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"Institutional complementarity and corporate governance :
a reassessment of the Russian transition failure"

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Very Preliminary Draft

I. Introduction

Our paper proposes a reassessment of the Russian transition failure through the analysis of institutional linkages and especially institutional complementary related mainly to the corporate governance domain.

We will first briefly expose the main facts related to the failure of corporate governance in the Russian transition, as these have already been exposed extensively in the literature. This will justify the significance of our subject as well as the scope and scale of this failure. This failure has been recently explained mainly by the legal problems and drawbacks in the transition, as these have been especially acute in Russia. We will consequently examine this legal explanation and show its limits, in general as well as more specifically in the Russian case. We do not want to reject nor deny the legal difficulties which are indeed striking. We just want to evidence how this explanation appears as a last ditch attempt to save the standard approach of reforms based on the property rights perspective. But this is a too shy attempt or incursion into the consideration of institutions. We need to go much further and adopt a real institutionalist view to understand the corporate governance fiasco.

Therefore, we will expose in a fourth part our theoretical basis, i.e. an institutional analysis based on current work by Aoki, "*Toward a comparative institutional analysis*". We will thus consider that an economy is an "over-all institutional arrangement", thus a complex set of institutions related to various domains. There are various synchronic linkages among the different domains' institutions, as social embeddedness, bundling or complementarity. Moreover, diachronic (temporal) linkages among institutions impact on the overall institutional evolution. We will hierarchise the over-all institutional arrangements proposed by Aoki in order to explain more precisely the characteristics of institutional change.

Finally, we will use this theoretical analysis to explain the Russian corporate governance fiasco. More precisely, we will show which were the main institutional deadlocks that prevented the elaboration of a coherent model of corporate governance. We will use the more widely studied models of corporate governance as references for comparison and divide the transition into three main periods. Our study may seem descriptive and excessively general as it attempts to draw the overall picture of the Russian evolution over almost ten years. Yet attempting to make sense of the mess and numerous contradictory evolutions in the Russian transition is already a sufficient challenge. Trying to test our proposition on the basis of significant micro data relative to enterprises would be a desirable though still extremely difficult one². We just tell a general story of the Russian failure in corporate

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² This point is underlined by the vast majority of researchers on the Russian transition, as evidenced by the following forewords : " ...(it is) difficult or impossible because meaningful hard data on enterprise behavior is hard to come by. Firms do not publish serious accounts of their own performance because managers hide their own ongoing thefts of firm assets from outside shareholders and from other who would seek to steal those assets themselves, including labor and mafia. Also, back tax debt, which pervade the corporate sector, mean that any reported income may be seized, making the effective tax rate 100 percent. So most income statements and balance sheet are fictional, making it difficult or impossible to undertake serious firm level econometric study of corporate governance changes....we are left with anecdotal accounts and surveys as our main sources of empirical information " (Fox and Heller, 1999, p. 6). The assessment by Black, Kraakman and Tarassova is

governance. And we will try to draw some more general conclusions from this story, especially concerning the relevance of the institutionalist program for analyzing the transition and more globally for understanding the real functioning of different capitalist economies.

II. The Russian corporate governance fiasco

Apart from macro stabilization, the first step of the transition program focused on market liberalization and privatization. More precisely, privatization was perceived as a way to distribute property rights, without much consideration put on the mechanisms allowing these property rights to become effective, i.e. at least to be implemented or respected. In view of the total lack of industrial restructuring (Nellis, 1999), the focus has then been put on corporate governance as a mechanism to enforce property rights.

The “ fiasco ” of Russian corporate governance has indeed been largely documented (Fox and Heller, 1999). We will not enter into details, even though these are often as enlightening and earthy than despairing. We will just provide a short summary or listing of the most prevalent and typical problems, alongside with the most famous examples that fed the media and nightmares of both Russian and foreign investors. Indeed, the Russian case provides all the relevant material for drawing an imaginative map of existing and possible pathologies of corporate governance. Investors' claims are not recognized when incumbent managers refuse to register shares (Krasnoyarsk Aluminium), to accept boards properly elected (Novolipetsk Metal Factory), or to vacate even if they are fired by the majority of shareholders (Kuban Gypsum-Knauf). The other and somewhat more subtle and widespread strategies consists in dilution (Sidanko³) and more recently fake bankruptcies (Sidanko here again⁴). In all these cases, inside managers succeed in wiping out the outside minority shareholders.

A second category of abuses consist in directly diverting assets, through blatant theft, not to say looting, or sweetheart deals with related people. All companies are thus surrounded by so-called independent companies managed by affiliated persons or family members of inside managers. Manipulations of transfer prices have been widely used and abused in a context where market prices are difficult to establish given the industrial structure, and where barter extension allowed to register official prices largely diverging from effective ones (Mesnard, 2000). In the oil and gas industry, pyramid structures were created by distribution through vouchers of minority stakes in the bottom levels, while the control of the top levels was sold to connected oligarchs. This kind of structure is an invitation to syphon off wealth from controlled companies (Bebchuck, Kraakman and Triantis, 1998). Indeed, this *de facto* gave rise to numerous abuses through profit transfers from subsidiaries to parent companies. Finally, more complex schemes have been elaborated in order to transfer valuable assets to off-shore companies (Yukos).

To explain this deep failure in Russian corporate governance, numerous explanations have been given. The first emphasis was put on the role played by initial conditions, namely the initial boundaries of privatized firms as well as the dominant position of insiders. The latter might be considered as resulting from the political constraint of going ahead quickly in order to make changes irreversible⁵. The former was quite unique to Russia given the “ bizarrely tangled and complex pattern of firms boundaries ”, with the excessive horizontal concentration inherited from Soviet command economy (Fox and Heller, 1999, p.26). Managers completed their secure control on firms acquired through the mechanisms of privatization by share registry control, share buy-backs to employees and threats to employees to prevent them from selling their shares to outsiders (Mesnard, 1996). The pitfalls of insiders' control was denounced as the implicit vicious “ cooperation ”⁶ between different insider

similar : “ ...we rely on news stories and sometimes, even less satisfactorily, on “ general knowledge ”....This means that we may inadvertently tell a story that is not true or, more likely, provide only a partial picture. Still we believe that the overall impression of Russian business that we paint is accurate. The problem in recounting misdeeds by Russian insiders isn't finding true stories, but picking among the juicy stories that abound ” [1999, p.8].

³ This has been the most famous and debated case as for the first time the Securities and Exchange Commission (RKTs) blocked the operation in the beginning of 1998. Indeed, inside shareholders have issued for themselves convertible bonds that would reduce remaining shareholders' share by third without any asset acquisition.

⁴ Faced with a exceptional legal retaliation on the dilution tactic, Sidanko's owners have elaborated a legal tactic to gain control without paying the fair price, by forcing it into a fake bankruptcy.

⁵ We will come back to this latter in part two.

