 2007, 33.71 percent in 2008, and 55.46 percent in 2009. The turnover ratio of stocks traded increased form 11.1 percent in 1996 with several ups and downs to 108.5 percent in 2009. The number of total businesses registered increased from 1,609,423 in 2000 (first year for which data are available) to 3,267,325 in 2007.[§§]

3. The early years

These indicators, however, indicate signs of structural change. According to Ickes & Ofer (2005), structural change proceeded too slow and still lacks behind the respective expectations. Hence, "[Russian] enterprises continue to produce the wrong products, with too many workers and in the wrong place" (Ickes & Ofer, 2005, p.1). This statement hints at the low productivity of the Russian economy, which is a legacy of its Soviet past. According to Rosefield (2007) and Rosefield and Hedlund (2009), Soviet economic performance has almost never been as successful as predicted. At least under Reform Communism (1953-1991) official Soviet as well as Western records were overestimated. On the contrary, Angus Maddison's data of GDP and GDP per capita demonstrate an almost continuous decrease compared to the US level (Rosefield, 2007, pp. 145-160; Rosefield & Hedlund, 2009, pp. 78-91). Hence, the Soviet Union never caught-up to the US but was falling behind in GDP per

[††] Value added as percentage of GDP, World Development Indicators, The World Bank.
[‡‡] Data on unemployment are taken form the World Development Indicators, The World Bank.
[§§] All data are taken from the World Development Indicators, The World Bank.

capita, at least during the Cold War. This is not surprising since centrally planned economies and the Soviet strategy of physical systems management completely lacked attention for the demand side. Hence, products were produced and even research and development were supported and the respective sectors grew, but they produced unnecessary goods. The production strategy was not directed to peoples' wishes and needs but was planned according to computerized physical management strategies. Consumer sovereignty never played a role, and private enterprise was criminalized. Therefore, demand and supply were not brought together and prices and wages were fixed by the respective bureaucratic bodies. Such an approach inhibits supply and demand equilibration and therefore is inefficient. Although the plan incorporated research, it was not conducted where it would have made products and processes more productive. Emphasis was on heavy industry and within that, of course, on arms production. Therefore, although it can hardly be proven with statistical facts, since the respective data are not available, probably a negative factor productivity growth was haunting Russia for decades.

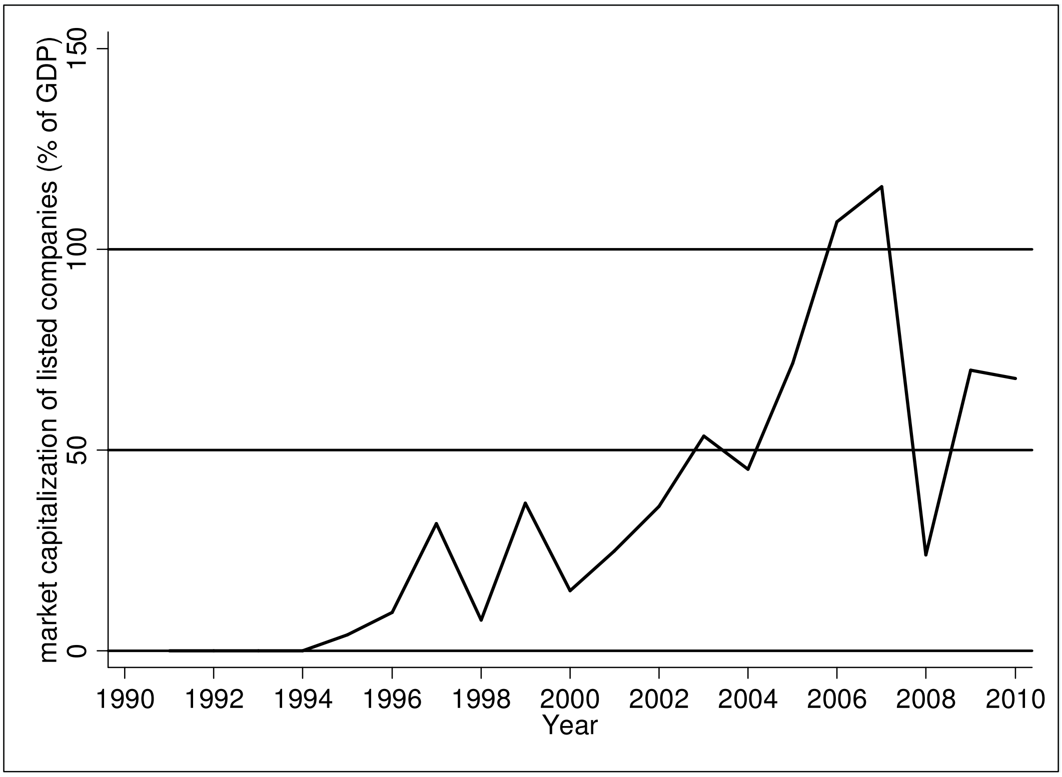

Figure 3: Russian market capitalization of listed companies, percent of GDP. Data Source: World Development Indicators.

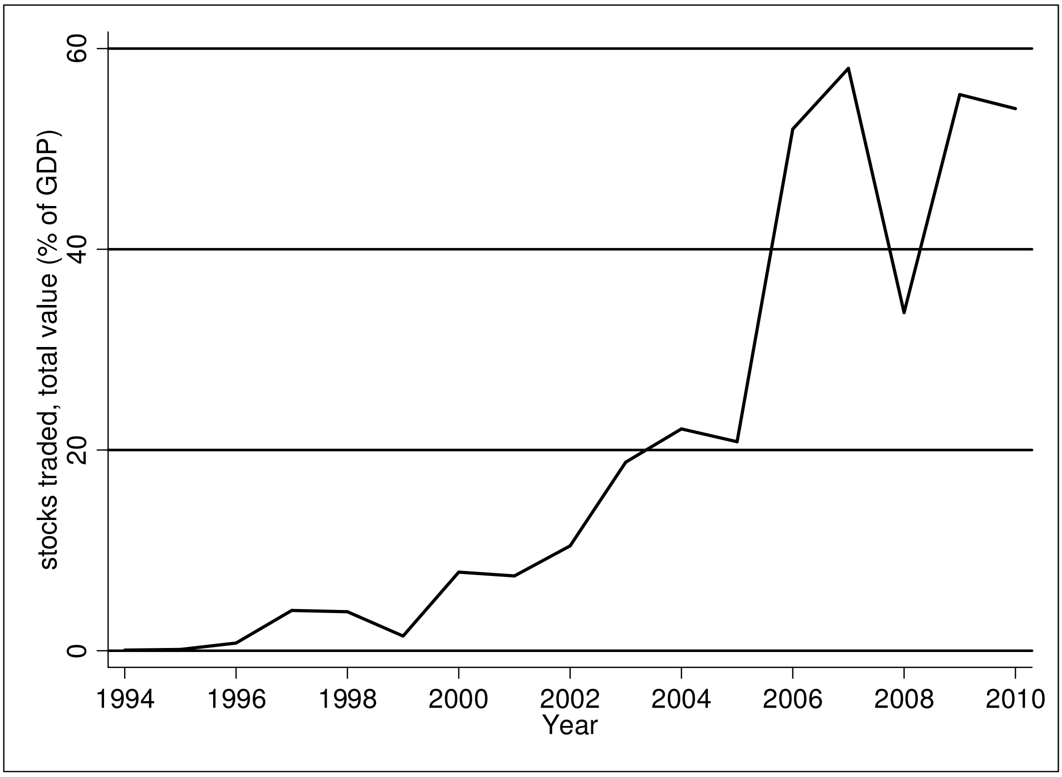

Figure 4: Russian stocks traded, total value of GDP, percent of GDP. Data Source: World Development Indicators.

