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Interim outcome of the Russian transition: clan capitalism

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Abstract

In this paper is the description of the features of socioeconomic system newly emerged in Russia as a result of transition to market economy. The main actors of this system are so called 'clans' containing of the business people affiliated with state officials and sometimes criminal groups. There is the analysis of clan's structure and principal defects of this system.

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1. Russian path to capitalism: between Eastern Europe and China

It has been achieved social consensus about necessity of changes in Russia at the beginning of the 1990s after collapse of the USSR. But it was the lack of understanding what changes are desirable and possible in this country. Moreover, there was no clear idea even about the principal aims of the changes. Is it simple transition to market economy? Or it is systematic shift towards capitalist society including idea of human rights and political democracy as well as unemployment, inequality and other socioeconomic consequences? What elements of the soviet society are failed and mandatory for removal? What soviet institutions are necessary to protect and save in restructured mode? There were no answers for these and many other similar questions because there was the lack of public experience, preliminary debates based on the expert's knowledge. Additionally, there was no proper expert's knowledge in Russia and outside and there was no plan for transition that was shared by public and elites. And finally, this optimistic picture was supplemented by fact that soviet state with its monopoly of communist party was near collapse.

Group of reformers headed by E.Gaidar tried to promote line borrowed from the transition experience of Eastern Europe based on neoliberal reforms, so called 'Washington consensus'. The key point of this line is the idea of creation effective market mechanism by means of rational economic liberalization restricted by fiscal discipline. They tried to make this policy and immediately met serious response from powerful economic agents. As an example, Gaidar described the story with the attempt of liberalization of prices for energy goods (oil, gas, and etc.) at the beginning of 1992: "There was expanding pressure to President. Crowd of lobbyists daily informs him that

this action is a crazy attempt or maybe betrayal promoted by these monetarists. Supreme Soviet (title of the Russia Parliament at the time – L.K.) issues a decree that government cannot change the prices of energy goods without its approval. Normal development of the reform in this major sector turned out that dangerously”¹. Of course, it wasn’t a ‘conspiracy of anti-reformers’, actually it was rational behavior of economic actors feared for worsen of their positions. Additionally, almost nobody exactly understood the reasons for liberalization measures that were conducted. In this situation of ‘global uncertainty’ we can also find irrational phobias and fears concerning any changes. But primarily it was essential systematic response of society that wasn’t specially prepared for liberalization policy, society that hadn’t clear desire to make liberalization. The initial conditions² for building of capitalist economy and society wasn’t so favorable in Russia, taking into account the length of communist rule and embedded character of soviet socioeconomic institutions, as well as long-term historical legacy, such as lack of tradition for using of private property, tradition of hyper-centralization of the state power, the lack of ideas and practices of human rights and civil society.

As a result during the first years of the transition, in 1992-1993, the minimal liberalization was conducted by the government: prices were partially released, some of the bodies responsible for central planning were eliminated (Gosplan, Gosstab, and etc.), role of the other Soviet ministries was diminished, the first steps for privatization of state

¹ Gaidar, E (1997). Dni porazhenii i pobed. Moskva, Vagrius, p. 168 (English translation: Yegor Gaidar (1999). Days of Defeat and Victory. University of Washington Press. Seattle and London).

² There is a vast literature on the initial conditions of the transition outlining its importance to the outcomes (see, for example, de Melo M., Denizer, C, Gelb A., and Tenev S. (October 1997). Circumstance and Choice: The Role of Initial Conditions and Policies in Transition Economies. World Bank Working Paper No. 1866, Stark D., Bruszt L. (1998). Postsocialist Pathways: Transforming Politics and Property in East Central Europe. Cambridge, Cambridge University Press and many others), though it is obvious that there is no fatal predestination in the course of the reforms. But initial conditions especially important in Russian case in particular because of the lack of ‘external anchors’ which are important for Eastern Europe.

property were done, and the aim of financial stabilization was proclaimed. Some restrictions of state expenditures were made.

But these measures couldn't create really favorable conditions for emerging market economy in Russia. Major part of prices was still under direct state regulation (first of all – price for energy goods) or strictly controlled by the government (retail trade prices); the most part of the property was also state owned. Control from the hands of functional ministries was turned to economic and financial departments (Ministry of Finance, Ministry for Economics), as well as to major banks located in Moscow, which were formally private but informally strongly affiliated with state bodies. Major companies in fuel and energy industry (gas, oil, electricity) found themselves in position of semi-state firms, however, without real government influence. State financial policy actually followed zigzag line: stabilized measures in order to pay one's way sometimes changed to huge payments for the sake of any lobbies.

However, due to liberalization measures in conditions of opposition of many actors, spontaneous creation of market institutions from the ground has started. Many new small, medium and big companies were founded; banks, lawyer's firms, private business juries and notary offices, trade chambers, business associations, and etc. were established by independent persons and people from old Soviet nomenclature. Spontaneous emerging of market institutions couldn't originate quickly, because it depends from both collective learning³ in operation of market economy and civil society, while Soviet people were innocents in these both realms until the beginning of 1990s.

³ 'Collective learning' in terms of Hayek as accumulation of experiences (Hayek, F.A. (1960). *The Constitution of Liberty*, Chicago, The University of Chicago Press)

This was some sort of ‘intermediate path’ between the lines followed by any Eastern European countries (like Poland or Hungary), in the one hand, and China, in the other hand. As in Poland or Hungary Russian reformers tried to conduct rapid liberalization policy to create the foundations of operating capitalist economy. As in China the leading role in the Russian socioeconomic system was preserved in hands of the state.

Meantime, instead of the “reform”, as it was and it is in Eastern Europe and in China, with elaborated program developed by government, there were many isolated and spontaneous economic innovations in Russia promoted under the political clashes between powerful social actors⁴. This path to market system led to many economic and social expenses (severe economic crises and decline of living standards). But maybe the most important outcome is that the socioeconomic system emerged as a result of transition was unexpected by government, public and experts. Some scholars call this system as ‘criminal capitalism’⁵, or ‘Kremlin capitalism’⁶, or ‘Potemkin capitalism’⁷, and etc.

In my point of view, good term for this system is ‘*clan capitalism*’ because of the relation with the principal actor within Russian capitalist society⁸. These actors are so called ‘clans’ that have their origin in the Soviet past. Probably, the most important feature of Soviet society that influenced on the transition course and performance was

⁴ This manner of doing transition A. Shleifer and D. Treisman accurately called ‘without a map’: see Shleifer A., Treisman D. (2000). *Without a Map. Political Tactics and Economic Reform in Russia*. Cambridge, Massachusetts. The MIT Press.