⁶ This is more akin to the paradoxical alliances that sustained barter development. Nevertheless, these alliances can hardly be considered as “ social consensus ” or even “ *par défaut* social status quo ”, as analyzed by Zlotowski [1998]. They result from violent and excessively asymmetric power struggles where one side has de facto no other choice. Employees do “ prefer ” delayed and in kind payments than clear lay-off, while some enterprises do also prefer entering barter schemes than stopping activity (Mesnard, 2000).

groups led to looting by managers, maintenance of extra labor and maintenance of some public services fulfillment (Frydman, Pistor and Rapaczynski, 1996). Each insider group exerts his rights in order to block the others, leading to a “tragedy of the anticommons” (Heller, 1998)⁷. Insider domination is also held responsible for having prevented any development of the stock market, and with it of a control market that could have been a limit to outright abuses (Fox and Heller, 1999, p.45). Nevertheless, the institutional and especially legal sophistication required for a smooth functioning of such control markets make this contra-factual explanation hardly plausible. A mythical corporate control market would have only accelerated the driving out of good owners by “crooks” (Black, Kraakman and Tarassova, 1999). Meanwhile, in order to face the insider domination problem, academic and reformers’ efforts focused on building a stockholder control model. This is a bit paradoxical, as in such a model the essential theoretical problem lies in the separation of ownership from control, as described by Berles and Means [1932].

Last but not least, the obvious collusion between a weakened State and a financial and industrial oligarchy has also actively contributed to large scale asset-stripping (Blasi, Kroumova et Kruse, 1997). The emergence of large and powerful financial and industrial groups did not facilitate the financing and restructuring of controlled firms (Mesnard, 1999). On the contrary, this gave rise to even more systematic abuses against outside and minority shareholders. Moreover, there has been a vicious mutual relationship between poor corporate governance and capital flight⁸.

These phenomena described above have been and are still crucial without any doubt. Their scale as well as intensity have been indeed striking. Thus, the final outcome of privatization was the emergence of a kleptocracy⁹, and “the bigger the stakes, the dirtier the deal” (Black, Kraakman and Tarassova, 1999, p.20). The tradeoff between immediate benefits from these abuses and potential future benefits from normal operation has systematically been arbitrated in favor of present benefits. Indeed, given the unusually high level of uncertainty, future benefits are very heavily discounted, while being originally quite low and problematic given the low level of profitability and the restructuring needs. Moreover, the scale of abuses has made it difficult for normal business perspectives to compete with them. Finally, the voucher privatization, by separating control and cash flow rights, allowed the controllers to externalize the costs of self-dealing (Black, Kraakman and Tarassova, 1999, p.23). In this perspective, abuses constitute a rationale value-maximizing choice giving rise to a “grab-and-run mentality” (Wagener, 2000). This is even more the case as some managers, especially the new emerging oligarchs, are keen, one could dare to say “brilliant”, at the asset-stripping business, much more than at managing effective firms¹⁰.

A change in the trade-off between present abuses and future benefits would require promises relying on legal enforcement. Indeed, reputation mechanisms are ineffective in a highly uncertain, moving and non transparent economic environment. This is even more the case as management norms have been deeply jostled. Thus, in the academic literature as well as political circles, the standard explanation of the corporate governance fiasco has then shifted toward the prevailing legal environment.

⁷ Here again, we must qualify this power to block the other groups with the *de facto* asymmetry prevailing in these relationships (at least concerning labor).

⁸ On the one hand, capital leaves Russia partly because of the impossibility to invest safely in a diversified portfolio domestically given poor corporate governance. On the other hand, asset stripping combined to or through capital flight is a major manifestation of this poor corporate governance. Capital flight remains quite high and worrying, in spite of the reinforcement of exchange controls in the first semester of 1999. Russian deposit in foreign banks increased by 4 billions \$ in 1999 (in 1998 they decreased by 1 billion \$). Capital flight also appears in the balance of payment under the rubric “commercial credits and advances to no residents”, that also increased by 6,7 billions \$ in 1999. Meanwhile, the decrease by 5,4 billion \$ in “other investments / non repatriated exportation receipts and advances on imports” seems more related to the decrease in exchanges. Globally, capital flight is estimated at \$ 15 billions, a stable performance compared to previous years (Courrier Economique et Financier Russie-CEI, N:374-- 375-376-377, 19 April 2000 et 24 may 2000).

⁹ This appears in the Russian language with the expression grab-privatization (*prikhvatizatzia*), and the surname of Anatoli Tchubais as the chief grab-privatizer (Black, Kraakman and Tarassova, 1999, note 34, p.17).

¹⁰ “They devoted themselves, instead, to activities at which their skill is unquestioned: skimming profits from their companies; starving them of funds (...); replacing managers who resisted the skimming (or threatening, bribing them into submission); shooting managers and local government officials who resisted too strongly” (Black, Kraakman and Tarassova, 1999, p.40). See the case of Khodorkovski in Yukos described p.40-42.

III. The legal explanation

A. *The theoretical origin of the legal explanation*

As a matter of fact, the standard explanation of the corporate governance fiasco came to lie in the inability of the Russian judicial system to apply laws and regulations related mainly to bankruptcy, shareholders' rights and more recently minority investors' protections¹¹. In this perspective, the privatization program should have been preceded or at least accompanied by the building of a “decent” legal and enforcement infrastructure, and above all to control inside dealing (Black, Kraakman and Tarassova, 1999). The dirty privatization “by any available means” supported by the Washington consensus “was detrimental as far as it subverted for long the “rule of law” (Stiglitz, 1999). More generally, the legal weakness has been considered as a major cause of the stymied transition (Aslund, 1995). More notably, the underdevelopment of legal institutions fostering impersonal relations between economic agents is analyzed as a fundamental obstacle to capitalism development (Hendley, 1997, PSA). This recent upsurge in literature of legal arguments is described as “post mortem analysis of the disappointments (which) concentrated on mistakes in the conception and assignment of regulatory and property rights by reform legislation” (Stephan, 1999, p.12).

This new focus on the legal factor has a double theoretical origin. Firstly, it corresponds to the neo-classical view of a world of contractual relationships supported by effective legal institutions. Secondly, it also evidences a slight openness to the institutionalist argument underlying the crucial role of modern states as guaranteeing the enforcement of freely contracted obligations in the process of capitalist development. Reformers counted on the newly private owners to form a constituency in favor of property rights legal enforcement. Doing so, they relied on Weber [1967] as well as North [1990] analysis of the evolution of legal systems in Western Europe, based on the hypothesis of law efficiency. In these analysis, the first stage of legal development is a bottom-up one and derives from economic agents incentives. Nevertheless, the role of the state to institutionalize the legal system is a necessary second step to achieve formal legal rationality. We will come back to these theoretical backgrounds at the end of this section to qualify the *de facto* legal evolution in the Russian transition. Finally, this new focus on the legal factor derives also from a quite concrete and practical factor. The global pressure for standardization or at least harmonization of commercial laws is strongly felt by the indebted and investment starving Russia. Multinational organizations have given the main impulse or even directly written new laws, too often leading to the adoption of technically good but maladapted laws. These new laws are indeed perceived as irrelevant to the Russian circumstances.

