The Dynamics of State Power and Economic Reform in Russia

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Introduction and Hypotheses

In economic reform, political and institutional constraints prevent a reform-minded leader from choosing optimal policies to maximize the level of the general social welfare. In some countries, these constraints are extremely high. Post-soviet Russia is one example. The weak state institution that poorly disciplined state agents and powerful interest groups (so called oligarchs) highly constrained a feasible set of policies when the leader decided to reform. This study attempts to explain how the political leaders in Russia facing such constraints have achieved some important macroeconomic reforms such as macroeconomic stabilization and fiscal reform.

I argue that diminishing collective action of private interests and asset property of the dominant economic actors created the dynamics of state power with respect to state autonomy and capacity. The dynamics or resurrection of state power was in turn associated with the outcome of economic reforms. Regarding state institution formation as a dependent variable, affected by the interaction of the state elite and politically and economically influential groups, I argue that state power in Russia significantly changed and that this explains macroeconomic stabilization after 1996 and fiscal and regional reforms in the 2000s in Russia.

My argument against state autonomy theory (Haggard and Kaufman 1995) is that a leader can mobilize interest groups (ones that have a strong interest and ability to seek economic rents) with selective incentive into economic reform and growth instead of being insulated from them. It goes further to say that not only political capacity but also overall state institutional capacity might be improved in this process. Showing how this possibility was realized in Russia, I will demonstrate that a significant change of state power with respect to state autonomy and capacity had occurred in the course of market reform, which in turn made feasible what was not feasible before for the leader in the area of policy choice and policy implementation.

At the same time I disagree with the pessimism of the structure-based explanation of economic reform, I find the pure voluntarism that solely emphasizes the strategic choices of reformists also problematic. Schleifer and Treisman (2000) raise an interesting issue about reformers' strategic choices such as "co-optation and expropriation" as a way to deal with politically powerful rent-seekers, but they do not pay enough attention to structural factors that affect the political power of rent-seekers and change a feasible set of a leader's choices. What is not asked in their study is why Russian rent-seekers gave up their previous rights and methods that were more profitable in exchange for less lucrative selective incentives.

An important theoretical aim of this dissertation is placed in the middle of these criticisms. It is to provide an approach to examining and explaining the dynamics of state power during marketization. Post-communist transition is unprecedented in a sense that a massive transformation occurred simultaneously at the level of the state and the economy (Elster, et al. 1998). Because of this, any theory of market reform in post-communism should include the factor of the dynamic change of state building. I argue that state power with respect to state autonomy and capacity significantly fluctuates in a relatively short period in Russia and this factor determines a feasible set of policies for the policy-maker and the success of policy implementation in an important way in Russia's market reform.

First Hypothesis: The collective action dilemma among rent seekers and the dynamics of state autonomy

First Hypothesis: A privatized state becomes more able to reform its economy as time goes on because the potential for collective action of rent-seekers becomes weaker and weaker under a privatized state and this makes the state more and more autonomous.

Recent important studies of social cooperation mainly examine the interaction between individuals at the micro level. They have succeeded in illuminating conditions to overcome collective action dilemmas, but their findings are heavily related to social and economic variables instead of political ones (Frye 2000, 33-4).[1] A sociological approach stresses institutional conditions embedded in individual interactions, and an economical approach emphasizes such factors as interest heterogeneity, the size of interaction, the number of players, and discount rate of future returns. Both approaches focus exclusively on the possibility of cooperation in the absence of a reliable third party enforcer (Axelord 1984; Talyor 1987).

Because of this narrowly defined, though important, research interest, the idea that different types of the state as the main third player in society produce different possibilities for social cooperation is notably missing in their inquiry of social cooperation. I attempt to bridge this theoretical gap in this paper. To do so I will explicitly rely on propositions related to conditional cooperation in the absence of a central authority. This means the following causal chain: I treat types of the state institution as the independent variable and social and economic variables as the intermediate variables. The dependent variable is social cooperation. My treatment of the state as a macro institutional variable is different from Frye's (2000) emphasis on specific state policy. I examine the impact of the state as an institution, measured in terms of the degree of rule-governed behavior and collective cohesiveness, on the possibility of conditional cooperation.

The first task for this analysis is to conceptualize the Russian state. Evans (1995) provides an excellent starting point for my conceptualization. He measures the state in terms of corporate coherence and rule-governed behaviors among state organs and their agents. According to him, a "predatory state" is defined as follows:

> Predatory states lack the ability to prevent individual incumbents from pursuing their own goals. Personal ties are the only source of cohesion, and individual maximization takes precedence over pursuit of collective goals. Ties to society are ties to individual incumbents, not connection between constituencies and the state as an organization. Predatory states are, in short, characterized by a dearth of bureaucracy as Weber defined it (Evans 1995, 12).

The post-Soviet Russian state embodied such key features of a predatory state as the priority of private interests of state agents and the absence of any significant collective cohesiveness within the state institution, but it did not contain a "strong despotic or infrastructural power" (Mann 1986) that a predatory state has (Evans 1995,

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[1] A notable exception has been recently made by Frye (2000) and Ha (2005).

45). On the contrary, its policy decisions were significantly subject to social influences outside the state. Unlike a predatory state, a privatized state was not able to penetrate society and to mobilize social resources for many important state goals either. Therefore, I use the concept of a privatized state rather than a predatory one to classify the Russian state after the collapse of communism.

I define a privatized state as a state where there is an explosion of private interests within and toward the state for the (re) distribution of state property, institutions, and authority and which, due to institutional weakness, cannot resist these private demands. In Russia, the privatization of the command economy and the institutionalization of property rights over almost everything under the weak state after the collapse of the party-state based on state ownership created enormous opportunities for rent-seeking and strengthened the incentive to destroy the state further. In the distribution game, the determining factor for economic success was position within the state and the privatization of part of the state. Consequently, the state was captured by private interests of individuals not only within but also, and more importantly, outside of the state. As a result of the privatization of the state, the state was drained into the networks of private interests, in the Russian case, clans connecting newly enriched big businessmen, later called oligarchs, which influential politicians and regional and central governmental officials. In sum, a privatized state is a state exploited by predatory private interests. This definition differentiates the privatized state from other weak states in terms of the degree of state capture, corruption, and institutional fracture. A privatized state is a state where particularistic interests totally dominate the fractured state.

I argue that the privatized state weakens society and makes it unable to form strong collective action. To logically support this hypothesis, I will make three propositions to explain the social consequences of a privatized state. First, a privatized state is likely to strengthen the concern for relative gains in society, which in turn frustrates the cooperation that might be otherwise easily realized. Second, a privatized state is likely to make it hard for players to enjoy a long-term time horizon and to hinder cooperation. Third, a privatized state encourages social groupings based upon a narrow but strong group boundary and produces a fragmented and parochial society. This makes it disadvantageous for extensive reciprocity to spread trustworthiness and "norms of generalized reciprocity." Therefore, extensive cooperation with outsiders is unlikely to happen. In short, a privatized state, causing the intensification of concern for relative gains, a shortened time horizon, and disconnected social groupings, increases the possibility of social non-cooperation and hinders the development of self-governing organizations. All of this means that collective action of rent-seekers becomes weaker and weaker under the privatized state. For my present purpose, I will focus on the first two propositions in this paper.

A privatized state is likely to increase the centrality of relative gains because it increases zero-sum conflicts in society. Such a state is very willing and able to transfer public resources to a private party whenever a minimum amount of material incentive attracts the agency's opportunism. The distribution of wealth and power through the private occupation of public domains resembles a zero-sum game, which means that one's gain is another's loss. Therefore, a privatized state vulnerable to parochial demand is more likely to increase the probability that the public is involved in a zero-sum game, everything being equal.

In order to understand the negative effects of increasing zero-sum conflicts on social cooperation, let us suppose that a pair of players deals with cooperative and zero-sum games sequentially or simultaneously. Players might believe that the others get asymmetrically favorable outcomes in cooperative games even though cooperation is mutually beneficial. It is conceivable that asymmetric outcomes upset the previous status quo. Consequently, the following zero-sum game is likely to result in a widening of the gap. The frequent connection of cooperative and zero-sum games sensitizes players to the asymmetric outcomes of the cooperative game. As zero-sum situations become more frequent, the sensitivity to relative gains becomes stronger. As the pressure of relative gains increases, social interactions become non-cooperative (Snidal 1991).

Not only does a privatized state create an environment to transform cooperative interaction into a non-cooperative game, but it also undermines the possibility of conditional cooperation in an iterated non-cooperative game. According to an iterated Prisoner's Dilemma (PD) game model, when people perceive that they will meet their partners in the future, there will be a possibility of cooperation, unless future returns are severely discounted. A high anticipation of future returns in this game transforms a PD game into more harmonious games such as the assurance game, in which mutual cooperation is the dominant strategy and results in optimal payoff (Taylor 1987, 65-67).