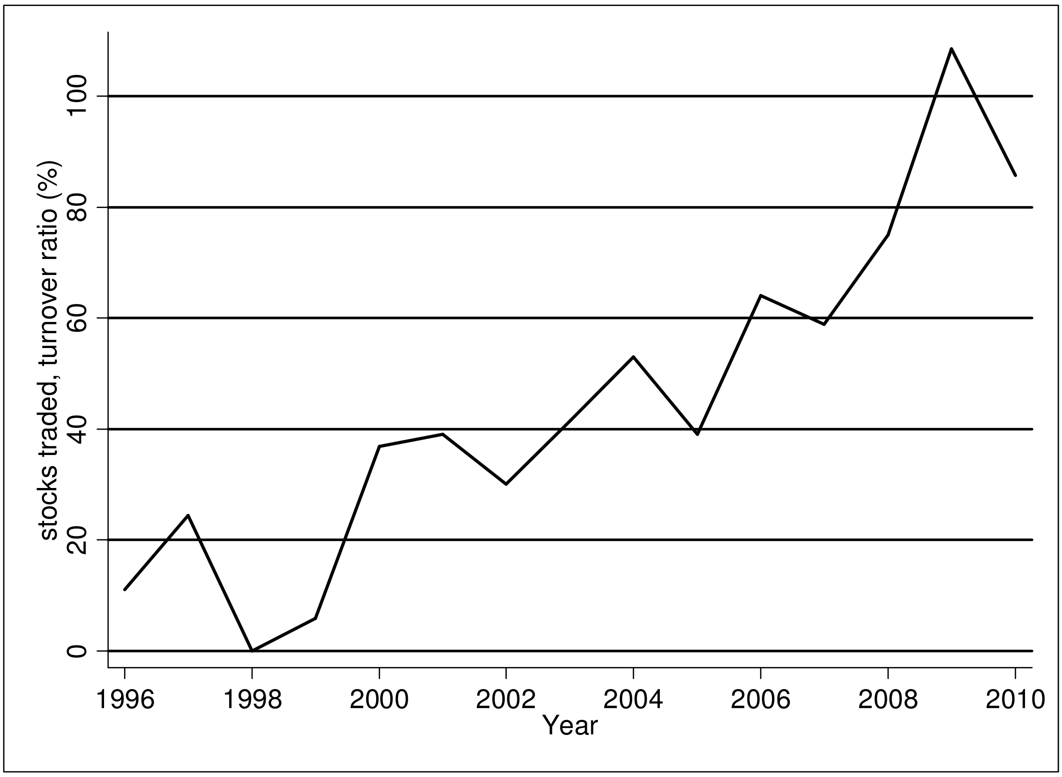

Figure 5: Russian stocks traded turnover ration, percent. Data Source: World Development Indicators.

However, after the collapse of the Soviet Union, Russia was not able to bury its past. This is not surprising from an institutional point of view. Institutions understood as informal mental models and belief systems and, more practically, as formal rules like the political or legal system of a state or certain laws, cannot be easily changed, added or omitted. Besides, transition in Russia meant more than merely adapting some economic rules. The political, legal, economic, and at best the societal system had to be heavily modified. This is a difficult task, the more so since transition should be conducted 'over night'.

Emphasis of the so-called *shock therapy* was on macroeconomic stabilization, price liberalization and finally privatization. As good as these approaches might be, their implementation neglected two important aspects. First, the remaining institutional structure was neither considered nor adapted. Hence, the reforms were realized without implementing the rule of law and therewith an independent judiciary, democracy, and certain civil rights like the freedom of the press. Secondly, in reality the reforms conducted differed considerably from what was officially decided and written down.

Liberalization inter alia meant that prices, which were fixed by the governmental bureaucracy until then, were liberalized on January 2, 1992. It was hoped that this step would fill the retail traders' shops and would enable the population to buy the necessary goods. Furthermore, price liberalization would force productivity since the consumers would determine which goods to produce. Additionally, private trade and private enterprise and manufacture were allowed. Subsidies to state enterprises and farms were cut. Barriers to foreign trade were decreased to allow foreign imports with which the indigenous producers had to compete.

What one had not thought of was that firm managers that were educated in fulfilling state directives did not have a clue about profit maximization, efficiency, and productivity. Firms suddenly had to deal with the fact that the state reduced subsidies and did not fulfil his role as reliable purchaser anymore. Additionally, they should be profitable all at once.

Price liberalization led to a much higher inflation than expected. Fixed incomes and pensions of workers, pensioners, widows, and so on lost value and therefore, living standards decreased drastically.

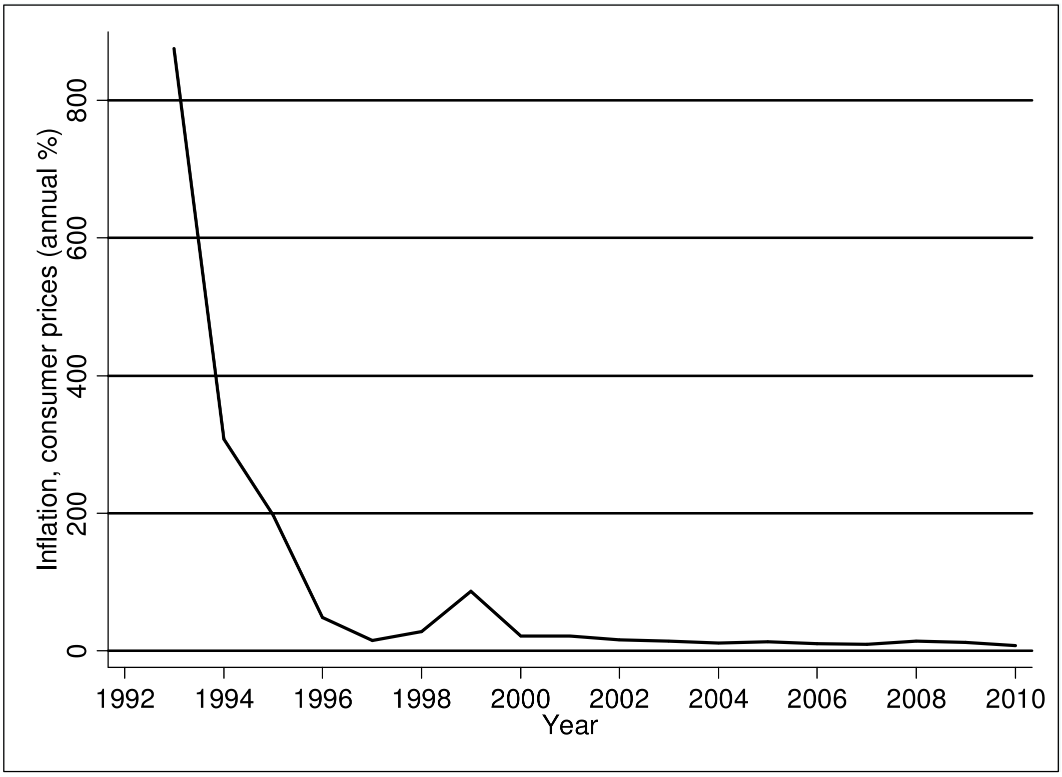

Figure 6: Russian inflation consumer prices, annual percent. Data Source: World Development Indicators.

The central bank's expansive monetary policy, which was introduced to finance the state's debts, mainly inherited from its Soviet past, exacerbated inflation. The expansive supply of money and credits in 1992 and 1993 let the rouble devaluate. The situation ended in the well-known hyperinflation that hit Russia in the 1990s. The development of the inflation rate is depicted in *figure 6*. Enterprises lost their production plans and additionally the state as reliable purchaser. For decades the firms' existence had been based on physical systems management. They got their production plans from the appropriate authority that told them what, how, and which quantity to produce. Wages were fixed by the state, hence, enterprises never had to calculate on labour and other input costs. After a time of inter-firm credit lending supported by the central bank in 1991 and 1992, which further boosted inflation, the government restricted credit expansion to state-owned firms (Robinson, 1999). Since the firms, instead of decreasing production, were producing inventory stocks, the credit crunch resulted in monetary shortages. Many firms had to be shut down. This had far-reaching consequences. Often, a certain firm was the only employer in the region. Therefore, a region's whole working-age population got unemployed at once. The Soviet enterprises were not only mere employers, they also covered many social services. Industrial firms dealt with their employees' housing, health service, education, and other social functions. Furthermore, the state was heavily in debt and not able to pay wages or pensions and had to cut the few services that existed. Altogether, the 1990s were characterized by a severe decrease in living standards and social indicators. A more thoughtful plan for transition that incorporated these issues could have resulted in a better outcome. In reality, Russia's economic transition ended in circa 3.4 million premature deaths between 1990 and 1998 and in impoverishment of large parts of its population (Rosefield, 2001).

