

Master Thesis



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From state capture to business capture:

A qualitative analysis of institutional development in post-Soviet Russia

By

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ABSTRACT

This thesis investigates Russian institutional development since the breakdown of the Soviet Union. The aim of the study is to explore whether the role of formal institutions has increased at the expense of informal institutions during Putin's presidency, as a result of his recentralizing reforms. In addition to examining Russian institutional development, I consider the effect of institutional change on trade relations. In order to illuminate this issue I explore the fisheries industry in particular, looking at trade relations between Norway and Russia. The thesis utilizes institutional theory and comparative historical analysis as tools to map the mechanisms and processes connected to institutional change and their effect on trade relations. Qualitative interviews with actors connected to fishery trade in Norway and Russia have been conducted to supplement documentary, and to a certain degree observational data. The main findings of this thesis are the stickiness of institutions and the importance of institutional legacies in institutional development and change. In addition to this, I have found that the interrelationship between formal and informal institutions is not a zero-sum game, and even though an increase in the significance of formal institutions has occurred, informal institutions remain strong within the Russian institutional framework.

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Chapter 1: Introduction

“Nothing is impossible in Russia but reform.”

- Oscar Wilde, *Vera* (1883)

1.1 The issue

The collapse of the Soviet Union brought massive systemic changes, politically and socially, as well as economically. Russia, through a shock therapy approach, implemented an externally generated model of capitalism based on Western liberal capitalism in the early 1990s. The combination of electoral democratization, wild privatization and orthodox liberalization had fatal consequences for both the Russian economy, and for the essential state building process in post-soviet Russia. Strong formal state institutions required to secure property rights and create a safe environment for the development of a modern capitalist economy were non-existent in Russia in the 1990s. Instead, public resources fell in the hands of so-called *oligarchs*, who were in the position to shape policy making, regulatory and legal environments to their own advantage, generating concentrated rents at the expense of the rest of the economy (Cappelli 2008:537-538).

Hence, in the presidential period of Boris Yeltsin from 1991 to 1999 we observe that the lack of strong formal institutions created an institutional void that was filled by informal institutions, where private actors intervened in matters of the state. This resulted in a state capture kind of relationship, where private actors are more powerful than public actors, resulting in an unproductive economy where oligarchs manipulate the public system for their own personal gain (Puffer et al. 2010:446). Vladimir Putin’s presidency from 2000 marked a sharp contrast to Yeltsin’s liberal reforms. After Putin came to power there has been a shift away from liberty and “back to the state”, and the state has become a more dominant actor, both in society and in the economy. Through recentralizing reforms Putin reversed the massive privatization and decentralization of the 90s, and attempted to re-establish political sovereignty and renegotiate the compromise with powerful social actors, both in the economy and in the periphery, to secure their support (Cappelli 2008:552). Hence, this thesis poses the following question: Has this recentralization contributed to strengthening Russia’s formal institutions? In order to answer this question, we first need to ask in what way institutions affect the significance and efficiency of the market, and what institutional design determines a well-functioning market economy. This is the issue under investigation in this thesis, and I

would like to inquire the Russian institutional development and its effect on Russia's development towards a well-functioning market economy.

Neoclassical economic theory is based on the fundamental assumption that economic actors' behavior in the market has the goal of maximizing their wealth. Furthermore, the theory assumes a frictionless exchange process in which property rights are perfectly and costlessly specified, and information is also costless. These models may serve as an effective tool to describe developed (Western) market economies, but their logic fails to explain underdeveloped and malfunctioning economies (North 1990:11-12) such as the Russian economy. Such "imperfect markets" generate insight into the economic significance of non-market institutions such as the state, the law, the family, the firm, and so on. Transition economies, such as the Russian case, are often characterized by underdeveloped formal institutions, which often results in an unstable environment and the creation of an institutional void usually filled with informal institutions (Puffer et al. 2010:441). Robinson (2011) refers to Russia's economic system as a form of *patrimonial capitalism*. Patrimonial forms of political and economic organization, where power over the economy is highly personalized and economic exchange is particularistic and involves high degrees of relational capital, characterize this type of capitalism. However, through market reforms (often forced upon such a system because of relative competitive economic failure) market logics and global economic competition are added to this system of traditional personalistic and state-bureaucratic modes of domination. This variety of capitalism developed under Yeltsin and was stabilized under Putin (Robinson 2011:434). Ledeneva (2013:2-3) explains that this type of network-based governance is complex, diffuse, unpredictable and seemingly unmanageable, but at the same time it serves to glue society together. The patterns of informality that rely on personal relationships compensate for the failure of organizations, and personal trust works as a substitute for the low levels of trust in public institutions.

Puffer, McCarthy and Boisot (2010:443) recognize *blat* as an informal institution of great significance to the functioning of the Russian economy. In an environment where formal institutions are weak and the protection of private property is at risk, informal institutions often replace the formal ones. For example, if the state cannot protect the ownership claims to your house, you will make sure that your "friends" do. *Blat* is an informal cultural institution based on personal relationships or networks, and transactions normally include the expectation of reciprocity (Puffer et al. 2010:450). Russia is a low-trust society where formal

rules and laws are contradictory and unstable, and enforcement of these rules and laws are lacking, resulting in a higher level of uncertainty. As a result of this formal institutional void, a strong cultural tendency to distrust individuals, groups and organizations that fall outside personal relationships has developed in Russia. Trusting relationships exist within in-groups of family members, friends, and colleagues, while out-groups are typically distrusted because they are not seen as sharing cultural values and because trusting relationships with outsiders are hard to establish. Trust is inherent in the cultural and institutional context of a business relationship. This is not surprising, since former Soviet countries have been classified as particularistic rather than universalist, and thus decisions are usually based on relationships rather than rules of behavior (Puffer et al. 2010:448-449). When economic transactions to a large degree are based on personal connections, it is particularly difficult for actors outside these networks (*outsiders*) to access these markets. The economic power rests in those sectors where elites dominate, and these are resistant to outside penetration since the absence of the rule of law and contract rights are best secured through personal connections (Robinson 2011:437-438).

In sum, Western institutions are generally built on the basis of generalized trust in formal institutions (such as the government, regulatory agencies, and the judicial system), but in Russia these institutions are not fully developed. This fact, coupled with the traditional lack of trust in outsiders and formal institutions, exacerbates the Russian tendency to rely on particularized relational trust instead (Puffer et al. 2010:448-449). This has created a somewhat hostile environment for outsiders who are not connected to the traditional personal networks and do not have the same knowledge of the relevant norms and values that are important in these economic systems. Examples of such outsiders are foreign investors and trade actors. The question is: Has the reliance on informal institutions (such as *blat* and personal networks) *decreased* after the Russian state acquired a more dominating position in the Russian economy in the aftermath of Putin's recentralizing reforms? And if so, how has this affected the outsiders that are part of the Russian economy, namely foreign trade actors?

1.2 Research question and clarifications

The formal institutional void in transition economies has generally resulted in a lack of stability, necessitating the dominance of personal trust among entrepreneurs, rather than more generalized trust. This has certainly been the case in Russia, where traditional cultures have personal trust deeply embedded in entrepreneurial transactions. I want to investigate the rate

of change in Russia towards a strengthening of Russia's formal institutions, looking specifically at the institutional changes that have taken place during Putin's two first terms as president. In order to explain the developments that took place during Putin's presidency, I will account for the historical legacy that Russia carries from the Soviet era and from the political and economic chaos of the Yeltsin presidency. Through presenting a historical narrative I will attempt to identify some critical junctures in Russian institutional development and account for the features and mechanisms leading to institutional change. In order to exemplify these developments I will look at the fisheries industry in particular, and look at reforms that have affected this industry. Furthermore, in the aftermath of these laws and in the context of the Russian fisheries industry, I will examine if these centralizing reforms have had the intended effect, which is whether the informal institutions have declined in importance and the formal institutions have increased in importance. To illuminate how the Russian system works, I have conducted interviews with actors connected to the Norwegian-Russian fishery trade, both on the Norwegian and the Russian side. This interview data will not only be illustrative of the general tendency of Russian institutional development, it will also introduce some new and unknown aspects about the Russian case and the characteristics of the dynamics of Russian institutions. The leading research question in investigating this issue is:

To what degree have Putin's recentralizing reforms contributed to increasing the significance and role of formal institutions relative to that of informal institutions?

Based on the logic of the interaction between formal and informal institutions presented above, I have developed the following hypotheses to guide my research project:

H1: A strengthening of formal institutions through centralizing reforms in Russia will reinforce the state's position in the market.

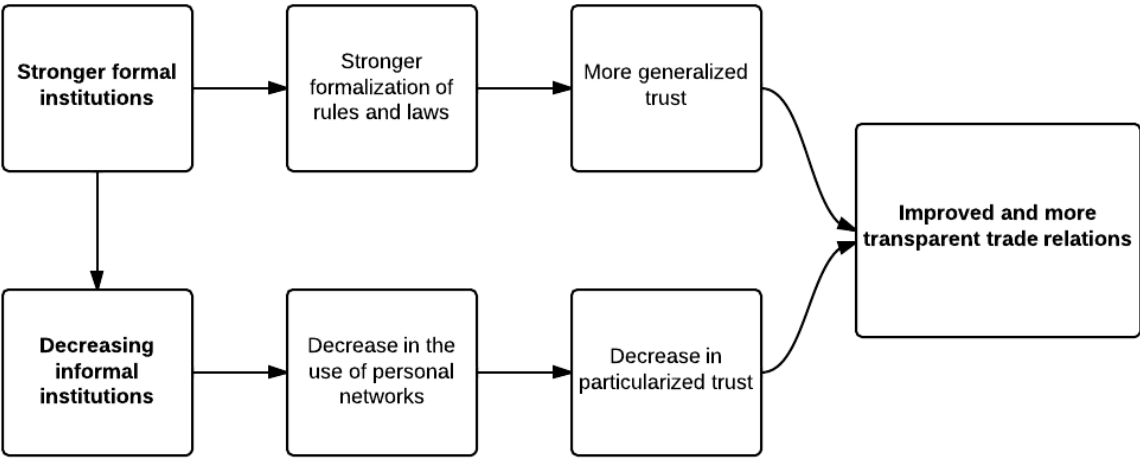
H2: As a consequence of stronger formal institutions in Russia, a decrease in informal institutions will occur.

H3: An increase in Russia's formal institutions at the expense of informal institutions will lead to a stronger significance of public law and an increase in generalized trust.

H4: An increase in generalized trust will result in a more transparent and predictable economic environment, strengthening Russia's trade relationships.

These hypotheses depict a causal process where, if one assumes a zero-sum relation between formal and informal institutions, this causal chain will lead us to expect a reduction in informal institutions when there is an increase in formal institutions. This causal process is illustrated in the figure below (Figure 1.1). This thesis utilizes comparative historical analysis applied to a single-case study, and since this method emphasizes temporal processes and causal chains, the causal process illustrated in the figure below is a suitable starting point for this analysis.

Figure 1.1 The causal process of institutional change



1.3 Theoretical approach

The focus of this work is to explore and describe how and why the Russian economy does not function as a Western-type capitalistic economy, and looks deeper at the role of the state in the economy. In order to do this I will apply institutional theory. The reason for this choice is that this school of thought has good explanatory power in explaining why decisions of behavior vary across different settings and to what extent the role of geography and culture, and laws and regulations are important factors that have significant influence on both the formal and informal institutional environment (North 1990). North (1990:3) defines institutions as the “rules of the game” in a society, or more formally, “*the humanly devised constraints that structure political, economic and social interaction*”. They consist both of *informal constraints* and *formal constraints*, as well as *third-party enforcement*.

Informal constraints contain many aspects of former society, so-called cultural heritage. These are codes of conduct, norms of behavior, and conventions that are socially

transmitted and a part of culture (North 1990:36-37). In the case of Russian institutions, one could assume that despite a systemic change after the breakdown of the Soviet system, these informal constraints will still be present in the new institutional structure.

Formal constraints are formal rules that may increase the effectiveness of informal constraints, modify them, or supersede them (North 1990:46). A change in formal rules or in their enforcement will result in a disequilibrium situation, since the informal constraints cannot change as rapidly as the formal ones. A new informal equilibrium will evolve gradually after the change in the formal rules (North 1990:87-88). This indicates that the rapid change from a planned economy to a market-based economy in Russia is problematic. The formal rules of the political and economic system may have changed, but the people *within* these structures are still the same as during the Soviet Union, and their codes of conduct, norms of behavior and conventions will not immediately match those of the new system.

Thirdly, *third-party enforcement* stresses the role of the state as a coercive force able to monitor property rights and enforce contracts effectively. This is problematic, because if the state has coercive force, then those who run the state can use that force in their own interest and at the expense of the rest of society (North 1990:59). In Russia's case the state traditionally has had a very dominant place in political and economic life. A rapid shift from a state controlled economy to a market-based economy is problematic because the Russian state, with its legacy of a planned economy *without* property rights, has no experience in how to monitor property rights or to effectively enforce contracts. Bates (1989:4-6) supports North's notion that markets can operate effectively only if underpinned by the appropriate institutions. Political institutions play the same role in politics that markets play in economics: For rational actors they create incentives that lead to characteristic choices. By creating a system of incentives, they help to account for the decisions taken by the government. Public choices are choices resulting from struggle among competing interests within political institutions, rather than markets. Political forces transform economic interests, promote their differential mobilization and thus shape the way governments intervene in the economy.

1.4 Relevance of the research question and scientific contribution

Why is this issue of relevance as a scientific contribution? King, Keohane and Verba (1994:15) stress two criteria for research projects in the social sciences that are crucial in justifying the scientific contribution, namely:

- i. *“A researcher should pose a question that is “important” in the real world, and*
- ii. *A research project should make a specific contribution to an identifiable scholarly literature by increasing our collective ability to construct verified scientific explanations of some aspect of the world. “*

In relation to the first criteria, Russia has often been (and remains to be) seen as a riddle to the Western world. But in an increasingly globalized world with an increasing amount of goods and services crossing state borders, the need for an understanding of how transition economies, such as the Russian, work is not to be underestimated. The second requirement for choosing a research question refers to explicitly locating a research design within the framework of the existing social scientific literature. The rationale behind doing this is to minimize the risk of “duplicating” studies, and securing that the study contributes with new perspectives to an existing theoretical framework (King et al. 1994:16). I argue that my research will contribute to the field of transition economies in two ways, theoretically and “case-wise”. Firstly, it will contribute to enhance the importance of institutions in the political economy. In neoclassical economic theory there is a great gap regarding institutions. Neoclassical economic theory is based on the fundamental assumption that economic actors’ behavior in the market has the goal of maximizing their wealth. Furthermore, the theory assumes a frictionless exchange process in which property rights are perfectly and costlessly specified, and information is also costless. Through the use of institutional theory I will attempt to illustrate that human behavior has proved to be much more complicated than the neoclassical economic model indicates.

Furthermore, this thesis contributes to the somewhat deficient literature on informal institutions. Within the political science literature the workings of formal institutions have been thoroughly investigated and analyzed, but the features of informal institutions as well as the complex interplay between formal and informal institutions requires more attention in the scholarly literature. My thesis attempts to make such a contribution. Secondly, as mentioned in relation to the first criteria, the Russian version of capitalism and its reluctance to follow the Western “rules of the game” is a complex matter. I hope that a descriptive in-depth research can be a small contribution to improve our understanding the complexity of the Russian political economy.

1.5 Structure of the thesis

In chapter 2 I will present the theoretical framework for the thesis. I will clarify the concept of institutions, and what role institutions play in economic performance. Furthermore, I will identify some tools for explaining institutional change, and try to explain the interrelationship between formal and informal institutions in institutional change. I will refer to examples from Russia throughout the chapter in order to relate the theoretical framework to my specific case.

In chapter 3 I present my methodological framework and which data the thesis will be based on. In order to illuminate the research question I will do a macro-historical case study of Russia using comparative historical analysis to identify critical junctures in Russian institutional development since the breakdown of the Soviet Union. In order to do this I will rely on document analysis, but I will also conduct interviews with both Norwegian and Russian actors connected to the fishing industry in order to diversify my data, and shed some light on the issue using informants with first-hand experience of the Russian system.

In chapters 4 and 5 I will present the historical background that constitute the framework for the analysis. Chapter 4 briefly elaborates on Russia's institutional legacy from the pre-Soviet and Soviet period, and it accounts for the institutional developments that took place during the 1990s, which was a period characterized by decentralization, privatization and economic and political oligarchy. Chapter 5 explains the introduction of a new era in Russian institutional development under Putin's presidency from 2000, namely that of recentralization and increased state control, both politically and economically. I will limit the time period to Putin's first two terms as president from 2000 to 2010. I will use these two chapters to regularly relate these historical developments to my theoretical framework, and use my interview data to illuminate the tendencies of the two distinct periods. Each historical chapter will also have a presentation of developments in the fisheries in Russia, in order to provide a concrete example, which more concretely illustrates the tendencies in Russia's institutional development from the early 1990s until 2010.

Chapter 6 provides an analysis of the findings from the two foregoing chapters, and attempts to explicitly point out what has changed and what has remained the same regarding Russia's institutional development. In the analysis chapter I will revisit the hypotheses

presented in the introduction, and clarify which of them can be discarded and which have been confirmed by my findings.

The final chapter of the thesis will summarize the findings of the analysis, and clarify what conclusions can be drawn from my research project. In addition to this I will present a short discussion about the prospects for a modernization of the Russian system.

Chapter 2: Theories on institutions, institutional change and economic performance

The purpose of this chapter is to introduce institutional theory as a framework for the analysis of the interrelationship between institutional change and economic performance. The workings of the Russian system are very complex, and the impact that environmental forces play on the Russian economy has proven challenging to handle in scientific research. It is therefore of great importance that I develop a rigid theoretical framework, through which I can analyze my research question. In this chapter I will use examples and relate the discussion to the post-Soviet Russian transition economy. Through the discussion I will illustrate why institutional theory provides a solid theoretical framework for the analysis of the Russian case.

2.1 What are institutions?

The concept of an “*institution*” is used not only in scientific circles, but in the general public as well. This means that the term can have different meanings for different groups and people, also within academic circles (Jentoft 2004:137). In general usage, institutions can be perceived as an organizational arrangement of some sort by which people act together, pursue society goals and organize themselves. Still, Nobel prize winner of economic science and an important theorist of economic history and institutional theory, Douglass North (1990:5), stresses the important distinction between institutions and organizations. Organizations are groups of individuals that are bound by some common purpose to achieve objectives. How these organizations come into existence and how they evolve, is influenced by their institutional framework. Hence, institutions are the underlying *rules of the game* for the workings of a certain society. North (1991:97) defines institutions as “...*the humanly devised constraints that structure political, economic and social interaction. They consist both of informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights).*”

Scott (2008:48-49) describes institutions as multidimensional, durable social structures made up by symbolic elements, social activities and material resources. Their distinct properties are that they are relatively resistant to change, and they are transmitted through generations and thereby maintained and reproduced. The development of institutional theory up till the late 1980s has been characterized by a rather disparate meaning, both across and

within disciplines (Nilssen 2002:49). Scott (2008), however, finds some resemblance in what could, or should, be the central issue of the paradigm, namely to explain social behavior at various levels. He stresses that institutions “...are comprised of regulative, normative and cultural-cognitive elements that, together with associated activities and resources, provide stability and meaning to social life (Scott 2008:49)”. Each of these elements, or “pillars”, of institutions represents different variables from a range of different streams of thought from the earlier phase of development of the institutional paradigm. All of these aspects have been identified by social theorists as important factors in institutions, and does in this way contribute to the understanding of social choice and behavior (Nilssen 2002:49).

Table 2.1: The three pillars of institutions Source: (Scott 2008:51).

