Property rights in post-Soviet Russia: violence, corruption, and the demand for law

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To cite this article: Scott Gehlbach (2018) Property rights in post-Soviet Russia: violence, corruption, and the demand for law, Post-Soviet Affairs, 34:4, 262-263, DOI: 10.1080/1060586X.2018.1435240

To link to this article: https://doi.org/10.1080/1060586X.2018.1435240

Published online: 06 Feb 2018.

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Interviewing business owners and managers in Russia in 2009, Jordan Gans-Morse would ask about the dangers of mafia rackets. “Mafia, please – that was so 1990s!” was the typical response. So much had changed since then, with businesses transitioning to state-sponsored rackets by the early 2000s (mentovskie kryshy rather than banditskie kryshy), and after that increasingly to the use of formal legal institutions.

If the response to Gans-Morse’s question strikes you as unsurprising – and it might, if you have read the work of Kathryn Hendley and Vadim Volkov, among others – you might ask how this development was possible. After all, the transition to formal legal institutions has not proceeded uniformly across the postcommunist world. I distinctly remember a conference in Kyiv in 2007 at which a number of participants stumbled across a contract signing in the forest; in this secluded spot, it was easier for various enforcers to size each other up. (My Russian colleagues were derisive: contract signings in Russia had moved to the boardroom years before.) More generally, business in many countries is governed by violence. How did Russia make it this far?

A naive observer might appeal to the growth of the state under Russian President Vladimir Putin. But it is not so clear that state legal capacity is that much higher now than it was in 2000. Along some dimensions, it certainly is: more funding for the courts, for example. But along others – most notably, the state’s ability to constrain lower-level officials – capacity may actually have declined. In any event, as Hendley and others have shown, enough legal infrastructure was in place by the late 1990s to justify use of the courts, but the demand for law wasn’t there.

Demand for law is the focus of Gans-Morse’s excellent new book on Property Rights in Post-Soviet Russia. A key contribution is to identify the determinants of this demand – such factors as the firm’s tax compliance (tax cheats are reticent to engage with the state and so are more reliant on illegal enforcement) and whether ownership in the firm is concentrated (undisputed control implies longer time horizons and therefore a greater willingness to play by the rules), as well as the (endogenous) proportion of other firms that choose to rely on formal institutions to protect their property rights. Drawing upon an original survey of Russian firms in eight cities, as well as numerous interviews and the analysis of survey data collected by others, Gans-Morse shows that each of these factors is correlated with the legal strategies that firms employ.

Property Rights in Post-Soviet Russia is the first book to really bring together the literatures on organized crime, postcommunist legal development, and business–state relations, updating much of what we know in the process. The evolution of Russian business from the lawless 1990s to the law-ish (if vulnerable) present was not automatic but the consequence of decisions often made for other reasons. The primary goal of tax reform in the early 2000s was to increase tax revenue, but once firms were out of the shadows, they had less to fear from formal legal institutions. Similarly, majority owners squeezed out minority shareholders because they could, but once they had done so, there was greater incentive to take their disputes to court. As all of this was happening, businesspeople looked around. Seeing other firms using law increased their incentive to do the same. It was a virtuous circle that moved Russia closer to a rules-based economy.
There is a little slight of hand here. Much of the evidence that Gans-Morse provides is cross-sectional in nature: correlates of legal strategies from survey data collected in 2010, observations from interviews conducted a year earlier. (Gans-Morse does re-interview some of his subjects five years later, which helps to establish trends in the business environment.) Yet the argument about Russia’s evolution is fundamentally dynamic. Thus, for example, the fact that tax cheats are less likely to use formal legal institutions in 2010 is taken as evidence that the decline in tax evasion earlier in the decade contributed to increased use of formal legal institutions. That is plausible, but it is not as convincing as would be evidence from panel data, or even cross-sectional evidence with clearly exogenous drivers of tax evasion. Alas, the data do not exist to definitively nail this down. Gans-Morse does his best to work around this constraint. Far more than any other study of which I am aware, his survey data discriminate among legal and illegal uses of state resources. One only wishes that he had been around earlier in the transition to ask the same questions.

Where does this leave us? Looking back on the postcommunist transition, it seems that we have come full circle. The architects of Russia’s reforms hoped that demand for law would arise naturally once property rights were allocated through privatization. That it failed to do so led many to argue that Russia’s reformers neglected to build state institutions that market actors would want to use; alternatively, that early winners from reform pressured state actors not to build those institutions. Eventually those institutions were constructed, but demand did not immediately follow supply. What was necessary was to lower barriers to the use of law and to reduce the attractiveness of illegal alternatives. Jordan Gans-Morse tells a compelling story of the emergence of demand for law in postcommunist Russia. Anyone interested in the origins of market institutions should read his account.

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[https://doi.org/10.1080/1060586X.2018.1435240](https://doi.org/10.1080/1060586X.2018.1435240)