Macroeconomic instability in the first half of the 1990s was due to a sudden price and exchange rate liberalization, high and growing government debt, excessive money expansion, the resulting devaluation of the exchange rate and hyperinflation. Since 1993, however, macroeconomic stability became a main target. A restrictive monetary and fiscal policy was implemented, interest rates were increased, credits restricted, and subsidies reduced.

Polterovich (1995) argues that the negative results of the shock therapy, which were unforeseen by proponents and opponents alike, are not only due to monopolies and incompetence to perform in a market economy but that, above all, "it was the particular 'cooperative' structure of relationships and interests that had been established during the process of the evolution of the Soviet enterprise that was a root cause of the economic crisis" (p.277). He calculates that labour collectives in industry, construction, trade, and consumer services, gave work to more than 50 percent of the employed population in 1992. "The economic 'battle' that took place in that year consisted of the struggle between the liberally-oriented government and the labor collectives (including their managers), the latter of which regarded the government's reform program as an encroachment upon their wages; their jobs; and their rights to use, manage, and own principal funds"(pp. 266-7). The resistance of labor collectives enterprises to the austere credit and monetary policies of the government and their continued practise to rely on governmental help contributed to economic inefficiency and social injustice. Workers in all those sectors which could not develop markets for their final products, such as health, culture, education, the arts and sciences, and therefore could not follow the double-strategy of raising output prices and delaying payments to suppliers in the inter-enterprise debt crises which developed, were suffering most.

These economic and political struggles and conflicts that would come to exist were not considered by the Russian and foreign inventors of the 'shock therapy' before. However, looking back at the Soviet history, this is something that could have been expected. At any rate, it was not, and political fights endured after the coup that ended Gorbatchev's reign and brought Boris Yeltsin into the leading state position. The replacement of Yegor Gaidar as Prime Minister by Viktor Chernomyrdin complicated things for the economic reformers since economic and political pragmatism entered the stage (Robinson, 1999). The never abolished Russian properties of networks, relationships, authoritarianism and rent-granting defined daily business. Yeltsin's plan for re-election necessitated this strategy. However, it was not incorporated in mainstream economic modelling of transition. Political struggles continued to influence economic development in several ways. Policy, economy, and business got mixed up by the implementation of the respective personnel, especially from the banking sector, in political positions. Lobbyism affected every sphere of governmental decisions, like subsidies granted to certain sectors, possibilities of tax evasion, or unfairly gained profits from privatization. In this way, lobbyism and rent-granting had an influence on the budget deficit, since they inhibited policies of debt reduction and a restructuring of the state budget. Especially the intertwining of banks and politics caused problems. The hyperinflation caused a demonetization of the economy that left the commercial banks as the only liquid actors. Therefore, the state heavily hinged on the banks to finance its budget deficit. To reduce the budget deficit, the lax taxation system had to be reformed and tax evasion reduced. However, strict taxation would hit the banks and the industrial firms (which were partly owned by banks) particularly hard. Therefore, the government was penetrated by internal power struggles while the President had his re-election in mind. The banks' linkages with the government can be demonstrated with the appointment of Vladimir Potanin and Boris Berezovsky in 1996. Again in 1997, Anatolii Chubais and Boris Nemtsov became part of the government while Vladimir Potanin had to leave. Boris Berezovsky and Vladimir Potanin became two of the Yeltsin-era Russian oligarchs. Their places in government simplified enforcing their interests. The entanglements between banks and government had far-reaching consequences regarding the second wave of privatization and regarding the 1998 currency crisis.

4. Privatization

Privatization was conducted in two steps. The first privatization program, the 'voucher' privatization, started in 1992. Beforehand, retail shops and other small one-man enterprises were just transferred to the employee(s). Then, it was decided which of the large enterprises, with thousands or tens of thousands of employees, should be privatized. Here the struggle started. The firms to be sold within the voucher program were the more or less worthless, inefficient enterprises whose production until then was planned via physical systems management. On a free market, those enterprises were valueless. The remaining high-value enterprises, often those exploiting natural resources, stayed in the hands of the state for the present. The firms taking part were transformed into stock companies. The stock was managed by property funds until the auctions were put into practice. However, the insider dominance that characterised the privatization process already started before the first firm was privatised with specifying the rules for the distribution of shares. It was decided that 51 percent of the enterprise shares should be sold to worker collectives at favourable prices. Hence, a majority of the shares went directly to insiders – that is worker collectives and former managers (Hedlund, 2001). The remaining shares should be open for purchase by the Russian citizens. Therefore, every Russian was provided with a voucher worth 10.000 roubles in nominal value. Now every Russian individual should be able to purchase an enterprise-share using her or his voucher at the upcoming auctions. In reality, however, due to hyperinflation vouchers lost almost all their value. Additionally, since people did not trust the program and thought it would not take place anyway, vouchers were traded at street kiosks for a bottle of vodka or were sold for cheap to speculators. When the auctions at least took place in 1993/1994, the realization was quite dubious. Some auctions were announced only shortly before they started, they were conducted at places lain apart and access could be restricted via arrangements with the police or the security services (Hedlund, 2001, p. 230). Hedlund (2001), referring to Lieberman et al. (1995), states that "[…] 80 % of the capital [of the enterprises that participated in the voucher privatization], had either remained in the hands of the state or gone straight to enterprise management and the worker collectives" (pp. 230-231). Hence, already the voucher privatization ended in ownership dominated by insiders and therefore by the former managers.

The second step of privatization took place in 1995-1997 and should privatize the high-value oil-, natural resource-, and telecommunication-companies. This part of the privatization, however, was influenced by the political struggle penetrating the government. The commercial banks played an important role since they were the last liquid actors that could help the government shoulder its high debt burden. The deal of the so-called 'loans for shares' privatization was as follows: the shares of the enterprises were given to the banks as collateral. In return, the state got credit by the banks to finance its budget. In case the credit was not repaid until August 1996 the banks were allowed to hold auctions and sell the enterprise shares. Of course, the credit was never repaid and the banks sold the firms under value to insiders, often themselves. Treisman (2010) describes the example of Surgutneftegaz, a large Russian oil company. The auction was fixed in November 1995 in the Siberian town 'Surgut'. Strangely, the nearest airport was closed that day and competitors form Moscow could not fly in. At least two bidders were allowed to take part in the auction. The winner was “Surgutneftegaz’s own pension fund” (Treisman, 2010, p.1).

The political context becomes clear when we look at the relevant dates – the loans were made before the 1996-election, but the auctions took place afterwards. That way the potential buyers and the bankers had a reason to support Yeltsin’s re-election campaign and to inhibit a return of the Communists. The buyers, however, were probably selected long before the auctions occurred and often the lenders more or less sold the shares to themselves at low prices (Hedlund, 2008; Treisman, 2010). It is often argued, and in some cases it is in fact true, that the ‘loans for shares’ auctions led to the emergence of the Russian oligarchs, who thus were able to buy lucrative enterprises at low price. The economic outcome of these developments is discussed controversially. Corruption, manipulation and insider trading led to a form of privatization that differed from what was intended by Russian and Western reformers. However, Woodruff (2004, p. 92) writes, some of the distortions incorporated in the privatization programs were wanted by the Russian reformers and their Western advisors. Accordingly, they knew that the Soviet managers would try to strip assets and to self-enrich themselves. Therefore, they wanted to give the managers an advantage in acquiring shares and in controlling enterprises to force them to join the new competitive environment and to produce according to efficiency criteria. However, if this would be true, it seems to be a naïve plan, ignoring the Soviet managers’ past and environment they had to deal with until then.

At any rate, the Russian privatization program is often described as a betrayal of the Russian population, as plundering and theft (Hedlund, 2001; Hedlund, 2008; Rosefield, 2007). The method of privatization, with all the advantages it created for insiders, of course has to be criticized. Regarding privatization and its outcomes, the emergence of the group of Russian oligarchs and their role for the Russian economy is often critically discussed. It is argued, that the oligarchs owe their wealth to the ‘loans for shares’ auctions and inhibit the development of free-enterprise institutions like secure property rights, contract law, and independent judiciary. Guriev and Rachinsky (2005), however, find out that only few oligarchs owe their wealth to the auctions, including, for example, Roman Abramovich, Mikhail Khodorkovsky, Vladimir Potanin, Vagit Alekperov, and Vladimir Bogdanov. The rest of the 627 owners considered in the study got rich in different ways. Most of them, however, already belonged to the old Soviet nomenklatura (red directors) or they were able to take an advantage of the power struggles and reform efforts of the 1980s and 1990s. The authors further figure out that the oligarchs’ enterprises are more productive than other Russian firms. But besides, oligarchs do not support free-enterprise institutions (Guriev & Rachinsky, 2005). Treisman (2010) also demonstrates that oligarchism as it appeared in Russia is not a unique phenomenon in emerging markets and can take on even greater dimensions as is the case, for example, in Mexico. Furthermore, he shows that the stakes overtaken by later oligarchs in the ‘loans for shares’ privatization were not that high and that the prices the oligarchs’ paid were relatively moderate and not too low. The real winners from the ‘loans for shares’ program, but also and even more from earlier privatization efforts like voucher privatization and everything that happened before, were the red directors. The Soviet nomenklatura managed to get into the right positions, to win control over large enterprises for low cost and to influence the policy and bureaucracy.