The three pillars of institutions			
	<i>Regulative</i>	<i>Normative</i>	<i>Cultural-Cognitive</i>
<i>Basis of compliance</i>	Expedience	Social obligation	Taken-for-grantedness Shared understanding
<i>Basis of order</i>	Regulative rules	Binding expectations	Constitutive schema
<i>Mechanisms</i>	Coercive	Normative	Mimetic
<i>Logic</i>	Instrumentality	Appropriateness	Orthodoxy
<i>Indicators</i>	Rules Laws Sanctions	Certification Accreditation	Common beliefs Shared logics of action Isomorphism
<i>Affect</i>	Fear Guilt/ Innocence	Shame/ Honor	Certainty/ Confusion
<i>Basis of legitimacy</i>	Legally sanctioned	Morally governed	Comprehensible Recognizable Culturally supported

The columns of Table 2.1 above contain the three elements that make up institutions. The rows define some of the principal dimensions emphasized by different theorists of

institutions (Scott 2008:51). This table serves as a guide and an illustration as I consider each element in the following.

2.1.1 The regulative pillar

The regulative pillar represents the most accentuated and acknowledged aspect of institutions; that institutions constrain and regularize behavior. The purpose of the regulative pillar of institutions involves the capacity to establish rules, inspect others' conformity to them, and manipulate sanctions (rewards or punishments) in attempting to influence future behavior. These processes may be carried out through informal mechanisms, such as shaming or shunning activities, or they may be formalized through the workings of the police and courts (Scott 2008:52). As illustrated in Table 2.1, the institutions that comply with the regulative pillar are based on expediency, where rules, laws and sanctions are enforced by a coercive third party, usually that of the state.

2.1.2 The normative pillar

Some theorists argue that institutions rest primarily on the normative pillar. The normative element of institutions includes both values and norms, and the emphasis is placed on normative rules that introduce a prescriptive, evaluative, and obligatory dimension into social life. Normative systems are typically viewed as imposing constraints on social behavior, and sociologists, who are most likely to investigate institutions such as kinship groups, social classes, religious systems etc., mostly embrace the normative conception of institutions. As shown in Table 2.1, common characteristics for normative institutions are that common beliefs and values constitute an important basis for order through social obligation, and morality and binding expectations guide human behavior (Scott 2008:54-55).

2.1.3 The culture-cognitive pillar

Another set of scholars, mostly anthropologists, emphasizes the cultural-cognitive elements of institutions. This pillar holds that institutions respond to its environment, and is copying or mimicking environmental behavior. As shown in the table above, cultural-cognitive institutions are based on common beliefs, and shared logics of action that are culturally supported. This constitutes a shared understanding of how one should behave and interact with others. This presents culture as an essential factor in the workings of institutions, since culture provides patterns of thinking, feeling, and acting – in other words, social interaction is guiding behavior (Scott 2008:56-57).

These three pillars illustrate the variety of the concept of institutions, and the different directions in which institutional theory has developed within academic circles. Jentoft (2004:147) concludes that the weakness of these three pillars often become a reason for institutional failure:

“The rules that regulate behavior may be underdeveloped or poorly enforced. The normative standards may provide few incentives and little guidance. The knowledge that could inform decision-making may be inadequate or insufficient. Thus, governments should improve if these pillars are strengthened.”

In light of this statement, Russia emerges as an interesting case in point. In the early 1990s, as a result of the collapse of the Soviet Union, the entire institutional framework in Russia was altered, introducing a new state structure, a new economic structure and a new ideology. By beginning completely from scratch in building the new Russian state, the issue of underdevelopment of institutions presented by Jentoft above becomes a significant concern. I will focus mainly on the regulative pillar and the cultural-cognitive pillar in my thesis because I find that they comprise the institutional dichotomy that we observe in Russia. I would now like to further elaborate on the features of these two pillars by establishing the distinction between formal and informal institutions, which are terms that I will continue to use throughout the thesis.

2.1.4 The concept of formal and informal institutions

Formal institutions are openly and formally codified in constitutions or laws, and are guaranteed by state agencies. Hence, formal institutions receive their legitimacy through the state, and the nature of formal institutions is usually shaped and changed by actors with rule-making authority (Lauth 2004b:3-4). Formal institutions, then, coincides with the regulative pillar, and consists of formal rule systems such as laws and regulations, as well as enforcement mechanisms that are sanctioned by the state. Formal institutions constituted the basis of the Soviet Union, emphasizing their capacity to constrain and regulate behavior by establishing rules, inspecting others conformity to rules and controlling punishment and reward in connection to these rules. Formal institutions were also the basis for the planned economy, as one of the main mechanisms for governance of industrial enterprises (Nilssen 2002:51). However, with the collapse of the Soviet Union, these formal institutions lost their foundation, and new rules and regulations were introduced for managing the economy, largely

based on Western market economic principles. The result of the introduction of market capitalism in Russia in the early 1990s was massive privatization, which led to a weak state that was not able to secure the basic rules for a functioning market, and they struggled to secure property rights. The formal institutions had not yet developed enough to guide decisions in the market, and business people had to rely upon *informal institutions* for decision rules (Puffer and McCarthy 2007:4).

Informal institutions are institutions that are not formally codified; rather, they are based solely on the fact of their existence and of their effectiveness (Lauth 2004b:4). While formal institutions can achieve legitimacy through formal sanctioning systems, informal institutions base their legitimacy on social mechanisms such as codes of conduct, norms of behavior, and conventions. Informal institutions come from socially transmitted information and are part of our culture. Cultural heritage provides us with a language-based conceptual framework, and therefore, how we perceive information is not objective, but is influenced by this conceptual framework provided to us by our culture (North 1990:36-37). Thus, much of the behavior observed in political institutions reflects the norms of behavior and codes of conduct of the given society. Informal institutions must not be confused with the much broader concept of culture. Informal institutions are normally part of cultural patterns, but they are not identical with them. The term culture indicates a much broader concept, including rules, values, traditions and customs. Furthermore, while informal institutions are linked to sanctions, cultural patterns that do not find their expression in institutions do not possess such power sanctions. What determines informal institutions from the broader concept of culture is that informal institutions either compete with the state's claim to binding decisions by trying to establish parallel areas of competence, or, most commonly, by influencing the political decision making (Lauth 2004b:4-5).

Informal institutions become especially important in situations that are characterized by uncertainty, for example in new institutional frameworks where the decision-makers have no experience (Nilssen 2002:53). This is something we can recognize in Russia in the 1990s. The breakdown of the Soviet Union and the transition from a planned to a market economy created a great instability of formal institutions, as well as uncertainty of formal rules. Since formal institutions were weak and unable to secure the rules of exchange, economic actors relied on informal institutions, such as personal networks, in order to secure their business. In sum, formal institutions provide us with a set of formally codified laws and rules, while

informal institutions contains values and behavioral patterns that contribute to the making and interpretation of these rules and laws. The characteristic features of formal and informal institutions are summarized in Table 2.2 below.

Table 2.2: Characteristics of formal and informal institutions Source: (Lauth 2004a:71)

<i>Categories</i>	Formal institutions	Informal institutions
Officially codified	Yes	No
State sanctions	Yes	No (only social sanctions)
Legitimacy	Sovereignty of the people (democracy) or state authority	Auto-licensing (social acceptance based on various sources)
Modus of change	Action of political decision-makers	Change of incentives/public discussion
Timing of change	Short-term	Long-term
Coordinating center	Yes	No (seldom)

2.2 Why do institutions matter for economic performance?

After having clarified what institutions are, a natural follow-up question is *why do institutions matter for economic performance?* I will clarify this below. First of all, because of the regulative quality of institutions, economic exchange is highly dependent on them. Institutions set the basic rules of behavior in determining “*who and what are included in decision situations, how information is structured, what actions can be taken and in what sequence, and how individual actors will be aggregated into collective decision*”(Jentoft 2004:140). Institutions create regularity in repetitive interaction among individuals in providing a framework within which people have some confidence as to how outcomes will be determined. Actors in institutionalized worlds, then, are socialized into culturally defined purposes, which they identify themselves with. The legitimacy of institutions depends not only on the capacity of these institutions to accomplish appropriate objectives, but it also depends on that actors behave in accordance with legitimated procedures integrated in a culture through these institutions. This does not necessarily indicate political effectiveness

since the legitimacy of structures and processes embedded in institutions do not necessarily coincide with substantive efficiency (March and Olsen 2006:8-10).

The major role of institutions in the economy is to provide institutional stability that secures the rules of the game, and thereby reduces uncertainty in economic transactions. Institutions provide incentives and disincentives through a set of customs and rules. They entail enforcement either through self-enforcement, codes of behavior, or by third party policing and monitoring. This third party must necessarily involve the state, since the state is the actor with means of coercion. Therefore, a theory of institutions inevitably involves an analysis of the political structure of a society and the degree to which that political structure provides a framework of effective enforcement (North 1986:231).

To more rigorously clarify why institutions matter for economic performance, North (1986:232-235; 1990:31-35) presents five basic building blocks of institutional theory. The first one is based on the fact that *individuals maximize their own utility*. This means that the goal for economic actors in the market is to maximize their own wealth rather than that of the group or the organization they belong to. Even if individuals have the same objective function in an organization, there will be costs of transaction, because there are costs of information in the coordination and integration of any economic, political or social activity. The costs of information are the key to understanding the structure of institutions and organizations.

Because it is costly to measure the valued attributes in an exchange, the opportunity of wealth capture by devoting resources to acquiring more information is ever present. For example, a seller of oranges can put a variety of oranges out for sale, without devoting the time to measure the quality of each orange. The buyer, however, may find it worthwhile to devote the time to pick the best oranges. A transaction cost in an exchange therefore includes the costliness of the multiple attributes of goods or services involved in an exchange. Thus, the second building block is the *costliness of measurement attributes involved in an exchange*.

The third building block and a critical factor in the degree to which transaction costs in society are lowered and hence exchange is made possible, is *the cost of enforcement*. Enforcement costs are lowered by repetitive dealings and in personal exchanges involving individuals who are known to each other. But when an exchange takes place in an impersonal framework the gains from cheating or opportunism increase because neither repeated dealings or personal knowledge constrain behavior. When we do not know the attributes of a good or

service or all the characteristics of the performance of agents, we have to devote resources to measure and monitor them. For example, when someone is hired to a position, it is expected that the new employee has the required skills to do the job. There is little way of knowing the skills and characteristics of the new employee beforehand. Therefore, the employer must devote resources to monitoring the employee's output to be sure that his skills are deserving of the paycheck he receives. This increases the costs of contracting and the issue of enforcement arises. In other words, no institutional constraints increase the incentives for cheating and opportunism, as well as the uncertainty of contracting.

This is where the state, as third party enforcement, is a critical part for the costs of contracting in a society. The gains from trade cannot be realized without third party enforcement, because neither self-enforcement by parties nor trust can be completely successful. There will always be attempts of opportunism and cheating in complex societies, and it is close to impossible to create productivity in a high-income society with political anarchy. This is why a coercive third party is essential. Institutions provide the underlying structure for exchange, and thereby determine the cost of transacting. Therefore, another essential building block of institutional theory is *the way in which political institutions evolve and the way in which the institutional structure modifies, defines and enforces the property rights structure*.

North's fifth and final building block of institutional theory is *preferences*. He establishes that attitudes and ideological values influence people's views about the fairness and justness of contracts. Different ideological convictions are therefore important to take into account when investigating different institutional frameworks.

These building blocks are helpful in creating an understanding of the institutional development in Russia. The formal institutions of the Soviet Union distributed national plans of production, which meant that the capitalist economic principles of supply and demand were non-existent in formal economic rules. What and how much of a good that was to be produced was decided by the central state. To compensate for this, informal institutions developed as a source of supply of additional goods that were impossible to acquire through formal channels. The exchanges that took place through these informal institutions were to a large degree based on personal relationships and networks, hence, enforcement costs were lowered through repetitive dealings in personal exchanges. However, with a shift from a planned to a market

economic system the incentives for exchange changed, but the ideology and the preferences from the planned economy stuck with the economic actors, who now had to orient themselves in an entirely new economic system.

The new economic system was based on rules of impersonal exchange, but with the Soviet legacy of personalistic exchange these rules were not properly executed. This resulted in weak formal institutions unable to create and secure an effective property rights structure, and individuals turned to cheating and opportunism in order to maximize their own utility. In Russia in the 1990s, this meant that a few strategic actors were able to enrich themselves on the malfunctions of the system at the expense of the rest of the economy and at the expense of the well-being of most Russians. In reaction to the poor performance of the economy in the 1990s, a strengthening of formal institutions took place during Putin's presidency from 2000. This institutional development did to a certain degree contribute to reduce uncertainty in economic exchange and create more predictable and transparent rules of the game. However, despite the development of stronger formal institutions under Putin we still observe the prevalent and consistent influence of informal institutions in Russian politics and economics. This accentuates the stickiness of institutions and the major role that historical legacies have played for Russia's institutional development. The case of Russia illustrates how markets cannot operate effectively unless underpinned by the appropriate institutions, and consequently, institutional frameworks play a major role in the performance of an economy.

2.3 What causes institutional change?

I have now established the fundamental features of institutions and explained why institutions matter for economic performance. I will continue by laying out what causes institutions to change. An institutional change is the deliberate replacement of one set of economic institutions with another (Blyth 2002:45). This replacement indicates a shift in the rules and enforcement procedures leading to the constraining or encouragement of different behaviors (Cook and Levi 2008:407).

North (1990:83; 1986:234) establishes that the agent of change is the individual entrepreneur responding to the incentives embodied in the institutional framework. The source of change is the fundamental and persistent changes in relative prices or preferences, which lead one or both parties of contracts to perceive that they could be better off by alternations in the contract. If these alterations can be achieved within the existing

institutional framework, no institutional change will occur. But if the existing structure of institutions –that is, rules, customs, and norms of behavior – must be altered to accommodate such new forms of contracting, then we observe a persistent tension in the system that may result in institutional change. In other words, organizations will maximize their potential within the existing institutional context, or they will attempt to alter the institutional framework to maximize their potential (North 1986:231).

Furthermore, the process of institutional change is usually a dynamic process that in most cases occurs incrementally over time. This indicates that institutions are not built from scratch, but rather that they are built upon older institutions through a process of path dependency. The rules, routines, norms, and identities that are embedded in institutions function as instruments of stability as well as of change. Change is a constant factor of institutions, and the existing institutional arrangements have an impact on the emergence of new institutions, as well as on the reproduction or change of old ones (March and Olsen 2006:11). Tsai (2006:120-121) makes the distinction between two types of institutional change, namely *sequencing* and *institutional layering*.

2.3.1 Path dependence and sequencing

The sequencing approach to institutional development focuses on the self-reinforcing dynamics of path-dependence and institutional continuity. Path dependence emphasizes the dynamics of positive feedback processes in a political system, which can be highly influenced by relatively modest agitations at early stages. Such positive feedback processes, then, can produce more than one outcome. However, once a particular path is established, self-reinforcing processes make it very difficult to reverse these processes and divert from the chosen path. Hence, the increasing return mechanisms reinforce the direction once on a given path (Pierson 2004:10). However, this does not prevent change to occur over time. Pierson (2000:74-87; 2004:10-11) makes a distinction between *self-reinforcing event sequences* and *reactive event sequences*. The former is when political actors consolidate power during an early formative period and end up promoting institutions and rules that enable them to maintain their authority over time. Once these institutions and rules have been established, patterns of political mobilization, the institutional “rules of the game”, and even the citizens’ basic ways of thinking about the political world will generate self-reinforcing dynamics.

Events that occur earlier in a particular sequence can have a much greater impact on the final outcome than events later in the sequence. However, this does not necessarily mean movement in the same direction. The course of the path may matter precisely because it sets the stage for a reaction that leads to the path taking a new direction. This leads us to reactive event sequencing, which is when certain events occur in reaction to former events and these drive subsequent developments along an alternative trajectory. This indicates that the trajectory of institutional development is potentially non-linear, and that significant changes are possible and plausible without system breakdowns, and within the apparent limits of the existing political system (Tsai 2006:120).

This introduces *critical junctures* as an essential factor in understanding institutional development. Capoccia and Kelemen (2007:341) suggest a dual model of institutional development “*characterized by relatively long periods of path-dependent institutional stability and reproduction that are punctuated occasionally by brief phases of institutional flux – referred to as critical junctures – during which more dramatic change is possible*”. The choices made during critical junctures contribute to close off alternative options, and they place institutional arrangements on trajectories or paths that are difficult to alter afterwards. The junctures are “critical” because they constitute the starting points for many path-dependent processes by placing institutional arrangements on paths that are very hard to alter (Capoccia and Kelemen 2007:341-342; Pierson 2004:135; Hall and Taylor 1996:942).

The dissolution of the Soviet Union was without a doubt one such critical juncture. The rigid planned economy and state centered regime of the Soviet Union provoked a reactive event sequencing where an institutional design at the opposite side of the spectrum was chosen: decentralization and privatization. Furthermore, and referring to the critical juncture that is of more interest in this particular thesis, the shift away from the liberal policies of the 1990s was a reaction to the failure of economic policy. President Putin’s recentralization reforms after 2000 marks the movement in a new direction in Russian institutional development. In contrast to the critical juncture that led to the breakdown of the Soviet Union and the complete alteration of the economic and political system, the changes in the institutional framework under Putin’s presidency happened within the apparent limits of the existing system. These institutional changes took place as a reaction to the poorly developed institutional framework of the 1990s, and it is an excellent example of Tsai’s notion that significant changes can occur without a complete alteration of the system.

2.3.2 *Institutional layering and friction*

A second approach to explaining endogenous institutional change emphasizes institutional layering, which refers to the fact that most institutional environments comprise a variety of institutions, some of which may have inconsistent or competing objectives (Tsai 2006:121). As I have explained above, the intention of formal institutions is to provide a certain element of predictability and stability to human interactions. However, formal institutions do not always function as intended, creating space for informal institutions that emerge as adaptive responses to the constraints and opportunities of formal institutions. With the emergence of adaptive informal institutions the multilayered institutional context will limit the degree of coherence that particular formal institutions may have at any given point. The friction among these multiple institutional layers may motivate institutional change. This proposes an evolutionary development of institutions, where friction among various institutional layers may motivate actors to establish adaptive patterns of behavior that are simultaneously new, yet familiar.

The use of existing institutions for new or alternative purposes, then, plays a vital role in institutional change and development. This stands in contrast to the self-reinforcing view of institutions, since this perspective recognizes that even though formal attributes of institutions may remain the same, their substantive role may change dramatically. Such evolutionary changes are most likely to occur when there is a gap between the original intentions of formal institutions and the perceived needs and interests of local actors. In sum, the relevance of institutions, whether they are formal or informal, depends on their capacity to guide human perceptions and practices. The causal mechanism for institutional change depends on the interactions between various state and non-state actors and their degree of coherence (Tsai 2006:123-126, 140).

For example, in the Soviet Union informal institutions were an integral part of the workings of the planned economy. Since the formal institutions proved incapable of supplying people's needs, the system of *blat* developed, an informal network system that attempted to fill the gaps where formal institutions proved inadequate. When the formal institutions changed with the breakdown of the USSR, the informal institutions adapted to the new institutional environment. The sudden shift to a market economy in the early 1990s was problematic, and formal institutions struggled to acquire legitimacy and to effectively establish and secure the rules of the game. This created an imbalance between formal and

informal institutions, where the weak formal institutions that were unable to function as a third-party enforcer, created space for informal institutions to take advantage of the fragile new system, encouraging rent-seeking behavior and opportunism.

Moreover, the stagnation and economic crisis of the 1990s motivated further change, since the system was not working optimally. Putin's presidency is another critical juncture that marks a shift in the interrelationship between formal and informal institutions. While informal institutions could take advantage of the weak formal institutions in the 1990s, Putin's recentralization and rebuilding of the state and formal institutions meant a shift in informal institutions' approach and interrelationship to formal rules and to formal institutions.