Unfortunately, a privatized state shortens the time-horizons and makes reciprocity unreliable, which in turn makes collective action for the public goods less likely to happen, since the widespread private occupation of the public domain creates a strong positional power. Positional power is generated when actors place themselves in certain strategic positions. Whoever has positional power is able to define terms and conditions unilaterally over others. We have to keep in mind that a privatized state maintains the unwavering ability to create exclusive private rights for public resources, since it is closely related with the personal interests of state agents. Institutionalized particularism in a privatized state makes it easy for individual bureaucrats to construct various entrance barriers that favor their clients. In short, positional power is easily and frequently created in a privatized state. The easy and frequent appearance of positional power makes a reciprocal strategy useless and greatly shortens time horizons. When a defector has strong positional power, utilizing a significant difference in payoffs between unilateral cooperation and defection, it is feasible for the defected to punish the defector because the defector dictates terms and changes the rules for the next encounter. Under such a circumstance it is self-destructive to adopt a tit-for-tat strategy, to be nice in the first move and to maintain a long-term time horizon. In conclusion, a privatized state eliminates the two conditions for conditional cooperation: the feasibility of reciprocity and a long term time horizon because an initial defection produces a great amount of positional power.

These two propositions lead to the conclusion that a privatized state makes social cooperation difficult. They are especially relevant to elite groups because their relatively easy access to the privatized central power provides them with a substantial opportunity to expand their wealth and political power. This all means that they are likely to be subject to collective action dilemma because of their fierce competition for relative gains and positional power.

This has significant implication for reform politics. As time goes on, a privatized state becomes more able to reform distorted economies than before not because it is insulated from social pressures but because the vested interests cannot take collective actions effectively. Because of the diminishing collective action ability of rent seekers, the state improves its autonomy to be able to expand its feasible set of policy choices.

Yet in spite of enhanced state autonomy, lingering doubt remains over the feasibility of market-oriented economic reform by a privatized state. Reforms that aim to expand the role of the market and reduce the intervention of the state in economic decisions concerning resource allocations ironically need a strong state that is able to maintain consistent policies, as well as resist social demand for state intervention for rent generation. This "orthodox paradox" questions of whether a privatized state has the ability to implement its goals.

Here is the place to differentiate two different concepts related to state power, state autonomy, and state capacity. State autonomy is the degree of freedom of state agents from social interests in their policy decision. State capacity is the degree of ability of state agents to implement their goals effectively or efficiently. Once again, the social consequences of a privatized state still do not solve the issue of state capacity, which will be discussed next.

Before discussing how a privatized state as the typical case of a weak state solves the "orthodox paradox," I would like to make a distinction between two different types of state policies: passive and active. Passive reform policies require a simple ending for what the state did previously. In this case enhanced state autonomy would be enough to accomplish the goal of reform. An example is macroeconomic stabilization.

State capacity becomes an issue when the state needs to enact active reform policies. Fiscal reform is an example. Given its prevalent agency opportunism to maximize private interest over public goals, it is obvious that the privatized state is badly equipped to implement active reform policies. In terms of institutional economy, it increases transaction costs of the ruler because of agency opportunism (Levy, 1988).

There might be two different solutions for the ruler to reduce agency opportunism. One is to change state institutions to create habits of compliance. This is probably a long-term solution. For a short term solution, the ruler has to create an incentive structure of his agents identical to his in order to successfully implement his goal. Alternatively, he needs to recruit an outside force whose interest is identical to his into the government policy network.

This discussion provides a new perspective of the inner logic of why the Russian government promotes big firms whose size is large enough to be monopolistic. This industrial structure might be used to reduce transaction costs to rule the state. In the face of an ubiquitous agency opportunism, the leader of the government would prefer a short policy circuit to skip middle layers in the state administration and a highly centralized policy network. Monopolists as "stationary bandits," different from middle-level state agents, might share common interests with a state leader. The creation of monopolies might be a suboptimal but realistic solution in the face of severe agency opportunism. The next section will discuss the condition and strategy of a privatized state able to compensate its institutional weakness with its cooptation of the business sector.

Second Hypothesis: Asset Property of Rent Seekers and State Capacity

Second Hypothesis: If asset property of rent seekers is mobile rather than fixed, they will have a weak interest in the improvement of state capacity. On the other hand, if the dominant form of their assets is industrial capital, they will help to improve state capacity.

I presume that asset property of the dominant business sector greatly affects the possibility that a privatized state might compensate its institutional weakness and its "agency opportunism" through the cooptation of capitalists. I classify two different types of capital in terms of asset mobility: financial and industrial. I hypothesize that industrial capitalists are more likely to support the state elites to expedite market reform than financial capitalists when the state tries to reform its rent seeking economy.

This presumption finds its support in the argument that interest groups and individuals behave differently according to their asset specificity (Frieden 1991, 19-22). More specified asset owners are more interested in government policy and more politically active than mobile asset owners. I argue that this proposition explains the difference between pre-1998 and post-1998 Russian political economic systems. Before the 1998 financial crisis, the dominant rent-seekers in Russia were large banks. After the crisis, conglomerates almost completely replaced them. This change of the oligarchs' asset characteristics is responsible for the improvement of state capacity in the 2000s, if partial.

My argument in the second hypothesis is quite different from state autonomy theory, which underlines the importance of political and institutional demobilization of rent seekers. A recent study argues that strong state autonomy, resulting from the insulation of policy makers from interest groups, is not a necessary condition for economic reform. Schamis (2000) demonstrates that such reformist actions as exchange rate reform and monetary liberalization, which are often perceived as public goods by neo-classical economists, result in serious distributive effects and produce private goods that asymmetrically benefit economic actors with very mobile assets. He insists that successful economic liberalization in Latin America in fact depended on this distributive coalition. According to his explanation, the success of neo-classical economic reform in Chile, Mexico, and Argentina is not the result of an autonomous state that is insulated from economic losers. The reform is politically supported because there are selective incentives to encourage collective action for economic liberalization.

There is already an interesting explanation of the importance of mobilization or cooptation of rent seekers in Russia's market transition. Treisman (1998) maintains that stabilization in Russia was peculiarly achieved through letting powerful bankers buy state securities whose returns were set artificially high. The provision of rents in a different form made the Russian bankers change their preference from pro-inflation to anti-inflation. Schleifer and Treisman (2000) develop their theory of "expropriation and cooptation" of interest groups who are against efficiency-enhancing market reform as a way to overcome political setbacks. This strategy, according to them, made the Russian privatization and stabilization possible because policy makers properly utilized a new form of rents to buy off strong opposition against reform.

However, the Russian case shows that, in market reform, the institutionally weak state needs to do more than politically buy off rent seekers. Persistently negative GDP growth rates and a rapid downfall of capital investment cast serious doubt on the "Washington consensus" that overemphasizes price liberalization and privatization: the total retreat of the state from the market at once.

The Russian experience forcefully confirms the argument of the neostatists that a strong state is indispensable in building a sound market economy because the market is not an institution-free place. On the contrary, the market is full of institutions. Scholars that find Asian developmental states in the period of rapid economic growth argue that state building should occur prior to market building.

Unfortunately, there was no strong bureaucracy to rationalize state management in the Russian state. Internal fragmentation and agency opportunism prepared the state to be far away from a capital mobilizer. Instead, its proper role might be a depressor of capital investment. It is needless to say that the privatized Russian state failed to provide institutional support for market building.

Given the severe institutional distortions found in the Russian state, a simple prescription of more "stateness" could not be realistic in the short term. This study argues that the reform of state institutions from within is neither feasible nor inevitable. I instead argue that the improvement of institutional conditions for economic development might come from the expansion of institutional boundaries of the state decision making and policy implementation to include private economic actors. Through this incorporation of the newly enriched private sector, the state may be able to create a policy network to penetrate and mobilize society. Stark and Bruszt (1998) delved into a feasible alternative to replace market liberalism and statism. Their institutional solution was "a deliberative association, networks for binding agreement under the control of extended accountability which is ensured by the embeddedness of the decision making center in networks of autonomous political institutions that limit the arbitrariness of incumbents." Frye (2000) finds another outside force to help the improvement of state power. He argues that self-governing organizations reinforce state power or compensate for its lack of power to manage the economy.

The Russia can develop extensive self-governing organizations outside the state, which regulate their members to make binding agreements enforceable, is not feasible. The reason for this is the same as what Frye (2000) notes: the political. While Frye underlines the negative impact of state policy to impose high costs on the free and open flow of information, I stress that the general institutional condition of the privatized state intensifies concern for relative gains. I rather agree with Stark and Bruszt (1998) that it might lighten the institutional burden of the state to build a direct or close nexus between the policy makers and the business community. Furthermore, the importance of asset property of the leading business groups for the implicit or explicit building of the policy network of the state elites with private sectors. The construction of a policy network outside the state might help to detour agency opportunism and to increase the state capacity to realize its goals.