5. On the way to the 1998 crisis

In 1996-1997, however, the Russian economy was characterized by strong connections between the government and the banking sector. The government was unable to collect taxes and hence, to pay its bills. Therefore, the strange relationship with the banking sector was a necessity. Wages were not paid, living standards decreased, and industries were provided with non-monetary subsidies in the form of fuel. This contributed to the demonetization of the economy, to the emergence of a barter system, and it further decreased the government’s ability to raise taxes (Robinson, 1999, p. 550).

The lack of deeper institutional reforms and the maintenance of the Muscovite authoritarian style coupled with events in Asia led to the Russian currency crisis of 1998. The Asian crisis might have hit Russia anyway, however, the prevalent structures were responsible for its severity. Political struggles, lax tax collection, hyperinflation, demonetization of the economy and a high fiscal deficit contributed to Russia’s extreme downturn in 1998/1999.

Reformists politically lost ground in 1994, when Yegor Gaidar and Boris Fedorov resigned from government after the Duma-elections. The growing influence of lobbyists had affected state finances, tax collection, and subsidies. Since many of the bankers that gained influence owned stakes in the already privatized or to-be-privatized enterprises, they were busy in inhibiting a more severe tax system. Lax tax collection, on the other hand, led to a further decrease in state revenues and to an increase of the budget deficit. Non-monetary subsidies, primarily fuel, worsened the situation and further contributed to the demonetization of the economy. In October 1994 the rouble collapsed, inflation further shot up and in 1995 a fixed exchange rate corridor was implemented. Since many members of the Soviet nomenklatura were part of the new banking sector and had close ties to the government, both sides were already mingled. The state needed the banks to finance its deficit. The banks, on the other hand, used their influence to gain an advantage in the upcoming 'loans for shares' auctions. Hence, the state further lost its ability to collect taxes, paid non-monetary subsidies to the industry and continued to run into debt. Commercial banks invested in treasury bills and hence helped the government to finance its deficit. On the other hand, they influenced the 'loans for shares' auctions and inhibited the formation of market prices for the firms to be sold. Then, they prevented the government from tax collection and therewith exacerbated the state's financial situation. The banks supported Boris Yeltsin during his re-election campaign and in 1996, after the election, two from their ranks, Vladimir Potanin and Boris Berezovsky, became members of the government. It was discovered that the only way to cover the state's debt was through international finance. However, to attract international investors, the state needed regular and high enough revenues to create confidence. Besides opening the bonds market to foreigners, a stronger tax collection was enacted. This led to a conflict between the state and the banks and at least Vladimir Potanin was released from government, and Anatoli Chubais and Boris Nemtsov were brought in. These policy changes as well as anti-inflationary actions led to an international upgrading of Russia's solvency. Exports of natural resources, especially fuel, resulted in a balanced foreign trade. Oil was sold at a high price at the world markets. The World Bank and the IMF promised further assistance. Inflation had decreased from 131 percent (1995) to 11 percent (1997) (Chiodo & Owyang, 2002). Limitations for foreign investors on the bond markets were removed. In 1997 the market for short-term government bills almost exploded. Within one year foreigners tripled their holdings of government bonds and foreign cash financed 56 percent of the government's deficit (Robinson, 1999, p. 552). However, although from an outsider's point of view the situation seemed to improve, no real changes were made to the economy apart from bond markets. Tax receipts improved compared to the previous year, but the general trend did not change and tax evasion and indebtedness had even increased. Real wages were significantly lower than in 1991, and large parts of the workforce still suffered from wage arrears. The linkages between bankers and government were ravaged by conflicts since more severe tax laws affected the banks' interests. A scandal concerning the 'shares for loans' auctions caused the degradation of Anatoli Chubais and ended in the dissolution of the government in March 1998. Prime Minister Victor Chernomyrdin was fired and replaced by Sergei Kiriyenko. In 1997, prices for fuels and other natural resources began to fall on the world markets. The drop in prices resulted in a deterioration of the trade balance. The additional government crisis and the Asian crisis led to a decline in investors' confidence. In November 1997, the Russian central bank had to defend the rouble with almost US$ 6 billion (Chiodo & Owyang, 2002). The short-term government bonds expired within a year and hence, investors started to withdraw their money. In August 1998, Russia announced a debt default, floated and therewith devalued the rouble, and suspended payments by banks to foreign lenders (Chiodo & Owyang, 2002; Kharas, Pinto & Ulatov, 2001; Robinson, 1999).

The crisis of 1998 can be attributed to the prevalent weak economic fundamentals. Public debt problems, large parts of it inherited from the Soviet past, could not be solved with the political and economic structures at hand. After the break-up of the Soviet Union, the country was thrown in at the deep end without the necessary reforms of the economic, political and legal fundamentals. The omitted reforms, for example the introduction of secure property rights via an independent judiciary and the rule of law, made a solution of the debt problem and everything it incorporated – expansive monetary policy, hyperinflation, demonetization, real appreciation of the rouble, economic recession, and strongly decreasing living standards – impossible.

6. A new decade – time for reform?

In the aftermath of the 1998 crisis, however, Russia exhibited a surprisingly fast recovery with an average growth rate of 6.7 percent per year between 1999 and 2007 (Hanson, 2007, p. 869). Such a positive economic development after a severe crisis came unexpected. It is often argued that Russia's impressive growth performance in the 2000s is due to developments on the world markets for natural resources. Accordingly, the increasing oil price in particular enhanced Russia's economic growth, especially between 2000 and 2004. The economic downturn of the 1990s is described as 'transition recession' ("valley of tears") which was overcome with the end of the crisis in 1998; thereafter Russia had performed relatively well compared to other transition countries until the 2008/9 crisis. However, according to Vinhas de Souza (2008, p. 3), 70 percent of Russia's economic growth since 1999 cannot be directly attributed to natural resources. A boom in services and construction contributed to the improved growth performance (Hanson, 2007). However, although oil, gas and other natural resources might have had a limited direct effect on the growth rate, their indirect contribution is enormous. The revenues created in the natural resource sector went largely into the state budget and contributed to a fast decrease in external and internal government debt which was less than five percent of GDP in 2007. Furthermore, the natural resource revenues increased personal gains and enterprises' profits, driving domestic demand for consumption and investment. Therefore, Russia's government budget, its trade balance, and GDP in general depend on natural resource extraction and especially on oil production and exports. The fast economic upturn after the 1998 crisis can be contributed to increasing oil prices during that time, as well as to the fivefold devaluation of the Russian currency (Hanson, 2007, p. 870).[***] Especially in 1999-2000 the Russian industry took advantage of the devaluation and the coincidental low real wages and energy prices. Both developments, however, disappeared by and by. Still the early 2000s were characterized by an enormous increase in exports, especially oil. Ahrend (2006, p. 5) estimates that, between 2001 and 2004, 70 percent of industrial production growth can be attributed to the natural resource sector. Thereby the oil sector was responsible for 45 percent of the growth in industrial production. Furthermore, the oil sector's direct contribution to GDP growth in 2000-03 was 24.8 percent and its export share accounted for more than 50 percent. Hence, at least until 2004 the oil sector strongly influenced GDP development.

The Russian government, however, dealt wisely with the growth benefits – mainly the oil windfalls – after the 1998 crisis. A Stabilization Fund was created that collected parts of the natural resource windfalls which were then used to pay off state debt. Oil exports and rising oil prices resulted in an inflow of foreign currency which the central bank used to build up the third largest foreign-exchange reserves worldwide (Hanson, 2009, p. 25). Nevertheless inflation was successfully brought down into the single-digit range in 2006 and the tax system was reformed (Hanson, 2007, p. 871).