Helmke and Levitsky (2004:728) have elaborated on the variety of such coherence between formal and informal institutions by creating four categorizations of informal institutions based on their variety in interaction with formal institutions. Their typology of informal institutions is based on two dimensions. The first is *the degree to which formal and informal institutional outcomes converge*, which means the degree to which following informal rules may produce a substantively different result than following the formal rules. When following informal rules leads to a substantively different result, then formal and informal institutions diverge. If the two outcomes are not substantively different, then formal and informal institutions converge.

The second dimension is *the effectiveness of the relevant formal institutions*. This refers to the degree to which formal rules and procedures are enforced and complied with in practice. Formal institutions that are effective constrain or enable political actors' choices through the high probability of sanctions by official authorities on noncompliance. If formal rules and procedures are ineffective, actors calculate a low probability of enforcement of sanctions, and therefore they expect a low cost of violation of formal rules (Helmke and Levitsky 2004:728-729). These two dimensions are the basis for the fourfold typology of informal institutions shown in Table 2.3 below.

Table 2.3: A typology of informal institutions Source: (Helmke and Levitsky 2004:728).

Outcomes	Effective formal institutions	Ineffective formal institutions
Convergent	Complementary	Substitutive
Divergent	Accommodating	Competing

The first category is *complementary informal institutions*, which coexist with effective formal institutions. This means that actors expect formal rules to be enforced, and informal institutions are complementary in that they address contingencies not dealt with by formal rules, or by facilitating the pursuit of individual goals within a formal institutional framework. Complementary informal institutions may therefore enhance efficiency, and contribute to strengthening incentives to comply with formal rules that otherwise exist only on paper.

Accommodating informal institutions combines effective formal institutions and divergent outcomes. This means that this category of informal institutions contradict the efforts of formal rules, but without directly violating them. Accommodating informal institutions are often created by actors who oppose the outcomes that are generated by the formal rules, but who are unable to change those rules. In this way, accommodating informal institutions can contribute to reconcile these actors’ interests with the existing formal institutional arrangements, which further may reduce the demands for change in formal institutions. Accommodating informal institutions can be recognized in the Soviet Union and the informal system of *blat*. This informal exchange system contradicted the formal rules of the planned economy, and provided economic actors with goods that they were unable to retain through the formal system (Helmke and Levitsky 2004:729). This categorization can also be recognized after Putin’s recentralizing reforms after 2000. Putin did indeed strengthen formal institutions to a large degree, but in order to do this a continuous negotiation among actors involved was required. Since formal institutions were so poorly developed, negotiation through informal institutions was essential to overcome institutional divisions and negotiate outcomes. So even though Putin’s rule has been characterized by an increase in the significance of formal institutions, the resort to informal networks has been essential in order to resolve tension in the system (Ledeneva 2013:83)

The combination of ineffective formal rules and divergent outcomes produces *competing informal institutions*. Since formal rules and procedures are not systematically enforced, actors are enabled to ignore and violate them. In violating formal rules the informal institutional structure is incompatible with the formal institutions: To follow one rule, actors must violate another. This illustrates the interrelationship between formal and informal institutions of the transition period of the 1990s in Russia. Formal institutions were poorly developed and were unable to articulate and enforce effective “rules of the game” in the Russian economy. This led to an abuse of the system by private actors and informal institutions, creating an oligarchic economy with a few extremely rich and powerful economic actors who acquired their wealth at the expense of formal institutions and of the rest of the economy.

In cases where ineffective formal institutions and compatible outcomes are combined, *substitutive informal institutions* are created. Similar to complementary informal institutions, substitutive informal institutions are employed by actors who seek outcomes that are compatible with formal rules. However, since the formal institutions are ineffective, substitutive informal institutions end up achieving the outcomes that the formal institutions were designed, but failed, to achieve. This type of interrelationship between formal and informal institutions usually emerges where state structures are weak and lack authority.

These categorizations illustrate the variety in the ways informal institutions interact with formal institutions. Helmke and Levitsky’s categorization makes it clear that informal institutions cannot be classified in dichotomous terms, either as functional or dysfunctional. This classification contributes to a more nuanced understanding of the dynamics of informal institutions and how they coexist with formal institutions (Helmke and Levitsky 2004:730).

2.3.3 Market-oriented institutional transitions

Peng (2003:275-277) discusses how institutional changes, or transitions, matter for the strategic choices of economic actors within a given institutional framework. He has developed a two-phase model of market-oriented institutional transitions. This model focuses on the longitudinal process to move from a relationship-based, personalized transaction structure largely based on networks to a rule-based, impersonal exchange system based on market-centered strategies. Market-oriented institutional transitions vary in the degree to which they are incremental or discontinuous. Some fundamental institutional changes can happen

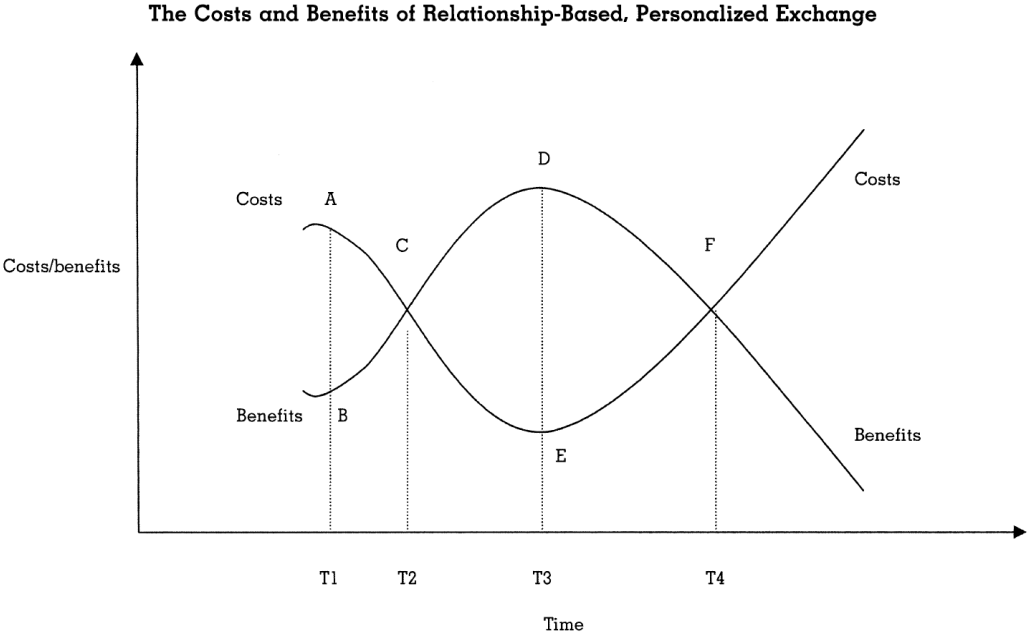
overnight, such as the abolishment of the planned economy and the legalization of private ownership. However, the dismantling of old institutions does not necessarily coincide with the creation of new institutions, which can create a period of incremental evolution full of uncertainties.

I have established that the role of institutions is to reduce uncertainty by establishing a stable structure to human interaction, and that the institutional framework in this way affect the performance of the economy by their effect on the cost of exchange and production (North 1990:5-6). Market-oriented transitions, then, are moving from one primary mode of exchange to another in order to reduce uncertainty. This institutional transition is nevertheless likely to introduce instability and increased costs as new institutions emerge to replace the old (Peng 2003:278). Furthermore, as North (1990:6) points out; “*although formal rules may change overnight as the result of political and judicial decisions, informal constraints embodied in customs, traditions, and codes of conduct are much more impervious to deliberate policies*”. This means that informal institutions play a particularly crucial role in regulating economic exchanges in a country during the unstable period of a transition. In this period of time, informal institutions have considerable influence over both the behavior of individual managers and their firms, as well as over the new generation of formal constraints (Peng 2003:278).

The way we exchange or transact vary greatly across the globe, but Peng (2003:279-280) categorize transaction structures into two main groups, “*relational contracting*” and “*arm’s length transaction*”. The former is relationship-based, personalized exchange that has characterized large parts of economic history. Figure 2.1 illustrates the development of costs and benefits of this type of personalized exchange over time. At the initial point in time, T1 in Figure 2.1, the cost of engaging in relational exchange is high (at point A) and the benefits are low (point B). This is because building strong social networks with the transaction partners is a time- and resource consuming process. However, as the scale, scope and specificity of the transaction expand, the costs are reduced (from A to C and then to E) and the benefits increased (from B to C and then to D). The threat of opportunism is limited by the extent to which informal sanctions are used against opportunists. The demand for costly, formal, rule-based, third party enforcement is low. Thus, between T2 and T3 the economy is likely to benefit from relational contracting. Past T3, however, the costs start to outweigh the benefits. This is because in the absence of formal institutions the possibility to increase and vary the

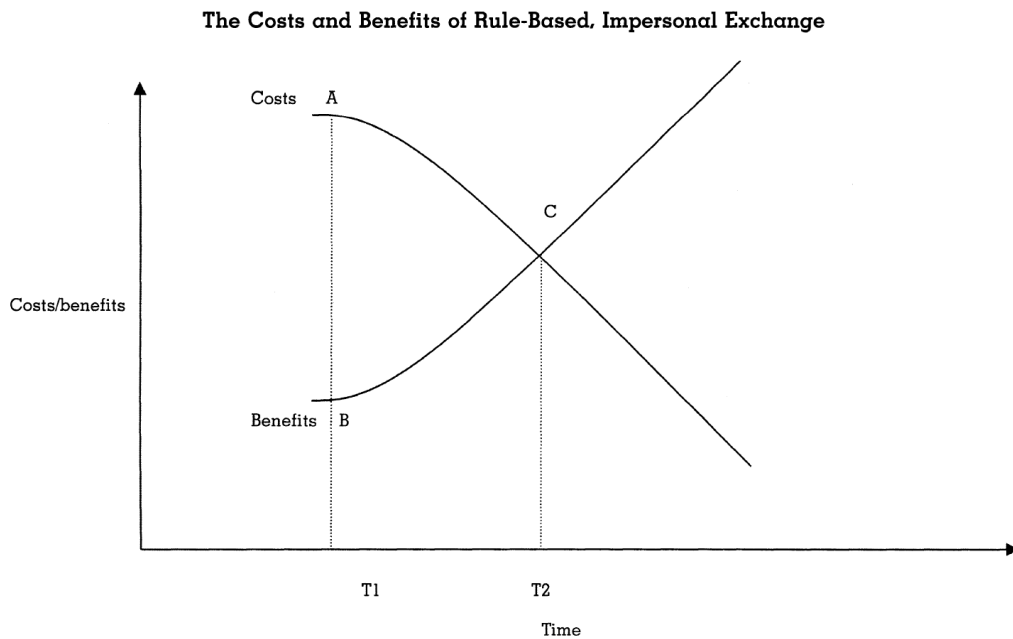
number of exchange and trade partners is limited because of the resource demanding nature of the personalized exchange. With an expansion of transactions in a more complex economy, the strength of network ties are challenged, and trust can more easily be exploited and abused. Relational contracting has then reached its limit at time T3, and the cost outweighs the benefits at T4, suggesting an increased demand for a more formalized, rule-based type of exchange system (Peng 2003:279-280).

Figure 2.1: The cost and benefits of relationship-based, personalized exchange Source: (Peng 2003:279)



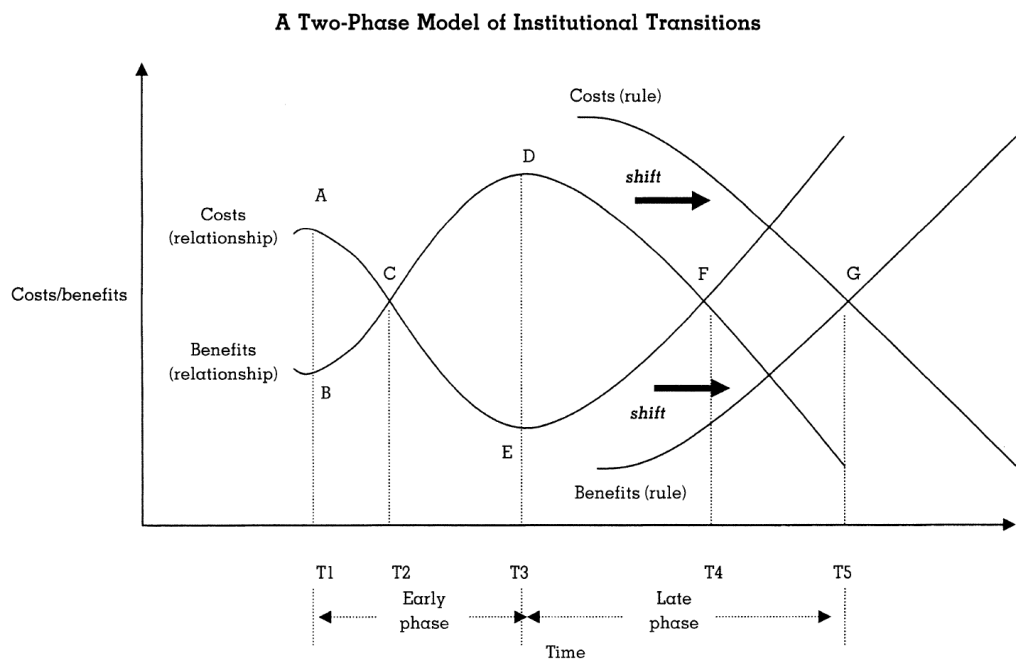
The arm’s length transaction refers to a transaction mode which is rule-based, impersonal exchange with third-party enforcement. This is illustrated in Figure 2.2. As the economy expands and the scale, scope and specificity of economic transactions rise, it requires formal legal and regulatory measures by a third-party enforcement. Such laws and regulations should be market-supporting formal institutions designed to facilitate more impersonal economic exchange. As show in Figure 2.2, the initial cost of transaction is high because of the high costs to develop and implement formal institutions. Over time, however, the third-party enforcement is likely to facilitate the widening of markets, because unfamiliar parties, who were discouraged from transacting before, are now confident enough to capture the gains from a more complex trade (Peng 2003:280).

Figure 2.2: The costs and benefits of rule-based, impersonal exchange Source: (Peng 2003:280)



The shift or transition from a relationship-based transaction process to a rule-based transaction structure is an incremental process, and the initial transaction structure of the transition economy is predominantly relationship-based. Gradually, and with time, this structure may move towards a rule-based structure. This is illustrated in Figure 2.3 below, which is a merge between Figure 2.1 and Figure 2.2.

Figure 2.3: A two-phase model of institutional transitions Source: (Peng 2003:281)



The transitions start at T1, which is the point in time where the costs of relationship-based transactions begin to drop and the benefits begin to rise. This is due to new opportunities as the economic landscape is being shaped. This way of doing business may also be legitimated by historical traditions associated with informal trading. In the process between T2 and T3 many firms grow and develop by using a network-based strategy based on personal trust and informal agreements among managers and officials. This is in order to overcome institutional uncertainty and to reduce risk in transaction. However, past the point of inflection at D and E, the scale and scope of transactions are expanding and becoming more complex, which requires the support of formal institutional mechanisms. At the critical point in time T3, the accumulated momentum toward having more formal rules starts to outweigh the incentive for the previous, relationship-based transaction structure. This change in the cost and benefits for the players within this transaction structure may motivate changes in political regimes, shifts in economic policies or even revolutionary changes in institutional frameworks (Peng 2003:281). This explanation of institutional change coincides with North's (1990; 1986) notion that institutional change is driven by the entrepreneur's responses to incentives embodied in the institutional framework. The source of change is the relative prices or preference (costs and benefits), which may lead the entrepreneur to think that he/she could be better off by an alteration in the system.

As I have previously noted, the informal system of exchange in the Soviet Union was largely relationship-based and personalized. With the breakdown of the USSR and the implementation of a market economy came the demand for a more generalized, rule-based formal institutional framework. However, the initiation of a market economy in Russia came at high costs; throughout the 1990s the formal institutions were not sufficiently developed to articulate and enforce an efficient formal institutional framework to regulate and monitor economic exchange. This resulted in exchanges remaining largely relationship-based, even though the economic structure was based on generalized and rule-based exchange. In the early 2000s we observe a shift towards stronger formal institutions and an increasingly rule-based economy, but features of the relationship-based model is still lagging in Russia's economic system.

2.4 Limitations and Challenges of Institutional Theory

In contemporary political science, different theoretical styles, or different "institutionalisms" have developed, each with different approaches and emphasis on how to

tackle the phenomenon of institutions in political life. Some of the characteristics of these different schools of thought have been highlighted in the introduction of institutions above (see Table 2.1). In newer literature there are three main approaches to institutions, namely historical institutionalism, rational choice institutionalism, and sociological institutionalism. Each of these schools of thought remain very different in their approach to institutions and human behavior, and each one of them displays different strengths and weaknesses (Hall and Taylor 1996:937-950). Due to the scope of this thesis, I will not go into detail on the developments and variances of these approaches¹, but I acknowledge that the variation in the conceptualization of institutions, and I recognize that this might be a source of confusion and inconsistency in the understanding of institutions in political science. Some have argued for the wholehearted embrace of one of these approaches at the expense of the others. However, Hall and Taylor (1996:955) argue that each of the approaches have a significant contribution to the scholarly literature, and they suggest a greater interchange among them.

Helmke and Levitsky (2004:733-734) recognize the issue of identifying and measuring informal institutions as a subject that needs greater attention in mainstream comparative institutional analysis. Formal institutions have been thoroughly analyzed in political science, and since formal institutions are usually written down and officially communicated and sanctioned, the task of identification and measurement is relatively straightforward. The nature of formal institutions requires little knowledge of particular cases, and therefore more easily enables large-*N* comparison. Identifying and conceptualizing informal institutions, however, can be more challenging. It is easy to identify a country's constitution or presidential or parliamentary system, but it is much harder to establish the degree of clientelism or kinship networks. This also indicates a much more complex research process, which makes it harder to generalize and do large-*N* comparisons. The inquiry of informal institutions presents other challenges than the study of formal institutions, and the task of identifying the shared expectations and enforcement mechanisms that sustain informal institutions is a challenging task that requires substantial knowledge about a single case. Hence, the development of good theories on informal institutions and their role in politics and economics are unbalanced compared to the rigorous literature on formal institutions.

¹ For a more detailed elaboration on institutionalism, see (Hall and Taylor 1996), (March and Olsen 1984), (March and Olsen 2006), (Goodin and Klingemann 1996).

Chapter 3: Methods: Case study research and comparative historical analysis

“Without a deep understanding of time, you will be lousy political scientists, because time is the dimension in which ideas and institutions and beliefs evolve.”

- Douglass North (1999:316)

3.1 Choice of methods: Equipping the thesis with the right tools

The purpose of this thesis is twofold. The primary objective is to investigate *the development of institutions in post-Soviet Russia and the interrelationship between formal and informal institutions*. Simultaneously, a secondary objective of the thesis is to give some insight into the *implication of institutional development on trade relations*. The thesis aims to make a contribution to the literature on institutions and institutional change by investigating this phenomenon in a specific setting, namely post-Soviet Russia. Unfortunately, social scientists do not have the advantage of basing their research on universal laws. Therefore, in order to illuminate the phenomenon under investigation as realistically and objectively as possible the methods in social science provide political scientists with tools to guide their research.

This chapter will therefore begin by discussing the method most appropriate for my research purposes, namely comparative historical analysis applied to a single case study. I will start by discussing the importance of this type of analysis, and I will also comment on its weaknesses. Then follows a section that discusses case selection, where I argue that the interplay between theory, data collection and analysis presented by this research design is most suitable for my research project. Furthermore, I will account for my data collection, which is based on qualitative interviews and document analysis, and finally, I will provide a short discussion concerning concept-measure consistency and conceptual stretching.