This possibility critically depends on asset properties of rent-seekers. Asset specificity is believed to be strongly associated with the preferences of economic actors and their intensity (Frieden 1991, 19-22) to state policy. According to the logic of asset specificity, financial sectors have the least opportunity costs to state institutions and economic policy because of their asset mobility to adjust to new changes. The other side of the coin is that financial sectors do not have a strong incentive to arrange plans with the government for long-term development. Rent seekers whose main asset is in the form of financial capital are likely to be very opportunistic because of their low opportunity cost for institutional underdevelopment. This implies that they are strongly inclined to maximize short term interests at the expense of long term development. A set of incentives of financial capitalists as mobile asset owners reinforces and aggravates market distortion detrimental to investment in a rent seeking economy. Since financial capital is susceptible to myopic interests due to its asset mobility, when the dominant economic sector is banking, there will be little chance for the state elites to mobilize this powerful economic actor for reform. This is especially true when the state greatly suffers from its own institutional weakness.

In contrast, rent-seekers who own industrial capital could find that the supply of public goods at the cost of reduction of rents does not considerably hurt their interests because they could reap benefits from an improved infrastructure, a sound market order, and a strong domestic demand. This means that the benefits associated with public goods should be added to the expected utility of rent seekers when they are industrialists or immobile asset owners instead of bankers. Since industrial rent seekers lose less than bankers as a result of reform, industrialists are more likely than bankers to decide to accept the reform decision of the incumbent.

So far I have suggested that a privatized state, however much it suffers in the beginning from the collective actions of interest groups, gains relatively autonomous power over society as time goes by. This opens a space for strategic moves by a reform-minded leader and for his cooptation of some segments of the oligarchy. The further trajectory of this cooptation for economic reform is determined by asset property of rent-seekers. When assets are in the form of financial capital, the cooptation of rent seekers does not help the state improve its institutional capacity or strengthen its policy network. On the other hand, when assets are in the form of industrial capital, the state elite might utilize powerful businessmen to strengthen state capacity to manage the economy.

Social Consequences of the Privatized State: Diminishing Collective Action Ability among Rent-seekers

Russia's privatization process really proves the importance of relative gains and positional power in social interaction under the privatized state. Financial capitalists earned significant relative gains in the beginning of market transition. They then transformed the relative gains into positional power and became the biggest winners in a "winner takes all" economy. The financial capitalists, initially well-positioned to distribute soft credits, strengthened their political position through their initial relative gains. After this, they got almost every important piece of state property through the loans-for-shares auction.

An important role that the seemingly weak state played in the creation of zero-sum conflicts is demonstrated by the existence of prevalent opportunities for economic rent in Russia. The persistent partial economic equilibrium associated with an internally disorganized bureaucracy, enjoying arbitrary decree power and making supervision from above meaningless, encouraged relentless rent-seeking activities in Russia. According to Aslund (1997, 89-90), three sources of rent, such as soft state credits, differentiated exchange rate, and distorted market price of natural resources, totaled seventy-five percent of the GDP in 1992. In this rent-seeking game, one's gains are another's losses.

Budget politics, such as the lobbying of textile manufacturers, evidently demonstrated the importance of relative gains. Like other manufacturers, textile producers needed government money to keep their factories open and exercised collective pressure in the Duma hearings. In spite of their common interests in federal commitment to the industry, the essence of their lobby was "the competition over who will be the first to manage to squeeze out of the budget in order to keep up capacities at a concrete company, factory or plant" (Segodnia March 5 1997 translated in Lehmbruch 2001, 142-143). In order to be the first one to secure government resources, businessmen preferred an informal and individualized route rather than collective representation to the government (Barov, Kommersant Daily June 20 1998).

Lehmbruch (2001, 118) explains that weak state ability to implement what was promised or planned caused weak collective action ability. Because of a high degree of uncertainty in policy implementation, there was, in essence, no necessity for collective action to affect government policy. However, her institutional structural explanation cannot fully elucidate why there was steep competition among economic organizations. A high degree of uncertainty in the area of government policy implementation only explains part of the weak collective action of interest groups: the absence of encompassing and well institutionalized secondary association. To complete an explanation of fierce competitions of fragmented interest groups, we have to consider the aspect of state capture. Russian businessmen were not just passive responders to a high degree of uncertainty, but they were actively engaged in capturing a piece of the privatized state for their relative gains.

According to my theoretical expectation, Russian industrialists and financial oligarchs were in general very likely to lose their ability to take collective action because of their relative closeness to the privatized state. During the heyday of privatization they were thus very susceptible to relative gains and positional power competition because of their high accessibility to rent-seeking opportunities in the privatized state.

Between these two powerful interest groups, Russian industrialists were the first victims to significantly lose the ability for collective action. Early cooperation among enterprise managers that successfully resisted the drastic privatization plan to create outside ownership could not endure the divisive competition among the members themselves, and their political significance rapidly diminished after the turmoil between the Duma and Yeltsin in 1993 (Remington 1998). Even within the single industrial sector, industrialists failed to make themselves into a strong interest group. The only exception was the gas sector because there was only one company in the whole sector, Gazprom (Lepekhin 1995, 71).

The collective action of factory managers once evinced a formidable power. At the time that the State Property Committee (GKI), led by Chubais, set up a privatization plan to create outside ownership in very early 1992, factory managers collectively objected to the plan and drew a big concession from the government. They forced the government to abandon its original goal to convert state-owned industries to open joint stock companies and create outsider ownership complying with microeconomic indicators to ensure their market profits (Boyco, Shleifer, and Vishny 1995, 73-81). The 1992 compromise of the so called "Option Two," which allowed a "labor collective" consisting of workers and managers to purchase up to 51 percent of voting stocks, resulted in insider privatization which gave the managers solid property rights (Appel 1997).

However, the strength of the collective action of the factory managers, originally strong enough to create de jure property rights of state-owned factories, rapidly dwindled after they succeeded in securing those rights. As discussed earlier, they then sought individualized deals with the government to enrich secured property rights (Cooks and Gimpleson 1995).

Indeed, survey research finds that there was a significant behavioral change among Russian industrialists between 1992 and 1993. Kharkhordin and Gerber (1994), surveying industrialists in St Petersburg in 1993, find that the boundary of the exchange of "mutual help" shrunk to include just an "essential few." A survey conducted a year ago reports that industrialists were prepared for cooperation with more than the "essential few."

The industrialists' weak collective action potential was clearly demonstrated in the auction of GKO bonds and the loans-for-shares arrangement. They were not able to purchase the very lucrative GKO bonds. Finally, bankers took over the ownership of factories, and took natural resources away from factory managers through the loans-for-shares scheme.

The industrialists' diminishing collective action ability helped the government to achieve macroeconomic stabilization. The logic of a war of attrition (Alesin 1994) suggests that if two important factions are in power parity, macroeconomic stabilization will be postponed because these factions, unable to incur any cost to each other, will tend to maintain the status quo. As soon as factory managers lost their collective action power after their creation of insider ownership and the 1993 constitutional amendment deteriorated the political opportunity structure of the managers, the power parity was broken and the government achieved macroeconomic stabilization at their expense. It stopped issuing soft credits to them.

The most visible example for the argument that a privatized state hinders social cooperation is the "bankers' war" that took place in 1997. In 1995, at the beginning of the notorious loans-for-shares scheme that gave financiers huge economic favors, one of the leading financiers, Oneximbank head Vladimir Potanin, achieved quite considerable cooperation among the oligarchs to defeat the industrialists. Freeland (2000, 174) reports that Nevzlin, a partner of Mikhail Khodorkovsky, another leading financier and the head of Menatep Bank and Yukos Oil, said that "we [oligarchs] reached an agreement of who would take what. We agreed not to get in each other's way." As later became known, in the first round of the loans-for-shares scheme in 1995 the agreement was well respected, and each financier waited to take its turn as promised. Potanin was given free reign to single-handedly overcome the resistance of the factory manager of Norilsk Nickel; Khodorkovsky got Yukos Oil without competition. In the first round of the loans for shares, as oligarchs agreed, they cooperated successfully to steal very lucrative state properties from the red directors. This was a definite victory of the Russian financiers over the moribund industrialists. Their successful coordination continued to be practiced even after Berezovsky's Sibneft claimed its share. The power of cooperation among the oligarchs was demonstrated once again in the ability of the financiers (or "oligarchs," as they became known in the press) to join forces to ensure the re-election of Yeltsin in the 1996 presidential election.