Now there is concern that Russia might suffer from the *'Dutch Disease'* phenomenon without a 'Polder model' yet in sight. Hence, that natural resource exports drive up the rouble exchange rate while other sectors of the economy are not competitive on world markets. These sectors are not able to catch-up and to progress because the exchange rate pushes up the prices for Russian products.

The problem of Russia's oil and gas industry is its low technology level. Natural resource exports are not much processed and research-based high-technology production is also missing in other sectors. This, however, could also be a sing of the 'Dutch disease' (Hanson, 2007, p. 875). Investment shares are generally low and productivity gains can be traced back to the formerly under-utilized capital stock. After the 1998 crisis, much of the production

[***] Zhuravskaya (2007) also emphasizes that the high commodity prices and the devaluation of the rouble "provided Russia with extremely fortunate terms of trade". Furthermore she states that "Yeltsin's radical reforms of 1991-96 and, in particular, completion of privatization created necessary preconditions for the subsequent growth and, second, the effects of favorable external conditions were strongly supported by continuation of liberal reforms and responsible macroeconomic policy during Putin's first term in power in 2000-2004" (p. 135, n. 10).

facilities lay idle, and production and productivity could be increased by using the idle capital stock. Therefore, even the oil sector might face future problems since necessary investments to keep up its production-capacity are missing. ‘Easy oil’, that is oil extracted from fields with until then under-utilized capacity, is running out for years, what might have contributed to the slowdown in oil production in 2004. The private oil firms did not make substantial long-term investment to adjust their production facilities to new technology levels. Investment was only conducted to absorb short-term gains. The reason for this behaviour may be due to the insecure situation regarding property rights. Since 2003, the government distinctly increased its influence in the oil sector by state-acquisition of oil-firms. Examples are Yukos, which was overtaken by the state-controlled oil-firm Rosneft, and Sibneft, which was bought up by Gazprom, a state-owned gas monopolist. State intervention was also observable in other sectors, for example electricity, arms production, automobile production, shipbuilding and nuclear industry (Ahrend, 2006, p. 7; Hanson, 2007, p. 877).

A result of the state intervention was a slowdown in the oil sector. As has already been argued, insecure property rights and under-utilized capacity inhibited long-term investments in the exploitation of new oil fields in the early 2000s. The Yukos affair caused an even more severe crisis regarding secure ownership rights and let the business climate deteriorate. Therefore, growth in oil exports decreased since 2004. However, Russian exports are still governed by natural resources. According to Hanson (2009, p. 21), oil and gas were still responsible for 65.9 percent of merchandise exports in 2008, while metals and coal added another 15 percent.

At any rate, despite the slowdown in oil exports since 2004, the Russian economy in general has become more productive between 1998 and 2008. This is due to productivity increases of the labour force and the use of under-utilized capacities (Hanson, 2009, p. 12). The economic boost in 1999-2000 can be traced back to the severe rouble devaluation and increasing oil prices. The upturn between 1998 and 2008 must be attributed to additional factors. Resources were reallocated from heavy industry to the service sector and into new industries like telecommunication (especially mobile phones) and software development. Employment shifts were observable from agriculture and manufacturing into construction, services, finances, and trade. FDI provided more productive management skills, new technologies, machinery and equipment (Hanson, 2009, p. 14). Estimates exist that certify Russia a TFP growth of 3.3 to 4.7 percent per year (Hanson, 2009, p. 13). However, Russia started from a low level. Hence, despite productivity increases its labour productivity, for example, is still only between one fifth and one third of the US level (Hanson, 2009, p. 19). The same is true regarding its production facilities and machinery. Russia is still unable to compete with low-wage manufactures from Asian countries

However, the increase in statism since 2003 put a damper on Russia's growth, despite some positive developments. Indicators positively highlight Russia's macroeconomic stability, its educational level, and its market size (Hanson, 2009, p. 16). At any rate, indicators measuring the *institutional quality* rate the country worse. In the World Bank's Doing Business 2011 report, for example, Russia achieves the 123rd place out of 183 countries. The report measures business regulations and the security of property rights and hence, the quality of regulations influencing business activity. Additionally, Russia's position deteriorated since 2010 (rank 116). The World Economic Forum's Global Competitiveness Report 2010-11 (Schwab, 2010) paints a slightly different picture. In 2010-11 Russia is ranked 63rd out of 139 countries. However, the index incorporates areas where Russia shows a better performance. This is the case regarding infrastructure (47), health and primary education (53), higher education and training (50), and market size (8). Russia exhibits a bad valuation regarding its institutions (118), especially property rights (128), judicial independence (115), burden of government regulation (128), reliability of police services (128) and protection of minority shareholders' interests (132). Still inflation depicts a major problem for the country's competitiveness (125), as well as its inefficient goods markets (123), and its underdeveloped financial markets (125). Russia's technology level is also badly rated (Schwab, 2010, p. 287). Hence, it can be stated that Russia's institutional development, as measured with, for example, the above indicators, is economically inefficient and inhibits a better economic performance.

The 2008/9 crisis, however, hit Russia particularly much harder than the other BRIC economies China, India and Brazil. This is due to Russia's relatively high integration into world markets and its export dependence. As helpful as these characteristics are in normal times, they make a country vulnerable to external crises. Furthermore, Russia experienced a capital flight after investors' confidence declined. Foreign creditors reclaimed their money, investors withdrew and Russian businessmen switched their assets from roubles into other currencies, mainly dollars and euros (Hanson, 2009, p. 27). All emerging economies were affected by capital withdrawals and fleeing investors. Russia, however, was hit particularly hard. This can be traced back to the fact that both, Russians and foreigners involved, were conscious about the institutional environment. Hence, that property rights were insecure, the rule of law was absent, and governmental actions were unpredictable and could end up in expropriation or sanctions like forced investment or employment. Additionally, the financial sector was still underdeveloped. Most banks were controlled by the state; the stock market

consisted of mainly natural-resource based and state-controlled companies and the turnover ratio was still relatively low. Even private Russian companies sent their profits out of the state to offshore holding firms situated in other countries (Hanson, 2009).
Hence, Russia's corrupt regime, its missing property rights, its absent rule of law, its interventionist government, and the knowledge that the state is the patrimony, enforcing its interests when necessary against all resistance, made foreign and Russian investors and businessmen cautious, and they were ready to withdraw at any time.

7. Historical institutional reasons

Regarding the role of institutions in Russia's economic history of the last 20 years, almost everything that happened can be referred to the country's 'rules of the game'. Its ambitious transformation into a free-enterprise economy and the shock therapy at the beginning of the 1990s was penetrated by omitted institutional influences. The idea of fast liberalization and privatization without previous adjustment of the formal and informal rules might work theoretically. Leaving history aside and assuming rational and perfectly informed actors, liberalized prices and firms suddenly forced to produce according to efficiency criteria might indeed induce property rights, contract law, and an efficient business environment. This is the case since the theory's actors are not driven by experience, social concepts, and certain ossified habits that established themselves within decades or centuries and have been unchanged for generations. If the Russian politicians, the old nomenklatura, the entrepreneurs and the population in general were objective entities without history, experience, and embedment in society, then they might have established the relevant efficient institutions after liberalization and privatization, because they would have realized that these rules were necessary to maximize profits and to optimize everybody's wealth. Hence, liberalization and privatization would have enforced the relevant adjustments. In reality, however, people's minds are inert and cannot suddenly adjust to efficiency criteria. They keep on behaving as they did before and as their ancestors did. Behavioural patterns that can be traced back on experience, upbringing, social opinion, worldview, tradition and moral can hardly be changed. Change does occur since societies and institutions are dynamic entities. But modifications of habits, traditions, moral, codes of conduct and so on are only marginal and can hardly be observed from one generation to the next. Hence, power structures implemented for decades or centuries are inert and will not suddenly adjust to new ideas, even if it can be proved that these ideas would lead to more efficient outcomes and would improve everybody's economic situation. Not only the members of government, but also the Russian population per se had never experienced property rights and the rule of law and a state that enforces these rights. On the contrary, although Russian citizens were the owners of their assets, they were aware of the fact that the patriarch, whether the Grand Prince, the Tsar or the President, could always access their property. According to Pipes (1974), the Russian head of state had the same function as the patriarch of a family, with the family members being the Russian population: his wife and his children had rights to which everybody adhered, but the patriarch could override them whenever he wanted to. The characteristics about Russian history, politics, and society were and still are, that sovereignty has always been equated with ownership. Sovereignty and property were an entity and the sovereign owned everything within the realm. These patterns of a patrimonial state are still observable today. No matter whether the Grand Prince, the Tsar, or today's President – the head of state is in control of everything. Regardless, for example, whether an enterprise is owned by a Russian or by a foreigner, the patriarch can expropriate the apparent owner. If the sovereign wants control of the firm he is allowed to go and get it. This behaviour appeared in the 2000s, when the Russian state intervened repeatedly in private enterprise ownership and got hold of majority shares, no matter how. However, it was already observable earlier during the processes of privatization. The procedures were influenced by interest groups and the government, grapping the most valuable entities themselves.