B. *Legal evolutions and difficulties during the transition*

The legal evolution has indeed been crucial and far-reaching, with the adoption of necessary laws and a deep transformation of the judicial system (Hendley, 1996). Changes occurred mainly during the second half of the 90's, as evidenced by the significant improvement in World Bank and EBRD relevant ratings¹². These laws are decent and cover main domains of economic significance (except the investment funds). For example, the 1996 Corporate Law was designed to face the problem of insider domination, notably through mandatory cumulative voting rights and approving by outsider shareholders for significant operations (Black and Kraakman, 1996)¹³. As a result, outsiders on the boards did increase and had a positive effect on performance. Nevertheless, new ways and mechanisms were found and used to circumvent the corporate law. One must not forget that under socialism the skills to circumvent control mechanisms (bureaucratic ones at this time) and to exploit weaknesses in formal procedures developed into a survival art (Blankenagel, 2000). Such skills were easily re-deployed in front of the still underdeveloped and somewhat unsophisticated legal system.

¹¹ “ (the insider owner-managers) ...gain instead by manipulation the corporate legal system, the bankruptcy law, and other laws to reduce or eliminate the claims of some or all of its shareholders on the firm's residuals” (Fox and Heller, 1999, p.19).

¹² The most important laws concerning corporate governance which have been adopted are the Civil Code between 1995 and 1997, the Law on Securities in 1995, the Law on Joint-Stock Companies in 1996, the Law on Bankruptcy in 1998, and the Law on Limited Liability Companies in 1998. Consequently, while in 1996 Russia was classified in the third group concerning legal reforms, well behind the leaders, its 1998 rating was close to theirs. It got a “4 --” for the coverage of commercial laws, compared to a “4” for the leaders, but still a poor grade as regards the efficiency of commercial law, with a “2” (compared to 3 or 4 for the leaders) (The World Bank 1996; EBRD, 1998).

¹³ This measure, even so widely considered as necessary to protect minority investors' rights, as been often badly understood and implemented in Russian firms, when it was sometimes perceived as a tool to consolidate the power of Moscow-based institutional investors (Hendley, 1996).

Indeed, the existence of law does not provide nor for its interpretation neither for its implementation. As far as interpretation is concerned, the existence of an equivalent to the US fiduciary duty¹⁴ (the obligation for managers to act in the interest of the company reasonably and in good faith) does not provide that this clause would be interpreted in the relevant manner by Russian courts. Such broad legal concepts should be replaced by “bright line rules” or “laundry lists of prohibitions and mandatory rules” fitting the prevailing business institutions and practice (Hay, Shleifer and Vishny, 1996). As for enforcement in general, “courts function slowly if at all, some judges are corrupt, and many are Soviet-era holdovers who neither understand business nor care to learn” (Black and Kraakman, 1996, p. 1914). For example, special procedures provided for large and significant transactions¹⁵ are difficult to enforce, even if they are not sophisticated nor complex *per se*. Indeed, they require that the interests or relations of some directors or shareholders might be established in courts, which is utterly problematic in the globally non transparent business climate (as evidenced in the scandal of Sidanko bankruptcy and the mystery concerning the real identity of the acquirer). More globally, any court enforcement rests on some mechanisms for verifications¹⁶, among which accounting auditing which is still in infancy. In the Russian legal tradition, the courts rely only on documentary evidence. Thus, the overall information vacuum constitutes a serious obstacle to any satisfactory level of legal enforcement¹⁷. This information vacuum is caused and reinforced by barter development as well as the catastrophic tax system¹⁸. Finally, corruption and biases of local courts force plaintiffs to go through long appeal procedures. Even if they succeed *in fine*, decisions have very little chance to get implemented, as this will have to be done by the initial corrupted and/or biased court.

Moreover, some specific legal institutions were *de jure* created, but without the necessary financial, human means nor the political power to be effective. The prime example is the Securities Commission (FKTs) and its paralyzing political battle with the Central Bank over the control of the exchange market, or about the establishment of a central depository¹⁹. There was also a political battle between the Federal Service for Bankruptcy Affairs and the Supreme Court of Arbitrage, both key elements of the bankruptcy procedures²⁰. The prime result of this global ineffective legal system combined with these conflicting organizations is the absence of any legal prosecution of the bank officials who stripped the remaining assets after the August 1998 financial collapse²¹.

In view of these legal pitfalls, propositions have been done, and these go from neutralizing local governments' voting rights (Black and Kraakman, 1996) to extending this measure to all insiders, i.e. allowing only outsiders to elect directors (Fox and Heller, 1999). Doing so could only partially alleviate the problem of interested or related outsiders. Indeed, this would be efficient for medium business, but totally insufficient for big business where the sophistication and means of looters are much more advanced than the official legal instruments. Finally, some of the most informed and competent western advisors ended up with advising a partial and selective re-nationalization in the most outright abuse cases. They also regret that the *perestroika* leasing

¹⁴ Significantly, the concepts of fiduciary duty as well as self-dealing did not exist in the Russian language, as explained in Black, Kraakman and Tarassova [1999], note 42, p.25.

¹⁵ Such transactions should be approved by the majority of directors (board members) who are not interested or related to the concerned transaction, and even sometimes by a majority or a super-majority of non interested shareholders.

¹⁶ Thus, contracts may only be excessively incomplete [Grossman and Hart, 1986] as, on the one hand, the future is highly unpredictable, while on the other hand verification is awfully problematic.

¹⁷ “A barrier to action by outsiders is the information vacuum that prevails in many insider-held firms. They all try to look poor. The only real books are in the director's safe, or his head”. Edwin Dolan, Resisting shock of New, Moscow Times, April 8, 1997, cited by Fox and Heller [1999], p.43.

¹⁸ main commentary and data on the tax system (see Courier)

¹⁹ The FKTs only received wider power in terms of regulation and minority investors' regulation in August 1999, following the revelations about Central Bank's embezzlement, and its resulting declining influence and political clout with the government.

²⁰ The former favored a greater state involvement in bankruptcies while it had a very liberal and economic-oriented conception of bankruptcies as efficiency enhancing mechanism. The latter is more concerned with social objectives and minority creditors' protection and advocates for the intervention of a “neutral” institutions, even the State, as a lesser evil (Zlotowski, 2000).

²¹ The inconsistencies in government policies and conflicting action by different legal institutions have not ceased until now. For example, the Central Bank, after having asked the ARKO (Agency for Restructuring Credit Organizations) to keep Promstroibank afloat one year ago, revoked its licence later. It had recently decided to bankrupt the bank, while the Prime Minister Kasyanov had decided on the contrary to help it. Another example is the ruling out by an appel court of the bankruptcy procedure on Imperial Bank ordered by the Central Bank (Semenenko I., “Battles Keep Raging Over Bank Corpses”, Moscow Times, Friday June 2, 2000).

program had not been pursued²², with some caveats, and transformed progressively in a slower and staged privatization scheme (Black, Kraakman and Tarassova, 1999).