The process of the breakdown of this cooperation and the start of the “bankers’ war” fits well with my theoretical expectations. Potential conflicts based on concerns for relative gains began to appear as soon as Potanin was given the position of first deputy minister for finance and he developed a strong tie with Anatoly Chubais. This political tie challenged the bankers’ arrangement. As soon as Potanin enjoyed strong positional power in the privatized state, he and his Oneximbank group claimed their right to participate in the auction of a 25% stake in Svyazinvest, a new telecommunications firm formed from the Soviet telecommunications infrastructure. The problem was that Potanin was playing out of turn to capture the Svyazinvest tender at an uncompetitive rate.

The bankers’ war illustrated that the rent-seekers failed to maintain cooperation which would have generated more economic profits and helped to continue their dominance over the economy. Instead of creating an institution for their strong control over the economy, the financiers lost their reputations and authority because of their vigorous pursuit of myopic interests. This is the most visible case that proves the argument that the privatized state ruins the possibility for social cooperation.

In fact, this embarrassing tug-of-war permitted the government to decide on policies disadvantageous to the powerful bankers. In July 1997, Yeltsin signed a decree that there would be no more privatization of state property like loans for shares (Mcfaul 2001, 253).

Another important decision, facilitated by the loss of collective action of bankers was to liberalize the GKO bond market. The returning rates of GKO bonds in 1997 decreased dramatically after the government decided to liberalize the GKO bond market. This government decision to liberalize the market indicates that the large banks failed to secure their big source of profit. They became another victim who experienced collective action dilemma because of the privatized state. Their weak collective action ability actually explains why macroeconomic stabilization was not endangered even after the closed GKO bond market, which was the most important selective incentive to “coopt” the large banks for macroeconomic stabilization, according to Schleifer and Treisman, disappeared.

This confirms the argument that a privatized state weakens the collective action of rent-seekers as time goes on, and opens strategic room for the leadership to “coopt” or to “expropriate” rent-seekers. After the financiers lost their collective action power, the government had no strong reason to buy them off in order to co-opt them.

Failed Reform Attempt in 1997: State Autonomy without State Capacity

The explanatory power of my two hypotheses of Russian reform process is verified in the case of the 1997 reform attempt and its failure. This event has received little attention and remains very much unexplained. The two hypotheses provide an explanation of why the government was able to attempt reforms but unable to accomplish them. The government was able to attempt reforms because it improved its state autonomy as the outcome of internal conflicts among oligarchs caused by their vigorous pursuit of relative gains and positional power. This enhanced state autonomy allowed the Chubais team to undertake reforms that were opposed to the interests of the financial oligarchs. However, with no change in the asset property of oligarchs, the government was not capable of achieving its goals.

My theory of the dynamics of state autonomy explains that it was not coincidental that a renewed reform attempt was made in 1997. The privatized Russian state fragmented society, which in turn weakened the collective action of interest groups and rent-seekers. As a result, state autonomy increased. This process culminated in 1997 when financial oligarchs fought each other over a few remaining state properties. It was in 1997 that the state was prepared to commence another reform endeavor.

As if reflecting the demand for the end of a "bandit economy," the new administration in 1997 launched important liberal economic reforms very similar to those made in the 2000s. While the attempt of the Putin government was successful, ones made by Yeltsin and his dream team led by Chubais in 1997 completely failed. Nemtsov (Nezavisimaia Gazeta March 17 1998), one of the main reform drivers in 1997, ascribed their failure to the resistance of the "financial- bureaucratic groups." My theory attributes the failure to a more specific variable: asset property of these groups.

There was an important policy parallelism between Putin in 2000 and Yeltsin in 1997 in the area of tax reforms. In fact, fiscal reforms had been the most urgent and serious task since macroeconomic stabilization. The government had controlled macroeconomic stabilization successfully, maintaining remarkably low inflation rates in 1996 (22%) and 1997 (11%) compared with the previous years. In 1997, GDP, for the first time after market transition, grew at a positive rate (0.9%). Under such favorable economic circumstances, the government's pursuits went beyond macroeconomic stabilization in 1997 and it attempted to reform tax collection. Its prime targets were large tax debtors to the federal budgets. Its effort to improve tax collection partially succeeded when the gas giant and largest debtor to the government, Gazprom, paid its taxes in 1997. Unfortunately, however, this success was not long-lived.

Surprisingly, some notable movements of the government against the banking sector could be observed in 1997. This is substantial evidence of state autonomy from the financial oligarchs. The efforts of "the reordering of state function," as Boris Nemtsov described in his interview with Nezavisimaia Gazeta (March 17, 1998), included the reform of the authorized bank. Earlier that year, the Kremlin signaled its policy change by replacing Andrei Vavilov with Alexei Kudrin, who was a tough minded young market reformer, at the post of deputy finance minister (Freeland and Arkady, Financial Times April 16 1997). In the summer of 1997, a financial scandal that revealed an inappropriate profiteering of authorized banks occurred. Three commercial banks illegally diverted federal budget funds into the government securities market (Financial Times July 3 1997).

The Chubais government began to break this kind of deep monetary connection between banks and the government. A presidential decree was declared to change the nontransparent handling of "authorized" banks of government funds (RFE/RL Newsline May 14 1997). In August, Chubais wanted a further reform to prohibit commercial banks from collecting customs duties (RFE/RL Newsline August 7 1997). This measure was particularly interesting because it hurt the interest of Oneximbank most (RFE/RL Newsline August 7 1997). Oneximbank was reported to hold over some 5.5 trillion rubles ($950 million) in customs duties in its account (RFE/RL Newsline August 8 1997). It appeared that the state elites started to envision the future Russian economy differently than the bankers. But it turned out that they were not capable of realizing it.

Robinson (2001) argues that state weakness and administrative incapacity, in fiscal areas in particular, had dictated economic policy choices such as shock therapy, GKO bonds, and shares-for-loans throughout Yeltsin's Russia more powerfully than the political power of the financial oligarchs. He argues that the Kremlin's 1997 policy on authorized banks and the GKO bond market opening demonstrates that the financial oligarchs were not in a position to maintain their political and economic power as ably as the equilibrium metaphor used by Hellman implies (1998).

I agree with Robinson only in the sense that the state reclaimed its autonomy in 1997 and became more or less free from state capture of the financial oligarchs. Otherwise, my theory of the dynamics of state autonomy does not concur with Robinson and it provides a different explanation of why a once weak state relative to the oligarchs started to set goals divergent from the interests of the powerful interest groups. I agree with the explanation of Hellman's "partial reform equilibrium" until 1997. Oligarchs were in a position before 1997 to dictate government economic policy, including fiscal and exchange rate policies. This equilibrium started to change, however, not because of the change of administrative capacity but due to the weakening collective action power of the oligarchs.

In my evaluation, Robinson also (2001) overemphasizes the difference in interests between the Chubais team and the financial oligarchs in 1997. In spite of its partial departure from the interests of the financial oligarchs, throughout this year, government policy consistently favored bankers who heavily borrowed foreign currency with the help of the government guarantee. Along the road toward the financial crisis, interests of the financial oligarchs were well protected by the government and the Central Bank of Russia. Strong evidence for this was the defense of the ruble's value.

Another important government policy decision that favored the financial oligarchs was the permission of the Russian banks' greater role in the equities market. The final verdict of the conflict on the issue of the banks' role in the capital market between the Central Bank and the Federal Commission was for the former in 1997. Anatoli Chubais, who once believed in a clear separation between the banking industry and the capital market, shifted his position to side with the banks (Frye 2000, 190-2). Then the banks speculated their money in the stock market. As it turned out, this action was deeply associated with the financial crisis afterwards.

More importantly, in the course of fiscal and tax reform after 1997 the government made no significant attempts to mobilize industrial capital. There was a very clear conflict of interest before the financial crisis between active export-oriented groups and bankers in terms of exchange rate policy. The former wanted devaluation of the ruble, which essentially meant bankruptcy of the leading Moscow banks (Mau 1998, 8). Attempts by the industrial capitalists, including the directors of Lukoil and other major oil companies in February 1998, had been consistently disregarded by the government in general. Moreover, the last and most important representative of the real sector, Chernomydin, was fired (Peregudov 2000).

Even the policy of tough tax enforcement, which Robinson (2001) argues was the reflection of the state elites' interests in maintaining its governing ability, was written by Oneximbank's Potanin, the most powerful financial oligarch at that time. Resolution 254 "allowing firms with tax debts to retire their payments due to the budget by issuing new shares" made it possible for banks to strengthen their controlling power over industries after prohibition of the loans-for-shares program. The case between Nizhnevatouskneftegaz and Alfa group proved the underlying purpose of the tough tax enforcement (Woodruff 1999, 189-90). This evidence clearly shows that strong monetary tax policy by the reformers was not completely against financial oligarchs.