Other properties penetrating Russian history, politics and society since early times are corruption and nepotism. A Russian noble's social prestige depended on the position he or she held within the patrimonial bureaucracy. Hence, a person's connection to the court and its bureaucratic position determined its social and economic status. Merchants faced a similar situation. Rich merchants enjoyed many privileges that, besides the possibility of ownership of land cultivated by serfs, where similar to those of the nobles. However, a financial loss could lead to a sudden downgrading. Therefore, they were keen to achieve the status of nobility. Hence, to avoid an economic fall and the incorporated social degradation, the merchant's aim was a position in the public service which was achieved via relationships and connections to the corresponding people, and not with new investment and greater economic efficiency (Buss, 2003, p. 36). Today, corruption and fiddling depict some of Russia's largest problems regarding its business environment. A good example is the hiring and firing of government members in the 1990s and 2000s, depending on which interest group was most influential and which policy was currently followed.

Regarding its formal institutional framework it must be noted that Russia never had a tradition of property rights and the rule of law. Secure property rights and the rule of law necessitate a third party enforcement mechanism able to implement the rights against private persons or the state. Hence, the state has to adopt the role of the enforcing actor, therefore it has to subordinate itself to a constitution and to an independent judiciary. According to Hedlund (2001) the Russian state had never established law as an instrument to secure individual property and the individual per se. On the contrary, law has always been experienced as an instrument that could be used by the state against its citizens. The state never took upon herself the task to protect property and contracts. On the contrary, law was used as an instrument when favourable for the state. Hence, Russians always had to trust on personal relationships and social networks, but not on the state. Personal connections, bribes and corruption could help to achieve a certain goal, but not the law enforced by an independent judiciary. Accordingly, Russia is characterized by "the path dependent absence in Russian tradition of a state that is ready, willing and able to shoulder a role as legitimate guarantor of the rules of the game, and in the equally path dependent evolution of organisational responses and mental models that help economic actors in exploiting the opportunities for gain that are offered by such a weak state" (Hedlund, 2001, p. 227).

It can be stated that institutions as the rules that regulate social interaction, whether habits and conventions or formal laws and directives, influenced Russia's development since 1991 despite reform efforts appealing to rational behaviour and efficiency criteria. Nowadays the economic decline of the 1990s is called a 'transition recession' and describes the logical economic development after reform efforts transforming a planned economy into a market economy (Vinhas de Souza, 2008, p. 2). Hence, the reforms cause a downturn and economic development takes a u-shape. During transition, economic growth first decreases and necessary adjustments have to be implemented, in case of need caused by a recession. Then, after the downturn, the economy recovers and after recovery it might overhaul its original level of development. However, such a process was not intended by the Russian and Western architects of the 'shock therapy'. The term 'transition recession' emerged afterwards, when the empirical evidence required it. It would have been irresponsible anyway, to promote transition, being aware of the fact that it would cause an economic recession leading to the loss of millions of lives and impoverishing millions of people (Rosefield, 2001).The original intention was that growth would take-off immediately after the implementation of the reforms. Basic institutional features like secure property rights and the rule of law would establish themselves after market participants suddenly had to deal with liberalized prices and privatized and therefore profit-maximizing enterprises. However, maybe the groundwork should have been set up before.

Then again, the question remains whether the groundwork could have been adequately established or changed, anyway. The rule of law, protecting property, contracts, civil liberties, and forcing the state to separate its power, may not be realizable in every society, at least not over night. Countries that exhibit no tradition of property, law, and individualism might not be able to deal with it. Solution strategies in the form of networks, social relationships and informal punishment strategies are developed to undertake certain tasks. The Russian state always had a different role to play compared to, for example, Western Europe, where a variety of reasons caused diverse outcomes. Hence, Russia, and many other countries, too, cannot be all of a sudden transformed into a typical Western-style free-enterprise economy. Of course, we do not know how feedback mechanisms from liberalizing reforms and integration into world trade will influence Russia's long-term development. Maybe the institutions penetrating Russia from the West will lead to a certain adjustment. However, this will probably take several decades or even longer. And still a copy of a free-enterprise economy should not be expected. Instead we should expect the country to develop in the Russian way, as it did before. Hence, certain habits and patterns, regarding, for example, the role of the state, might never completely change. Still, development and growth are possible, as Russia demonstrated in the 2000s and might demonstrate in the near future. Despite the fear that the country could suffer form the 'Dutch Disease' – it certainly does – it might find a way to keep up its economic performance. Because of its export dependence, Russia will stay vulnerable to external crises. This necessitates a government that knows how to handle crises and how to stabilize the economy. At any rate, ups and downs cannot be prevented when a country is as dependent from natural resource exports as Russia is.

Hanson (2009) develops two scenarios regarding Russia's future development, depending on how fast Russia will recover from the 2008/9 crisis. In the first scenario Hanson assumes that the 2008/9 crisis will be short and that recovery is under way by 2011. This case, however is characterized by a return to business-as-usual, hence, the crisis does not lead to fundamental reforms. Then, an average growth rate of 4.3 percent per year between 2012 and 2020 can be expected.[†††] The second scenario, however, is based on the assumption that Russia is currently dealing with an enduring crisis that leads to radical reforms. In this case, long sequences of political fights over power and interests would delay economic recovery.

[†††] However, Hanson (2009) repeatedly points out that these numbers are only core estimates.

Therefore, although longer-term prospects might be positive, the yearly average growth rate until 2020 would lay below 4.3 percent.
However, with only four years since the 2008 crisis, it is difficult to make assumptions on the economic future of Russia. It appears as if, again, Russia survived the crisis better than expected. Also the country was hit hard, effects on unemployment, for example, were less severe than expected. GDP growth in 2008 amounted to 5.2 percent, followed by -7.8 percent in 2009, 4 percent in 2010 and expected 4.4 percent in 2011 (World Bank, 2011). Hence, the recession following the crisis merely lasted for a year. In 2009 and 2010 the country exhibited lower growth rates compared to the first decade of the new century, but still its economy grew. Unemployment fell from 8.2 percent in 2009 to 7.2 percent in 2010. Most sectors experienced negative growth rates in 2009, but again positive growth in 2010 (World Bank, 2011, p. 5). Similar to the 1998 crisis, oil prices and exports were responsible for at least some growth in 2009 and 2010.
As the OECD (2011) has stated in its most recent economic survey on the Russian Federation, the Russian economy has recovered from the severe 2008/09 recession. However, in the third quarter of 2011 real GDP was still about percent below its pre-crisis peak having reached more than three years before. With a trend growth estimated of ca. 4 percent in the next years the Russian economy is neither fully exploiting the potential offered by its wealth of natural resources nor by the high skill level of its population. Due to technological backwardness the energy-intensiveness of GDP remains one of the highest in the world. Although progress has been made in the gradual decline in the inflation rate since the late 1990s, with an estimated inflation rate of 8.4 percent in 2011 and about 6 percent in 2012/13 Russia remains a relatively high-inflation economy.

8. Conclusion

In their survey of the first decade of economic performance of post-socialist transition economies Campos and Coricelli (2002, p.817) have provided us with “the magnificent seven” stylised facts: (1) a major fall in GDP; (2) a massive reduction in the technologically outdated capital stock; (3) a massive reallocation of labour; (4) a collapse of CMEA trade and an almost complete structural reorientation of trade towards the leading international economies; (5) high costs due to a rise in unemployment and income inequality; (6) an institutional vacuum being created due to the collapse of the old communist regime; and (7) a rapid decline of industry and consequential major structural changes in the composition of output and employment.