⁵ Satter D. (2003). *Darkness at Dawn: The Rise of the Russian Criminal State*. Yale University Press

⁶ Blasi J.R., Kroumova M., Kruse D. (1997) *Kremlin capitalism. Privatizing the Russian Economy*. Cornell University Press.

⁷ Schuler K., Selgin G.A. (1999). *Replacing Potemkin Capitalism. Russia’s Need for a Free-Market Financial System*. The Cato Institute, Policy Analysis, No. 348, June 7

⁸ L.Kosals (1995). *Razvitie klanovogo kapitalisma v Rossii, Znanie-sila, No. 3* (L.Kosals (1995). *Development of clan capitalism in Russia, Knowledge is power itself, No.3*), in Russian

system of the hidden social network that existed at every level, from bottom to the top of the social organization. In Soviet era every formal state institution was surrounded by the hidden practices providing its relative efficiency. For example, within the system of formal central planning was the practice of corrections during the planning period that adjusted often unrealistic government requirements to the needs of industrial enterprises. The system of corrections of the plan included practice of informal bargaining between managers of enterprise and ministerial officials located in Moscow.

The similar hidden social networks were operating in every part of Soviet society – in army, law enforcement agencies, science and education, retail trade, bureaucratic bodies. State vitally needed in these practices, because they guaranteed relative efficiency of formal institutions. They were vitally important for the individuals since hidden practices were the umbrella for individuals from the state pressure. They were widespread but formally banned. And if authorities really wanted to punish somebody for the shadow operations they could do it following to the formal law. Therefore hidden social network was operating not as links between individuals but as the system of hidden relations within certain social group glued by the personal trust between members. And information about these networks circulated within this group without leakage to outsiders. Such informal group was closed to strangers because they potentially could transform the “classified” data to the bodies creating the jeopardy of formal punishment⁹.

⁹ There are many valuable publications dealing with Soviet and Russian hidden socioeconomic practices: Berliner, J. (1952). The informal organization of the Soviet firm. *Quarterly Journal of Economics*, 66(3); Ofer, G and A. Vinokur, A. (1992). *The Soviet Household Under the Old Regime: Economic Conditions and Behavior in the 1970's*: Cambridge: University Press; G. Grossman. The 'Second Economy' of the USSR. *Problems of Communism*. XXVI, September - October, 1977; A.L. Hillman and A. Schnytzer. Illegal Economic Activities and Purges in a Soviet-Type Economy: A Rent-Seeking Perspective. *International Review of Law and Economics*, June 1986; Dennis O'Hearn. The Consumer Second Economy: Size and Effects. *Soviet Studies*, XXXII, No 2, April 1980; V. Radaev. Urban Households in the Informal Economy, in: Segbers, K. (ed.). *Explaining Post-Soviet Patchworks*. Vol. 2. Aldershot: Ashgate,

I think the best term for such group is ‘clan’ – closed social entity united by the common interest of survival in the hostile social Soviet environment and glued by the shadow relations regulating by the hidden norms¹⁰. The basic concept of this paper that namely these old Soviet and newly emerged clans became the principal actors of the post-Soviet economic and political life; and furthermore, these clans formed the system of ‘*clan capitalism*’ as a result of their daily interactions with government promoted policy of market transformation.

Since the mid-80s M.Gorbachev has started liberalization of the Soviet system clans in the various sectors of the economy and politics have got free-hands in the operation. And the new system was formed during a relatively spontaneous clash between different clans; and between clans and state bodies. And every law adopted for creating ‘civilized European-style market economy’ turn out into interests of powerful clans. For example, relatively liberal law on bankruptcy used in order to make ‘violent takeover’ of the profitable assets unprotected by the strong clans.

Further, I’ll analyze the term ‘clan’ and describe structure and typology of clans in current Russia. Section 3 is devoted to the description of the principal features of ‘clan capitalism’ as newly emerging system. Conclusion is about some perspectives of clan system and its possible conversion into oligarch capitalism.

2001, A.Ledeneva. *Russia's Economy of Favours: Blat, Networking and Informal Exchange*. Cambridge and New York: Cambridge University Press, 1998; M.Johanson, *Managing Networks in Transition Economies*, Elsevier, 2004. However, in the focus of these and most of other publication weren’t the social groups that formed within the hidden practices – what kind of hidden groups emerged in different sectors of Soviet society including state bodies, what ethics was formed within these groups, what are relations of these groups between each other and with Soviet authorities.

¹⁰ Below I’ll specially analyze of the term ‘clan.’

2. Structure of a clan and typology of clans in Russia

Term 'clan' is widespread in anthropology for analysis of the system of kinship and is defining as social group based on actual or alleged unilineal descent from a common ancestor. A clan includes several family groups. Some clans have an official leader such as a chieftain¹¹. Anthropologists, analyzing system of kinship, study clans in 'primitive' societies as well as in modern ones including Scotland, Ireland, Albania, China, Japan, and Scandinavia. Sometimes, they refer usage of term clan for analysis outside of kinship as insufficient¹². Meantime, the term 'clan' is widespread for analysis of the problems of transition in Russia, Central and Eastern Europe, and China¹³. And really "This usage reflects the assumption that their members act towards each other in a particularly close and mutually supportive way approximating the solidarity among kinsmen". However, this term now is common for analysis of the specificity of marketization in transition countries, there is the lack of its exact definition concerning to this application.

Furthermore, not only specialists in transition societies use term 'clan' but also researchers on management and organizational behavior to explain different types of

¹¹ See: I.Moncreiffe, *The Highland Clans*, London, Barrie and Rockliff, 1967; E.Gellner, *The Concept of Kinship and other essays of anthropological method and explanation*, Oxford, Basil Blackwell, 1987

¹² "Apart from these different traditions of kinship, further conceptual confusion arises from colloquial usages of the term. In post-Soviet countries for example it is quite common to speak of clans referring to informal networks within the economic and political sphere. This usage reflects the assumption that their members act towards each other in a particularly close and mutually supportive way approximating the solidarity among kinsmen" ("Clan", from Wikipedia, the free encyclopedia, <http://en.wikipedia.org/wiki/Clan>).