Recently, a new tendency emerged as to directly utilize legal proceedings to execute asset-stripping, especially through the 1998's Law on Bankruptcy. The number of bankruptcies has increased steadily. It doubled since 1997 and was multiplied more than tenfold since 1995 (Radygin, 1999). This derives from new legal provisions, especially the decreasing role that the State can play during the procedure and the new definition of suspension of payment²³. Nevertheless the underlying reality seems to be a multiplication of fake bankruptcies, either self bankruptcies to escape from creditors, either "hostile" bankruptcies provoked by financial structures attempting to acquire a cheap control on assets. In a logic of anti-selection, only the best firms are bankrupted, while the vast majority of Russian firms could legally be declared insolvent (Zlotowski, 2000). Thus, bankruptcies seem to constitute a new form of legal but abusive asset transfers. The local or regional authorities with minority interests are also using this new arm of fake bankruptcies over unpaid taxes to regain control on locally strategic enterprises.

C. *Some Russian legal characteristics and its origins*

This apparently paradoxical use of the legal framework is the illustration of a more general characteristic of the peculiar "rule of law" in the Russian transition. "The legal framework is caught up and corrupted by the effective economic functioning and the manifestation of informal factors" (Kuruneri-Millet and Zlotowski, 2000, p. 86, our translation). Thus, attention tended to "center on the irrelevant and to ignore the central question : why have the new laws had so little impact on people's behavior ?" (Stephan, 1999, p.12). Russia is not a lawless world. The choice faced by economic agents is more complex than the law or the mafia, as modeled by Hay, Shleifer et Vishny [1996]. To become effective, positive law has to correspond or to superimpose on informal norms regulating the economic practice. Otherwise, legal instruments become tools for (not so primitive) capital appropriation. Legal obligations are not respected unless they are perceived as legitimate according to other prevailing "natural", extra-legal and informal norms. This derives from the non-existence of the principle of "autonomy of will" in the Russian legal framework, (Kuruneri-Millet and Zlotowski, 2000, p.88).

This analysis is corroborated by a quantitative and qualitative survey analyzing the relative significance of relational contracting, self-enforcement mechanisms, social networks and legal institutions in private transactions. This survey shows a strong reliance on relational strategies based on trust and personal relationships. Enterprises nevertheless do also resort to arbitrage courts in case of failure of the relational strategies based on negotiation, which happens relatively often. Legal institutions consequently work and play a significant role, but complementarily to other enforcement mechanisms. The "not completely ineffective" role of law, which seems to be a recent phenomenon, is evidenced by the fact that enterprises investing in legal procedures show superior results. Moreover, legal institutions are perceived as more effective and less corrupted than the civil service, the parliament and the police (Hendley, Murrell and Ryterman, 1999, p.38, March).

Thus, instead of the emergence of a new class of capitalists that would be interested in legal development²⁴, as in

²² This leasing program was strongly criticized for treading the middle ground. Nevertheless, these critics could as well, if not more, have been addressed to the latter privatization program, as shown in the following assertions: "In practice,..., (leasing) created opportunities for profitable arrangements for the nomenklatura", or "lease enterprises had an indelible stamp of insider control that the new Russian government increasingly came to see as threatening its vision of privatization" (Frydman, Rapaczynski and Earle, 1993, p.21-22). Meanwhile, these already perceived pitfalls of the Soviet lease enterprises partially determined the very political balance that led to insider privatization.

²³ Suspension of payment may be declared whenever a firm does not honor a contractual or any other kind of legal financial obligation within three months after the due date. This insolvency criteria thus focus on liquidity rather than real solvency. This new legal orientation derives logically from the poor reliability of balance sheets, from the inherent logic of Russian accounting *de facto* based on liquidity principles, as well as from a desire to decrease non-payments on the over-all economy. Nevertheless, its consequences are problematic. Indeed, on the one hand, the vast majority of Russian enterprises may therefore be declared insolvent by any creditor. On the other hand, this unwillingness or/and incapacity to use a real solvency criteria leads to a weakening of property rights and encourages outsiders looking for cash-stripping.

²⁴ This idea was still defended in 1995 by Boycko et alii, as well as in 1996 by Hay, Shleifer and Vishny. This was an argument for giving the priority to privatization instead of legal reforms. "The politically feasible order of institutional reform, then, is privatization first, introduction of legal rules second, and bureaucratic reforms only in the very long run" (Hay, Shleifer and Vishny, 1996, p.565). With an good intuition (in 1996!), they nevertheless qualified their affirmation by the following point: "Surely, some of the laws that the property

the Weberian or Northian tradition above discussed, the privatization program gave power to many managers and “kleptocrats” who had strong interests in the non-enforcement of those laws. “The kleptocracy became self-reinforcing” (Black, Kraakman and Tarassova, 1999, p.50)²⁵. This failure of the reformers’ expectations are due firstly to the situation of “late development” of the Russian capitalism, in which the role for State impulse is much more necessary. Given the global weakness of the Russian state in the transition (until when ?²⁶), the difficulties of legal development are exacerbated. Nevertheless, legal reforms occurred *de facto* in a top-down manner, and even through Presidential Decrees rather than legislative acts, due to fierce opposition from the Parliament²⁷. This followed paradoxically the old legal style, contributing to maintain the status of law as a tool in the hand of power (Hendley, 1996).

Indeed, these legal characteristics derive more generally from “oriental despotism”²⁸, where the law is essentially used to regulate violently the relationships between the governing power and its subjects. Consequently, the law is *de facto* more efficient in regulating vertical relationships than horizontal ones, namely the market contractual relationships (Kuruner-Millet and Zlotowski, 2000, p.92). Thus, these Russian “Asiatic” characteristics and legal traditions simultaneously render the agents wary of law, while making them rely primarily on relational enforcement mechanisms (Jones, 1994). Moreover, the antipathy to law became even more widespread and pronounced following its “instrumentalisation” by the Soviet regime, as well as the total lack of autonomy of legal institutions. In such circumstances, “believe in the sanctity, or even the usefulness, of law requires a huge leap of faith” (Hendley, 1996, p.240). Considering these inheritance, a process of legal development similar to the Middle-Age Western European one would have been indeed surprising.

D. *The insufficiency and limits of the legal argument*

The above described hysteresis in legal behavior enlightens some fundamental and deep factors of path-dependency in the transition (Wagener, 2000). It also points to the fact that shifting in behavioral patterns requires similar changes in critical mass, and consequently a general evolution of representations which can not be induced only by legal means. Moreover, a change in behavioral patterns would also undermine in this instance a major source managerial power, namely the political connections. These considerations underline the necessary consideration of extra-legal factors to understand the functioning of legal institutions, and more globally agents’ behavior.

Indeed, to resort only to the legal explanation to understand the failure of economic reforms is in turn illusory, as was the first step of outright optimism concerning the “automatic” development of capitalism provided that basic institutions of property right and market exchange was established. Rewriting the rules of the game is not sufficient to trigger changes in representations and behaviors. The late opening of reformers, western advisors or academics to institutionalist arguments has indeed been too narrow. Firstly, it focused on the legal argument. Moreover, it tended to reduce it to clear-cut trade-off between the “rule of law” and the “mafia”²⁹. Understanding the effective legal behaviors in the Russian transition requires a larger and more complex representation of the agents incentives and choices.