3.1.1 Comparative historical analysis and single case study

The comparative historical analysis tradition entails a fundamental commitment to offering historically grounded explanations with a strong concern for causal analysis, the recognition of the importance of temporal processes and the use of systematic and contextual comparison. This indicates that causal arguments are essential in comparative historical analysis, and researchers utilizing this method are mainly concerned with explaining and identifying causal structures that produce major outcomes of interest. Therefore, the causal

mechanisms in question are carefully selected and tested rather than introduced as circumstantial parts of an overall narrative. A second and equally important aspect of comparative historical analysis is a focus upon historical sequences and the unfolding of processes over time (Mahoney and Rueschemeyer 2009:4-12). Pierson (2004:172) highlights the importance of adding “context” to our understanding of different social scientific phenomena, and that it is vital to take into account how events and processes are related to each other in social dynamics that unfold over extended periods of time. This focus on temporality includes sequencing and path-dependence, which are explanatory tools that I use in this thesis to account for Russian institutional development (see chapter 2). The comparative method does not necessarily have to contain the comparison of two or several countries. An alternative way of maximizing comparability is to analyze a single country at different points in time. Lijphart points out that “*the same country is not really the same at different times*”(Lijphart 1971:689). This is the basis for the inquiry conducted in my thesis, where I investigate the interrelationship between Russian formal and informal institutions and their effect on trade relations at different points in time. The importance of temporal processes and the notion that “history matters” are therefore vital arguments in creating an understanding of Russian institutional development.

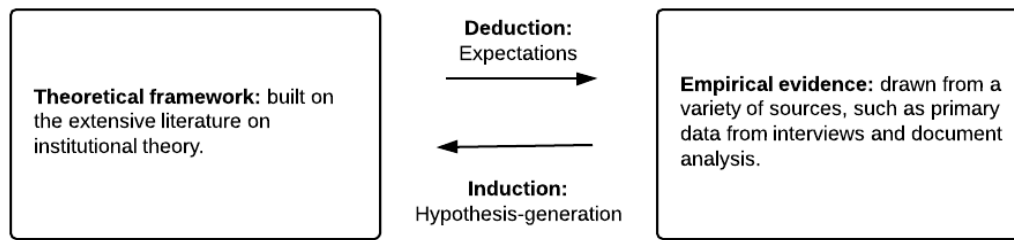
The fact that this method seeks to combine several explanatory variables with a small number of cases introduces the “small-*N* problem”, which is the method’s most common critique. This critique holds that studying a few cases or just a single case produces only one reasonable theoretical outcome, namely to generate hypotheses that can be tested in other, more numerous cases. This indicates a potential lack of external validity, which means that it is problematic to use explanatory features that are based on the study of one or a few cases to explain a general phenomenon or make general causal claims (Gerring 2007:43; Rueschemeyer 2009:305; Collier et al. 2010:10). Pierson (2004:173) emphasizes that this problem of “many variables, few cases” can to some extent be worsened by the temporal context of comparative historical analysis. This is because the examination of temporal processes, for example through path-dependent arguments, concerns itself not just with studying correlation among variables, but also the sequence of change in variables over time. According to this critique, then, the main objective of small-*N* analysis is the generation of theoretical propositions (theory generating), that requires testing in a larger number of cases, often through quantitative analysis.

However, Rueschemeyer (2009:318) and Lijphart (1971:691-693) argue that single case studies can contribute to more than just generating theoretical ideas. Case studies can also contribute to testing theoretical propositions and offering persuasive causal explanations. Case studies are important, since they can provide good historical descriptions of a phenomenon, allowing the researcher to both generate and test multiple hypotheses in a thorough manner (Gerring 2007:41). My thesis concerns itself with a single country study, namely that of post-Soviet Russia and my aim is to illuminate the interrelationship between formal and informal institutions in the face of institutional change. Secondary to this, I investigate how institutional change affects trade relations. Thus, similar to most case studies, my focus is on within-case variation (Gerring 2007:21).

King, Keohane and Verba (1994:46) emphasize that data collection, theory generation and theory testing take place interchangeably throughout the research process. One aim of this thesis is to contribute to the development of institutional theory by closely investigating the institutional mechanisms and their effect on trade relations in one specific country, namely post-Soviet Russia. A descriptive, in-depth approach that provides us with correct empirical information can contribute to both testing existing theories, as well as theory building, providing a more solid theoretical framework for addressing the phenomenon on a larger scale. A major advantage of doing a single country study, then, is the freedom to allow new information to reshape the assumptions and directions of my study throughout the data collection process. This interchanging between data collection, theory generation and theory testing provides me with an effective tool to create a more rigorous understanding of institutions, institutional change and its' effect on trade relations within the scholarly literature.

Furthermore, the examination of the effect of institutional change on trade relations is a subject that has not been thoroughly investigated. I hope that my contribution to illuminate the importance of institutions in trade relations can contribute to a more wholesome understanding of just how much institutions contribute to shape the world we live in. This continuous interaction between theory and data is illustrated in Figure 3.1 below. It is exactly this dialogue between theory and evidence that constitute the comparative advantage of comparative historical analysis (Rueschemeyer 2009:312).

Figure 3.1: The process between theory and empirical evidence in case study research



3.1.2 Case selection: *Why Russian institutions?*

Gerring (2007:20) and King, Keohane and Verba (1994:191, 213) emphasize that the goal of any research should be to maximize the number of observations in order to shed light on a larger class of cases (a population). Yet, increasing the number of cases is not always necessary in order to achieve a maximization of observations, and a research design including just a single case or a small number of cases can still produce fruitful results. This indicates that the goal of case selection is the same regardless of whether the research design is based on large-*N* cross-case analysis or case study analysis. As Gerring (2007:88) notes, the aim of any social scientific analysis is to “*identify cases that reproduce the relevant causal features of a larger universe (representativeness) and provide variation among dimensions of theoretical interest (causal leverage).*” This statement refers to the problem of external validity, which I briefly mentioned in the section above. In order for a case study to produce research results that are not uninformative about anything but itself, the case chosen should be more or less representative of some broader phenomenon (Gerring 2007:145).

Despite the fact that my research question is highly specific and directly aimed at investigating Russian institutional development, I argue that my thesis contributes to illuminate a phenomenon that is relevant for a larger population. Landman (2004:34) argues that “*a single-country study is considered comparative if it uses concepts applicable to other countries, develop concepts applicable to other countries, and/or seeks to make larger inferences.*” In my thesis I investigate institutional development in post-Soviet Russia, and an emphasis on the institutional heritage from the Communist system is highly emphasized. The planned economic system, as well as informal institutions such as *blat*, is not unique to Russia. These are characteristics that can be recognized in many former Communist countries,

such as the post-Soviet satellite states and China.² The population of my study therefore becomes those countries that share similar characteristics in their institutional legacy.

That being said, I will avoid drawing conclusions about what my case represents. This is because the interplay between theory and empirical evidence in the case study research makes it hard to pre-determine what will be the outcome and which factors are decisive in producing that outcome. This means that the population of the research is formed parallel with the progress of the research process and the conditions for an outcome appear gradually. These characteristics of case-study research introduce the problem of representativeness and external validity as a major weakness (Ragin 2004). By choosing to conduct a single-case study I have traded external validity for internal validity, which means that the detailed explanatory richness of the case study is prioritized at the expense of the explanatory power across cases (George and Bennett 2005:31-33; Gerring 2007:43). Nevertheless, I argue that my findings are relevant and replicable in other cases with similar institutional legacies, namely post-Soviet or post-Communist states.

3.2 Data collection

Yin (2009:114-115) argues that one of the major strengths of case studies is the possibility for using multiple sources of evidence. This adds to the validity and reliability of conclusions since using multiple sources of evidence develops what Yin calls “*converging lines of inquiry*”, meaning that several sources of evidence point in the same direction. The data collection process of any research project should be clear and explicitly accounted for, so that others can replicate the data collected. This strengthens the reliability of the study (Yin 2009:40). With this in mind, the following section will account for the different sources of data in this research project.

3.2.1 Qualitative interview

The opportunity to conduct qualitative interviews as a part of this research project gives me a chance to provide new information about a subject that has not been thoroughly investigated in the past, namely the effect of institutions on trade relations. I have conducted several in-depth interviews with a selection of key informants, so-called *elite interviews*. This

² There exist a variety of comparative analyses on China and Russia concerning formal and informal institutions and communist legacies. For examples see (Puffer et al. 2010), (Ledeneva 2008), and (Michailova and Worm 2003).

technique involves the selection of informants based on their connection to and expertise within the trade relation between Norway and Russia within the fisheries. An important criterion of expert interviews is precisely that the informants are not selected randomly, but on the contrary as a result of their qualification as an informant. Such qualifications may be particular status, specialized knowledge, or accessibility to the researcher (Phillips 1981:396). Goldstein (2002:699) identifies three basic goals when doing elite interviews. First of all, one objective is to gather information from a sample of officials in order to make generalizable claims about all such officials' characteristics or decisions. Secondly, expert interviews may contribute to discover a particular piece of information relevant for the research that cannot be obtained through other methods. Finally, interviewing key informants may contribute to informing or guiding work that uses other sources of data. I will to a certain degree aim at all three of these goals. By interviewing key informants on both the Russian and the Norwegian side within the fisheries trade sector, my hope is that these interview objects can give some insight into how the Russian system of institutions works, and how this sector has been affected by changes in these institutions. This will shed light on institutional change within a particular sphere, but it will hopefully also give clues and interpretations of other sources of data that I utilize, and help to create a more general knowledge and understanding of the dynamics of Russian institutional development.

The first step in the process of doing expert interviews is deciding who to talk to. Bogner and Menz (2009:52) highlight the value of expert interviews in their ability to provide crucial information that can shed light on the investigated phenomenon through *process knowledge*, which means that these elite representatives can provide crucial information about the phenomenon through their own interaction and experience with the system. Furthermore, through *technical knowledge*, these informants are better equipped and positioned to provide specific information about the field of inquiry. Finally, their *interpretive knowledge*, that is, their personal thoughts and interpretations of the phenomenon under investigation can be important in helping the researcher to grasp the broader picture. A big challenge when doing elite interviews is finding people who are willing to talk to you about the phenomenon that you are interested in (Goldstein 2002:669). In my case this proved particularly difficult, since the trade relation between Norway and Russia has been tense at times, and the position of Norwegian exported salmon in Russian cartels has been a hot subject in the Norwegian news³.

³ For more on this in Norwegian media, see (Riisnæs 2014).

Anonymity of the respondents therefore became a vital credential in gaining consent from the informants to conduct the interviews. All the interviewees except one requested quotation checks of the quotes that were to be used in the thesis. This has been sent out in the aftermath of the interviews, and it has introduced some minor hick-ups for the finalization of thesis. Some of the respondents wanted to make alterations or remove parts of their quotes, which created challenges for me in satisfying the wishes of the respondents, and at the same time maintain a holistic presentation of my findings. In the end, I am pleased that I could come to an agreement that satisfied all the respondents and at the same time did not compromise the presentation of my findings.

My respondents have been chosen through a process of so-called *snowballing*. This method for choosing respondents is based on the respondents themselves suggesting other respondents that can be included in the selection (Grønmo 2004:102). I had initially made contact with an organization connected to fishery trade and management on the Norwegian side, as well as a researcher that has done previous studies within this field. These contacts have been essential in the process of arranging interviews, both on the Russian and on the Norwegian side. Through recommendations from several respondents along the way, I ended up with conducting nine interviews in Russia and Norway with people within both the private and the public sphere connected to fishery trade.

All the interviews were semi-structured, which means that I used an interview guide based on open-ended questions that I prepared in advance, but I also asked questions that came up during the interview based on the answers of the specific respondent. The strength of this technique is that the respondent is allowed to elaborate more freely without predefined questions, and this increases the *response validity*, meaning that the material from each respondent is more likely to be representative of the respondent's actual thoughts about the inquired phenomenon (Aberbach and Rockman 2002:674). Throughout the entire interviewing process I tried to make sure that my questions were not biased, and I avoided asking questions that would steer the interviewee in a specific direction. This is to ensure that the respondents can formulate their own answers, and do not just give the interviewer what she wants to hear (Yin 2009:102). The interviewing process did for the most part go smoothly, and even though the interviews with the Russian respondents were conducted in English, I took advantage of my Russian language skills with respect to establishing a more comfortable setting for the respondent by starting the interview with some chitchatting in

Russian. Furthermore, due to occasional poor English skills, my knowledge of Russian language helped me to better understand what point the respondent was trying to make.

3.2.2 Other data sources

In order to control the reliability of the data it is important to contrast and compare the answers from one source with data from other sources. This is especially important when conducting semi-structured interviews, since a statement from one person does not necessarily constitute the entire “truth”, and personal opinions and involvement may “color” the respondents answers (Aberbach and Rockman 2002). The data collected from the interviews are therefore compared with other documentation, mainly through document analysis. This mainly entails all written documents that can be linked to the case under investigation (Yin 2009:102). I have relied on previous studies of Russian institutions, reports, and newspaper articles about the Russian fisheries. I have also been in contact with several researchers connected to this field, and they have given me tips and advice along the way.

In addition to this, I have used survey data from the World Value Survey (WVS 2009), which constitute a quantitative support to the qualitative data collected in this research project. This opinion survey portrays the issue of trust in Russia, which is an important indicator when investigating the strength of formal and informal institutions, and it also plays an important role in business relationships. A final source of data utilized in this research is direct observation. This sort of evidence is hard to trace in my written text, but by observing the respondents in their natural habitat, and especially in the country that I am investigating, this contributes to creating a more holistic impression of the workings of this system. Meeting with people that are a part of this system and that work with this every day has given me new perspectives when considering the significance of institutions and the role they play in people’s everyday lives.

3.3 Concept-measure consistency

An important issue when discussing data quality is the consistency between the concepts that constitute the theoretical framework for the analysis and the degree to which the operationalization and scoring of observations reflect the concepts that the researcher wants to measure. If the measurements are not accurate and do not reflect the basic structure of the concept, you risk measuring something different than intended (Adcock and Collier 2001:529; Goertz 2006:95). In constructing concepts, Goertz (2006:39-44) highlights the important

distinction between treating concepts in dichotomous or continuous terms. Concepts based on dichotomies require a set of necessary and sufficient conditions to be present in order for the concept to be valid, which means that in order for dependent variable Y to be present ($Y=1$), both explanatory variables $X1$ and $X2$ are necessary. If concepts are based on a continuous structure, however, only one of the two explanatory variables need to be present in order for $Y=1$. These considerations are vital in establishing the concept of institutions. In the theory chapter I have established the distinction between different types of informal institutions in their interrelationship with formal institutions, and thereby established that the concept of institutions is treated in continuous terms. Due to the fact that institutional development is a continuous process, I argue that restricting the analysis to any single dichotomous cut-point can obscure potential findings (Collier and Levitsky 1997:2-3).

The rationale behind choosing dichotomous concepts is that this will create clearer boundaries in what constitutes a concept and what does not. However, Goertz (2006:34) and Munck and Verkuilen (2002:9) argue for the utilization of continuous concepts, since this gives more content to the concept, making it easier to address relevant theoretical concerns and prevent discrimination among cases. When using dichotomous concepts there is an increased risk of measurement error, because one might downplay, or even ignore, the theoretical and empirical problems of grey zones. In choosing to use continuous concepts this will increase the complexity of our understanding of institutions, and it introduces the concern of conceptual confusion or *conceptual stretching* (Collier and Mahon 1993:845). By including too many attributes in a definition of a concept one might end up decreasing the usefulness of the concept to the degree that it is too overburdened to be of any analytical use (Munck and Verkuilen 2002:9). Nevertheless, I argue that using a dichotomous view on institutions is hard to justify, due to its inherent continuous nature. Accuracy is therefore traded for in-depth knowledge and increased measure validity, which contributes to create a deeper understanding of the interplay between formal and informal institutions.

Chapter 4: From state control to state capture: The Soviet legacy and the chaos economy of the 1990s

“Custom is stronger than law.”

- Russian proverb

The major goal of institutions in the economy is to provide an institutional stability that is able to secure the rules of the game in economic exchange. That is, to create a predictable framework for economic interaction and thereby reduce uncertainty in economic transaction. Chadee and Roxas (2012:23) points out that *“a well-developed formal institutional environment deters rent-seeking behavior by creating a level playing field where no economic player enjoys undue privileges nor suffers disadvantages, and a strong platform for innovation and competitive advantage is provided.”* The following chapter will provide an overview of the institutional development and its economic implications in the first decade after the dissolution of the Soviet Union. I will open with an outline of Russia’s economic legacy and the main features of the planned economy to provide a context and a basis for understanding the enormous institutional and economic change that occurred in the early 1990s. Further I will present an outline of the institutional development during Boris Yeltsin’s presidency in the 1990s and its implications for the Russian economy. I will also present a section on developments in the fisheries sector to provide a specific case to illustrate how these institutional changes have affected one specific industry. This chapter presents the background for the reforms and changes that took place during Putin’s recentralization process in later years.

4.1. Russia’s past: The context for economic reforms

Present-day reforms and conditions of the Russian economy cannot be understood without a consideration of some of the forces exerted by Russia’s past. Strict state control over individual economic activity has been a fundamental part of Russian polity ever since the legal code enshrined serfdom in 1649. Peter the Great established state-owned factories, took control over commerce, and brought foreign specialists to develop industries and exports in his attempt to “Westernize” the country in 1689. As the Western world developed toward capitalism, Russia moved back and forth between encouraging private property and controlling it (Blasi et al. 1997:13-15). This is a pattern that has continued until present day.

After the Bolsheviks seized power in the aftermath of the Russian Revolution in 1917, the economy returned to the policy of state control and implemented the planned economy. The planned economy had two main features, namely *state ownership of land and capital* (means of production) and *administrative allocations of resources carried out through national plans*. In other words, the planned economy was based on state regulation of all economic activity (Nilssen 2002:62). Plans were set to meet political goals and were not always mindful of what was economically possible. During Stalin's reign the planned economy ensured a rapid economic development, catching up with capitalist enemies at an impressive pace. The Soviet economy developed from being primarily based on agriculture to an industrial and urban economy. However, the very mechanisms that ensured this rapid economic growth were the same mechanisms that later led Russia towards backwardness and stagnation. The reason for this was that the planned economic system was close to impossible to operate and very resistant to change. The result was that the Soviet Union had locked itself in a model of economic development that over time was less able to ensure economic growth (Robinson 2013:15-19).

4.1.1 Peculiarities of the planned economy

North (1991:97) points out that "*institutions provide the incentive structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation, or decline.*" The planned economy developed a fundamentally different incentive structure compared to market economies. For example, in capitalist markets the value of goods is mostly set impersonally. This means that buyers and sellers can choose where they trade, and prices of goods are determined by supply and demand, costs of production, and costs of raw materials. Furthermore, the value of a good is expressed in a common, generally accepted unit of exchange, namely money. Consequently, all economic exchange in a national market economy has common or universal characteristics, and similar goods can be bought for approximately the same price across the national market, and paid for with the same unit of exchange: money. When goods are measured in their monetary value, they can be compared to one another, and resources valued in terms of money can be evenly taxed by the state across the economy (Robinson 2013:20-21).

In the Soviet planned economy, on the other hand, the monetary value of goods was assigned by the state. Prices were arbitrary determined by central planners without regard for the cost of supply and demand, and political goals were given priority over economic costs.

All production was subsidized by the state, and prices and monetary value were often nominal, which meant that economic success or failure was not measured in monetary terms. This made it impossible to calculate profit and loss of economic activity, which further led to the fact that budget deficits rarely resulted in bankruptcy. The single most important goal of the Soviet economic system was to execute the economic goals set by the state, so if a firm went bankrupt it would receive increased subsidies from the state in order to maintain production according to plan. Consequently, money was to a large degree detached from economic activity, and most distribution of goods and services took place through plan allocations provided by the state. However, due to shortages and planning inefficiencies within the Soviet economic system an additional or alternative system of exchange developed, functioning parallel to the rigid planned system of economic exchange (Robinson 2013:21-22). This system is commonly known as *blat*.