In general this also holds for the Russian economy, with some modifications. Thus the rise of mortality rates of Russian men has been quite severe, whereas the institutional vacuum has been less pronounced than in countries such as Poland, Hungary or the Czech Republic with a better basis for a historical and cultural path dependency towards a blueprint version of democratic Western institutions.[‡‡‡]

The output fall in the follow-up countries of the former Soviet Union was notably higher than in other post-socialist transition economies, not least because of institutional reasons. However, the shock therapy of the fundamentalist "big bang"-approach, which relied on the imposition of an idealized version of Anglo-American institutions and neglected the existing institutions and a historical and cultural path dependency, has proven a failure and made things worse. Serious economists such as Kenneth Arrow (2000) have early on favoured a mixed strategy where a rapid entry of private-ownership activities into commerce and light industry and a massive starting of private services is combined with a more gradual transition process in the management of a declining sector of heavy industry by the government, which is also responsible for the provision of infrastructure in traffic and communication to private industry, and in particular for the restructuring and developing of the legal and financial institutions required for a modern viable economy. Institutional changes are path dependent and should try to avoid *institutional traps* (Polterovich 2008), which are supported by cultural inertia and serious obstacles to economic reforms and a better growth performance in transitional economies.

Although prospects might not look that bright regarding systemic reforms, especially concerning property rights, the rule of law, the business environment and the end of state interventionism, it is conceivable that Russia will go its own way – as it did before. Hence, it will not develop into a perfect free-enterprise economy and therefore, it will not satisfy efficiency criteria of economic theory. Russia will face some severe issues in the upcoming years. Its population, and therewith its labour force, is in decline. Its technology level is low and its research and development sector is not comparable with world standards. In general, Russia's economy, apart from the natural resource sector, is not competitive on world markets. Technologically, its natural resource sector is also uncompetitive, but still it produces urgently needed oil, gas, and metals. Therefore it will keep on driving growth. The Russian government might implement some reforms, however, its general pattern will not

[‡‡‡] For a distinction of the two types of transition in Central and Eastern Europe see Zweynert and Goldschmidt (2006).

change. Basic institutions can not be easily modified, particularly not when they are rooted in certain convictions and habits that persisted for decades or centuries and penetrated the whole society. The level of Russia's growth rate will continue to depend on natural resource exports and it will be vulnerable to external economic crises. Living standards will probably stay behind those of highly developed industrial nations. Hence, Russia will not belong to the richest countries soon, but it will also not fail completely. In this sense, Russia might be described as a 'normal' middle income country, whatever that means (Shleifer & Treisman, 2005). The term 'normal' requires that there is one true, normal standard development path, probably defined by a theoretical model. It suggests that the high-technology and high-income countries followed this path once they got there. Each country deviating from this standard path is 'abnormal'. According to Rosefield (2005) this is the case for Russia, since it will not democratize and become a free-enterprise economy, soon. However, the classification into 'normal' and 'abnormal' countries seems rather odd. Any country follows its logical, normal development path. This path leads some of them to democracy, the rule of law, individualism and eventually to high technology levels and living standards. Other paths lead to autocracy, oppression, low growth and therewith low living standards. Anyway, every path depicts a logical consequence of accidents that cannot necessarily be consciously influenced. Still it can be tried to improve a country's development pattern and hence, to improve its growth performance. But it cannot be transformed into a perfect copy of another country or into a model. Hence, Russia departs from certain models and other countries since its prerequisites and its institutional environment differs. Some factors influencing its economic performance can be improved, others cannot, as, for example, Russia's systemic lack of the rule of law and therewith of secure property; the character of the Russian political system with the patriarch as the head of state; and the resulting necessity of corruption and bribes inhibit the realization of its full growth potential. But still Russia will not fail. However, its population will not exhibit a living standard similar to high-developed countries, soon.

References:

Ahrend, R. (2006) Russia's Post-crisis Growth: Its Sources and Prospects for Continuation, *Europe-Asia Studies*, 58(1), pp. 1-24.

Arrow, K.J. (2000), Economic transition: speed and scope, *Journal of Institutional and Theoretical Economics,* 156(1), pp. 9-18.

Boettke, P. J., Coyne, C. J. and Leeson, P. T. (2008) Institutional Stickiness and the New Development Economics, *American Journal of Economics and Sociology*, 67(2), pp. 331–358.

Braguinsky, S. (2009) Postcommunist Oligarchs in Russia: Quantitative Analysis, Journal of Law and Economics, 52(2), pp. 307-349.

Buss, A. E. (2003) The Russian-Orthodox Tradition and Modernity, Leiden, Boston: Brill.

Campos, N.F. and Coricelli, F. (2002), Growth in transition: what we know, what we don't, and what we should, *Journal of Economic Literature*, 60(2), pp. 793-836.

Chiodo, A. J. and Owyang, M. T. (2002) A Case Study of a Currency Crisis: The Russian Default of 1998, The Federal Reserve Bank of St. Louis, pp. 7-17.

David, P. (1994) 'Why are Institutions the "Carriers of History"?: Path Dependence and the Evolution of Conventions, Organizations and Institutions', *Structural Change and Economic Dynamics*, 5(2), pp. 205-220.

Goskomstat, data [online] available at: <http://www.gks.ru/wps/wcm/connect/rosstat/rosstatsite/main/> [accessed November 2010].

Guriev, S. and Rachinsky, A. (2005) The Role of Oligarchs in Russian Capitalism, *Journal of Economic Perspectives*, 19(1), pp. 131-150.

Hanson, P. (2007) The Russian economic puzzle: going forwards, backwards or sideways? *International Affairs*, 83(5), pp. 869-889.

Hanson, P. (2009) Russia to 2020, Occasional Paper, Finmeccanica Research Department.

Hedlund, S. (2001) Property without Rights: Dimensions of Russian Privatization, *Europe-Asia Studies*, 53(2), pp. 213–237.

Hedlund, S. (2005) *Russian Path Dependence*, Abingdon, Oxon, Routledge.

Hedlund, S. (2008) Such a Beautiful Dream: How Russia Did Not Become a Market Economy, *The Russian Review*, 67(April), pp. 187-208.

Huff, T. E. (2003) *The Rise of Early Modern Science: Islam, China, and the West*, 2nd edition, Cambridge, New York: Cambridge University Press.

Ickes, B. W. and Ofer, G. (2006) The Political Economy of Structural Change in Russia, *European Journal of Political Economy***,** 22(2), pp. 409-434.

Jacob, M. C. (1997) *Scientific Culture and the Making of the Industrial West*, New York, Oxford, Oxford University Press.

Kharas, H., Pinto, B. and Ulatov, S. (2001) An Analysis of Russia's 1998 Meltdown: Fundamentals and Market Signals, *Brookings Papers on Economic Activity*, 1, pp. 1-50.

Landes, D. (1998) *The Wealth and Poverty of Nations*, New York: W. W. Norton.

Lieberman, I. W., Ewing, A., Mejstrik, M., Mukherjee, J. and Fidler, P. (eds.) (1995) *Mass Privatization in Central and Eastern Europe and the Former Soviet Union. A Comparative Analysis*, The World Bank, Washington, D.C.

Lipsey, R. G., Carlaw, K. I. and Bekar, C. T. (2005) *Economic Transformations: General Purpose Technologies and Long Term Economic Growth*. Oxford and New York, Oxford University Press.

Maddison, A. (2001) *The World Economy: A Millennial Perspective*, Paris: OECD.

Maddison, A. (2003) *The World Economy: Historical Statistics*, Paris: OECD.

North, D. C. (1990) *Institutions, Institutional Change and Economic Performance*, Cambridge, Cambridge University Press.

North, D. C. (2005) *Understanding the Process of Economic Change*, Princeton, NY: Princeton University Press.

OECD (2011) *OECD Economic Surveys: Russian Federation 2011*, Paris.

Pipes, R. (1974) *Russia under the Old Regime*, London, New York: Penguin Books.

Polterovich, V.M. (1995), Economic Reforms in Russia in 1992: The Government Battles. Labor Collectives, *Journal of International and Comparative Economics*, 4, pp. 265-287.

Polterovich, V. (2008) ‘Institutional trap’, in S. N. Durlauf and L. E. Blume (eds.), *The New Palgrave Dictionary of Economics. Second Edition*, New York and London: Palgrave Macmillan.