¹³ See: J.R. Wedel. Clans, cliques and captured states: rethinking 'transition' in Central and Eastern Europe and the former Soviet Union, *Journal of International Development*, Volume 15, Issue 4, 2003; Dinello, N. (2002) "Clans for market or clans for plan: social networks in Hungary and Russia", *East European Politics and Societies*, Vol. 15, No. 3; Boisot, M. and Child, J. (1996) "From fiefs to clans and network capitalism: explaining China's emerging economic order", *Administrative Science Quarterly*, Vol. 41; Stark, D. (1990) "Privatization in Hungary: from plan to market or from plan to clan?", *East European Politics and Societies*, Vol. 4, No. 3

coordination and control in current business in both advanced and developing countries¹⁴. This usage had emerged in the 1980s because of the incomplete explanation of the human behavior within ‘the pure economic analyses’ based on neoclassic approach under analysis of the modern organization operating within the diverse cultural and political settings. It is more important in the 21st century under globalization process when business environment becomes more diverse and less predictable. So, W.Ouchi, studying types of control mechanisms inside and outside organization, revealed three types of control which included: 1) the market pricing mechanism, 2) bureaucratic control and 3) the clan¹⁵. In a real business organization all three mechanisms are in operation, though the role of each are various in different types of organization. To build up effective organization businesspeople have to provide the specific combination of all these control mechanisms. Meantime, specialists in organizational science, studying clan’s business activity as a sort of control mechanism, mostly focus on specific relations and networks than on groups with its structures and social norms.

In my point of view in order to understand the principal peculiarities of the current Russian economic system it is crucially important to examine the social essence of clans as the main actors in economy and politics. It is necessary to describe main features of clans that are operating in the transition countries and in Russia in particular, to analyze its internal structure and forms of activity.

¹⁴ See: W.Ouchi (1980) “Markets, bureaucracies and clans”, *Administrative Science Quarterly*, Vol. 25; M.Alvesson and L.Lindkvist (1993) “Transaction costs, clans and corporate culture”, *Journal of Management Studies*, Vol. 30; M.Boisot and J.Child (1996) “From fiefs to clans and network capitalism: explaining China’s emerging economic order”, *Administrative Science Quarterly*, Vol. 41.

¹⁵ W.Ouchi, 1979. A conceptual framework for the design of organizational control mechanisms. *Management Science* (September) and Ouchi, W. (1980) “Markets, bureaucracies and clans”, *Administrative Science Quarterly*, Vol. 25

First of all, such clan isn't a group of relatives but it is business entity with for profit activity. It isn't so important does such clan include relatives or doesn't, because the major interest of clan is to gain money, to conquer the new markets and to capture new assets. These is a 'business clan' not system of kinship. In Russia among the members of the clan usually are businesspeople, state officials, and sometimes criminals. And very often there is a small amount of relatives among them or lack of relatives at all. For example, Luzhkov's (mayor of Moscow) clan contains his relatives (wife, her brother and others), but Hodorkovsky's clan didn't include his siblings. Clan can include (control) many formal organizations as well it can operate within one entity or even within part of the formal organization.

The general strategic purpose of the clan is to accumulate the resources and to expand its power and influence in the field of operation. Every clan intends to reach a stable position and to control external environment, to create favor external socioeconomic and political conditions. Many clans desire to become a monopoly to protect internal operation. In specific tactic goals they depend on the current situation they meet at every moment. Sometimes it is plan of invest into a new production line or desire to take over some valuable assets; sometimes it is promotion of a lobbyist into local parliament, to push potentially profitable draft into the State Duma or to capture the high governmental post; sometimes it is a project of elimination of some competitors or removal former business partner.

Clans are shadow and closed social groups keeping information on their activity from public and official bodies. The most open data on clan's structures and activities

were generated during clan's wars, when competitive clan distributes the information about its enemy. And of course, no any social control over clans by public or government.

There is a system of intimate relations between members of the clan that makes up informal network. In contrast to formal organization relations within clan are based on personal contracts and duties not on impersonal formal norms. Though informal relations exist in every formal organization in all countries but they have another status – informal relations within clan are more important than formal law. And powerful enough clan can protect its member violating the formal law from the official punishment but it cruelly hunts those members who ignore inside informal norms¹⁶.

The intimate relations between members within clan are accompanied by very high level of personal trust and sympathy¹⁷. Sometimes the members call these relations as 'brotherhood' or 'family'. Usually they emphasize the specific 'warm' psychological climate and high rate of internal integration. The social norm in this informal community is strong loyalty to the group in general and to the particular actions without any doubts. The reverse of this matter is an acute hostility to strangers. For example, this type of relations performed in media concerning Hodorkovsky's clan: 'There were no betrayals inside the team. Dealing with outsiders they follow the idea: "If our parrot is croaked let's buy another one"¹⁸.

¹⁶ As S.Mizobata argued analyzing the practices of disputes related with corporate governance: "With the interaction of the formal system and the informal system, the latter's dispute settlement mechanisms prevail" (S.Mizobata. Diverging and Normalizing of Corporate Governance in Russia. Document de travail 05-2, CEMI (EHESS), Mai 2005 (<http://www.ehess.fr/centres/cemi/pages/documents/doc108-mizobata.pdf>, p.24).

¹⁷ Very high level of trust in Russian clans marked by A.Aslund comparing Russian and Ukrainian oligarchs (Aslund, A. (2005). Comparative Oligarchy: Russia, Ukraine and the United States. Paper presented at the CASE Conference, "Europe after the Enlargement," Warsaw, April 8–9)

¹⁸ Yu.Latynina. Hodorkovsky's Empire. "Sovershenno sekretno" ("Top secret"), August, 1999

Those who are suspecting by clan of ill-will or disloyal behavior become in risky to turn to ‘enemy’. It is some sort of ‘defense consciousness’ perceptive their group as a ‘deposited fortress’ surrounded by real and potential enemies. In one hand this consciousness of the business clan is a result of transformation of the ideology of ‘hostile surroundings’ that was the element of official propaganda during Soviet era. Russian society officially refused from this ideology and there is no mechanism for this state propaganda but it is reincarnated at the level of the personal and group mind¹⁹. In other hand this group consciousness of clan is near to the psychology of some small religious sects toughly controlling believes and behavior of their members.

The internal social structure of the clan is as follows.

At the top of the clan is the leader or ‘chieftain’, who is usually founder of the clan and enjoys personal charisma between members. Among the most popular ‘chieftains’ are Eltsin, Putin, Hodorkovsky, Luzhkov, Chubais, Chernomyrdin, and etc. Chieftain is the informal unquestionable authority for all members, and status of all important persons within clan is determined by him. He recruits himself the key persons for his team and creates the principal informal norms of internal relations. At the same time he controls all major internal relations inside the entity. Inner life of the clan is always shaped by the key influence of his habits and values in spite of any formal laws. For example, if he has habit to finish his working hours after 11 p.m. the subordinates are forced to share this rule though it isn’t follow official Labor code.