4.1.2 *Blat: A system of relational capital*

The rigidity and the shortage problem of the planned economy forced individuals to satisfy their needs through informal exchanges. In other words, strong informal institutions developed during the reign of the Soviet Union. The function of these informal institutions, or informal practices as Ledeneva (2008:118-119) calls them, in the planned economy were to compensate for shortages and defects in the state distribution system. Blat, then, is “*the use of personal networks and informal contacts to obtain goods and services in short supply and to skirt formal procedures*” (Ledeneva 2008:120). This coincides with the category of accommodating informal institutions (see Table 2.3). Because of the rigidity and restricted nature of the formal rules individuals turned to informal institutions, through personal networks and blat, in order to fulfill the needs that were unattainable through formal institutions. This was strictly not a legal system of exchange, but it enabled actors to find a way around formal procedures, and to ensure that the needs that formal rules could not fulfill were satisfied through informal channels (Helmke and Levitsky 2004:729).

In result, economic transactions within the Soviet economic system were *particularistic*; each exchange as well as the value of the goods of exchange was unique, unlike economic exchanges in a national market economy. Within this informal system, as well as in the official system, these transactions took place without reference to the monetary value of the goods being exchanged. Such particularistic exchanges were highly personal, based on acquaintance, mutual affinity and trust rather than on a desire to make profit and avoid loss, as

would be the case in monetized capitalist economies. Consequently, the most important form of capital for economic actors in the planned economy was not financial capital (money) but *relational capital*. In order to serve the needs of personal consumption and material welfare personal ties, connections and mutual aid were exercised at the expense of public resources. Access to economic resources came not from the possession of money but from personal connections (Robinson 2013:22).

In sum, during the Soviet Union the institutional framework was based on rigid formal institutions and strict state control. These formal institutions were accompanied by accommodating informal institutions largely based on relational capital and personal connections. The features of this type of economy can be recognized in Figure 2.1, which illustrates relationship-based, personalized exchange. As mentioned in the beginning of this chapter, a well-developed formal institutional environment is able to create a level playing field for economic players, where no one enjoys undue privileges or suffers disadvantages. The rigid and static qualities of the Soviet formal institutions, combined with strong and particularistic informal institutions based on relational capital created an unlevelled playing field for economic players in the planned economy. As indicated in Figure 2.1, in an exchange system based on relational contracting the benefits will exceed the costs of transaction up until a certain point in time. After this critical point in time the absence of well-functioning formal institutions limits the ability to develop a more complex exchange system because of the resource demanding nature of personal exchanges. This fact illuminates the flaws of the planned economic system, and provides an explanatory factor for its stagnation and eventual breakdown.

4.2 Economic transition: From planned to market economy

After the dissolution of the Soviet Union in 1991 the Russian government initiated radical economic reforms or “shock therapy” aiming to transform both the Russian economy and society. The goal was to use the market to change society, breaking up existing blocks of economic power and replacing them with new social forces loyal to the government. In other words, the reforms did not deal with relative backwardness directly, but aimed to change the nature of Russian economic society by creating profit-seeking enterprises, independent from the state, through rapid privatization of state property. This was intended to result not just in capitalism, but in political freedom as well, which had been constrained by the state during the reign of the Communist Party. International financial institutions and governments

supported these reforms, since it looked like the shortest route to investments from overseas. The reforms promised a central state in a dominating position and a change and recovery of the Russian economy (Robinson 2013:23-24; Pavlovskaya 2013:1299-1300). Unfortunately, the reforms did not live up to its expectations.

4.2.1 Institutional failure and state capture

Based on the ideology of the “Washington consensus”, Russia’s first president Boris Yeltsin initiated minimal state activity and an economic reconstruction based on competitive market-led forces. The economic transformation had three major domestic components: (1) to introduce a market system of prices, (2) privatization of assets, and (3) the reconstruction of (state) enterprises (Lane 2008:177). The idea was that private property would generate profit-maximizing behavior and privatization would automatically result in capitalism (Pavlovskaya 2013:1299). This rapid shift in formal rules, from a planned economic system to a capitalist one, was problematic since the people within these systems had no experience with the workings of a capitalist system. As I have highlighted in previous sections of this thesis, formal institutions may change rapidly, but changes in informal institutions are incremental. This imbalance between formal and informal institutions in Russia in the 1990s had catastrophic consequences.

Even the initiation of a capitalist system provided Russia with an unfortunate point of departure. The transfer of state assets to the public domain was legitimated by saying it would make everybody richer. This stands in contrast to the development of capitalism in the West, where the incentive for personal ownership of productive resources was related to the propensity to invest or to accumulate wealth. In post-Soviet Russia the incentive for personal ownership was to increase personal assets for individual gain. This attitude became symbolic of the state of the Russian economy in the 1990s, where Russian oligarchs enriched themselves through devious methods at the expense of the rest of the economy. By transferring state assets to the public domain through a system of “loans-for-shares”, the government got credit from banks formed by entrepreneurs, using industrial assets as collateral. This meant that if the loans were not repaid the lenders were given assets free of charge (Lane 2008:177-179). The oligarchs’ hunger for state subsidies and subsidized credits put the government in a “state capture”, where the wealth and power of a small number of actors sitting on very large and powerful financial-industrial enterprises reached all the way into the Kremlin. This not only compromised the legitimacy of the government, but it also

disorganized the entire economy since the success of the oligarchs gave them the power to “capture the state” and shape policy making, regulatory and legal environments to their own advantage, skewing distribution in their favor and at the expense of the rest of the economy (Puffer and McCarthy 2007:5; Åslund 2002:2; Cappelli 2008:539). This combination of ineffective formal rules and informal institutions that obstruct these rules corresponds with the category of competitive informal institutions (see Table 2.3). The new formal rules, laws and procedures were not systematically and effectively enforced, which gave actors the opportunity to ignore and violate them. Hence, the role of informal institutions in interaction with formal institutions had been altered from being accommodating under the system of planned economy, to becoming competing under capitalism.

The chaos economy of the 1990s was a product of communal economic traditions, both pre-Soviet and Soviet in origin. Since private property in Russia has a short and disrupted history, Russian actors interpreted private property in light of their experience with other practices of property. This includes the particularistic, informal and non-monetized economic systems of the planned economy. The continued use of and development of these Soviet systems of exchange complicated the implementation of the neoliberal model based on Western market economies. The privatization process in Russia turned out to be a much more open-ended process than intended, and a simple shift from “plan” to “market” proved to be problematic (Pavlovskaya 2013:1301; Lane 2008:177). This underscores the importance of the cultural-cognitive element of institutions, and the essential role that institutions play in the economy. In Russia, the primary legacies have been behavioral patterns, referring to the attitudes and the understandings of the economic environment. In order to survive within the new and unclear framework of the new economy, economic actors still relied on traditional trade partners and traded through networks that had survived from the Soviet era. These trade relations were still to a large extent based on barter trade and non-monetary terms, building on the legacy of particularistic exchange in the planned economy (Ericson 2001:295-296). This also coincides with Peng’s (2003:281) (see Figure 2.3) notion that the transition from a relationship-based to a rule-based transaction structure is an incremental process, and that at the initial stage of the transition to a rule-based structure, the economy will be predominantly relationship-based.

4.3 Implications of Russia's legacy: A low-trust society

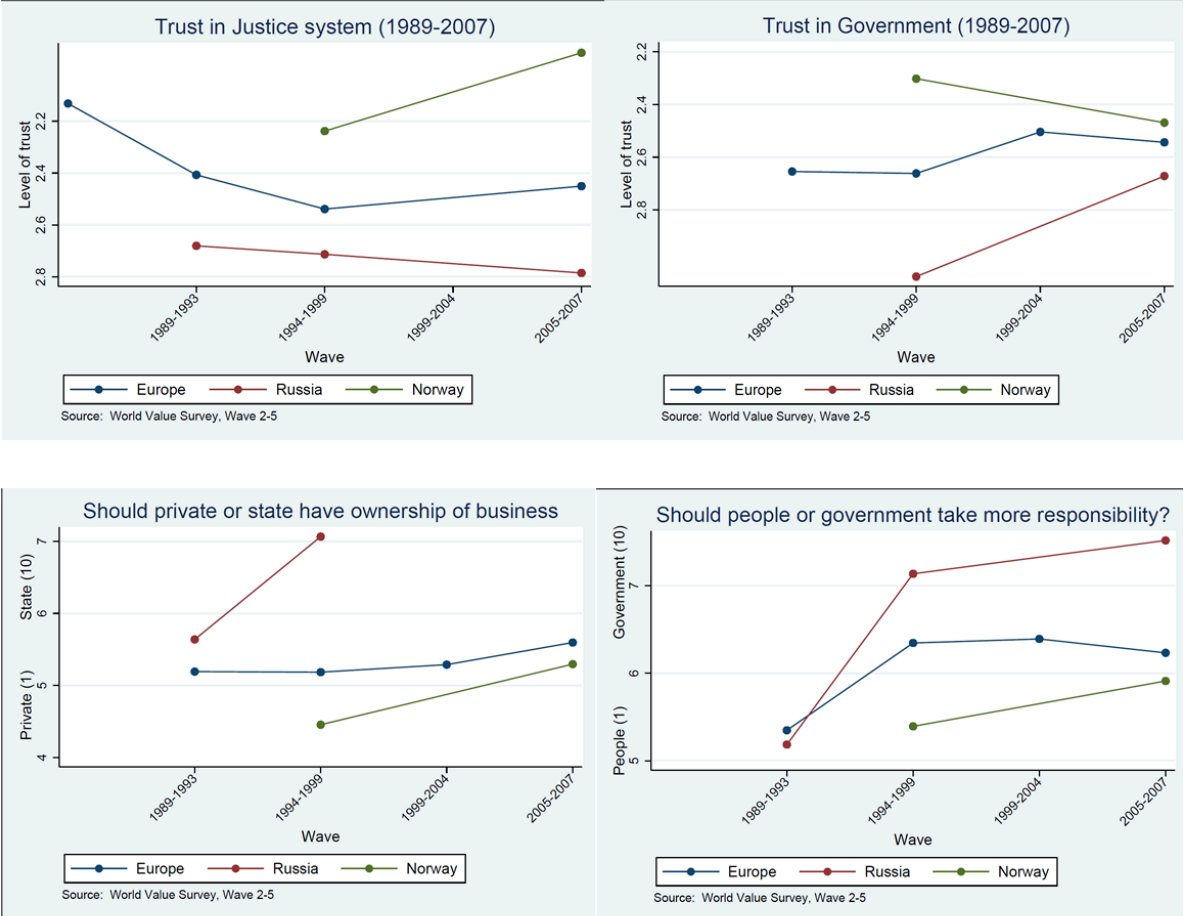
I have accounted for Russia's institutional legacy and its effects on the implementation of capitalism after the breakdown of the Soviet Union. I would now like to elaborate on what implications this institutional legacy and institutional environment has on the level of trust in Russian society. In this section I will introduce some quantitative data to illustrate this phenomenon, and I will also for the first time apply my qualitative interview data to highlight the issue of trust. In the foregoing paragraphs I have shown how the Russian economic system traditionally has been based on particularistic rules of exchange rather than generalized rules of exchange, and relational capital has been prioritized over financial capital. The development of such a system of exchange has also had implications for the general level of trust in the rule of law, in public agencies and formal rules and procedures.

As I have already established, the role of formal institutions in a well-functioning economy is to reduce transaction costs by enforcing contracts and property rights. This removes the need to spend time and resources on building relationships of trust among individuals, organizations and firms that are in business with each other. The role of formal institutions, then, is to facilitate transactions based on generalized trust, rather than particularized trust in specific individuals. Western institutions are generally built on the basis of generalized trust in the government, regulatory agencies, the judicial system, as well as other formal institutions, indicating that the same rules and laws apply to all. In Russia, however, these institutions are poorly developed. Moreover, because of Russia's institutional legacy there is a strong cultural tendency to distrust individuals, groups and organizations that fall outside personal relationships. Russia has traditionally been and remains to be viewed as a low-trust society, where trusting relationships exist within in-groups of family members, friends and colleagues (Puffer et al. 2010:448-449).

Trust is inherent in the cultural and institutional context of a business relationship, as well as in the social norms and cultures of the parties in the relationship. The reality in Russia is that formal rules are contradictory and unstable, and enforcement is lacking, resulting in a high level of uncertainty. This lack of trust in formal institutions and outsiders, exacerbates the Russian tendency to instead rely on relational trust rather than formal rules of behavior (Puffer et al. 2010:448-449). In order to illustrate Russia's low trust in formal institutions I have made four graphs from cross-tabulate analyses (Figure 4.1) of Russian people's general trust in public agencies. The analysis compares Russia, Norway and the mean of Europe in the

time period from 1989 to 2007⁴, and looks at trust in the justice system, trust in government, public opinion about state ownership of business, and public opinion about the level of government responsibility. The analyses are based on a dataset from World Value Survey (WVS 2009).

Figure 4.1: Trust in formal institutions in Russia Source: (WVS 2009).



The first two graphs show that Russia has the lowest score on trust in formal institutions (here represented by justice system and government) in all time periods compared to the European mean and Norway. Trust in the justice system has remained stably low in Russia with a slight decline throughout the three waves with available data, while trust in

⁴ Each point on the timeline in the graph illustrates the available data on the different time periods. I have missing data on the variable “Trust in Justice System” on Norway from 1989-1993 and from 1999-2004, and on Russia from 1999-2004. Missing data on the “Trust in Government” variable are on Norway from 1989 to 1993 and from 1999 to 2004, and Russia has missing data on the same time periods as Norway. On the variable “Should private or state have ownership of business” there are missing data on Norway from 1989 to 1993 and from 1999 to 2004, and on Russia the only available data is from 1989 to 1993. On the last variable “Should people or government take more responsibility” there are missing data on Norway from 1989 to 1993 and from 1999 to 2004 and on Russia from 1999 to 2004.

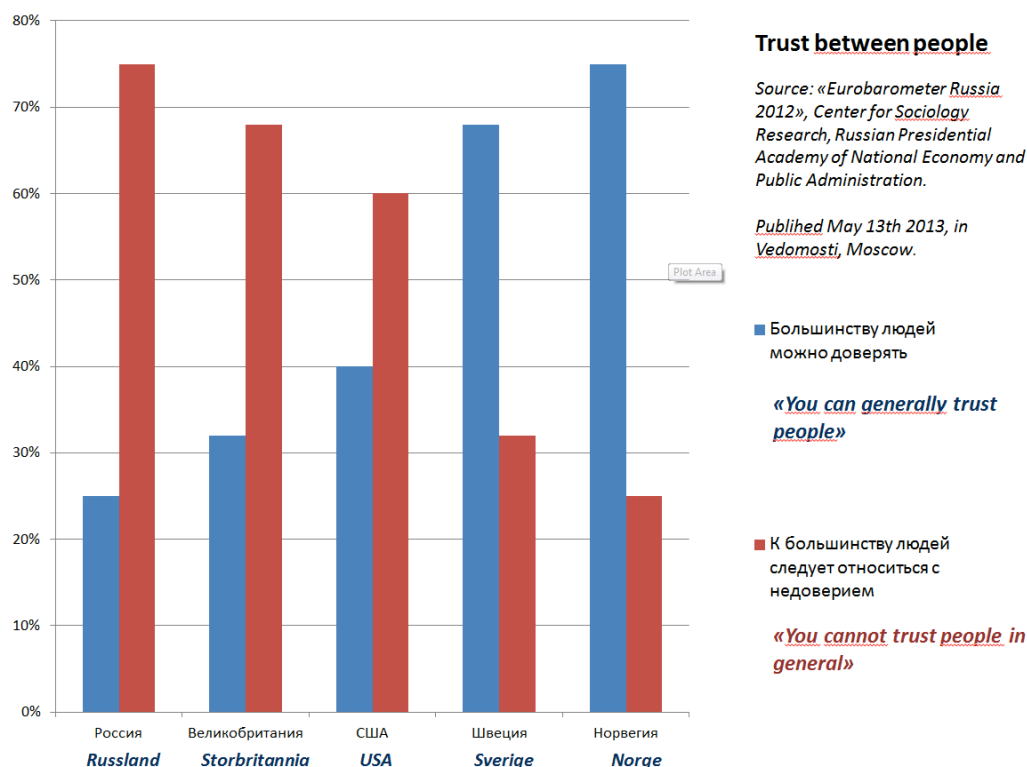
government has increased on the two waves with available data on Russia. Despite this increase, the level of trust in both the justice system and in government remains lower than the mean of the level of trust in Europe and much lower than the level of trust in Norway.

Paradoxically, the next two graphs show that even though the level of trust in formal institutions is low, people still want the state to be a dominant actor in the economy and expect the state to take responsibility. Except for the first wave showing that the Russians think that people should have larger responsibility than the state, the graph shows higher levels for state domination in business and state responsibility than in the EU and in Norway. Unfortunately, the graph showing opinion on state ownership of business lacks data on the last two waves (1999-2007) for Russia. These findings demonstrate the tendency in Russia for low generalized trust, in other words, low levels of trust in formal institutions. The quantitative data underscore my argument in the previous section, namely that Russia's historical legacy of relationship-based exchange, as well as low trust in formal institution has had an impact on the implementation of a new political and economic system in Russia, and that this legacy still plays a role in the continued development of the Russian institutional framework for the Russian economy. Furthermore, the paradox that people nevertheless desire more state intervention in business and expect a great responsibility of the state is arguably a product of the well-established tradition for a strong state in Russia and the long Soviet legacy of a state that has penetrated all aspects of society⁵.

Russia as a low-trust society entails not only low levels of trust in formal institutions, but also low levels of trust in outsiders in general. This has important implications for economic transactions. Since particularized trust for a long time has been a trademark of the Russian exchange system this means that building strong personal relations with trade partners is still important in Russia. In order to illustrate this, consider Figure 4.2 below. This is a comparison of Russia, Great Britain, USA, Sweden and Norway in a survey examining the level of general trust in people (Stepantsov 2013). Russia and Norway are on opposite ends of the spectrum, where in Russia the general level trust in people is very low (75 percent) and in Norway it is very high (75 percent).

⁵ The reason for the rise in people's wish for more state ownership and more state responsibility is arguably related to the poor performance of the Russian economy in the 1990s, and the economic crisis of 1998, which had fatal consequences for Russia.

Figure 4.2: Trust between people Source:(Stepantzov 2013).



In one of my interviews this statistic was brought up, and Respondent 7 offered an explanation for the huge deviation between Norwegian and Russian levels of general trust in people:

“I would also like to say something about Norway according to these statistics. I would not say that Norwegians are particularly open hearted and naïve, running around and signing off on anything without some previous knowledge. In my experience, Norwegian businessmen have a healthy skepticism. The reason that Norway comes off the way they do in the survey is because we have a different understanding of the risk involved in trusting someone. If something should happen, we are used to having someone around that can step up, and that we can get a fair treatment from a third party. Therefore we can take that risk of trusting someone. If that security does not exist, and if you have no expectation of someone coming to your rescue, then it is natural to feel that you can’t trust anyone. Then trust is much harder to establish. Therefore, Russians spend a lot of time establishing trust, because they know that if something should happen they have no

control over the outcome. So therefore, the issue is more about trust in external systems than about trust in people in general”.

The argument that Respondent 7 makes coincides with points made by several of the other respondents. The different conception of trust seems to be a consistent challenge between Norwegian and Russian businessmen. Respondent 8, who has decades of experience with the Russian market, illustrates the instinctual skepticism that is required in order to survive on the Russian market:

“The big difference is that in Norway they have far too strong trust, and in Russia they have none. In a sense, both these systems have overdone themselves. In Russia they don’t trust anyone at all, while in Norway they trust blindly... When I lived in the West I trusted most people, but I’ve learnt one thing: Now I don’t trust anyone! It is a better starting point to trust no one, rather than starting out with trusting someone blindly. Then you can start out more defensively. I have learnt that you have to think this way in Russia.”