Therefore, a proper evaluation of the policy stance of the reform team in 1997 should conclude that there was a partial, not a total, departure of state elites from the financial interests. Even though the government was able to be autonomous from the financial interests, it chose not to desert these interests completely. In other words, it maintained a coalition with the financial oligarchs.

The limitation of state capacity for fiscal reform came from this coalition formation. According to my second hypothesis, the financial oligarchs were unlikely to be a strong coalition partner for building state institutions. There are three important players in fiscal politics: the center, the regions, and the powerful economic sector (Woodruff 1999, 180). The center should overcome the regional forces to end tax arrears and non-monetary tax payment. The key to changing the balance of power between the center and the regions belongs to the powerful economic sector. I propose two types of sectors: financial and industrial. The latter is more likely to help the state improve state capacity than the former. However, the Chubais-Nemtsov team rejected coalition with industrial capitalists from the beginning of their reform efforts. Or more precisely speaking, industrial capitalists were not strong enough to be alternative coalition partners for the 1997 reform team to replace powerful bankers. Russian financial capitalists had no strong interest in fiscal reform because of their mobile asset property. Moreover, because of their monopoly of the scarce exchange means, the ruble, they were inclined to maintain the status quo of Russia's non-monetary economy. This leads to the conclusion that the central administration could not change the balance of power with the regions to end fiscal incapacity when they built a coalition with the bankers.

The failure of the central administration to tax natural monopolies and oil companies contrasts sharply with its success after 1998. The difference, I argue, comes from changes in the asset property of the coalition partners of state elites. In the next section I will show that the 1998 crisis allowed the state elites to decisively disconnect themselves from financial capitalists, even though the disconnection was still not complete (Tsyganov 2002, 97-98). The state elites then succeeded in making a coalition with natural monopolies and private conglomerates including oil companies.

Asset Property Change of Oligarchs and State Capacity Change After the 1998 Financial Crisis

Since the unexpectedly rapid downfall of the once powerful banks as a result of the 1998 financial crisis, there has been a strong appearance of industrial capital. The post-crisis recovery was definitely led by Russian industrial capital that successfully sold their products in the domestic and world market. Accompanying this economic recovery, natural resources firms and other manufacturing enterprises, appearing as big conglomerates, replaced the banking sector as the leading economic sector. This indicates that there has been a visible change in asset property of Russian oligarchs since 1998. Table 1 nicely demonstrates this point. After 1999, only Fridman from Alfa bank and

Kiselev from Impexbank represented the banking industry among important Russian oligarchs; everyone else was significantly affiliated with the real sector.

Table 1: Oligarchs in 1996-7 and 1999-2000 in Russia

1996-7	1999-2000
Vladimir Vinogradov (Inkombank) Aleksandr Smolensky (SBS-Agro Bank) Boris Berezovsky (no commercial bank affiliation) Vladimir Gusinsky (Mostbank, Meadia-Most) Vladimir Potanin (Oneximbank) Mikhail Khodorkovsky (Menatep Bank) Mikhail Fridman (Alfa-Bank)	Vladimir Potanin (Norilsk Nickel, Novolipetsk Metallurgy, and Perm Motors) Roman Abramovich (Sibneft) Anatoly Chubais (UES) Rem Vyakhirev (Gazprom) Vagit Alikperov (Lukoil) Mikhail Khodorkovsky (Yukos Oil) Mikhail Fridman (Alfa-Bank) V. Lisin (Novolipetsk Metallurgy Complex) V. Vekselberg (large aluminum producer, SUAL) K. Benukidze (Urals Machinery Plant) A Karachinsky (Computer Industry) L. Zimin (Vympelcom) A. Mordashev (Northern Steel Plant) V. Maschitsky (Rosinvestneft Group) O. Kiselev (Impexbank)

Source: Tsyganov 2000, 90-5

That a strong coalition between the Kremlin and relatively fixed asset owners was made after 1998 was evidenced by changes in virtual economy. An important indicator of the changes was the monetization of the Russian economy, which signifies a change of the protection of virtually bankrupt industries. The strong political forces behind an escape from the ruble economy were the coalition between local and regional political leaders and workers and managers of the virtually bankrupt and previously state-run factories and stores. The scheme of barter exchange among the bankrupt allowed them to continue to operate and disconnect themselves from the fittest-survival market discipline (Woodruff 1999). Therefore, the enforcement of cash transactions means the disappearance or at least weakening of the protection mechanism.

Barter transactions, increasing without any interruption throughout the 1990s and reaching more than half of the total industrial production exchanges in 1999, substantially diminished after 2000. According to a business survey, in the second quarter of 2002, remarkably 89 percent of the total industrial commodity exchange was made through cash (Russian Economic Trends 2002 (4), 103).

Most importantly, the energy policy as the key chain of virtual economy has been experiencing a great change recently. The key method of virtual economy is tax and payment arrears and barter exchange, where value adding natural resource sectors subsidize value subtracting manufacturing industries through tax and payment arrears (Gaddy and Ickes 1998). Before 1998 energy firms, in particular, Gazprom was a "virtually quasi-fiscal institution" that almost replaced the function of the Ministry of Finance. Gazprom had a very large sum of debt from its consumers, and at the same time affiliates of Gazprom built up a remarkable amount of tax debts owed to the Federal Budget. In fact, Gazprom was the single largest debtor to the Federal budget (OECD 1997, 123). To make liquidity issues worse, a large proportion of payment from their customers to energy firms, if it ever happened, was made mainly through non-cash settlements.

Here I disagree with the implication of Schleifer and Treisman (2001, 71-78) that Gazprom and other energy firms were not victims at all in the virtual economy. Their evidence for this is that the energy firms were permitted to build tax arrears to the federal budget and as a result of that their profits were growing from 1994 to 1995. However many energy firms earned profits from their tax debts to the federal budget, as we see in the fact that Gazprom earned most of its profits from its export of a quarter of the total production, it would be much better to be free from the chain of virtual economy in which their domestic gas prices were significantly lower than the world market prices and their export was subject to quantity regulation. But it is still true that Gazprom was partially compensated by the federal government for their loss from local and regional enterprises. Or more precisely speaking, a nontransparent barter exchange produced lucrative opportunities for Gazprom managers to grow their personal wealth at the expense of the total profit of Gazprom. The only real loser in this non-monetary economy was the federal government that suffered from budget shortages.

After 1999, non-payments without penalty and barter trade with overpriced manufacturing goods sharply diminished, while a low price control of gas and electricity still remained as of 2000.

Table 2: Forms of Payment to Gazprom and RAO UES, 1998-2001

	Cash Payment for domestic and foreign sales (%)	1998	1999	2000	2001 Q1
Gazprom	Cash	58.3	58.4	70.7	80.5
RAO UES	Cash	19.0	28.8	62.4	77.8

Source: OECD 2002, 128

Low gas and electricity prices were about to change remarkably after 2000. As cash transactions increased and payment discipline improved, the natural monopolies such as Gazprom, United Power, and the Ministry of Railroads pressured the government to raise their utility prices. This kind of effort was unprecedented as the enterprises accumulated inter-enterprise arrears with the natural monopolies which at the same time built tax arrears with the governments. This effort is diametrically opposite to the previous attempt of Gazprom to lower formal prices in order to be paid in cash even in spite of the objection of tax authority in 1997 (Woodruff 1999, 190-198). The two giant natural monopolies, Gazprom and UES, more than doubled prices in 1999-2002. This indicates that the protection of economic losers from market forces through cheap energy prices began to wane.

Table 3: Electricity and Gas Price Changes in 1999 - 2002 (Dec 2000 = 100, end of period)

Period	Electricity	Gas
1995	41.4	20.0
1996	56.0	45.4
1997	60.9	45.4
1998	62.5	50.2
1999	***71.5***	***61.3***
2000	***100.0***	***100.0***
2001	***130.2***	***141.5***
2002 Q 2	***152.7***	***187.9***

Source: Russian Economic Trends 2002 (4), 89

It should be underlined that the political forces behind the monetization of the Russian economy were the coalition between the federal government and the energy sector. There was a clear deal between them. Large tax payers such as Gazprom (the gas monopoly) and UES were forced to pay their taxes in cash in return for their right to reduce supplies to delinquent customers (OECD 2002, 13). The evidence is that since 1998 the federal government noticeably reduced the list of delinquent customers that were exempted from paying energy bills. It is often reported that RAO UES actually used its right to reduce electricity supplies in some local areas, which resulted in physical confrontations in some instances. Or local governments had to sell their properties to pay energy bills (RFE/RL Newsline September 13 2002). The cash-only rule of the federal government for the budget, since the second quarter of 1998, was another important factor for better payment discipline (OECD 2002, 127-128). Gazprom and UES returned the favor by paying taxes to the government. Surprisingly, the Tax Ministry's department for major taxpayers announced that Gazprom and UES overpaid their taxes in 2001 by 8 percent and 9 percent, respectively (Moscow Times August 31 2001).