Chieftain also concentrates all main formal and informal data concerning clan’s operation, usually without sharing with anybody. Often there are some legends about

¹⁹ Especially Putin’s government in increasing frequency utilizes the propaganda of ‘hostile surroundings’ to explain inner problems of the country and fails in official policy

creation of the clan and about acts of the chieftain. These legends are circulating in the internal communication (and outside for big and powerful clans) as the integrated ideology. Sometimes legends about chieftain are specially fabricating by him or his collaborators. For example, as one of the Putin's subordinates shared in the book hosted at the official website 'Kremlin.ru' and titled "In person. Talks with Vladimir Putin": "Before 1991 there were two types of the portraits at the offices in Smol'ny (mayor's headquarters of St.Petersburg) – in offices of the top leaders you can find both Kirov and Lenin, and in the offices of lower officials – only Lenin. But when all these portraits were removed, just empty hooks have been there. And new bosses chose the new portraits. The most of them preferred Eltsin. But Putin booked the portrait of Peter the Great... after raid to Prussia and Northern war Peter has created the foundations of the Russian empire"²⁰. And forgoing the story related with the same historical tsar about activity of Putin in St.Peterburg reported by the journalists of 'Novaya gazeta': "Corporation '20th trust' has got the loan from the city budget on preferential terms in order to construct modern business center 'Peter the Great' in the end of 1993 as per Putin's request in the course of exception. The sum of this loan was 2.5 billion rubles²¹ and the interest was only 6% annually, meantime in this period the regular interest was 200%. Corporation '20th trust' left 55 cars as a deposit for this loan and some other loans which it got from the city government. At the end of 1990s the financial inspection of this corporation revealed that

²⁰ See: N.Gevorkian, N.Timakova, A.Kolesnikov. "In person. Talks with Vladimir Putin", <http://www.kremlin.ru/articles/bookchapter6.shtml>

²¹ Near 1 mln USD

there is no business center ‘Peter the Great’ and there are no tracks of budget funds, and only 22 cars are still available”²².

The chieftain isn’t only exclusively concentrates comprehensive information about the clan’s operation he also controls all important external relations of the clan with various agents – other business entities, government officials, public leaders, media, top criminals. Therefore, usually the chieftain is known alone for the most business partners, government officials and public as the representative of this clan. Other members are still unknown or almost unknown. As a result chieftain enjoys of the full control over the clan, securing himself from the internal coup. He occupies the unique position as ‘irreplaceable’ leader and usually it is true. After his removal or death very often clan disappears or becomes much weaker. In this situation one of the effective tools to continue of the clan operation is appointment of the ‘successor’ providing by the clan chieftain. This appointment is the informal procedure for socialization of the potential new leader of the clan with aim to adopt new leader by members of the clan, in one hand, and external partners, in other hand.

The second element of the clan is the ‘core’ combined the key persons – closest collaborators of the chieftain. Among them are usually his friends of childhood, relatives, colleagues of former job, intimate and most trustworthy business partners and etc., having informal friendly relations with the leader. This is a small group for both everyday life supporting of the chieftain and strategic decision-making. Of course, these two sub-groups are often absolutely different. The first is for security guarding and meeting

²² A.Rstaki, S.Borisov. Putin’s file. Novaya gazeta, 2000, No 11, March 2000. By the way, as per estimation of M.Sal’e, member of city Duma and head of the city’s parliament group for investigation, there was 850 mln USD of lost funds because of the activity of Committee of Foreign Affairs headed by V.Putin (M.Sal’e. V.Putin – ‘president’ of corrupted oligarchy. Public foundation ‘Glasnost’, March 18, 2000).

everyday needs of chieftain. It includes body guards, trusted servants and techno-managerial assistants. The second is for the analysis of the major challenges and threats and for elaboration of the key decisions concerning operation of the clan, as well as for the conducting of the most delicate shadow actions. Also in responsibility of these persons are usually control over the key sectors of clan activity, such as first of all financing, external relations, buying and selling of the new assets. Of course, they are operating as the representatives of the chieftain, and share only the part of the overall data controlling by the chieftain himself. In spite of different roles sometimes persons from the first sub-group can move to the second. Key persons have personal informal contacts with chieftain and possessing main benefits from the clan activity, sharing main profits and benefits (especially it is true for the second group, and sometimes - for the first).

For chieftain this core is the major source of the clan's success – if he can recruit and manage loyal and effective persons for his core ('his team') he has high odds to win in competition. But often this core is the principal threat for the position, and sometimes, life of the chieftain. Because, the members of the core are the most well-informed persons on clan operation including shadow and illegal actions. They know best the major weaknesses and disadvantages of the clan and its chieftain. Therefore, the dissent in the core or between key persons and chieftain is one of the major challenges for the clan effective operation and even existing. This is the reason why 'betrayal' is accounting as the gravest crime in clan's group ethics.

The size of the core is varying from few to several dozens of persons. For example, core of Hodorkovsky's clan is less than 10 persons. As per data circulated in media and in Internet among the key persons are as follows.

1) L.Nevzlin started as the subordinate of Hodorkovsky at the end of 1980s and became his closest friend and partner strongly supporting him all the time. Beneficiary of the 'MENATEP' group;

2) M.Brudno started as the head of the one of the Bank 'Menatep' department and was responsible for the regional projects of the UKOS. Beneficiary of the 'MENATEP' group;

3) V.Dubov from the end of 80s has started to serve as the one of the top managers of the Bank 'Menatep' and then became the member of the UKOS's Board of the Directors. Beneficiary of the 'MENATEP' group;

4) P.Lebedev was attracted to this clan by L.Nevzlin. Head and beneficiary of the 'MENATEP' group;

5) S.Monakhov together with M.Hodorkovsky created Bank 'Menatep';

6) B.Zolotarev started as the head of one of the department of Bank 'Menatep', then he was elected as governor of republic 'Evenkia'. He is serving at this post to date;

7) V.Shahnovsky officially has joined to this clan at the end of 1990s as one of the top managers of the 'UKOS-Moscow' (daughter company of UKOS). Beneficiary of the 'MENATEP' group.

Estimating in 1999 (before the 'UKOS criminal case') Hodorkovsky's activity of the creation of his team at the end of 1980s, one of the businessmen replied to the journalist Yu.Latynina: "At that time people have made business one by one. We made business together only during single project, sharing profits and then stopped joint operations. Otherwise we were at risky to be imprisoned. But Hodorkovsky preserved

and legalized his team. He tremendously ran risks. But finally he won an enormous prize²³.