These quotes illustrate the uncertainty and the risk involved in economic transaction in Russia, which is an indicator of poorly developed formal institutions and a lack of generalized trust. Ledeneva (2013:11-12) points out that networks and informal institutions did not cease to exist with the dissolution of the centralized system. On the contrary, they increased during the transition period. Informal networks compensated for the defects of the market, and low levels of impersonal trust in formal institutions were balanced by strong interpersonal trust. I will now look closer at what implications these developments had for one industry in particular, namely the fisheries.

4.4 Developments in the fisheries sector: From national plan to national plunge

“Fish becomes rotten from the head.”

- Russian proverb

The Russian proverb above indicates that the situation in the fisheries is closely connected to the existing state of affairs in Russia as a whole. I will now take a look at the developments in the fisheries sector to provide an example of the institutional developments in Russia. This section will focus on the main institutional changes that took place in the sphere of fisheries management in order to illustrate how changes in Russian institutional arrangements affect the behavior of industrial actors.

4.4.1 The Fisheries in transition

During the Soviet Union the sole purpose of the fishing industry was to serve and supply the domestic market with fish and fish products. In order to accomplish this task the individual members of the industrial associations behaved in accordance with national plans, supplying no more fish products than prescribed. The industry was dominated by a small number of large state-owned fishing fleets, which were heavily subsidized. The planned economy was organized according to the sector principle, which meant that all functions related to the fisheries were incorporated under the Ministry of Fisheries. Furthermore, the country was divided into five main fisheries regions. All activities related to the fisheries in each of these regions were supervised by a regional management body that served as an extension of the Ministry of Fisheries in that region (Nilssen and Hønneland 2001:316; Jørgensen 2009:88). In other words, the fisheries management structure of the Soviet period was built as a hierarchic structure, with the Ministry of Fisheries at the federal level as the main institution responsible for the organization of the activity of fisheries in all the different regions (Ivanova 2005:46).

After the disintegration of the Soviet Union, from 1990 to 1993, the fisheries industry underwent a rapid privatization and spontaneous decentralization. The sector-based Soviet system of management was abolished, productive and management functions were split from each other and the process of fragmentation continued within these two spheres. The Ministry of Fisheries was abolished and the State Committee for Fisheries was established as its successor. Only in the course of a few years most of the fishing fleets were split up into several smaller companies. The general tendency of profit maximizing behavior in the Russian transition economy inevitably found its reflection in the fishing industry as well. The focus of this sector changed from taking responsibility for food supply to the domestic market to orienting itself almost exclusively towards high-profit activities. The large scale privatization of the Russian economy and the rapid disintegration of the Soviet monolithic fisheries complex led to a dramatic change in the incentive structure of a large number of actors in the fishing industry. Without the support of state subsidies and production plans the industry suddenly to a much larger extent than earlier depended on their actual catches (Hønneland 2004:171; Riabova and Ivanova 2009:86). This rapid change in the institutional framework within the fisheries was hard to deal with for the actors involved in the sector, as Respondent 5 explains:

“In the past the fleet belonged to the government and the country, and its distribution was not based on economic laws, but rather on fixed prices. This could mean losses for the producers. Now they are trying to monitor the situation all around. The fishermen who sell fish to the Russian market do not feel too good because of competition, and that it is a quite difficult market. The pelagic market is quite tough, margins are very, very small, and the market is sensitive to changes.”

The respondent is indicating that the actors involved in the fishing industry were thrown into a new system, based on market economic principles, which they were not accustomed to. The fishermen had for decades been a part of a system without competition and profit maximization, and the transition to a new system discarded all their previous knowledge of how their industry worked, forcing them to adapt to a new system where the rules of behavior was unknown and unfamiliar to the actors involved.

In order to make profit, fishing companies sold certain high-profit species (mostly cod) to neighboring countries such as Norway, Japan and Korea, and stopped delivering cheap fish products domestically. This proved to be much more profitable since foreign buyers were able to pay higher prices for the products, and because it was cheaper to land the products in foreign ports. The vessels that were landing their catches in Russia were subject to time-consuming and often very costly procedures from as many as fifteen to twenty-five different control bodies. With most of the catches from Russian fleets being delivered to foreign ports, this had fatal consequences for the land based fishing industry, such as production and processing factories. The modes of production were old-fashioned, over-dimensioned and outdated and they lost the competition for raw materials to foreign companies (Nilssen and Hønneland 2001:315; Jørgensen 2009:89.90), or as Respondent 5 put it:

“I can say that the Russian fleet is not modern, it is quite old. The quality of vessels is poor, the machines and equipment is poor and they need money to renovate this. The owners who are smart get money and invest in their production facilities. But it is not possible to compare the Norwegian and Russian fishing fleet, it will be like comparing Mercedes and Russian Lada.”

Ultimately, the result of the transition from a planned to a market economy for the fisheries was high unemployment and low supplies of foodstuffs to the domestic market. The industry went from being a cornerstone of the planned economy during the Soviet Union, to

being unsustainable within the transition economy, creating dependency on imported goods in an arena where Russia previously had been self-sufficient (Nilssen and Hønneland 2001:315; Jørgensen 2009:89-90). Respondent 5 highlights the troubling times of the fisheries in the transition period:

“Fisheries were one of the main parts of the Russian industry that was important for the country. The majority of fish that the fisherman caught was distributed around Russia. This was in the USSR times. After the USSR this was broken. There were no investment to the fisherman fleets, and the fisherman fleet was getting older, so no developments, and no new things. So for a long time, for many years, Russian fishermen were suffering through quite hard times.”

4.4.2 Post-Soviet fisheries management: Institutional implications

An important reason for the unfortunate developments in the fisheries is related to the lack of coherence in the Russian institutional arrangement. Along with the privatization program and the implementation of capitalism in Russia followed dramatic changes in the institutional framework. For instance, there was no longer any federal or regional responsibility for the existence of the Russian fishing industry. This also meant that all governmental and regional transfers of money and resources were stopped, and the formal right and ability of central and regional government bodies to impose on decisions in the fisheries ceased to exist. Furthermore, during the planned economy structural developments, maintenance and upgrading of production material were supplied through the planning system. With the dissolution of the latter, these systems and functions disappeared and the development of the industry was left to the individual actor. As a result of this, the only surviving party of these reforms were the fishing companies, who were completely dependent on the successful persistence of cod fishery and sales of fish to foreign markets (Nilssen and Hønneland 2001:320-322).

Domestically, changing interests and shifting alliances within different governmental bodies characterized fisheries management. The post-Soviet period has been characterized by power battles, both between different ministries at the federal level, and between the center and the regions. The State Committee for Fisheries wanted to regain its former status as a powerful body at the ministerial level. However, other federal bodies, such as the Ministry of Economic Development and Trade, the Ministry of Natural Resources, and the Ministry of

Agriculture, attempted to rescind the Committee's exclusive power to rule the fisheries. This struggle between different federal bodies severely weakened the capacity to produce any fundamental legislation for fisheries management. Furthermore, this period was influenced by a battle for power between the center and the regions. While the Committee was fighting to regain its former high status of a powerful body, the administrations of the regions battled to secure their role in fishery governance. Some regional administrations claimed their right to take part in fisheries government, and demanded a say in quota distribution. Similar to the general tendency of the power-relationship between the center and the regions in the transition period, the regions managed to acquire some important responsibilities at the expense of federal control over the fisheries sector ⁶ (Riabova and Ivanova 2009:87-88).

The lack of consensus between main players on core management principles and values made it extremely hard to develop a stable legal and institutional framework for the fisheries sector. This lack of stability weakened both the ability and the willingness of the industry actors to play by the rules. Furthermore, the State Committee for Fisheries has had a reputation for being notoriously corrupt, and since the early 1990s the head of the committee has been replaced on average once a year. Still, the position has been popular among high-profile politicians and bureaucrats, since the job is associated with a high potential for personal enrichment. Because of this extreme tendency for corruption there has been a continuous demand for reform, and the state committee has been through eight major reorganizations since 1991, with changes both in its status and in name. This has only made formal rules and structures more unclear for industrial actors, and the fisheries ended up in a "vicious circle of reforms" (Jørgensen 2009:91-92), being completely unable to create any form of stable, clear and transparent formal institutional framework for the workings of the fisheries.

In sum, the transition to capitalism had grim consequences for the fisheries. The survivors were the fishing fleets, which achieved high profits by delivering fish to foreign ports. This had fatal consequences for the domestic processing industry, which suffered under an institutional framework that was corrupt, inefficient, unproductive and unable to enforce formal rules and legislations. This inadequacy of formal institutions created a formal

⁶ Some regions, like the Murmansk Region in 1993, managed to acquire the responsibility of the total Russian share of the Barents Sea quota, transferred from the State Committee for Fisheries (Riabova and Ivanova 2009:87-88).

institutional void, creating space for informal institutions that encouraged rent-seeking behavior, opportunism and corruption. This underscores the argument that I have previously established, namely that the category of competing informal institutions developed during the 1990s, due to a weak and poorly developed formal institutional framework.

4.2.3 Implications for trade relations

The inability to ensure domestic supply of fish products resulted in imported fish products occupying a large share of the Russian seafood market. Norway became Russia's biggest supplier of fish, with an export growth from NOK 490 million in 1990 to almost NOK 800 million in 1991. During the following 10-year period the export of farmed fish from Norway grew from 6 percent to about 60 percent of the total value of Norwegian seafood exports to the Russian market (Elvestad and Nilssen 2010:273-274). In other words, in a country that had traditionally been self-sufficient in fish supply, Norway now became an indispensable supplier of fish products to the Russian market. However, it proved to be challenging for actors connected to this trade relation to familiarize with the Russian market. Poor formal institutions also dominated the sector for imports of seafood products, resulting in chaos and corruption.

Several of the respondents, both exporters and importers, describe the situation in Russia in the 1990s and early 2000s as extremely chaotic, characterized by illegal transfers through tax paradises, laundering of money and corruption. Respondent 8, an importer of fish products on the Russian side, provides a description of the chaotic situation:

“It was cowboy style. There were extremely high degrees of tax fraud, customs fraud etc. Salmon was imported as herring, since herring had a lower price and a different custom code. It was extremely hard to compete, because you didn't know how much your competitors were paying in fees. The market was entirely non-transparent... All fish was traded through tax paradises. Before 2006 there was no actual export of fish from Norway to Russia, because all the fish was billed through tax paradises, such as the Virgin Islands, Saint Bart's and all those places. This meant a huge loss of money for the Russian state. There was practically no collection of taxes, since everybody did this. It was standard procedure.”

This indicates that Russia's formal institutions were in such a poor state that they were actually unable to collect taxes and create an even playing field for economic actors. Trade

relations were characterized by tax fraud, corruption, and unclear and unstable terms of exchange. As a result of this, informal institutions and network relations became increasingly important in trade relations. Some of the respondents highlight the importance of relationship building in trade relations with Russia. Respondent 1, a Norwegian exporter explains:

“On my first trip over there [to Russia] in 1998, this whole thing with relational building was huge in Russia. When we came back we had discussed very little business, and everything was very much based on building relations. There was an unbelievable drinking and partying culture, and an expectation that we should become friends. And the issues concerning the actual trade... Let’s just say that that was not what was most important.”

This quote underscores the issue of trust in Russia, which I have elaborated on in previous sections (see Figure 4.2). Because of the poor state of Russia’s formal institutions and the unpredictable nature of formal rules and laws, economic actors in the Russian transition economy were largely dependent on creating stability and predictability in economic exchanges through informal institutions such as personal networks. This coincides with Peng’s model (Figure 2.3) explaining the transition from a relationship-based, personalized exchange system to a rule-based, impersonal exchange system. As Peng (2003) and North (1990) emphasize, the transition from a relationship-based to a rule-based exchange system is an incremental process, and even though the formal rules and institutions may change rapidly, the ability of economic actors and informal institutions to adapt to this new institutional framework happens gradually and with time. The behavior of actors within the fisheries in the Russian transition period of the 1990s can be explained by the logic utilized in the theory chapter: Since formal institutions were so poorly developed they were unable to fulfill their function of creating stability, predictability and securing the rules of the game in economic transaction. As a result of this, economic actors resorted to informal channels in order to reduce uncertainty in economic interactions.

Furthermore, the inability of the state to act as a third party enforcer of formal rules and laws resulted in a decrease in the possibility of sanctions for opportunism and rent-seeking behavior. In the fisheries sector a myriad of often short-lived companies popped up, staffed by people who were seeking their luck – aiming to earn big money, quickly. These were often people with little relevant experience or education. Several of the respondents

characterize Russia in this period as a “land of opportunity”, and many Norwegian seafood producers saw an opportunity to establish themselves in a new and promising market. Respondent 1 remarks the large number of companies operating in the 1990s and early 2000s:

“Earlier there were a lot of the same people involved in the fisheries business, but there were constantly new companies popping up. Companies disappeared, and new ones popped up with the same people involved.”

With the formal rules of the game being so unclear and poorly enforced, and with countless companies popping up and trying to get their share of the cake, Russia developed into a “dumping market”. The openness and lawlessness of the Russian market attracted exporters who saw the opportunity of selling low-quality fish for high profits. In other words, because of the lack of stable and solid formal institutions able to secure market rules, opportunism and rent-seeking behavior was thriving. Respondent 2, a Norwegian exporter, explains:

“We didn’t start exporting to Russia until 2005, but I remember that earlier the attitudes of some exporters were “let’s just send the shitty products to Russia”... I remember this very well. In the beginning of the 2000s there was a lot of weird stuff being sent to Russia. You know, Russia was a new market, it was exciting and everyone had access to it. So then one person buys fish from a second guy, who sell’s it to a third guy, who sell’s it to him, and then to her, and then they sell it to Russia. So the products that finally came to Russia were old products that didn’t fulfill the requirements that they should have.”

The quotes above give an insider’s perspective and concrete examples of the state of institutions in the transition period of the 1990s. They illustrate how a poorly developed formal institutional framework can contribute to extreme opportunism and rent-seeking behavior. In Russia, the legacy from a largely relationship-based exchange system made the transition to a rule-based exchange system very problematic. In line with the theoretical assumptions, the respondents exemplify the implications of underdeveloped formal institutions, namely that informal institutions become increasingly important. As the first quote by Respondent 7 illustrates, when there is no formal system to create security and predictability in economic transactions, you need to spend huge resources on establishing trust with your business partners to reduce the costs of exchange. In this way, stability and

predictability is created through informal institutions and relational capital, rather than through generalized rules and formal institutions. These are symptomatic features of Russian institutions during the transition period of the 1990s. However, with a change in presidents, and the emergence of Vladimir Putin as a powerful political character, changes in the institutional framework were looming.

Chapter 5: From state capture to business capture: Establishing the power vertical

“Today there is too much government involvement in property ownership, entrepreneurship and, to some extent, consumption. On the other hand, the government remains passive when it comes to the creation of a single economic space in the country, the mandatory enforcement of laws, and protection of property rights.”

- President Vladimir Putin, July 2000 (Jeffries 2011:16)

This quote by president Putin is a fitting illustration of the change in attitudes toward the role of the state in the market in Russia in the early 2000s. It is also an acknowledgement of the fact that after the Yeltsin period, stronger formal institutions able to articulate and enforce formal rules and laws, and protect property rights were urgently needed. In the 1990s, most Russians suffered under economic depression, the collapse of social welfare structures, and the concentration of wealth and power in the hands of a small group of tycoons. Therefore, the economy that Putin inherited had few of the institutions needed for a successful market economy: The regulatory bodies to referee market competition were biased, law enforcement and judicial bodies were unable to enforce contracts and property rights, financial markets were not capable of allocating capital efficiently, etc. (Remington 2012:191-192). In other words, formal institutions were unable to create stability and reduce uncertainty in economic exchange. The change in presidents and the emergence of Putin as a powerful figure in Russian politics is a critical juncture in Russian political and institutional development.

5.1 Administrative reform and stronger state control

In reaction to the chaos and mismanagement of the 1990s, the newly elected president Vladimir Putin vowed to take control of the country and bring back prosperity and stability through measures to protect property rights, tackle corruption and spur economic growth. The socio-economic conditions did indeed stabilize under Putin, real incomes grew and the government gained more control and legitimacy. However, this newborn state control came at the expense of individual freedoms and democratic institutions, since the state expanded its control over economic and political activities (Shkolnikov 2008:100).

5.1.1 Political consolidation and centralization

Putin's strategy after his inauguration as president was to distance himself from the "democratic" Yeltsin administration, which was associated with chaos and corruption. At his first address to the Federal Council, Putin did not once use the word "democracy", but focused instead on the need for rebuilding a great nation, focusing on economic growth, raising the standards of living and consolidating state control (Shkolnikov 2008:108). At the heart of this vision was state reform and Putin applied terms such as *vetikal'naya vlast'* (vertical of power), *diktature zakona* (dictatorship of the law), and *upravlyaemaya demokratiya* (managed democracy). Through these articulations, he hinted at a trade-off between liberty and stateness, where centralization of power and enforcement of law and order were essential factors in rebuilding Russia as a great and powerful nation (Cappelli 2008:552).

During the 1990s, privatization and decentralization had provided great political and economic power to Russia's regions. In several cases, subnational governments had managed to make an arrangement with the federal government, allowing them to avoid transmitting collected taxes from their republic to the central government. Through bilateral agreements with the central government, the regional governors had become very powerful, which created a competition for power between the center and the regional powers. With the Russian regions not aligning with the formal rules of the federal state, Putin made it his top priority to recentralize power over the federation and clear up the mess of the Yeltsin period. In order to do this, one of his first measures was to remove the governors' seats and the parliamentary speakers from the upper house, and turn the Federal Council into a political body consisting of rubber-stamping presidential appointees, stripping them of virtually all political power. Furthermore, Putin pushed through a law that enabled him to remove sitting governors that refused to bring regional laws in line with the federal constitution and federal laws.

Another measure to gain control over the Russian regions was the creation of seven new "federal districts", each of which had a special presidential representative, who was supposed to monitor the laws and actions of the local governments in certain regions. This law was implemented to strengthen the control over the federal bodies of the regions, since these agencies in the 1990s tended to fall under the influence of dominant governors. Finally, in 2004, the direct gubernatorial elections were abolished, being replaced with a system where

governors are recommended by the president and ratified by the regional council⁷. Earlier, the manipulation of direct elections had played a crucial role in providing regional leaders with a firm grip on local power. By restraining electoral democracy, and removing the opportunity to directly elect governors, Putin took a great step towards *vetikal'naya vlast*, strengthening the power vertical (Remington 2012:73-80; Sakwa 2008:139; Desai 2005:102; Cappelli 2008:553).

Another clear tendency that developed under Putin's presidency, especially from 2004 when Putin began his second term, was the emergence of a dominant political party, that of *Yedinaya Rossiya*, or United Russia. Putin had taken measures to shrink the political space and reduce political competition by consolidating a united and powerful political party that was loyal to the president. In order to do this a law was passed that eliminated the single-district plurality voting system, requiring members of the State Duma to be elected fully by closed party-list proportional voting. This prevented voters to vote for individual candidates, and moreover it eliminated the opportunity of independent candidates to be elected to Parliament. Additionally, the political strength of United Russia was increased by raising the electoral threshold from 5 percent to 7 percent, limiting small opposition parties' opportunity to get a seat in Parliament, as well as passing a law that prohibited members of Parliament from switching parties. The consequences of these laws have been a consolidation of a political party that is loyal to president Putin, and a party that is big enough take control over the executive initiative, the legislative process and government formation. In other words, political power has shifted; with the presidential administration and his support party United Russia within the executive branch now controlling the political agenda in Russia (Shkolnikov 2008:112; Desai 2005:102; Ledeneva 2013:69).