Along with their effort to increase domestic utility prices, utility companies with the help of the government successfully increased their export to the international market, which offered much better prices. In the heyday of the virtual economy, the government practiced a victimization of the energy sector not only through price controls but also export quotas. In the 1990s the Russian government limited exports of oil and gas companies that had strong economic incentives to sell their products in the world market. For them earning hard currency is the only way to solve their liquidity problem. This is in stark contrast to the current comprehensive efforts of the Putin government to enhance gas and oil exports in order to increase its revenues.

Not only gas and electricity, but also oil companies changed their economic institutions with the help of the state, or sometimes by themselves. After 1998 the government made significant policy changes that greatly affected the oil industry, especially in the area of taxation. The government repeatedly failed to simplify the Russian tax structure since 1995. Finally Part 1 of the new tax Code went into effect on January 1, 1999. Along with Part I of the new tax code, the Putin government pushed further to change the Russian tax system from gross-revenue based regimes to profit-based ones. Sagers (2001, 178) stresses that this change would make the oil industry less subject to short-term economic fluctuations. Until then investment in the oil and gas industry was discouraged because of an excessive tax burden on oil and gas production caused by the tax regime that mainly relied on revenue-based and production taxes, such as excise, royalties, and export duties. Along with the attempt to change it into a more profit-based tax regime through production-sharing agreements, the government made another effort to replace the production-based excise tax with a surtax on profits (OECD 2001, 29). New oil legislation in 1999 stipulated obligations under civil law between investors and producers. Under the new law, investors' financial obligations were more clearly drawn. For example, the government was prohibited from revoking the production license once the production-sharing agreement between investor and producer was effective. The implementation of this law markedly lightened the problem of legal uncertainty (Arlie 2001, 18).

In the meantime, the Russian state started to resemble the rentier state, with 40 percent of tax revenues of the consolidated budget coming from power and fuel sectors. For instance, the government simultaneously made coordinated efforts with oil companies to increase export and increased oil-export duties in 2002 (RFE/RL Newsline October 1 2002). Collecting revenues earned outside the domestic market, the rentier state distributes them to consolidate its political base and increase political autonomy. Instead of distributing oil subsidies in a decentralized manner through regional governments, the central government was able to directly purchase political support from principal constituents in cash with the cooperation of energy firms. For example, in return for their support for government reform agenda, deputies from Unity, People's Deputy, OVR, and Russia's Regions demanded budget expansion for government spending to help their reelection (Remington 2002, 47). Thanks to the solid state budget supported by natural resources companies, the Duma deputies were spending more on campaign activities and getting reimbursed by the federal budget (RFE/RL Newsline December 27 2002). In fact, there was an allegation that the Kremlin controlled a multimillion dollar slush fund whose money came from the tax payments of the oligarchs to support politicians in national and local elections (RFE/RL Newsline October 10 2002). The Russian government also attempted to improve the economic welfare of the Russian people with its recent income policy. There was a marked increase in wages in both the civilian and military sectors, as well as pensions and other personal transfers. For example, the nominal monthly wage grew in 2001 by 45 percent.

This discussion of a weakening virtual economy demonstrates the strong coalition between the central administration and the energy sector after the 1998 crisis. The energy sector became more and more autonomous and escaped from the constraint of virtual economy with the help of the federal government. This coalition worked against regional governments that wanted to protect their bankrupt and inefficient local enterprises.

This coalition strengthened state capacity. The most visible improvement as a result of that was a series of fiscal reform. In this fiscal reform the federal government was a clear winner, and the regional governments lost their previous advantages. Actually, there was a visible coalition between the federal government and industrial oligarchs that supported fiscal reform. Ostensibly, industrialists started to pay taxes, and the federal government in return protected and promoted their interests. Thanks to this cooperation between them, the reclaim of federal authority over regional government led to quite comprehensive fiscal and tax reforms. The government started to restrain the chaotic fiscal decentralization that had devastated the national economy (Mckinsey Group 1999; Schleifer and Treisman 2000) while the memory of the financial crisis due to delayed fiscal reforms was still fresh.

It was crucial to clarify the demarcation of tax jurisdiction between the federal and regional governments in Russia. The collusion of regional authorities and major taxpayers for tax evasion was, according to Schleifer and Treisman (2001), substantially caused by ill-designed tax systems such as poorly defined tax sharing and the taxation of federal, regional, and local authorities on the same tax revenue source. They argue that this institutional design resulted in the extreme overtaxation of local and regional businesses, and it easily wiped out tax bases in the Russian economy.

This institutional drawback was corrected considerably in 2001 by drawing a clear line among various tax bases. For example, value-added tax (VAT), which was the largest tax resource, was shared by federal and regional governments before 2001. The regional share of revenue from the VAT was reduced from 25 per cent in 1998, to 15 percent in 1999-2000, and 0 percent in 2001. The VAT has become a purely federal tax, while income tax is controlled by regional governments. Tax reforms also eliminated some overtaxation due to the shared tax base between the federal and regional governments. For example, on July 13, 2001, the Duma approved the third reading of a law on taxation of natural resource extraction, replacing the three separate laws to govern taxation of natural resources (OECD 2001, 162).

Another task for the central authority to strengthen its governing capacity in the area of taxation was the monetization of tax collection. Non-cash receipts took a significant proportion of federal and regional tax revenues until 1998. For example, in 1996 and 1997, non-cash receipts comprised about 40 percent of federal tax revenues. At the regional level, non-cash payments of taxes were higher than at the federal level. In 1998 more than 50 percent of regional taxes were paid through non-cash methods (OECD 2000, 90).

In the practice of the demonetization of tax collection, the regional governments were the biggest winners. As illustrated in OECD (2000, 102-105), the use of various money surrogates (tax offsets, debt offsets, bills of exchange, and barter) in budgetary operations offered subnational administrations a very convenient and effective tool for the conduct of informal budgetary activities. Non-cash tax collections at the regional level made the highly centralized budgetary system in appearance malfunction. Manipulating the prices of these offsets and making individualized deals with large tax payers, regional governments concealed their real revenues and kept a larger share of tax revenues. The loser in this game was definitely the federal government, which was vulnerable to tricks implemented by the regional governments that enjoyed close ties to local enterprises. In fact, tax arrears to the federal budget in both 1995 and 1996 grew faster than those to the regional budgets, and the regional governments collected tax debts from delinquent enterprises more effectively (Schleifer and Treisman 2000, 130).

Given the strategic advantages of regional authorities in demonetized tax collection, a significant progress toward monetization means that the balance of power tipped toward the federal government. The federal government took a series of measures to reduce this non-cash tax collection method, and its effort culminated in an amendment to the Budget Code in 2000 that completely prohibited the use of money surrogates in tax collection. Remarkably, in 2000 no non-cash receipts appeared in federal tax revenues, and the use of offsets in the tax collection of regional governments drastically decreased by 2000, when non-cash settlements were less than 15 percent of the total consolidated regional tax revenues (OECD 2002, 167).

As a result of tax reforms, the Putin administration improved tax collection remarkably. This contrasted greatly with the failed attempt of the Chubais-Nemtsov team just a couple of years ago. Russian Tax Minister Gannady Bukayev once announced that "Russia's consolidated budget tax collection in January-September was up 34.8 percent on the year to 1.381 trillion rubles" (Itar-Tass Weekly News October 18 2001). This sound tax collection allowed the Education Minister to announce in 2002 that "the level of wage arrears to teachers was the lowest level in the past 10 years" (RFE/RL Newsline September 30 2002).

Fiscal recentralization through the clear jurisdictional demarcation of tax collection and tax collection in cash made regions more and more dependent on the federal budget. After several tax reforms, significant taxes such as VAT went to the federal treasury. As a result of that, more and more regions, including the traditional donor regions, became dependent on transfers from the federal budget to meet their budgetary demands (RFE/RL Newsline Oct 17 2002).

These fiscal reforms illustrate that as industrial capitalists replaced financial capitalists as another form of oligarchs, the central government significantly improved its governing capacity. This is what my third hypothesis expects. The improvement of state capacity was found not only in fiscal reforms but also in regional reforms. In fact, an important part of fiscal reforms, which I discussed before, presupposes the change of the relationship between the center and the regions.

However, the improvement of state capacity was not unlimited. While I recognize recent regional reforms as a major departure from chaotic decentralization in the period of Yeltsin, I will also concede limitations in Putin's attempt to reclaim his central authority.