The third element of the clan is the skilled professionals – lawyers, managers, book-keepers, technical specialists gaining high level of salary. Usually most of them are recruiting by the core of the clan without sharing of the top leader. Contrary to the key persons they have no direct, intimate and informal relations with chieftain. They do not share the most part of ‘classified’ data concerning clan operation. They have access only to minor part of operation and data which is depends on their professional responsibility. Of course, they do not share the profits, but sometimes they suffer during the clan’s wars, as S.Bakhmina (deputy of the head of the law department, ‘UKOS-Moscow’) during the ‘Hodorkovsky’s case’.

The fourth element of the clan is the ordinary members – specialists and manual workers employed in business entities controlled by the clan. They have no profits and benefits, only relatively stable salary and position. Usually they have no access to any data on operations of the clan.

And finally, the fifth element of the clan is ‘agents of influence’ – people outside clan but serving it because of their unique positions in media, law enforcement agencies, local or federal government, local or federal Parliaments, public organizations. They render important services for clan providing insiders’ information, warning about any jeopardy, trying to direct the policy to the sake of the clan. The biggest clans have their representatives at the top of the power – administration of the President, federal government, State Duma. Correspondingly, local clans have their agents at the regional bodies. These agents are supporting by clan’s financial resources and informal networks.

²³ Yu.Latynina. Hodorkovsky’s Empire. “Sovershenno sekretno” (“Top secret”), August, 1999

Therefore it is a hard task to replace such agent even if he is inefficient functionary – clan can try to stop replacement using all tools from administrative pressure to the criminal actions. And some strong clans can preserve their agent in government even if Prime-minister wants to fire him. As a rule agents of influence are recruiting by chieftain and key persons. The activity of these agents is over the direct control of chieftain who concludes informal contract with them and put them specific tasks.

These five elements combine the structure of the clan – see figure 1. Every clan is the hierarchic entity with scale of the ranks. As in every group social order within clan is maintaining by the system of incentives and sanctions. The most important incentive is the promotion to the higher position in the clan inside hierarchy that showing itself in intimacy with clan leader. More intimacy – higher position in the clan – higher income and prestige. There are many punishments in clan for wrong behavior, from soft obstruction to exile outside clan and even assassination. And the most improper behavior isn't violation of the formal law, but 'betrayal' – disclosure to the competitors or official bodies of the 'classified' vitally important data circulated among members.

There are many clans in current Russia controlling economy, politics, law enforcement agencies, media, public sector. We can find 4 major types of these clans

1) top clans controlling federal bodies and the lion share of the assets in the country. There are dozens of clans operating at the top level. As per estimation of V.Pribylovsky analyzing analyzing this type of clans, there are four major clans among them:

- i) 'Chekists' or 'New Piter's group' headed by V.Putin;
- ii) 'Old Kremlin group' or 'Semya' headed by Eltsin and his cronies;

iii) 'Old Piter's group' or 'Chubais clan';

iv) 'Moscow Luzhkov's clan'²⁴.

Now Putin's clan fully dominates, meantime others are losing power step-by-step, especially Luzhov's clan;

2) clans operating within different sectors of the Russian economy and society – the most powerful clans are in industries dealing with extraction, processing and export of natural resources (oil, gas, metals); FSB; financing; military; law enforcement agencies; defense industries. There are thousands of these clans and the most powerful of them are the FSB and those are dealing with natural resources;

For example, in metallurgy there are revealed near fifteen major clans controlling companies with sales more than 50 bln. USD, with around 10 bln. of net profits and officially paying near 5 bln. USD of taxes²⁵. Russian leading business media 'Kommersant' outlined three categories of clans differing with the background of their emerging:

i) core consists of people possessing of the metallurgical background who were professionals since the Soviet era;

ii) core contains persons from so called 'tsehoviki' – shadow entrepreneurs who have started to make business in Soviet era. They informally contracted with former directors to produce consumer goods using metallurgical facilities and lately redeemed them;

²⁴ See: V.Pribylovsky. Oligarchs of the Putin's era. Most powerful nomenklature clans of Russia. Journal 'Smysl', No. 7, May 1, 2003

²⁵ M.Molina. Plowmen of the metallurgical field. Supplement to newspaper 'Kommersant', No 172 (3256), September 14, 2005 (in Russian)

Environment: government bodies, law enforcement agencies, media, public sector

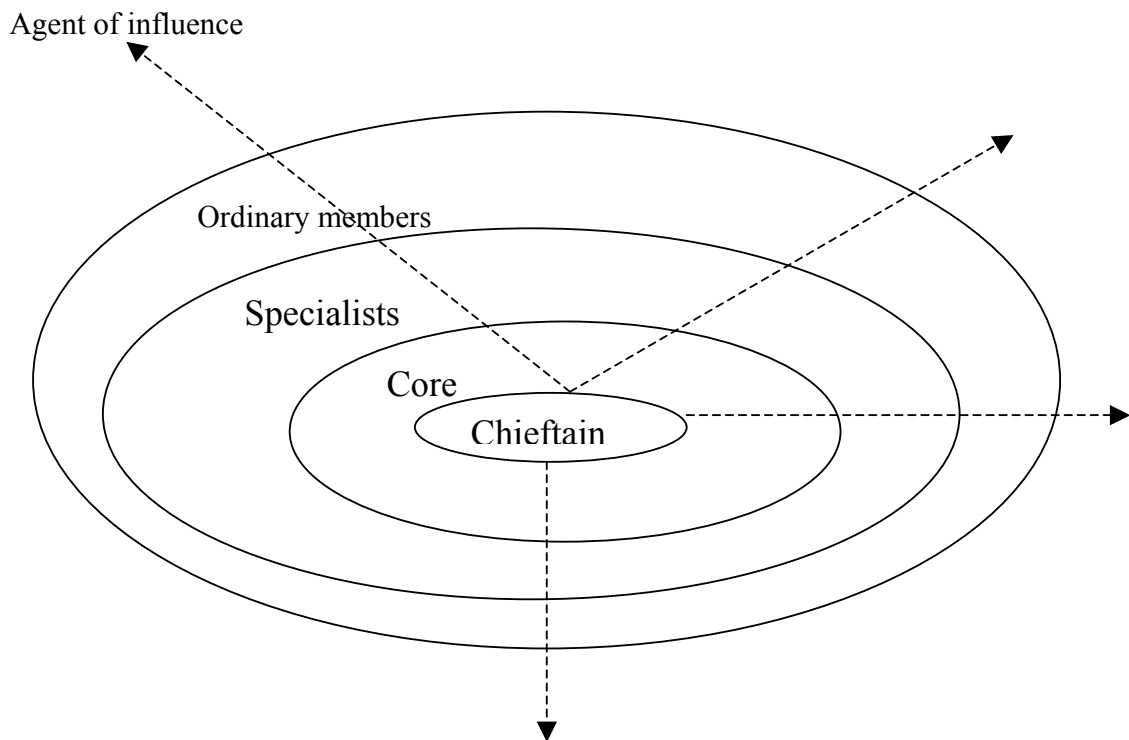


Figure 1. Inner structure of the clan

iii) core from former ‘smart boys’ graduated prestigious Moscow universities and with cronies in government and law enforcement agencies. They were engaged in trade and then invested accumulated funds into shares of metallurgical factories²⁶.