Putin's *upravlayemaya demokratiya*, managed democracy, has compromised the actual democratic function of Russia's political system for stronger central control over the political process. The attempt to align local rules with federal laws and the constitution, the restraining of regional governors' power to reduce corruption and regional lawlessness, and the reduction of political competition in order to create a more efficient political machinery is

⁷ Popular election of governors was reintroduced again in 2012 after massive protest against this law. However, in 2013 Putin signed a new law that allows the regions to decide whether they want to elect the governor by a direct popular vote or if the governor is to be nominated by the president and ratified by the regional legislature (Bogodvid 2013; Roth 2012).

definitely a strengthening of Russia's formal institutions. It is also, unfortunately, a reduction in Russia's democratic capacity.

5.1.2 Implementing state capitalism

What effect has Putin's presidency and his recentralizing reforms had on Russia's political economy? In his speech of July 8th 2000, Putin stated that *"we have to recognize that the state itself was largely responsible for the growing strength of the unofficial, shadow economy, the spread of corruption and the flow of great quantities of money abroad...An inefficient state is the main reason for our long and deep crisis (Sakwa 2008:138)"*. The economic crisis of 1998 triggered a radical rethinking of the type of capitalist economy that had been implemented in Russia, and Putin signaled that the government should play an increased role in the economy. The oligarchic capitalist economy of the 1990s had been a major obstacle for Russia's transition to market economy and a more legitimate form of capitalism. Putin's unsettling threat of his 2000 presidential campaign to "liquidate oligarchs as a class" indicated that he was ready to change the power relations between the state and big business. Putin met with several of the most influential oligarchs in July of 2000, where he established that as long as the oligarchs stayed out of high politics and kept investment in Russia rather than sending money abroad, he would leave them alone (Remington 2012:203). Some found out the hard way just how serious he was.

One of the oligarchs who were ruthlessly driven out of business, and who after legal persecution was given a long prison sentence, was the oil tycoon Mikhail Khodorkovsky. He was chairman and major shareholder of Russia's largest and most successful oil company Yukos, and one of the richest men in Russia. In 2003, Khodorkovsky publicly supported oppositional political forces, and intended to run for president. This ultimately resulted in his arrest and conviction on various charges including tax evasion, fraud and corruption, and he was sentenced to nine years in prison and to pay back the \$28 billion that the company owed in taxes. The company's major assets were broken up and sold at auction, and these assets then formed the basis for the new state-owned petroleum company, Rosneft (Puffer and McCarthy 2007:1; Cappelli 2008:553).

This type of business take-over by the state was an antidote to the phenomenon of "state capture" that took place in the 1990s. With the "liquidation of the oligarchs", Putin paved the way for a new phenomenon of "business capture" by state officials. Business capture

constituted a dramatic increase in the formal state share ownership in certain strategically important sectors, such as petroleum, energy and media outlets (Ledeneva 2013:69). This entailed the appointment of entrusted state officials, who were loyal to the president, to strategic areas of big business. The emergence of these state officials and their formal and informal supervision of business signaled the emergence of a new elite of Putin's trustees on the political scene, the *siloviki* clan. The word *siloviki* stems from the Russian word for power (*sila*), and usually refers to people with military-security background, including army and intelligence personnel, leading officials of the law enforcement and power ministries, and managers from the military-industrial complex. These people had formed personal ties with Putin from his home city of Leningrad (now St.Petersburg). During the first years of Putin's presidency, people from these networks were appointed to central government agencies, regional administrations and state-controlled corporations (Cappelli 2008:553-556).

These developments demonstrate a dual state under the rule of Vladimir Putin. There has indeed been a strengthening of formal institutions through centralization reforms and measures to increase the power and legitimacy of the state. But simultaneously there has been a consolidation of informal institutions, namely the informal network of the influential *siloviki* clan that has acquired a natural network in the political sphere, with the president at the center. The growing power and influence of the *siloviki* has weakened the workings of the formal institutions that emerged in the earlier years of Putin's presidency, and it has strengthened the influence of informal institutions, which are characterized by networks (Puffer and McCarthy 2007:6-7). This marks a shift in the interrelationship between formal and informal institutions in Russia. In the Yeltsin era we recognize Helmke and Levitsky's category of competing informal institutions, where private actors were in a position to ignore and violate formal rules, largely at the expense of formal institutions. Putin's presidency, conversely, marks the return of a strong state and an increase in the power and legitimacy of formal institutions. However, through the influential power networks of the *siloviki* we still observe an important role for informal institutions. They have now become accommodating informal institutions, since they are aligning themselves with formal rules, and they are an integral part of the institutional development in Russia.

5.2 The fisheries reformed

Putin's presidency also introduced institutional changes in the Russian fisheries. The period from 2000 marked the return of fishery governance to the federal center, a tendency of centralization that is in line with the general tendency of Putin's presidency.

5.2.2 Administrative reform and stronger state presence in the fisheries

The process of reformation of the fisheries management system has lasted for decades, with the rules being extremely unstable and changing constantly. During the 1990s the federal fisheries management authority changed its institutional identity 6 times, and there have been 10 different leaders of the federal body in 10 years, with only 2 of them having professional background from the fisheries. The absence of a proper legal framework combined with the elimination of state support, faulty tax and custom policy led to the complete failure of the fisheries management practice in the 1990s and the beginning of the 2000s. This inefficiency of the existing system was a major motivation for reformation of the fisheries, and there have been several significant institutional changes during Putin's presidency, initiated by the large administrative reform that took place in Russia in 2004 (Ivanova 2005:67). These administrative reforms aimed to change the country's federal administrative structure in order to shrink federal bureaucracy, reduce duplications of work between ministries and the government's administration, and to create a more logical ministerial structure, especially regarding the relationship between ministries and their subordinate bodies.

This introduced a brand new institutional structure, also within the fisheries. The State Committee for Fisheries was eliminated, and to replace it three new categories of federal executive bodies with specific responsibilities was introduced. The State Committee's policy-making functions were transferred to the Ministry of Agriculture, while the Federal Fisheries Agency (FFA) was created to implement the policies defined by the Ministry and provide services to the population. The third category of the federal executive power was the federal services, in the fisheries represented by the Federal Service for Veterinary and Phytosanitary Surveillance (*Rosselkhozadzor*) (hereafter the veterinary service or VPSS), which was given the responsibility for all monitoring and enforcement activities in the agricultural sector, including the fisheries⁸ (Hønneland 2012:47; 2005:185; Ivanova 2005:68-72).

⁸ Ministries and state committees are different types of "independent" administrative bodies at the federal level. The ministries are placed higher in the political hierarchy since their leaders are members of the federal

Furthermore, a framework law for the fisheries was finally adopted in 2004. Such a legal framework for the fisheries had been absent throughout the entire post-Soviet period. Before this law was passed, the fishing companies had to deal with a myriad of different decrees and regulations, which were often contradictory and frequently changing. It was especially difficult to establish clear rules and criteria for the allocation of fish quotas, and since such rules were not properly established, the fishermen operated based on the notion that *“fish as much as you can today – you might not have a quota tomorrow”*. This resulted in extreme overfishing (Jørgensen and Hønneland 2013:368). The quarrels between the federal center and the regions throughout the 1990s were also a source of disorganization and inefficiency within fisheries governance. There were disagreements on whether fish should be defined solely as a federal or partly as a regional resource and during the transition period the regions gained larger influence in fishery governance.

The reforms of 2004 were supposed to establish a clearer “power vertical” also within the fisheries, and the law on fisheries created favorable conditions for the federal center, and a decrease in the possibility for regional participation in resource management within the fisheries. This also included federal control over the economically important power of quota allocation, and a more stable framework for quota allocation in giving quotas for a time period of five years (Jørgensen 2009:92-93; Ivanova 2005:74; Riabova and Ivanova 2009:89-90; Jørgensen and Hønneland 2013:368). In line with the general tendency of Putin’s recentralization, we observe a strengthening of the federal center at the expense of the power of the regions. The 2004 administrative reforms attempted to create a more vertical power structure, and to articulate clearer formal rules for fisheries management to reduce corruption and overfishing in the sector with decisions being based in the federal center.

Unfortunately, the administrative reform of 2004 did not show any significant improvement of the state affairs in the fisheries sector. The law on fisheries created turmoil within the sector, and since it was very vaguely articulated the rules of the game within the fisheries remained unclear. Additionally, the administrative reform gave rise to a number of transitional issues, and bitter conflicts between new and old federal bodies contributed to paralyzing the fisheries sector completely. In reaction to this, a reformation of the law on

Government, but the state committee is not subordinate to any ministry. By eliminating the State Committee for Fisheries, its powers as an independent body was eliminated, and policy, implementing and controlling functions were divided between three different bodies of governance (Hønneland et al. 2003:229).

fisheries was initiated in 2007. The three federal bodies responsible for the fisheries (the Ministry of Agriculture, the FFA and the VPSS) were again assembled in one body of governance, by reestablishing the State Committee for Fisheries. This meant that the Committee was no longer subject to the Ministry of Agriculture as was the FFA, but it was directly subordinate to the government. The intention of the 2004 reform was to split up political, implementing and controlling functions between different bodies of governance in order to reduce corruption. In recent years, however, the State Committee has been increasingly active in policy-making, legislative work, and fisheries control, as well as its main function of implementation of government policies (Hønneland 2012:47-48; Jørgensen 2009:95-103)⁹. Furthermore, the time period for quota allocation was increased from five to ten years in 2007, and stronger sanctions were initiated for overfishing. Also, some resolutions of the 2007 reforms encouraged small companies to merge, creating bigger companies that could run more efficiently and that would stimulate more “responsible” and “transparent” economic behavior. Such a decrease in the number of companies also made it easier for the authorities to control the number of actors in the market (Jørgensen and Hønneland 2013:370-371).

These developments illustrate a political will to alter the system and to create a more stable and efficient formal institutional framework to create a viable fisheries sector in Russia. However, the institutional changes have largely been characterized by interagency struggles for power over fisheries management, and the instability and inconsistency of the fisheries formal institutional framework and rules of the game continues. This fact indicates the relative failure of Putin’s effort of administrative reforms to achieve a well-coordinated cooperation between the various bodies of state power at the federal level, and the inability to create strong and legitimate formal institutions and clear rules and laws to guide fishery management.

⁹ In 2008, under President Dmitry Medvedev, there was again an alteration in the power relation within fisheries management. After protests from the Ministry of Agriculture the State Committee for Fisheries was again disbanded and transformed into an agency under the Ministry of Agriculture. However, after lobbying from the fisheries interests the ex-committee remained an agency, but it was removed from the Ministry of Agriculture and made directly subordinate to the Prime Minister (Jørgensen 2009:96). This illustrated the continuance of the interagency tug-of-war over the fisheries, underscoring the continued instability of the sector. However, since these developments happened after the limited period of time which this thesis concerns itself with, I will not elaborate on it.

5.2.3 Implications for trade relations

As I have explained above, the 2004 administrative reforms were meant to create a clearer institutional framework for the operation of government agencies. During the transitional period of the 1990s the national government operated in a capacity constraining and inefficient system, and this competing and overlapping institutional framework made it impossible for the government to implement effective policies favorable for economic growth. The 2004 reforms aimed to reduce administrative barriers and rent-seeking opportunities in order to make a more prosperous business environment. The reforms, then, introduced a more united, systematic and centralized formal institutional framework (Bjørnstad 2013:32; OECD 2004:47). These developments led to a change in the character of Russia's trade relations within the fisheries.

The biggest consequence of the 2004 administrative reform for seafood trade was the establishment of the veterinary service, which was fully authorized on behalf of the Russian Federation to exercise control and supervision of production and sales of domestic food products, as well as import of such products. The VPSS was given independent authority to make decisions based on scientific-technical evidence, which meant that it was not subject to any ministry or federal body, and other governmental bodies could therefore not so easily change its decisions. The fact that the VPSS was independent from any ministry and that its function in regulating trade of foodstuffs and plants was rooted in scientific-technical evidence made it an important instrument for the government in international trade relations. Since the 2004 administrative reform, the tendency has been that countries exporting food and other agricultural products to Russia have been subject to a quite strict import regime under the authority of the veterinary service (Elvestad and Nilssen 2010:269). Respondent 4, a Russian importer, explains how the integration of Russia into the international economic environment, and especially with respect to fulfilling the requirements for membership in the WTO, limits a range of possibilities for the Russian state to influence the market. State organizations such as the Russian veterinary service then becomes a tool for Russian authorities to protect their domestic market from foreign competition:

“Rosselkhoznadzor is a pure political organization...The main issue for Rosselkhoznadzor is to protect and to regulate...it is more a political motivation than bacteria and other issues.”

This quote illustrates an attitude of protectionism in order to sustain Russia's domestic food production and create an advantage for Russian companies. Furthermore, I would argue that the quote reflects a feature of the Russian mindset as a product of Russian institutional history, namely an acceptance of the fact that the state should have a significant role in the business environment as a protector of Russian interests. This coincides with the cross-tabulate analysis presented in chapter 4 (Figure 4.1), showing that Russian people are positive to a large degree of state ownership and state responsibility in the economy. This underscores the importance of the cultural-cognitive element of institutions and shows how historical legacies and the behavioral patterns connected to these historical legacies affect the workings of the economic system.

In November 2005 the VPSS announced to the Norwegian Food Safety Authority (*Mattilsynet*) that it had discovered high levels of cadmium and lead in farmed Atlantic salmon and rainbow trout exported from Norway. Despite objections from the Norwegian party, which responded by showing approved values on the test results on the establishments concerned, four Norwegian producers were banned from the Russian market. In addition, the VPSS warned that all seafood from Norway could be banned if similar cases of contaminated fish were identified. Following these events was a total ban of all fresh and farmed fish from Norway from January 1st 2006 (Bjørnstad 2013:36-37). The VPSS argued that the Norwegian surveillance system and test regime was too poor, and that the guarantee that fish from Norway was safe was too small. As a result of this, the Norwegian control system for farmed fish was enlarged, and documentation of the new, strengthened Norwegian control regime was produced on demand, only for the Russian market. However, the VPSS continued to introduce temporary bans on specific Norwegian export companies, claiming that the fish contained harmful levels of bacteria. The test results and documentations of this were, however, never submitted to Norwegian authorities, and the Norwegian party was kept in the dark about which requirements for food safety and quality were actually in force, and which criteria the VPSS applied when inspecting, approving, banning and re-approving Norwegian export establishments (Elvestad and Nilssen 2010:270-271). Respondent 6 shares her opinion about the reasons for the development of such a strict regime:

“I think one of the reasons is that the Russians are extremely concerned with food safety... In addition to this, I think that they are afraid of becoming a second-hand market, where bad products are dumped in Russia, while the products of highest quality are sent to the EU and the USA... Furthermore, I think that there is an element of protectionism of their own market. They have a very big desire of being self-sufficient, which they are definitely not at the moment.”

These events have been characterized by a strong lack of transparency from the Russian side, as well as an inconsistency in the argumentation and requirements of the VPSS. These measures taken by the Russian authorities can be characterized as protectionist trade restrictions established to reduce imports and foreign competition on the Russian market (Åslund 2010:54-55). Nevertheless, Elvestad and Nilssen (2010:271-272) makes an interesting point, namely that in spite of the bans of Norwegian fish and the introduction of stricter trade regulations, the total volume of Norwegian seafood export to Russia has actually increased (except for a temporary drop in 2006). Though, there has been a remarkable change in the number of export companies present on the Russian market. The tendency in later years has been that the veterinary service has only allowed a few large producers to supply fish to the Russian market, and smaller companies have been squeezed out. Thus, the number of companies operating on the Russian market has been markedly reduced. Respondent 8 underpins Elvestad and Nilssen’s argument that the behavior of the VPSS is not only aimed at protectionism, but is also reflecting the state’s motivation to gain greater control over the actors on the Russian market:

“The Russian authorities don’t want to control a myriad of companies. They want to have a smaller amount of companies so that it is easier for them to control them. It is easier to control a few, than hundreds. They don’t have the resources for that. In Norway there is a different system. There, you trust the companies to control and monitor themselves. In Russia the authorities don’t trust the companies, and they want to monitor and control them in their own capacity. These are two completely different regimes...”

Moreover, the veterinary service was not satisfied with the system of certification of Norwegian exporters, and claimed there was a problem of false export certificates. Therefore, they initiated new requirements for Russian import companies that now were obligated to

obtained detailed information about Norwegian enterprises wanting to export fish to Russia. This information was required in order for the Russian import companies to receive import licenses from the VPSS. The result of this was that Norwegian exporters were no longer able to freely choose who to do business with, and only a handful of Russian importers received licenses from the veterinary service. These fortunate companies were then in a position to dictate prices and terms of delivery from Norwegian exporters (Elvestad and Nilssen 2010:276). This means that the new and stricter requirements initiated by the VPSS have actually created an advantage for a few fortunate importing companies, which play a dominant role on the Russian market. Respondent 6 explains how these developments have resulted in a large decrease in both Norwegian exporters and Russian importers presence on the Russian market:

“There are extremely few companies [in Russia] that have the opportunity of importing. There are really just 4-5 companies that dominate. This is probably largely because of the restrictive import regime that has arisen, and that other importers have basically been squeezed out because Norwegian exporters who have tried to sell to companies outside this cartel have been blacklisted.”

Furthermore, I would like to include Respondent 3’s story about his experience with the new control regime. This quote is very illuminating in getting an understanding of how the Russian system works, and it introduces several dimensions of the reasons for the developments that have taken place during the first decade of the new millennium:

“In the mid-2000s they [the VPSS] closed all import of salmon and trout from Norway. Everything was closed. They claimed that they had found lead and cadmium in the products, and that there was a health risk to eat farmed salmon. This was their reason for stopping Norwegian export. But there were other reasons for this shut-down. As I have understood it, the Russian customs and tax authorities wanted to put an end to the transactions that went through foreign tax paradises... So after this, all transfers came directly from Russian banks. This has been a necessary clean up to gain control over trade affairs. Secondly, after shutting Norwegian producers out of the Russian market for a couple of months, the reopening allowed only a handful of companies to export to Russia. We were one of the companies that were opened quite early on... What happened next was that we were told that there were 4-5 companies

that we could deal with, and we were not allowed to trade with anyone else. Additionally, an agreement was made, stating that we should relate only to one importer, and that all business should go via this importer... We could deliver to other companies, but only under agreement with this one importer. So this was the world that we had to relate to... and we were clearly informed that if we did not stick to this agreement we would immediately be shut out. This was a bit complicated for us, however, because we produce 50 percent trout and 50 percent salmon, and our client wanted only salmon. Since the demand for our trout on the European market was low, we were left with large quantities of trout, which there was a large demand for on the Russian market. So finally, we took a risk and tried to deliver trout to a different customer without having clarified this with the client that had been appointed to us. What happened next was exactly what they had warned us about; we were shut down immediately...”

Respondent 3's story is an excellent example of how the institutional development in Russia under Putin's presidency has been a dual one. On the one side we observe a strengthening of formal institutions, for example by the measures taken by the authorities to regain control over the economic space of taxes and customs that had previously been dominated by illegal transactions through tax paradises. On the other hand we see a clear tendency of the development of opportunism through informal institutions and the development of cartels. In other words, the newly developed and stricter formal institutions have actually created the space for actors within informal institutions to enrich themselves through cartels that limit the number of companies that are in play. Thereby, competition is severely limited and the remaining companies on the Russian side are able to dictate prices and terms for trade.

The institutional developments presented in this chapter have accentuated the assumptions of my theoretical framework, namely the extreme stickiness of institutions. It has exemplified the important implication of historical legacies, and shown how the intensification of formal institutions may be skewed as a result of the workings of informal institutions and their interrelationship with formal ones. There is little question that formal institutions have been strengthened under Putin's leadership, but the evidence from the two chapters above do not necessarily indicate a decrease in informal institutions. In the following chapter I will look closer at why that is.