This focus on legal argument resulted from the obvious failure of the first step of reforms based on a pure neo-

owners lobby for serve their private, rather than social, interest” (idem)...

²⁵ The medium term political consequences of the dirty privatization are serious, regarding public distrust in market reforms, leaving aside public support for a resort to authoritarian solutions.

²⁶ The present Putin government seems to be increasingly based on security services and former KGB officials (as evidenced by the recent appointment of Sergei Ivanov as secretary of the Security Council, “a training ground for its team” (Anna Badkhen, “Voloshin keeps job as chief of staff”, Moscow Times, May 30, 2000). Moreover, the central government is trying to regain power against powerful regional leaders. The Douma have overwhelmingly approved in the first reading three bills allowing the Kremlin to sack regional leaders in case they do not synchronize their law with the Federal legislation (60 regions are said to show wide discrepancies between local and federal laws).

²⁷ On the contrary, law promoted “from the bottom” were generally more inspired by a conservative spirit, or a protective one in Polanyi’s sense [1944], as evidenced by the law on financial and industrial groups (Mesnard, 1999).

²⁸ This refers to the “Asiatic” inheritance of Mongol domination, with its authoritarian tendencies that would have persisted since the XIIIth century in the Tsarist, Communist and present Russia.

²⁹ Such late acknowledgement of institutionalist arguments was underlined by Stiglitz [1999; 2000]. It may be illustrated by this cautious assertion made in 1997: “Our analysis *suggests* that stabilization *may*, indeed, not be sufficient for the resumption of growth, and that the building of market-supporting institutions is a separate and crucial requirement of a successful transition” (réf ? Shleifer and Vishny, 1996 ?) Hay, Shleifer and Vishny, 1996, p.565 ?.

classical view of market mechanisms. In fact, it simultaneously reflects and is at the origin of the current tendency in the corporate governance literature, namely to resort to the legal framework in order to explain the differences between national corporate governance systems. This introduction of the legal argument appears as a breach in the neo-classical paradigm as it questions the absolute domination of private arrangements' efficiency. It has at least "subversive implications" for this paradigm. Coffee is ironic by beginning its critic of this legal explanation by "a specter is haunting the neo-classical theory", referring to "a nowadays obscure XIX th century economist, Karl Marx" (Coffee, 1999).

This legalist view has been notably developed by LaPorta, Lopez-de Silvanes, Shleifer and Vishny, sometimes called the "gang of four", or more succinctly LLSV. Shleifer and Vishny have significantly studied extensively the Russian transition. Their recent works on the legal argument in general derives from the obstacles they had previously faced in their attempt to understand and explain the cause of the Russian transition failure. Their argument is based firstly on the impact of regulation on financial systems (Zingales, 1995; Rajan and Zingales, 1999), as it has been widely and thoroughly documented in the US case. More generally, LLSV [1997] attempt to show a correlation and even a causal relationship between on the one side legal origin or characteristics, and on the other side finance or corporate governance, as well as in fine economic performances. More precisely, they show that the legal framework affects the financial structure through the protection of minority investors, and that this protection is stronger in Common Law countries. Legal protection and ownership concentration appear consequently as substitutes. Finally, a recent analysis of the ownership structure as deriving from a rent protection policy allows to explicit or explain the correlation evidenced by LLSV (Bebchuck, 1999).

Our purpose here is not to reject categorically the legal argument, but to show its fragility and limits when it appears alone as a crutch or recourse to save to neo-classical view. We will now briefly argue that the legal argument is not sufficient for a comparative analysis of corporate governance systems. Firstly, the legal argument does not resist to a closer analysis of its specific mechanisms of influence. For example, Coffee [1991] shows that the US regulation can not by itself explain the passivity of US financial institutions, as it is often argued. Moreover, a longer historical perspective shows that, apart from the UK, all remaining developed capitalist countries (US, France, Germany, Italy and even Japan) enjoyed a similar level of financial development at the turn of the century, while their legal frameworks were already widely diverging. This historical observation destroys the inferences drawn from LLSV's longitudinal regressions. Moreover, these regression suffer from a number of methodological pitfalls. Firstly, the quantification of endogenous variables may be discussed, and especially the protection of minority investors. Indeed, it only considers formal mechanisms typical of legal systems based on explicit contracts, i.e. the Anglo-Saxon ones. This somewhat results in the tautology that legal systems based on explicit contracts better protect explicitly and contractually investors' rights (Barca and Becht, 1999). The other usual caveats of such longitudinal studies are also relevant³⁰.

Some more broad arguments limiting the validity of the legal explanation as developed by LLSV lie in a closer legal look and are mainly exposed by Coffee [1999]. He insists on the fact that legal implementation is more relevant than the explicit legal system, as the very Russian example proves it. More specifically, a formal convergence may be less relevant than a functional one. This point is thoroughly illustrated by the observation that the convergence between the UK and the US, or even inside the EEC relies more on the stock market regulations than on formal systems that are more rigid (Pistor, 1999). Nevertheless, LLSV did include in their study variables concerning legal implementation. Another critic points at the supposed crucial differences between the two families of legal systems. LLSV based their analysis on a much criticized classification of legal systems. Common Law systems are very heterogeneous, as evidenced by the divergences between the US and UK systems³¹.

The main critic concerns the inferred causality from legal systems to financial development through investors'

³⁰ Results are very sensitive to environment variables. Heterogeneity of slope coefficients between countries is also problematic. Indeed, the underlying hypothesis is that the causal relationship is not only the same for all the different countries, but is also stable. Moreover, estimated convergence coefficients are asymptotically biased, invalidating consequently convergence tests. Finally, and probably above all, the interpretation of such types of correlation is very tricky due to the high degree of co-linearity between variables, whatever the number of control variables taken into consideration.

³¹ The usual example is the possibility of derivative action as well as class action that allow to face collective action problems in the US, and that are non-existent in the UK. Moreover, innovative capacity of US judges is much wider in the US than in UK, while this is supposed to be the main difference between common law systems and civil law systems. Finally, as for the British case, some specifically British institutions as the Takeover Panel combined to the relative narrowness of the financial community play a crucial role in investors' protection, while they are not related to legal system.

protection. Firstly, this causality may be questioned for high levels of development. A maximal and unconditional protection of investors is not always optimal (Rajan and Zingales, 1995). There is a trade-off with the protection of managerial quasi-rents (Burkart, Gromb and Panunzi, 1997). Moreover, Civil legal systems may be more oriented toward the protection of majority investors. This suggests another causality, namely that goes from the financial development to the legal system. Minority investors protection thus appears more like a symptom than a determinant of financial development (Rajan and Zingales, 1999, p.28). Another explanation could lie in the existence of a tierce determinant of both the legal characteristic on the one hand, and investors' protection and financial development on the other hand (Berglöf and Von Thadden, 1999)³². More fundamentally, the effect of ownership structure (in terms of dispersion / concentration) on financial development and economic performance are not obvious, as evidence by some country studies (Guegler, 1998). Roe develops the opposite reasoning by arguing that if bloc detention is advantageous for whatever reason, therefore a better legal protection should induce a more concentrated ownership [1999].