3) regional clans are operating within certain republic, ‘oblast’ (‘krai’), urban or rural areas. There are thousands of such clans. For example, the situation in the town ‘Votkinsk’ in republic of Udmurtia where is producing of intercontinental ballistic rockets ‘Topol-M’. There are three clans in this city:

²⁶ Op. cit.

i) Clan of Kochetkovs brothers, who are businesspeople controlling the most part of the business entities of this town;

ii) Clan of Bychkov who is the head of the building construction firm ‘Master’ closely affiliated with communists. He controls TV company ‘VTV’ and the most popular local newspaper ‘VTV+’;

iii) Factory clan headed by the leader of ‘Votkinsk’s Factory’ producing rackets ‘Topol-M’²⁷.

Representatives of these three clans competing for the control over post of mayor and local Duma.

4) criminal clans – organized criminal groups operating at the most of territories (cities and rural areas). As per estimations of Ministry of internal affairs there are around 10 thousand of such groups in Russia comprised near 4 millions persons. Minister Nurgaliev reported to the Soviet of Federation that there are 116 of the biggest among them which operating at the interregional and international levels combining more than 4 thousands active members. They control around 500 big companies in metallurgy, forestry, catching bio-resources, output and trade of alcohol and tobacco, producing and trade of cars.

These clans closely interacted and inter-related between each other, they cannot operate separately. There is some hierarchy in these relations: top clan control operations of many clans in different sectors and regional clans as well as criminal groups (see figure 2).

These three levels (presented at the figure 2) have their own hierarchy – small criminal ‘brigades’ are the part of big criminal bodies, small clans in towns are

²⁷ K.Yadrov. Abnormal town. Sovershenno konkretno, No 35 (191), August 28 – September 4, 2003

subordinating to bigger clans in capital of the oblast, some industrial enterprises are the part of big financial-industrial holdings, and etc. The biggest clans at every level headed by so called ‘oligarchs’. There are around one – two hundreds of oligarchs at every level, therefore, obviously, near one thousand oligarchs are operating in Russia totally at the moment including regional and criminal ones.

At the same time clans are competing between each other purposing to reach domination at their sector of operation. They are acting similar to agents of capitalist economy.

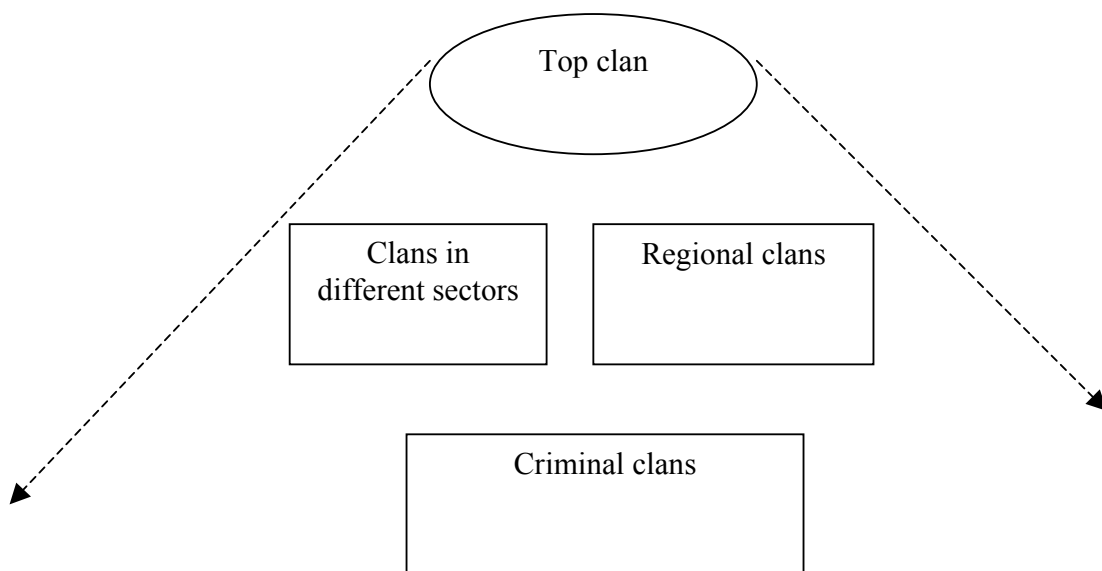


Figure 2. Clan’s hierarchy.

3. Clan capitalism in Russia

Clans are consist of groups of business people, state officials and sometimes organized criminals, who exclusively control most profitable markets and push off those who could produce cheaper goods of better quality. They are the main actors of the

socioeconomic system that has emerging in Russia as a result of transition – system of ‘clan capitalism’.

Scholars have starting to reveal some features of the system that is differing from the expected ‘competitive capitalism’ (‘capitalism of free market’, ‘modern capitalism, ‘civilizes market system’ or the like) in Russia from the middle of 1990s²⁸. In this system clans are dominating and clan’s control is prevailing over the other coordination mechanisms (market and bureaucratic²⁹). State in this system is clan-state that ‘operates in a context where there is little separation of the clan from the state. The same people with the same agenda constitute the clan and the relevant state authorities’³⁰. The main source of the development within this system is the competition among clans, that is mean the situation when not full monopoly of the single clan in every sector of the society, in every industry, and in every local community. Of course, it isn’t ‘free market competition’ as in classic capitalist system. Most likely it is ‘clan wars’ where economic tools are not unique instrument and, probably, not the principal³¹. But anywhere, due to these wars clans cannot converse into full monopolies and being mostly protected from market competition, they have no complete guarantees of achieved positions.

²⁸ See: Graham, Th. E. (1995). New Russian Regime. *Nezavisimaya gazeta*, November 23 (in Russian); Graham, Th. E. (1996). Russia’s New Non-Democrats. *Harper’s Magazine*, vol. 292, № 1751, April; Wedel, J. R. 1998. *Collision and Collusion: A Strange Case of Western Aid to Eastern Europe*. N.Y.: St. Martin’s Press; Kosals, L. (1995) “Development of the clan capitalism in Russia”, *Knowledge Is Power Itself (Znanie-sila)*, No. 3. (in Russian) and many other publications devoted to various features of Russian capitalism.