Chapter 6: What has changed and what has remained the same?

“I think there are many firmly rooted values that live on under new labels here in Russia. Ideas about leadership, power, responsibility, and distribution of influence have been maintained since the Middle Ages and have sailed under the flag of the Tsar, under the red flag, and now under a new flag.”

- Respondent 7, February 2014.

The historical chapters presented above have demonstrated elements of change as well as elements of continuation in Russia’s institutional development since the early 1990s into the first decade of the 2000s. This chapter seeks to explicitly point out these features of change and continuation, identifying *what has changed and what has remained the same* when addressing Russian institutional development. The chapter will provide a discussion about the role of formal and informal institutions in Russia, and relate my empirical findings to my research question and the hypotheses introduced in chapter 1.

6.1 The institutional paradox: Providing structure or reproducing inefficiency?

The role of institutions in the economy is to provide an incentive structure and a set of game rules to help economic actors to orient themselves in the market. In modern economies these tools of coordination are based on a combination of market, state and competitive and cooperative institutions (Lane 2008:181), in other words a combination of formal and informal institutions. In the last three decades major alterations in the interrelationship between such institutions have occurred in Russia, and this has had great consequences for the Russian economic environment, as well as for Russian society. Table 6.1 provides a summary of some of the features and mechanisms of Russian institutional development from the Soviet era to Putin’s first two terms as president. The different components presented in the table are based on the institutional developments that I have elaborated on in the forgoing chapters.

Table 6.1: Russian institutional development: What has changed and what has remained the same?

	Soviet Union Legacy (1917-1989)	Yeltsin's Presidency (1990-1999)	Putin's Presidency (2000-2010)
Economic system	Planned Economy	Oligarchic capitalist economy	State Capitalism
Incentive structure of the economy	Plan fulfillment	Profit maximizing	Profit maximizing
Political freedom	Extremely limited	Limited	Very Limited
Distribution of power	Highly Centralized	Decentralized	Centralized
Strength of formal institutions	Very Strong	Weak	Strong
Strength of informal institutions	Strong	Strong	Strong
Category of informal institutions	Accommodating	Competing	Accommodating
Generalized trust	Low	Low	Low
Particularized trust	High	High	High

As North (1990) and Peng (2003) emphasize, changes in formal institutions may happen rapidly, which is indicated in the table above. Rapid changes in formal institutions in Russia are reflected in the change in the economic system, in the incentive structure of the economy, in political freedom and in the distribution of power. In the course of three decades, formal institutions and the power of the state has gone from being all-penetrating and extremely powerful during the Soviet Union, to being decentralized and weak under Yeltsin, to again regaining great strength and legitimacy under Putin. There are, however, certain

elements and mechanisms of Russia's institutional development that indicate continuity over change, and these mechanisms are closely linked to Russia's institutional legacy.

The legacy from the pre-Soviet and Soviet period is strongly reflected in Russia's consistency of strong informal institutions. During the rule of the Communist Party in the Soviet Union, informal institutions compensated for the economic, as well as the political and societal rigidity of the political and economic system. The use of *blat* involved utilizing personal networks to obtain goods and services that were difficult to get through formal channels, creating an accommodating role of informal institutions in their interrelationship with formal ones. When the centralized system ceased to exist, many assumed that alternative currencies and exchange through such informal practices would no longer be needed, and it was expected that markets would take over the functions that were previously performed by informal institutions. However, history would tell another tale, and research shows that the strength and significance of informal institutions in Russia has not only diminished, it has actually increased. The Soviet legacy has often been blamed for the survival of strong informal institutions in Russia, and there is no doubt that it plays an integral part of the story. Yet, it is important not to discard the rationality of these informal practices and their effectiveness for problem solving. After the breakdown of the USSR, formal institutions were weak, lacking legitimacy, and they were not capable of creating and enforcing an efficient set of game rules for economic actors. This underpinned the traditionally low levels of generalized trust in state institutions, and the defects of markets and the incompetence of formal institutions were compensated for by informal institutions and particularized trust (Ledeneva 2013:11).

These developments highlight the importance of making a distinction between different categories of interrelationship between formal and informal institutions. Due to the poor condition of formal institutions during the transition period, a change in the interrelationship between formal and informal institutions occurred. Informal institutions acquired a competing role towards formal institutions by violating formal rules and procedures, competing for economic and political power and influence. Since, with the dissolution of the Soviet Union, the state had withdrawn from all the main economic activities that were previously under the state's control, the authorities had created an unforeseen vacuum regarding public regulation and control. Since the governing capacity of the Russian state was so poor, informal institutions filled this vacuum, giving rise to opportunism and

illegal economic activity which created an oligarchic capitalist economy (Elvestad and Nilssen 2010:276).

The reasons for the emergence of informal practices, however, are not the same as the reasons for their reproduction. There has occurred a fundamental change in the use of informal institutions in post-Soviet Russia, and the informal practices that were thought of as a solution has become a problem. Even with the emergence of stronger formal institutions under the rule of Putin, informal institutions still play a crucial role. The institutional development under Putin has introduced a great formal institutionalization and strengthening of the role of the state, but this has required a continuous negotiation among actors within informal institutions. The formal rules of the game have indeed become much more legitimate and to a certain degree clearer, but Putin's system contains a fundamental tension: The players now have to follow and obey the institutional boundaries set by formal institutions, unlike the tendency in the Yeltsin period, when informal institutions to a large degree contributed to setting the rules of the game. At the same time, though, players have to overcome institutional divisions in order to negotiate outcomes. The battles for influence and power within the fisheries, as outlined in chapter 4 and 5, is an example of such institutional divisions, which have proven problematic to solve through formal institutional channels. Informal networks have become an important solution to solving such tension, but at the same time the power, consistent utilization and decision capacity of strong informal institutions may obstruct the continued development of formal institutions and a more rule-based, impersonal transaction structure (Ledeneva 2013:83-84).

Respondent 3 exemplifies the continued significance of informal networks in Russia, and explains that Russian trade partners often emphasize the importance of having the right connections within the power hierarchy in Russia:

“It is important that you are “in” with the right people... They [Russian importers] will constantly try to point out what contacts they have in the Duma... It is obvious that they are competing among themselves. “He doesn’t have as good contacts as I do...and don’t worry; we have people that sit higher up in the system than his people do”. It is quite clear that there are tight bonds between some politicians and powerful people and some of the people we trade with... This is a tendency that has increased in the last few years.”

All things considered, the institutional developments in Russia pose the question of whether the development of the rule-based, impersonal transaction structure that Peng (2003) suggests is possible in Russia's case. Peng highlights that the development of such a system is a time-consuming process, and Russia may still be at an early stage in the process of developing such a system. However, I question the applicability of Peng's model to the Russian case. We can indeed observe that there has been an increase in formal institutions and an effort to implement a more rule-based system of exchange since 2000, which is a move in the direction of the rule-based transaction structure that Peng portrays. These systems are, however, negotiated and initiated through informal channels, and informal institutions are not only maintaining, but are arguably also increasing their position of power within the Russian institutional framework. With the consolidation of the *siloviki* clan as a power network loyal to the president after 2004, informal institutions have again received increased importance, and play an integral part of Russian institutional development. This underscores not only the stickiness of institutions, but also their adaptability. Russian informal institutions have shown an incredible ability to adapt to the development of new formal rules and structures. Respondent 7 emphasizes that Russia is difficult to categorize into Western structures, and that the expectation that the Russian system will develop towards an institutional model similar to the West is unlikely:

"I think it is safe to say that Russia has her own plan for who she wants to be. I think the previous expectation about Russia becoming a part of Europe and like us is ready to be rejected. They have their own idea about identity, uniqueness and values and they don't conceive Europe as a role model."

Bearing this in mind, one might question whether the development of a rule-based, impersonal transaction structure as the one illustrated by Peng will ever be possible in Russia. In my opinion, and as I have attempted to show throughout this thesis, Russia's tradition of particularized trust and personal networks, combined with strong state control over a huge territory, has produced an institutional legacy that is deeply rooted in the Russian mindset. This mindset has endured in Russia for hundreds of years, and will probably persist for a long time to come.

6.2 Returning to the research question: What does it mean?

So how do these findings contribute to answering my research question and verifying or discarding my hypotheses? This thesis aims to explain *to what degree Putin's recentralizing reforms have contributed to increasing the significance and role of formal institutions relative to that of informal institutions*. The leading hypotheses in order to investigate this issue assume that a strengthening of formal institutions through centralizing reforms will reinforce the state's position in the market (H1). Furthermore, as a consequence of stronger formal institutions, a decrease in informal institutions will occur (H2), and this trade-off between formal and informal institutions will lead to a stronger formalization of public law and increased generalized trust (H3). The last hypothesis assumes that the increase in generalized trust will result in a more transparent and predictable economic environment and that this will strengthen Russia's trade relations (H4).

Based on the evidence provided in previous sections, I argue that I have enough evidence to confirm H1. Putin's centralizing reforms have indeed contributed to strengthening formal institutions and reinforcing the state's position in the market. Through the investigation of the fisheries sector and through interviews with respondents connected to Norwegian-Russian trade relations within this sector, I have found a clear tendency, especially since 2004, of more state intervention and control in the economy and in trade relations. This is reflected in the establishment of a strict control regime based on food safety and quality requirements that have provided the VPSS, and in its extension the Russian state, with a tool to regulate and control economic actors on the Russian market. This shows a tendency of stronger formal institutions, but these institutional developments have also introduced an opening for opportunism through informal institutions. Since these administrative reforms were initiated, significantly fewer companies are in play on the Russian market. The handful of Russian companies that are allowed access to the market have a powerful position, since they have the possibility of dictating the terms of exchange and deciding who gains access to the market. There seems to be a strong connection between the dominating companies on the Russian side and the representatives of the Russian state within the VPSS, and there is a clear tendency of cartel activity.

Respondent 8, who represents a Russian import company, illustrates that the connection between big business and the state has increased in later years, and that it is an important part of doing business in Russia:

“You have to have personal contacts. When we started up we didn’t have any contact with the authorities at all. But when the borders to Norway were closed in 2005 we understood that we had to make a move and work on this. We spend many man-hours on government relations, and we are probably one of the organizations that are most active in this area. We have in many ways appeared as advisors for the government...and it is quite obvious that if you can contribute with good advice, you will get access and your life will become much easier. It is like this in all sectors in Russia.”

These tendencies indicate that H2 can be discarded, since there is still clearly a strong presence of informal institutions in Russia. This means that there is no trade-off between formal and informal institutions. In Russia the opposite tendency is observed, since despite the strengthening of formal institutions, informal institutions have not only remained strong, but have arguably even increased their significance within the institutional framework.

There is no question that the role of informal institutions has changed since Yeltsin’s presidency. In the 1990s, informal practices took part in obstructing and violating the workings of formal institutions, and stood as a major obstacle for the further development of state legitimacy and the rule of law. During Putin’s presidency, conversely, informal institutions have acquired an accommodating role in the interplay with formal institutions, and contribute to strengthen and reproduce a system that is partly based on strict formal rules, and partly on informal institutions and power networks. Respondent 3 explains how the development under Putin has put some important formal rules in place, but that informal practices and the development of cartels is a problem that shows few signs of disappearing:

“For the Russian authorities this development has been positive. They have achieved what they want concerning taxes and customs... But as far as the market is concerned it is quite clear that a tendency of cartels have developed, which is not good for Russian consumers or for Norwegian producers. When someone gains power over a large share of a market, and is controlling both the import and the sales in Russia, then they have a good opportunity to create good margins for themselves.”

This means that H3 and H4 can only be partly confirmed. There has to a certain degree been an improvement of formal rules and laws through the strengthening of formal institutions, but these rules and laws are constantly being compromised by the use of informal

institutions. This reproduces a certain degree of uncertainty in economic transaction in Russia, and many of the respondents on the Norwegian side emphasize the great unpredictability associated with the Russian market. Furthermore, looking at the quantitative data presented in chapter 4 we can see that the level of generalized trust remains low in Russia, even after Putin's reforms. In sum, the Russian market remains unpredictable for economic actors and the level of generalized trust in formal institutions remains low, leaving particularized trust and personal networks as a vital part of Russian business.

The findings presented in this thesis supports the critique of neoclassical economic theory presented in chapter 1, and underscores the significant effect that institutions have on the economic environment and on economic performance. The findings illustrate the complex, unpredictable and diffuse nature of economies based on a relationship-based transaction structure, but at the same time we can find rationality in such practices and recognize their ability to glue society together and make these systems work. Recall that actors in institutionalized worlds are socialized into culturally defined purposes, which they identify themselves with. The legitimacy of institutions is therefore not solely based on their capacity to achieve objectives, but they achieve legitimacy from being an integral part of culture and from the reproduction of patterns of behavior through former institutions. This means that both the establishment and development of institutions does not necessarily indicate that substantive efficiency is the goal (March and Olsen 2006:8-10). In the case of Russia, it has proved to be close to impossible to disentangle the state from a network of private interests, which has produced a 'network' character of the state. The workings of formal and informal institutions, then, are so intertwined that the elimination of illegal informal practices seems extremely challenging, if not impossible. The players on every level of the power hierarchy are dependent on and an integral part of the system, and are consequently "locked" into the networks that enable them to perform their public functions and satisfy their private needs. Therefore, the people who have gained a position of power within the system have also become hostages of the system (Ledeneva 2013:255).

Chapter 7: Concluding remarks: The ambivalence of the Russian system and prospects of its modernization

In this thesis I have attempted to shed light on the complex workings of the Russian system by focusing on institutional change and the interrelationship between formal and informal institutions. By using data from different sources I have attempted to construct what Yin (2009:115) calls *converging lines of inquiry*, meaning that evidence from several different sources are pointing in the same direction. Interviews with central actors of the fisheries trade industry have given me an insider's perspective of the phenomenon under investigation. These interviews have been supported by document analysis, and to some degree direct observation, to secure insights into the mechanisms of institutional development in Russia and its effect on trade relations. My findings present an explanation of the complex workings of the Russian institutional system, and they illustrate the significant role that institutional frameworks play both in the economy and in people's everyday lives. Through the support of institutional theory and comparative historical analysis I have shown that *institutions do matter* in economic performance, and institutional legacies are vital in helping us to understand how institutional and economic systems face and adapt to change. In this concluding section I ask *what have we learned*, and as a response to the knowledge that can be accumulated from this thesis I will share some thoughts on *the prospects for Russian modernization*.

7.1 The ambivalence of the Russian institutional system

"Ambivalence... is the chief characteristic of my nation."

- Joseph Brodsky, 1986 (Ledeneva 2013:244)

The investigation of *the degree to which the role and significance of formal institutions have increased relative to that of informal institutions during Putin's first to terms as president* has uncovered the complex workings of Russia's institutional system. Even though a strengthening of Russia's formal institutions can be detected during Putin's presidency, power networks and informal institutions remains a highly important part of the Russian institutional structure. As the evidence of my investigation indicates, formal and informal institutions may contradict or reinforce each other. At the same time, however, they form a symbiotic relationship through a system of overlapping and co-dependence between formal hierarchies and intertwined informal networks. As Ledeneva (2013:246) points out:

“The outcome is perceived as unpredictable: an anonymous force that rejects personal integrity and independence but instead favors personal loyalty and compliance”.

Despite the inefficiency and dysfunctionality of the Russian system, one should be wary of labeling Russia as a “failed state”. Even though the resilience and strength of Russian informal institutions sustain corruption on a large scale, this system also restricts corruption through informal control over assets and appointees, and it uses informal influence to re-negotiate property rights and positions. An example of this is illustrated in this thesis, namely the consolidation of the *siloviki* as a power network loyal to the president, using informal channels to pursue goals set by the state. Despite the complex, unpredictable and seemingly irrational workings of the Russian system, it somehow works, and the interplay between formal and informal institutions is what glues society together, contributing to both stability and change in Russian institutional development. This interdependence between formal and informal institutions highlights the great ambivalence of the Russian system, and this is the core in ensuring its’ own reproduction (Ledeneva 2013:249). This highlights the stickiness of institutions and the durability of institutional legacies in Russia. This analysis has shown that informal institutions have for decades functioned as a safety net against the formal institutional void that has created an institutional framework where the rules are flexible and inconsistent and the individual is vulnerable. Even though the nature of informal institutions may have changed – their function, their characteristics, the nature of their interrelationship with formal institutions, they still remain an integral part of Russia’s political and economic structure, and an understanding of their origin, development and contemporary expression is vital when operating on the Russian market.

7.2 Can Russia modernize?

“There is no right to private property. Those who clash with the system have no rights whatsoever... Can we be surprised that rational people don’t strive for self-fulfillment here in Russia? Who will modernize the economy?”

- Former oligarch Mikhail Khodorkovsky, November 2010 (Ledeneva 2013:20)

As Khodorkovsky points out in the quote above, a reformation or modernization of the Russian system seems extremely challenging. Ledeneva (2013:252-253) presents a threefold explanation for why it is close to impossible to reform the Russian system in the traditional sense of the word. Firstly, reformers that challenge the system do not only risk getting

expelled from their formal positions, they risk exclusion from informal networks, legal prosecution, or even being banned from the country. Khodorkovsky himself is an example of this, since he attempted to challenge the new game rules set by President Putin. For that he served a more than a decade-long prison sentence. This entails that the people who are in positions to change the system are so inextricably intertwined in and reliant on the system that attempting to change it will leave them destitute. Brodsky comments on this being “...*the ultimate triumph of the system: whether you beat it or join it, you feel equally guilty*” (Ledeneva 2013:244).

Secondly, if the practices of informal networks were abolished, it would have fatal consequences, since the interplay between formal and informal institutions is the glue that keeps Russia’s economy and society together. The use of informal leverage and personal networks has been a vital part of Putin’s modernization agenda. In the short run this has produced efficient results; Putin has managed to discipline the federal districts to follow national laws, he has confronted the oligarchs and to put an end to the plutocracy of the 1990s, and he has consolidated a powerful political party and stopped the fragmented political situation of the Yeltsin era. In the long run, however, the continued utilization of informal tactics to mobilize elites and allocate resources to insider networks is undermining fundamental principles of a well-functioning modernized state, namely the principles of the rule of law, the separation of powers and the security of property rights. Ultimately, the strong role of informal institutions in the Russian system is undermining Russia’s chances of achieving strategic goals of modernization. Russia is caught in a “*modernization trap of informality*” (Ledeneva 2013:252), which means that it is impossible to use the potential of informal networks for modernization without triggering its negative long-term consequences.

Finally, a modernization of the Russian system would require an enlightened leadership that is capable of abstaining from the use of personal networks for self-enrichment, and that is able to preserve the system’s capacity for innovation while at the same time replacing informal tools with effective alternatives. Unless the issues of informal governance are dealt with it is hard to imagine that Russia could modernize to its’ full potential. The 2011 announcement that Putin would return to the presidential chair, appointing the current president Medvedev to be his Prime Minister, triggered a wave of protest and dispute among the Russian population, especially the middle class. The protests of December 2011 showed a new dimension of opposition activism and a change in Russian people’s attitude to politics

and voting behavior. The outcome of the 2012 Presidential election proved that personal loyalty and utilization of power networks remains more important than loyalty to universal rules. The ultimate source of the demonstrations in relation to this election, however, was *Putin's system*, and little attention was given to the general principle of the leadership changeover. The debate about the fight for universal principles remains untouched in the country where “beating the system” and “privileged access” has become a part of all Russians' everyday lives (Ledeneva 2013:254-255). I suspect that a modernization of the Russian system is impossible as long as the system of informal networks and network-based governance remains an unspeakable subject. The modernization of the Russian system must start with the modernization of the informal network it relies on!

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