Finally, one may question the origin of legal differences. By doing so, Roe turns the legal argument upside down and, following Pistor insight on the significance of market regulations, shows that it is the development of financial markets that triggered the elaboration of the necessary legal system. New-York and London stock exchanges were founded at the end of the XVIIIth century in order to organize street transactions on public debt. Bond and stock markets developed later at the end of the XIXth century to face exploding financing needs resulting from the development of railroads and Secession War (Chandler, 1990). Market rules were progressively elaborated and enacted by the market players without being necessarily being formally legalized. "American laws on financial markets have been adopted in 1933 and 1934, well after the development of the Berles and Means firms" (Roe, 1998, p.20). Conversely, France and Germany were able for sure to elaborate sophisticated legal systems, but they did not develop such legal protection of minority investors because this was not necessary. In France, this was due to the monetary underdevelopment going back to the victory of the Currency School following the collapse of the John Law system in ????. In Germany, universal banks had emerged at the end of the XIXth century (Gerschenkron, 1962). Their untamed power after the WWII influenced the development of the legal system (Shleifer and Vishny, 1998)³³. Therefore, it is the financial development that determines the legal system. We will not elaborate from here on the origin of the financial development, as it is currently a very debated issue, especially after the 1997 financial crisis. Indeed, a recent literature developed the Schumpeterian insight according to which the financier was an essential actor of economic development as he made possible the destructive creation process [1911] (King and Levine, 1993; Levine and Zervos, 1996; Rajan and Zingales, 1996; Levine, 1997).

Consequently, the focus on the legal framework to explain the Russian corporate governance fiasco is indeed a step towards the consideration of the institutional determinants of the transition. Nevertheless, this step remains too shy and narrow, and appears as a somewhat desperate or last ditch attempt to stay within the property right and agency framework to analyze the corporate governance question. The legal framework had indeed hindered the implementation and respect of property rights in transition, and remains *de facto* a major difficulty. The understanding of the peculiarities of the Russian legal behavior is also crucial and should be analyzed in greater depth, with an emphasis put on implementation questions as well as informal constraints. To understand the legal behavior requires in turn to consider a wider set of institutions. We will thus attempt to widen our vision and take into account the overall institutional complementarity in order to give an account of the Russian corporate governance fiasco.

IV. A comparative institutional analysis

We have progressively discovered with the transition, notably in the Russian case, that private property and market coordination, even (or all the more) combined with macro-stabilization, was not sufficient to allow capitalism development or even transition to capitalism. A specific and sophisticated institutional framework was badly needed, and this goes beyond the legal environment. We now need to go deeper and try to analyze further the question of institutions during the transition in order to figure out which were the underlying logic and strengths leading to such an unintended result in the Russian case. In order to avoid to be blocked endlessly in chicken and eggs questions, we have to adopt a different perspective and consider institutions not in a linear and causal perspective. We should also avoid to just observe the *de facto* institutional failures, lacks or inertia. Institutions take time to emerge and evolve, and nobody should be surprised ten years from the beginning of the

³² Possible explanation are numerous, as the State intervention or the political system, as we will develop in the following part.

³³ This is taken by these authors as a counter argument to Roe's political explanation, whereas it conversely, to our point of view, argues against the legal argument *per se*.

transition to observe an imperfect, incomplete and unstable institutional framework. To go beyond a purely negative assessment, we will try to understand the Russian transition in terms of institutional complementarity. We will first evidence how this perspective is in line with the older debate on market socialism. We will then expose the main theoretical arguments developed by Aoki in its latest works. We will then try to go further and elaborate on a hierarchisation of institutions. Finally, we will use this hierarchisation to present the mechanisms of institutional changes in a way that goes beyond the traditional trade-off between institutional inertia and institutional “Big Bang”.

A. *An echo of the debate about market socialism*

Such an analysis in terms of institutional complementarity is a continuation of both the market socialism debate and more specifically of Kornai’s work. Indeed, Kornai showed that the socialist system was coherent because of the existing “affinity” between types of ownership and coordination mode [1984]. Affinity is here the equivalent of coherence. During the debate about market socialism, the problem was to introduce market mechanisms in an overall socialist system. During the transition, the point is to build capitalism on the basis of still predominantly socialist institutions. The theoretical question of coherence is the same. Paradoxically, while it was the finally accepted or proven impossibility of market socialism that led to radical reforms in the 1980’s and finally to the transition, the lessons about institutional complementarity were somehow forgotten. Indeed, reformers have installed the fundamental institutions of capitalism, namely private property and free prices, among the remaining socialist institutions. They have committed three mistakes. Firstly, they considered a too narrow institutional set. Secondly, they focused on explicit changes without taking too much care about subjective representations of economic actors. Finally, they aimed at a too farsighted model of corporate governance. Indeed, they tried to implement the stockholder model of corporate governance that was then and is increasingly the dominant convention in the capitalist world (Orléan, 1999). They have lacked a broader comparative perspective. This is even more the case for Russia which had not been very much concerned with the second wave of market socialism reforms, until the ultimate *perestroika* (Chavance, 1989). Reformers seemed to stand by a virtuous and somewhat spontaneous complementarity between the newly capitalists institutions and the old socialist ones to achieve a complete capitalist system. They were without any doubt influenced by the Property Right perspective, as this school of thought also derived from critics of this specific brand of market socialism that was the Yugoslav worker management (Pejovitch). They were also preoccupied by the urgency to break radically with the past system and avoid any possible U-turn. The double pillar of free prices and private property was thus considered as allowing to cross the Rubicon.

Thus, problems of transition and especially the Russian transition failure lead us to reconsider and reexamine the theoretical question of institutional complementarity. It invites us also to complete Kornai’s analysis of affinity between property and coordination mode by widening the perspective and taking into account the affinity with other institutions. In this sense, the Russian transition might contribute to an institutional analysis of capitalism. To avoid the already mentioned pitfalls, this analysis must be wide and comparative. It must also be able to analyze more informal and subjective changes in actors’ perceptions.

B. *Institutional complementarity*

To analyse the Russian transition, we therefore adopt an equilibrium oriented, endogenous rule of the game conception of institutions based on current work by Aoki, “Toward a comparative institutional analysis”. This conception of institutions fits into the tradition of Old Institutionalism as well as New Institutionalism. Indeed, on the one hand it combines the two conceptions of institutions of Veblen [1889] and Commons [1934], respectively as “mental habits” and “collective action controlling individual action”. On the other hand, Aoki uses game theory, combines the double perception of institutions as rules of the game or equilibrium of the game, and uses recent developments in repeated and evolutionary games. Finally, it allows to understand the double nature of institutions evidenced by Commons and developed by North, as simultaneously constraining and allowing through information condensation.