²⁹ See about coordination mechanisms in article of J.Kornai, who emphasized more diversity of these mechanisms than mentioned above (Kornai J. The Affinity between Ownership Forms and Coordination Mechanisms: The Common Experience of Reform in Socialist Countries. - *Journal of Economic Perspectives*, 1990, vol. 4, No 3)

³⁰ Wedel, J.R., “Flex Organization and the Clan-State: Perspectives on Crime and Corruption in the New Russia”, Pridemore, W.A. (ed.), (2005), *Ruling Russia*, Rowman & Littlefield Publishers, p. 114

³¹ To understand mechanisms of operating of clan system it is necessary to examine causes, forms and consequences of clan wars.

The principal cause of forming this system was the hostile business and political setting. Business people were forced to protect themselves from this setting shaped as a response to liberalization. There were no norms and traditions of the democracy and market in Russia when liberalization had started. It was the beginning of era of ‘free competition’ when state formally existed but could fulfill only elementary duties. Inside state rapidly formed clans combined the most active functionaries. They provided privatization for the sake of their cronies and formed affiliated clans. And this activity had its own economic logic and economic background, since in hostile setting it provides the reducing transaction costs³² inside certain clan because of very high level of personal trust in ‘not trustworthy’³³ environment. In this period state didn’t care and couldn’t establish any limits for unconventional activity.

Until to the end of 90s most clans had formed and the era of relatively free society in Russia had finished. They started to cruelly restrict economic and political freedom to protect their positions using state bodies.

Meantime, certain level of economic freedom is remained, though with lack of rigid and precise legal regulations. This allows not only powerful business clans to realize many kinds of economic activity, but also non-clan agents to conduct their businesses in those sectors, which do not exhibit much interest for clans. This freedom allows many social groups (“shuttles”, street merchants etc.) to survive though it can not ensure conditions for investments and innovations.

³² S.Mizobata outlined that informal system plays an important role in reducing transaction costs (S.Mizobata. Diverging and Normalizing of Corporate Governance in Russia. Document de travail 05-2, CEMI (EHESS), Mai 2005 (<http://www.ehess.fr/centres/ceci/pages/documents/doc108-mizobata.pdf>, p.27).

³³ Radaev, V. (2003) *How Trust Is Established in Economic Relationships When Institutions and Individuals Are Not Trustworthy (The Case of Russia)*, paper prepared for the CEPR/WDI Annual International Conference on Transition Economies, Budapest, 3-5 July, 2003

The important feature of clan capitalism in Russia is post-Soviet monopolism that is basically of not market character. It comes into existence as a result of functioning of clan structure, but not in a course of market competition. Its main sources are the state and criminal groups. The basic tools of its realization: 1) state bodies and some officials create various “authorized” structures and “crony” firms, which are headed by people to some extent connected to authorities and/or to officials, they create favorable conditions for these firms (issue contracts for building construction, etc.); 2) restricting the number of market agents by means of legal, administrative and force tools (closing markets against “outside manufacturers “, ruining competitive firms via tax bodies operation, etc.); 3) creating “roofs” for private companies of a various sort, constrained to pay for “services” imposed by force. In all these and other forms of post-Soviet monopolism the state acts not as a body of governing, but as the market agent having extraordinary powers. In particular, law enforcement agencies in this system aren’t the tools for supporting the law by instruments in economic competition and political disputes. Additionally, being one of the agents in the market and gaining as per our empirical study of militia more than \$US 3 bln. per year, they have reached relative independence³⁴. Therefore instead of market competition (in terms of prices, quality of goods, new products, better services of the consumers, and etc.) are clan’s wars when political, administrative, media and criminal instruments are carried out. The winner in clan’s war isn’t the businessmen who produce the best good but holders of most powerful agents of influence in administration and law enforcement agencies.

³⁴ O.Kolennikova, L.Kosals and R.Ryvkina. “Commercialization of Militia Service Activities: Opinion of Officers”. *Sociological Studies* (Sociologicheskie issledovania), No. 3, 2004, in Russian

As a result there is the distortion of the aims of enterprise – often economic efficiency are not so important in a decision-making because someone become the winner in competition using non-economic (first of all, political and criminal) tools in the current situation when there is no equal conditions for competition.

In system of clan capitalism is no rigid separation between the roles of a businessman and of an official. In the beginning of market reforms the nomenclature business was the price, which the society paid for the consent of the nomenclature to conduct reforms. Otherwise reforms would not be begun at all in the Russian society. By now nomenclature business has been institutionalized, its protection and reproduction mechanisms have been formed. Therefore, the essential feature of clan capitalism is ‘cronyism’—special intimate links established between officials and certain businesspeople representing powerful clans. ‘Cronyism’ is one of the specific features of clan capitalism. It was examined in detail within analysis of the specific model of capitalism developing in Latin America – crony capitalism³⁵. Economically, nomenclature business is evil (nomenclature businessmen enjoy undeserved advantages before “simple” businesspeople, and their business risks are shifted on the state budget³⁶) however in conditions of clan capitalism it is ineradicable.

Important feature of clan capitalism is institutionalization of shadow economy. While in countries with transitional economy as a whole the shadow part makes

³⁵ It would be productive to make special comparison of well-developed conception of crony capitalism with idea of clan capitalism. See further details of crony capitalism, for example, in the following publications: Haber, S. (ed.) (2002), *Crony Capitalism and Economic Growth in Latin America*, Hoover Institute; Kang, D. (2002) *Crony Capitalism: Corruption and Development in South Korea and the Philippines*, Cambridge University Press; Krugman, P. (2002) “Crony capitalism, U.S.A.”, *The New York Times*, January 15, 2002

³⁶ Analyzing the economic consequences of crony capitalism A.Kruger concluded in her chapter “Why Is Crony Capitalism Bad for Growth?” (in: Haber, S. (ed.) (2002), *Crony Capitalism and Economic Growth in Latin America*, Hoover Institute) that ‘crony enterprise’ operates similar to state-owned entity that is huge disadvantage in term of efficiency.

approximately 25%, in Russia it reaches 40 - 50 %, that corresponds to a level of developing countries (in advanced OECD countries it averages only about 15 %)³⁷. In the established system the shadow economy is an essential reaction of the society to inadequate behavior of the state, which can not limit and regulate its own (and its official') intervention into economic life. The shadow activity is a "through feature" of Russian economic system; this activity is present in operation of practically all organizations, including state ones³⁸.