I will argue that this conflicting outcome of Putin's federal reforms evidenced the importance of coalition politics for current Russian political and economic reforms as well as the institutional constraints of the privatized state. This means that I will deemphasize Putin's leadership style as an explanatory variable to explain the politics of regional reforms. Among the three important players, the presidency, the oligarchs, and the regions, my discussion of the trend of virtual economy recognizes the visible coalition making between the presidency and the oligarchs. I will argue that this coalition force was behind regional and other liberal economic reforms in the 2000s and that it actually explains the successes and limitations of regional reforms. The oligarchs helped Putin make a significant departure from the previous chaotic decentralization as well as some important changes in asymmetric federalism. However, a recentralization that strengthens presidential power too much was not wanted by either regional forces or the oligarchs. A highly centralized system similar to an unitary state could lead to a strong presidential power that might threaten the status quo the oligarchs desired to maintain.

The political capacity of the Russian state was notably enhanced after the crisis. To improve political capacity the Putin administration attempted to enforce the law, "On Political Parties." This law was an attempt to reduce the number of political parties so that big national parties with a strong party discipline might bring about a manageable party politics in the legislative. Even though the expectation of a significant reduction of party number is hasty (Ostrow 2002), there has been a stark difference in Putin's government compared to Yeltsin's in the area of executive and legislative relations. Under the rule of Yeltsin, frequent legislative-executive stalemates seriously impeded the political capacity of the state for economic reform and consistent government policy. So Yeltsin often chose presidential decrees instead of seeking cooperation with the legislature. This relationship substantially changed after 1999, and Putin received very cooperative actions from the legislative majority for his reform agenda (Rutland 2000, 335; Remington 2001). He succeeded in building pro-Kremlin majority. The so called "coalition of the four," Unity, Fatherland-All Russia, People's Deputy, and Russia's Regions consistently helped to pass very liberal economic reforms such as Land Code, Labor Code, and comprehensive tax reform (Remington 2002). The only visible protest against Putin was from Berezovsky, but even his protesting was done outside the country (Treti'akov, Nezavisimaia Gazeta November 30 2000).

With the help of its enhanced political capacity, the Putin administration was able to attempt to improve institutional and administrative capacity very effectively. Here it is important to notice that improved political capacity was exclusively aimed at weakening regional forces and there was no plan to weaken the economic power of the oligarchs. In contrast with his rigorous attack on regional forces, the president maintained a smooth relationship with powerful businessmen who had interests in preserving the status quo in the political world, except in the case of Gusinsky and Berezovsky. In fact, the absence of notable efforts to reduce the economic and political power of the oligarchs characterized Putin's oligarchic policy (Rutland 2002). This is hardly surprising, given the fact that the financial source for the legislative loyalty came from the purses of the oligarchs.

Putin, utilizing the strong political capacity coming from the conciliatory Duma, initiated reform of the asymmetric federalism that was formed in the process of bilateral and arbitrary bargaining between the federal and regional political forces. In asymmetric federalism under the rule of Yeltsin, diverse fiscal concessions to the regions and regional policy autonomy were made through bilateral treaties between the federal government and an individual region. More often than not, regions unilaterally issued laws that violated federal laws. As a result of that, the national market was severely unleveled and the state administration was fractured. Putin attempted to increase Russia's legal uniformity in spite of the resistance of some ethnic republics where bilateral treaties allowed them to behave like independent states (Hyde 2001, 732-33; Slider 2002, 12-3). Even Tatarstan, one of the most autonomous ethnic republics, made some concessions to reduce its claims to sovereignty. This step was also taken by another ethnic republic, Bashkortostan (RFE/RL Newsline December 4 2002). While the battle was far from over (RFE/RL Newsline Oct 4 2002), the Kremlin and the Duma continued to push. Putin had already made a clear division between the federal and the regional governments in tax collection. In addition, the presidential commission headed by Dmitrii Kozak was designing administrative reform that clearly delineated the comprehensive division of power among federal, regional, and local governments. The bills prepared by this team, which included the renewed effort of the Kremlin to remove governors, will invalidate all treaties on power sharing between the federation and its constituents after they are approved (RFE/RL Newsline November 20; November 22; November 24 2002).

However, in critical instances where the stake was the political future of regional governors, the battle between the center and the regions continued. A real threat to governors came from the bill that proposed the grant of presidential rights to fire governors who violate the constitution. However, after several amendments to this bill it pretty much lost its original threatening power. The passed bill made it much harder for the president to dismiss a governor (Hyde 2001, 732-3; Slider 2002, 14). This incident shows that the presidential power to restore vertical power was more or less limited. The Putin administration threatened governors through criminal investigations which often were dropped after several months. Instead of governors, deputy governors met real threats from the Prosecutor-General's office (RFE/RL Newsline October 1; December 23 2002). However, the government still devised an additional bill to dismiss governors. The new bill suggested by the administration granted the right to the president to dismiss fiscally irresponsible governors (RFE/RL Newsline October 8 2002).

Another important battle between the Kremlin and regional governors continued. The cooperation of the State Duma and the Kremlin was powerful enough to threaten the political future of regional politicians. For example, in July 2002, the State Duma passed an amendment to the law "On General Principles for the Organization of Legislative and Executive Government Bodies in the Members of the Russian Federation." This amendment meant that the number of regional leaders entitled to run for a third term would be reduced from 69 to 10 (Kamyshev 2001, 9). As expected it met a strong resistance from the upper chamber. In the end, the Constitutional court restored the eligibility of 69 regional heads to seek their third terms (RFE/RL Newsline July 10 2002).

This mixed picture of regional reforms supports the conclusion of not a few observers of Putin that Putin's presidential power was weak relative to his self-proclamation in the beginning of his presidency (Herspring 2002). Reddaway (2002) argues that "Putin's formally well articulated political power be originated from the consensus among the Russian elites who wanted such political stability" as Brezhnev had provided for the nomemklatura. A strong presidential leadership in Putin's Russia is somewhat lacking in the executive branch (Ostrow 2002). Unlike Yeltsin, Putin did not provide a strong unifying role. There were two very different economic programs, one developed under the auspices of Minister of Economic Development and Trade German Gref, and the other proposed under the auspices of Viktor Ishayev, governor of Khabarovsk. Putin did not choose either one decisively (Millar 2002, 120).

If Putin is a weak leader restrained by powerful oligarchs and he is content to be a balancer, where did political forces come from for regional reforms and liberal economic reforms? How was the federal government able to accomplish these changes? In fact, my hypothesis solves this puzzle without any contradiction with Reddaway's assessment of presidential power. According to my hypothesis, the relatively good terms between the "magnates" and Putin helped the federal government to implement some important economic and institutional reforms against governors and other regional forces. Even though Putin did not enjoy a strong upper hand over powerful economic groups, this did not prevent him from taking some significant reform initiatives. It worked oppositely. His compromise with big conglomerates strengthened his ability to advance important liberal economic agendas and regional reforms because the big conglomerates wanted reforms, too. Comprehensive liberal economic reforms including "tax revolution" in 2000-1

(EBRD 2001) principally aimed to promote economic interests of big and competitive enterprises. It directly evidenced the political base of the Putin regime: oligarchs.

At the same time that industrial capital took a dominant position in the Russian economy, economic cooperation among big conglomerates flourished. Yukos Oil and UES agreed to coordinate the sale of their stakes in regional power companies (Moscow Times July 8 2002), and Gazprom approached Yukos Oil to develop East Siberia's hydrocarbon reserves as a joint venture (Anna Raff, Moscow Times October 2 2001). In June 2000, Vladimir Potanin from Norilsk Nickel and Vyakhirev from Gazprom reached an agreement to cooperate in the engine-manufacturing and ferrous-metals sectors (Yelena Ivanova, Rusia Journal July 5 2002). A difficult cooperation was made between UES and Gazprom. These two companies were feuding because of a conflict over gas supplies to the national power stations. In Russia, gas is the main source for the generation of electricity. This conflict was much more visible because of their powerful managers, Rem Vyakhirev, head of the natural gas monopoly Gazprom, and Anatoly Chubais from UES. With the help of Putin's mediation and warning they resolved their differences (Alexeyeva and Klasson, Moscow News April 19 2000). Furthermore, they showed a very strong cooperation in increasing utility prices. Russian oil majors such as Lukoil, Yukos, TNK, and Sibneft used their cooperation to reduce arbitrary bureaucratic control of oil exports (RFE/RL Newsline Jan 4 2001). Lukoil, Yukos, and Gazprom got together to create a new company named the Caspian Oil Company to extract oil in the Caspian sea (Arlie 2001, 21). In September 2002, Gazprom and LUKoil signed an agreement to explore oil and gas fields in the northern and central parts of the Caspian Sea together (RFE/RL Newsline September 6 2002).