This game theory vision of institutions allows analysing the interdependencies of institutions in different domains. There are various synchronic linkages among the different domains’ institutions, as social embeddedness, bundling or complementarity. Institutions are complementary, which means that they are efficient not only by themselves, taken individually (Milgrom and Roberts, 1992). They must be coherent and mutually reinforcing: “an economy as a whole may be viewed as a robust and coherent over-all arrangement of mutually inter-dependent institutions” (Aoki, 2000, VIII-1). National systems are perceived as equilibrium in super modular games. In other words, there are different possible over-all institutional arrangements, and we can not rank them in terms of efficiency. This implies the possibility of more than one pure Nash equilibrium that may not be mutually Pareto-comparable. The existence of multi-equilibria is no more a problem, as it is usually game theory, but rather suggests to “utilize empirical, comparative and historical information to identify the

important historical, political and social factors that selected one equilibrium over the others" (Aoki, 2000, I-17). Thus, to understand a national "model" involves analysing and evaluating to which point and through which mechanisms/regulations the coherence or consistency between these different institutions is achieved.

Aoki elaborates a table of institutional linkages between the different institutions of various types of capitalism, theoretical ones (with the neo-classical model and the property right model) as well as existing ones, i.e. the most studied national capitalism as well as emerging ones (most notably the new venture capital model of the Silicon Valley) (see Annexe 1).

C. A hierarchisation of institutions

We will attempt succinctly to "hierarchize" these linkages in order to analyse further the mechanisms of institutional changes. Indeed, synchronic linkages are not necessarily symmetric in a dynamic perspective. For example, if two institutions A* and A** are complementary to respectively B* and B**, the consequences in terms of dynamic evolution are not obvious neither univocal. The evolution from A* to A** might trigger an evolution of B* to B**, or be blocked by a non-evolution from B* to B**, or even be independent provisionally but facilitate a later change, provided that some other institutional changes take place.

A kind of hierarchy is suggested by Aoki's definition of "proto-institutions" related to the social domain, the exchange domain³⁴, organisations' rules and the political domain. He analyses these proto-institutions in the first part of his book. The third part analyses the global coherence of different models of capitalism. Significantly, the first chapter of the third part is dedicated to corporate governance. This evidences the central role of corporate governance at the heart of institutional coherence of the different models of capitalism.

Thus there are three "levels" in institutional hierarchy. Corporate governance derives from and/or organises the coherence and complementarity of what we will call "median institutions", which are themselves based on proto-institutions.

Proto-institutions appear both as "prototypes" of institutions and as achieved models of institutions covering one domain. These two interpretations appear at different times in Aoki's book. Thus their conceptual status appears as somehow ambivalent, but we will use this ambivalence to elaborate more on institutional hierarchy. Indeed, as prototypes, they are crucial regarding both their scale or extent and their depth. As generic forms of institutions, they cover all the institutional domains, and are consequently widely relevant, in the sense that they provide with a kind of shape for the remaining institutions (thus the term "embedding" frequently used for the social domain [Granovetter, 1985]). Two proto-institutions, namely the social and the political domain, are moreover widely relevant as they concern all individuals or economic agents. Aoki underlines that agents do not have the exit option regarding these domains. As achieved models of institutions, they are not analysed further in Aoki's book, but have strong embedding relationships with median institutions, as it is already relatively well documented as far as the social domain is concerned.

Width and depth of proto-institutions go hand in hand with a relative inertia, in an analogy with North analysis of informal constraint inertia [1990] or Delorme's analysis of different changing speeds of various institutional domains [1996]. Our typology of institutions as well as their respective changing speed differs from Delorme's one, but we keep and consider as crucial the main underlying idea of differing changing speed. We will combine it to hierarchisation to analyse institutional change.

One question emerges as regards Aoki's table of institutional linkages. What is the role and place of the legal system? Indeed, the legal system does not appear as such. Aoki did not consider the legal system as an institution as it wanted to insist on the fact that.....**trouver citation et explication Aoki**. The legal system does have an impact on property rights, as well as other institutions that are taken into account by Aoki, as the financial system, the labour system, etc... Thus, the impact of the legal system on otherwise an-institutional reasoning is not only insufficient to make these analysis institutionalist. Moreover it evidences a misconception of what an institution is.

D. The political system

In Aoki's work, the political institution is not distinguished from other institutions, in the sense that it is not

³⁴ Besides, there is a shift as the exchange domain does not appear as such in the table of institutional linkages but is replaced with property rights. We therefore consider that property rights as a proto-institution that regulates the exchange domain.

considered as fundamental nor determinant for other institutions, contrary to Kornai 's analysis in " The Socialist system ", with the meaningful subtitle of " A Political Analysis of Communism " [1992]. The political system is here considered at the origin and the core of the coherence of the socialist system (see Annexe 2, Kornai 2000, p.29). Nevertheless, this determination is less clear-cut for capitalist systems in Kornai's analysis, or more precisely the political system is more weakly specified. It just need to " refrain from outright hostility " to private property. Thus, the political dimension plays the primary role in the transition from socialism to capitalism, and this transition can not be complete until changes have occurred in the political sphere³⁵.

In a stakeholder perspective, corporate governance is at the articulation between the firm and financial, labour as well as industrial institutions³⁶. Moreover, this position of corporate governance allows to understand how national systems of corporate governance are strongly determined by political systems and more broadly by political history (Roe, 1998). Indeed, financial, labour and industrial institutions fully participate to the political balance or strength relationships, as respectively the US financial dispersion with federalism (Roe, 1991 and 1993), the German codetermination with social democracy (Aoki, 1984), or the Japanese firms and keiretsu with administrative pluralism (Aoki, 1988, chap 7). Consequently, we adopt Roe's perspective and put an emphasis on the political determination of the national corporate governance system³⁷.

Some recent work by Rajan and Zingales [1999] elaborates on Roe's perspective and by going back to the already referred to concept of financial development. In their analysis, it is the lack of political support for financial development by the ruling elite that allows to understand the different national historic trajectories. More specifically, the ruling elite would oppose financial development as this, by decreasing market imperfection, could lead to a decrease in rents from the existing ownership structure³⁸. Moreover, the elite capacity to influence or determine financial development may in turn depend on the legal system. We go back to our previous discussion but this time by introducing the legal system indirectly in the impact on the political system on the financial one. A more concentrated political system and an Civil legal system allow the government to determine more directly financial development, whatever the direction of the evolution³⁹. This analysis seems quite relevant as regards the Russian case. The emerging financial elite that benefited utterly from the first phase of reforms do not have any more short term interest in a further financial development, and as such they block the legal and political evolution. We go back to our comment about the Russian transition failure in establishing a constituency in favor of property rights legal enforcement (cf part III.a). This political and historical perspective deserves also credit for showing that financial development is not irreversible. It leads to a destruction of social insurance mechanisms and as such may provoke a violent political reaction favouring power centralisation and economic coordination by the State (Polanyi, 1944). This aspect has also been underlined by Roe [1998] who advises to introduce in institution analysis the possibility of a political "backlash". Such an warning should be heard regarding the Russian evolution.