In this system property rights are unprotected for both the following reasons—i) the intervention of government and law enforcement officials in business, as well as criminal attacks by organized criminal groups; and ii) businesspeople included into informal networks within the clan, where despite the benefits afforded by patronage of this vast informal entity, they are forced to forgo their property rights to buy such protection. This is a sort of social contract—renunciation of economic sovereignty in exchange for security. As clan members, businesspeople are protected from hostile settings, but remain unable to invest money, innovate, sell their business or even hand it down without the informal permission of the clan leaders.

4. Conclusion: from clan capitalism to oligarch capitalism?

³⁷ On size of shadow economy in OECD countries, developing countries and in countries with transitional economy see D.Enste, F.Schneider. *Increasing Shadow Economies All Over the World - Fiction or Reality? A Survey of the Global Evidence of their Size and of their Impact from 1970 to 1995*. Bonn, The Institute for the Study of Labor. Discussion Paper No 26, December 1998

³⁸ See about this in Kosals, L. and Ryvkina, R. (2001) "The institutionalization of shadow economy: rules and roles", in Segbers, K. (ed.) *Explaining Post-Soviet Patchwork Vol. II: 'Pathways from the Past to the Global'*, Ashgate Publishing.

Being one of the many forms of the capitalist system in the modern world³⁹, clan capitalism in Russia is changing all the time⁴⁰. And it is vitally important for Russia to understand possible trajectories for this system.

Clan capitalism is an integral system, and its all features are closely interconnected. For example, monopolism creates conditions for nomenclature business. In turn, nomenclature business, being formally forbidden, in conditions of economic freedom leads to large-scale outflow of the capital abroad and to development of shadow economy. Within the framework of the established clan capitalist system there is a political consensus between various forces interested in conservation of the system. On the one hand, such a consensus provides social stability on the nearest future. On the other hand, it is one of major obstacles for improving the economic system. Therefore, there are no hopes that it is possible to extract itself from the bad post-Soviet trajectory⁴¹. Most likely, it is possible to make this only after deep systematic crisis.

It seems that we can expect the systematic crisis after the turn current clan system into the 'oligarch capitalism'. Oligarch capitalism means elimination of the current clan's competition and establishing the complete monopoly in every sector of the Russian society. Then several dozens of the oligarchs will be responsible for the decision-making in the country similar to the old Politburo of Communist Party.

³⁹ See about diversity of capitalism in: Crouch, C. (2005). *Capitalist Diversity and Change*. Oxford University Press, where presented typologies of capitalism (chapter 2). As per diversity of the capitalism in transition countries see B.Chavance "The Evolutionary Path away from Socialism: The Chinese Experience", in E. Maskin, A. Simonovits, eds., *Planning, Shortage, and Transformation: Essays in Honor of Janos Kornai*, Cambridge (Mass.), MIT Press, 2000 and also his article: B.Chavance (1999) "The Evolutionary Path away from Socialism: The Chinese Experience", in *Voprosy ekonomiki*, No 6 (in Russian)

⁴⁰ It is necessary to analyze clan capitalism in compare with the other capitalist systems first of all with those emerging in transition countries.

⁴¹ Contrary to Bulgaria, Russia has no 'external anchors' for the transition (see about external anchors in: D.Ialnazov, "Can Country Extricate Itself from the Post-Socialist Trajectory?", *Hikaku Keizai Taisei Kenkyu*, Vol. 10, 2003). Additionally, there is no developed program purposing to change the path of transition in Russia.

Now Russia is under way to oligarch capitalism. In my point of view the critical milestone in this path would be institutionalization of the ‘appointment of the successor’ and conversion trial with Putin’s appointment by Eltsin into the stable institution operating in all levels of system of governance⁴². In this case system soon will be grabbed by institutional sclerosis and hence shortly after by systematic crisis.

There are two important pre-requisites for emerging of the ‘institution of successor’.

Firstly, Putin and his clan are urgently seeking for the successor. So, replying to the question about successor asking by journalist just after his successful election in 2004, he had answered: “selection of the candidate had started already a long time ago. I have an idea what kind of person he has to be. He must be the honest and respectable person who wants and who capable to serve to our people. There are many such persons in the country”⁴³.

Secondly, there is some experience of the appointment of the successor both at the federal (Putin’s case) and regional levels. The latter was within the new procedure of the appointment of the governors: as per some preliminary analysis two appointed governors were successors of the former ruling clans among total nine appointed persons until to the beginning of the October this year⁴⁴.

⁴² Of course, if Putin and his clan will decide to keep the current president in power (as per many informal signals from the top this variant is under consideration too), oligarch capitalism will be completed immediately.

⁴³ Putin’s meeting with journalists in the election headquarters after the end of voting for President of Russia, March 15, 2004, 5 Red Square, Moscow
http://www.kremlin.ru/appears/2004/03/15/0321_type63380_61835.shtml

⁴⁴ Shavelev, A. (2005). New system for the election of the heads of the regions of Russian Federation, Website for the analysis and information “Eurasian House”, October 10,
<http://eurasianhome.org/?/forum/2005/10/03>

To summarize this experience I can outline the following elements of the forming institution of the successor.

- i) search of the potential candidates and concluding with them preliminary informal contracts providing guarantees for former leader;
- ii) informal talks within the clan's core about the group of candidates to successor and achieving consensus;
- iii) achieving informal consensus about this group with top clans headed by oligarchs;
- iv) achieving informal consensus with key regional clans and clans of different sectors;
- v) testing the candidates via appointment to the important posts with high level of responsibility to reveal their loyalty and professional skills;
- vi) final choice of the successor; official announcement and presentation of the successor to the public;
- vii) preparation to the elections by means of creation of the favorable conditions and advantages over his potential rivals to guarantee a triumph. To do this via elimination of the potentially powerful candidates by agreements or by restrictions if the access to financial resources and to media, as well as by force;
- viii) management of the procedure of voting to convict of West and Russian public that it was free elections with real competition. To do this top clans using different tools - restrictions of access observers from opposition to polling stations, and etc.;
- ix) gradual handing over credentials with preserving some 'informal anchors' to control new leader to guarantee that he will fulfill the initial contract.

Of course this isn't a real democracy, it is the 'demonstrational democracy' when elections of the president were replaced by the 'appointment of the successor'. In one hand institution of successor is the stabilizing element of the political and socioeconomic system because it based on the consensus of the key actors. It is in line with the habits and practices existing within clan structure in every level of society. In other hand it undermines the incentives for political participation of the public, and led to socioeconomic and political stagnation.

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