There was one symbolic incident that demonstrates the cooperation among the new oligarchs and their political power. On December 18, 2002, there was another closed auction for a 74.95 percent state-owned stake in oil major Slavneft, a practice that exactly resembled the notorious loans-for-shares auction. The winner was Sibneft which was controlled by oligarch and Chukotka Autonomous Okrug governor Roman Abramvoich. He won at $1.86 billion the company whose minimum starting bid was set at $1.7 billion. As a result of this purchase, Sibneft expanded to a size equivalent to that of the other three big oil companies, Yukos, LUKoil, and Surgutneftegaz. The outcome of this important auction that determined the shape of the future Russian oil market was already determined before the auction started. The state-owned oil company Rosneft stepped aside. More importantly LUKoil and Surgutneftegaz both "voluntarily" withdrew from the auction at the last minute (RFE/RL Newsline December 18 2002).

The role of oligarchs as determinants of balance of power between the center and regions became more and more significant as they increased their engagement in important regional affairs. This close connection of oligarchs with the regions was not found before 1998, when Moscow-based large banks separated themselves from the regional economies. To the contrary, in the 2000s, there was close involvement of oligarchs in regional election and politics. Roman Abramovich, the head of Sibneft and Siberian Aluminum, who became one of the most powerful oligarchs, found himself elected governor of Chukotka. There were other oligarchs to join him as a governor: Norilsk Nickel director Aleksandr Khloponin in Krasonyarsk Krai, Yukos director Boris Zolotarev in Evenkiia, and the head of the diamond monopoly Alrosa, Viacheslav Shtyrov in Sakha. It is interesting to see that Interros head Vladimir Potanin, Yukos head

Mikhail Khodorkovskii, and Siberian Coal and Energy Company head Oleg Misevra attended the inauguration ceremony of Kholoponin as the Krasnoyarsk Krai governor (REF/RL Newsline Oct 18 2002). Yukos head Mikhail Khodorkovakii also showed an interest in regional affairs by being appointed as "curator" of the Murmansk Oblast branch of the Union of Industrialists and Entrepreneurs (REF/RL Newsline October 9 2002). Another instance of the strong interest of oligarchs in regional politics is the episode of the Kalmykia Presidential election. The presidential election outcome in this region was changed several times because of different decisions of the regional election commission and the federal authority. It was alleged that two large financial-industrial groups were the real forces behind this battle. One was Interros, the other Rusal (Russian Aluminum) (RFE/RL Newsline Oct 4 2002). More recently oligarchs were ready to join election competitions in Magdan Oblast where the governor was murdered (RFE/RL Newsline Oct 21 2002).

These industrial oligarchic forces allowed Putin to restrain the chaotic decentralization of asymmetric federalism, and the increasingly close connection of oligarchs in regional affairs was likely to help build binding networks across regions and restrain centrifugal forces. At the same time this political coalition between Putin and the oligarchs explains why Putin could not reinforce the recentralization of the Russian federalism further. The oligarchs played a balancing role to prevent the presidency from being enormously powerful.

Conclusion

The dynamics of state power was evidenced by economic reform process in Russia. My paper argues that two important economic reforms, macroeconomic stabilization in 1996 and the fiscal reforms after the 1998 crisis, were deeply associated with the change of Russian state power. Measuring state power with respect to state autonomy and state capacity, it argues that the Russian state first reclaimed its autonomy, and then noticeably strengthened its capacity to manage the economy. In order to demonstrate and explain the dynamics of state power it depends on two hypotheses. First, the privatized Russian state caused social fragmentation, which in turn weakened the collective action of interest groups and rent-seekers. I argue that this led to the improvement of state autonomy and the consolidation of macroeconomic stabilization. Second, the Russian state enhanced its capacity to manage the economy because of the replacement of large banks with big industrial conglomerates after the 1998 crisis. The asset property change of the leading businessmen helped improve state capacity. I argue that this brought about fiscal and tax reforms in the early 2000s.

Macroeconomic stabilization without fiscal reform in 1995-1998 perfectly reflected the condition of state power, autonomy without capacity. Here I characterize macroeconomic stabilization without fiscal reform as a passive policy coming from the limitation of weak state capacity in spite of its increasing state autonomy. The government because of its improved autonomy from society was able to stop issuing money, but it could not make a successful fiscal reform that required more than state autonomy.

Not only macroeconomic stabilization but also an aborted fiscal reform in 1997 proves that the Russian state improved only state autonomy and not strong state capacity. The reform team in 1997 stood up against the financial oligarchs when they started to reform "authorized banks." It was certain that the disagreement of the government with the financial oligarchs was not unqualified, but considering GKO bonds and the loans-for-shares auction that completely followed the interests of the private bankers in previous years, reform attempts in 1997 were a significant declaration of state autonomy from the financial oligarchs. When the bankers' war erupted in 1997, it left a devastating effect on the collective action of the financial oligarchs, and this increased autonomy of the Chubais-Nemtsov team. Yet their enhanced autonomy to set their own state policy was not accompanied by the state capacity to implement it. There were no internal or external developments that helped increase state capacity until then. Naturally they continuously failed to correct their fiscal practices and to eliminate fiscal deficits. Essentially, in 1997 it was conditioned to be able to attempt reform, but the attempt was destined to produce fruitless outcomes.

Until the financial crisis brought devastating economic and political losses to large banks located in Moscow, help from private interests with strengthening central power in order to consolidate market institutions was completely absent. The bankers' shortened time horizon and their strong opportunism due to their asset property and disconnection from industrial capital was more aggravated by the fact that the improvement of state capacity hurt their monetary interests directly. Financial oligarchs accumulated their capital, extracting resources from the weak Russian state. Their profit earning methods, such as the distribution of soft credits issued by the CBR, the handling of various government funds through government authorization, GKO bonds trading, and the loans-for-shares auction, illustrated their parasitic relationship with the state (Johnson 2000). In this relationship banks had no incentive to promote institutional developments for the domestic market. On the contrary, the maintenance of a weak state complied with their real interest. Even though their myopic self-interest continuously undermined the governing capacity of the state over the Russian economy, distorted market behaviors throughout the country, and rapidly decreased GDP, they did not stop looting the state. Their asset property hardly made them "stationary bandits" who had an incentive to provide public goods or at least to stop smoldering productive activities for their future exploitation. They were little affected by economic costs due to the unleveled national market associated with weak central power. Furthermore, the financial capital had no significant leverage to affect regional political forces because of its disconnection from manufacturing industries. In a word, the fact that the leading industry in Russia until 1998 was banking means that there were no reliable private interests that might collaborate with the state to improve state power to consolidate the market economy.

A critical momentum to destabilize this equilibrium was generated by the 1998 financial crisis, and it changed the asset property of oligarchs. As a result of the crisis, industrial capital significantly replaced financial capital. Big and economically viable industries were found not only in the oil sector but also in other manufacturing sectors Because of their fixed asset property and the size of their capital, oil and manufacturing industries had much stronger interests than the banking sector in the development of the national market and institutional reform for capital investment.

Industrial oligarchs whose asset property prepared them to cooperate with the central authority in order to reconstruct the market formed a solid coalition with the Kremlin. In the post-crisis political economy, there was a visible coalition making between the Kremlin and the conglomerates led by the oil and utilities companies. Energy policies in the 2000s definitely departed from the previous practice of virtual economy, and this was clear evidence that the coalition worked effectively.

Change in the asset property of the leading industry from financial to industrial capital and the coalition formation between the state elite and the industrial oligarchs were directly responsible for improving state capacity in the 2000s. The coalition in particular fortified state capacity to remedy a chaotic asymmetric federalism in Russia. Comprehensive fiscal and regional reforms, quite in sharp contrast to the failure of reform attempt in 1997, demonstrated the substantial power of the coalition force.

My second hypothesis is actually confirmed by the seemingly empirical puzzle that Putin was not strong enough to control powerful businessmen but carried out very comprehensive liberal economic reforms centered on the relationship between the center and regions. Putin's political compromise with big conglomerates did not decrease state capacity. On the contrary, his alliance with them helped his administration to consolidate its controlling power over regions more and more. The reason is that big conglomerates were interested in expediting market reform and improving state capacity because of their asset property. The limitation of Putin's success in regional reform also proves the fact that this coalition force worked behind the reform drive. If Putin achieved such a high degree of recentralization so that it might jeopardize the basic federal structure, it would be very threatening to the oligarchs who desired to protect their property rights and were strengthening their regional ties through their direct political and administrative affiliation. So far it had appeared that the Kremlin could expand its power as far as the oligarchs agreed.

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