Przeworski, A. and Limongi, F. (1993) ‘Political Regimes and Economic Growth’ *Journal of Economic Perspectives*, 7(3), pp. 51-69.

Quadrio-Curzio, A. (1986) ‘Technological Scarcity: An Essay on Production and Structural Change’, in M. Baranzini and R. Scazzieri (eds.), *Foundations of Economics. Structures of Inquiry and Economic Theory*, Oxford and New York: Basil Blackwell, pp. 311-338.

Quadrio-Curzio, A. and Pellizzari, F. (1999) *Rent, Resources, Technology*, Berlin, Heidelberg, New York: Springer.

Roland, G. (2005) Understanding Institutional Change: Fast-Moving and Slow-Moving Institutions, paper presented at the Conference of Endogenous Institutional Change, Social Science History Institute, Stanford University, also published in *Studies in Comparative International Development*, 2004, 38(4), pp. 109–131.

Robinson, N. (1999) The Global Economy, Reform and Crisis in Russia, *Review of International Political Economy*, 6(4), pp. 531-564.

Rodrik, D. (2000) ‘Institutions for high-quality growth: what they are and how to acquire them’, NBER Working Paper No. 7540.

Rosefield, S. (2001) Premature Deaths: Russia’s Radical Economic Transition in Soviet Perspective, *Europe-Asia Studies*, 53(8), pp. 1159-1176.

Rosefield, S. (2005) Russia: An Abnormal Country, *European Journal of Comparative Economics*, 2(1), pp. 3-16.

Rosefield, S. (2007) *The Russian Economy: From Lenin to Putin*, Massachusetts, Oxford, Blackwell Publishing

Rosefield, S. and Hedlund, S. (2009) *Russia since 1980*, Cambridge, New York: Cambridge University Press.

Schwab, K. (ed.) (2010) The Global Competitiveness Report 2010-2011, Geneva, The World Economic Forum.

Shleifer, A. and Treisman, D. (2005) A Normal Country: Russia After Communism, *Journal of Economic Perspectives*, 19(1), pp. 151-174.

Treisman, D. (2010) "Loans for Shares" Revisited, NBER Working Paper Series, No. 15819, Cambridge, Massachusetts.

Vinhas de Souza, Lúcio (2008) Russia's Recent Economic and Reform Performance and Remaining Reform Challenges, Working Paper., New York.

Woodruff, D. M. (2004) Property Rights in Context: Privatization's Legacy for Corporate Legality in Poland and Russia, *Studies in Comparative International Development*, 38(4), pp. 82-108.

World Bank (2010), Doing Business 2011: Making a Difference for Entrepreneurs, Washington, D.C., The World Bank.

World Bank (2011), World Development Indicators (WDI) Online database, [online] available at: <http://data.worldbank.org/> [accessed December 2011].

World Bank (2011), Country and Lending Groups, [online] available at: <http://data.worldbank.org/about/country-classifications/country-and-lending-groups> [accessed December 2011].

World Bank (2011), Russian Economic Report, No. 24, March 2011, Washington, D.C.: The World Bank.

Zhuravskaja, E. (2007), Whither Russia? A Review of Andrei Shleifer's *A Normal Country*, *Journal of Economic Literature*, 45(1), pp. 127-146.

Zweynert, J. and Goldschmidt, N. (2006) 'The Two Transitions in Central and Eastern Europe as Processes of Institutional Transplantation', *Journal of Economic Issues*, 40(4), pp. 895-918.

SCHRIFTENREIHE DES PROMOTIONSSCHWERPUNKTS GLOBALISIERUNG UND BESCHÄFTIGUNG

Nr. 1/1998	Bernhard Holwegler und Hans-Michael Trautwein, *Beschäftigungswirkungen der Internationalisierung, eine Studie aus- und einfließender Direktinvestitionen der Metall- und Elektroindustrie im Raum Stuttgart*
Nr. 2/1998	Heinz-Peter Spahn, *Heterogeneous Labour, the Unemployment Equilibrium, and the Natural Rate*
Nr. 3/1998	Philip Arestis, Iris Biefang-Frisancho Mariscal and Harald Hagemann, *Capital Shortage Unemployment in Germany and the UK*
Nr. 4/1999	Theo Schewe, *Full Employment in the Age of Globalisation? Political-Economic Analysis of Effective Employment Policies in the Nineties. The Case of Norway.*
Nr. 5/1999	Hagen Krämer, *Dienstleistungen: Motor für Wachstum und Beschäftigung in Deutschland?*
Nr. 6/1999	Jürgen Kromphardt, *Lohnbildung und Beschäftigung*
Nr. 7/1999	Ewald Walterskirchen, *Beschäftigungspolitik in Österreich*
Nr. 8/1999	Reiner Franke, *Lohnzurückhaltung, Beschäftigung und (zu) einfache empirische Zusammenhänge*
Nr. 9/1999	Peter Kalmbach, *Implications of Integration for Wage Formation and Employment*
Nr. 10/2000	Arne Heise, *Theoretische Grundlagen einer Verhaltensabstimmung der makroökonomischen Politikträger*
Nr. 11/2000	Eckhard Hein und Carsten Ochsen, *Monetary Interest Rates, Income Shares, and Investment: Theory and Empirical Evidence for France, Germany, the UK, and the USA*
Nr. 12/2000	Guntram R. M. Hepperle, *Airbus – ein gelungenes Beispiel für beschäftigungsorientierte Industriepolitik?*
Nr. 13/2000	Bernhard Holwegler, *Implikationen der Technologiediffusion für technologische Arbeitslosigkeit*
Nr. 14/2000	Markus Schreyer, *Wachstum und Beschäftigung vor dem Hintergrund des Solowschen Produktivitätsparadoxons*
Nr. 15/2000	Mauro Boianovsky, *Some Cambridge Reactions to The General Theory: David Champernowne and Joan Robinson on Full Employment*
Nr. 16/2001	Marc-Peter Radke, *Law and Economics of Microsoft vs. U.S. Department of Justice: A New Economic Paradigm for Antitrust in Network Markets or Inefficient Lock-in of Antitrust Policy?*
Nr. 17/2001	Daniel Hartmann, *Taylor-Regel und amerikanische Geldpolitik*

Die Ursachen der gegenwärtig hohen Arbeitslosigkeit in einigen europäischen Ländern sind nicht allein in 'Funktionsproblemen des Arbeitsmarktes' zu suchen, sondern auch in Nachfrage- und Angebotsentwicklungen auf Güter- und Finanzmärkten. Im Promotionsschwerpunkt *Globalisierung und Beschäftigung* werden daher Dissertationsvorhaben gefördert, in denen die Beschäftigungseffekte gesamtwirtschaftlicher Entwicklungen untersucht werden - beispielsweise von neuen Technologien, von Prozessen der Internationalisierung und Systemtransformation, von marktseitigen Finanzierungsbeschränkungen oder von unterschiedlichen Strategien der Fiskal-, Geld- und Währungspolitik.

Die Betreuung und Vernetzung der Arbeiten im Promotionsschwerpunkt entspricht der Arbeitsweise eines Graduiertenkollegs. Betreuer des Schwerpunkts und *Herausgeber der Schriftenreihe* sind folgende Hochschullehrer:

Prof. Dr. Harald Hagemann hagemann@uni-hohenheim.de
Institut für Volkswirtschaftslehre (520H)
Universität Hohenheim
D-70593 Stuttgart

Prof. Dr. Heinz-Peter Spahn spahn@uni-hohenheim.de
Institut für Volkswirtschaftslehre (520A)
Universität Hohenheim
D-70593 Stuttgart

Prof. Dr. Hans-Michael Trautwein michael.trautwein@uni-oldenburg.de
Fakultät II – Institut für Volkswirtschaftslehre
Carl von Ossietzky Universität
D-26111 Oldenburg

Dissertationsprojekte im Schwerpunkt können durch Promotionsstipendien des *Evangelischen Studienwerks e.V. Villigst* gefördert werden. Bewerbungsunterlagen können unter folgender Adresse angefordert werden:

Evangelisches Studienwerk e.V.
Promotionsförderung
Iserlohner Str. 25
58239 Schwerte Tel.: 02304/755-215, Fax: 02304/755-250

Weitere Informationen zum Promotionsschwerpunkt sowie die Diskussionsbeiträge der Violetten Reihe im PDF-Format finden sich im Internet unter der Adresse:

http://www.globalization-and-employment.de