Thus, combining Aoki's table, our brief analysis of institutional hierarchy as well as our considerations about the role of the political system, we have elaborated the following scheme of relationships between institutions. The

³⁵ The Chinese apparent paradox has been often opposed to this view. The Chinese case is analysed by Kornai as an unfinished transition, which it may well be, how successful and impressive it can be. " The communist party is transforming from within through change from a sharply merciless anti-capitalist political force into one that is covertly, but even more openly pro-capitalist " (Kornai, 2000, p.33). Thus, the transformed Chinese communist party has the necessary characteristics for allowing a capitalist system. " ...it remains rhetorically communist, but in practice is no less friendly to private ownership and the market mechanism than Pinochet or the post-war South Korean dictators were " (idem, p.33). Another non contradictory and convincing explanation of Chinese success lies in the lower degree of disorganization induced by the remaining partial plan coordination (Blanchard and Kremer, 1997).

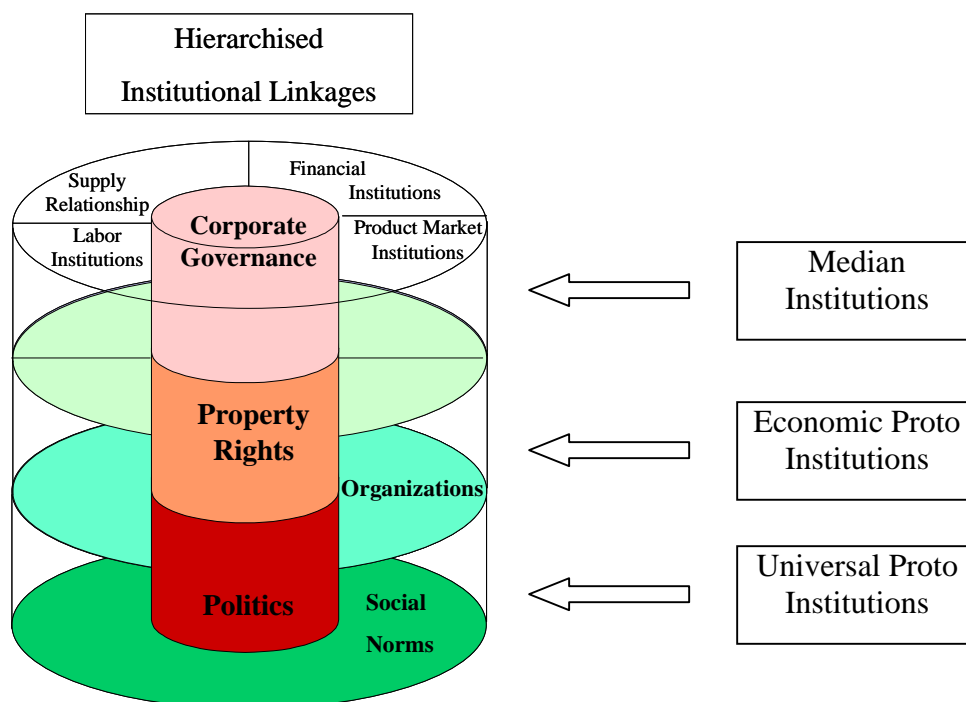
³⁶ We will not argument here on the validity of the stakeholder model of corporate governance. We will just refer to some main authors that have been adopting this perspective for a long time (Aoki, 1988; Blair, 1995). We want also to underline that the already referred to convention of corporate governance in a stockholder perspective is being more and more challenged or at least discussed, as illustrated by the work of Berglöf and Von Thadden [1999], two scholars who have been working significantly on the Russian transition.

³⁷ In doing so, we also return to the classical vision of Political Economy, as it differed on this point radically from the post-classic Economic Analysis (Heilbroner and Milberg, 1995).

³⁸ In such a perspective, the development of the London financial market may be explained by the combination of a weak government and an ruling elite that could profit directly by financial development.

³⁹ Based on these considerations, Rajan and Zingales show that this is the post-WWI until 1948 period that allow to explain current differences in financial development between OECD countries. The reaction to market development as described by Polanyi [1944] were stronger in countries of civil legal tradition with a more concentrated power. Conversely, the decentralisation inherent in Common Law countries rendered the political opposition to market development less effective.

place of corporate governance does not mean a hierarchical superiority nor a greater significance *per se*. This could just derive from a natural “themo-centrism” of researchers would tend to consider their subject as of the utmost importance. It just reflects the articulation role of corporate governance. There is a mutual complementarity between corporate governance and the four median institutions. This scheme also illustrates the crucial, determining and embedding role of political and social institutions.



The main points resulting from this hierarchisation of institutions are the following :

- Corporate governance is the central median institution, as it organises and guarantees the coherence between the median institutions which are financial institutions, labour institutions, inter-industrial institutions, and product market institutions;
- The median institutions are embedded in economic proto-institutions, which are property rights and organisations;
- Successively, these economic proto-institutions are embedded in universal political and social proto-institutions;
- Corporate governance derives from property rights which in turn derives from political strength relationships.

Consequently, we propose a new definition of corporate governance that emphasise this double aspect :

“Corporate governance is the manifestation in the median economic institutions of political power relationships, and corporate governance ensures and structures the institutional coherence between other median economic institutions”.

E. Institutional change

The transition is an over-all institutional change. We are not only concerned by the narrow sense of institutional change as applied to specific institutional arrangements, but also by a change in the whole institutional structure (Lin and Nugent, 1995). The implications of institutional complementarity for analysing institutional change are significant.

On the one hand, viable institutional arrangements may not be pareto-optimal, but nevertheless be robust to isolated reforms aiming at improving one domain's efficiency. This robustness and inertia⁴⁰ is reinforced by

⁴⁰ This consideration of inertia goes beyond the widespread inclusion of institutions as just external constraints that limit the free exercise of optimizing rationality. This perspective allows only to hide the failure of neo-classical economics to account for the real world. If recommendations fail, this is not because the underlying model was inadequate, but because the agents were bogged down in their social archaism, they “resist to change”

other types of linkage between institutions, namely social embeddedness⁴¹, enclosed linkages and bundling. Moreover, there is mutually reinforcing fit between existing institutions and agents' competencies as well as political power (Aoki, 2000, IX).

On the other hand, individual institutions may not be designed nor altered in isolation. In order for an over-all institutional arrangement to change, "either complementary institutions need to be changed simultaneously (the Big Bang approach), or a change in one institution in one domain needs to trigger a chain reaction in other institutions through the very complementarity relationship (the sequential approach)" (Aoki, 2000, VIII-19). In such case, there is a hierarchy in institutions, as the change in one institution drives or requires evolutions in the other complementary institutions.

These two characteristics of institutional change lead to path-dependency. We will now illustrate this by path dependency in corporate ownership and governance, as the analysis made by Bebchuk and Roe [1999] is very congruent with our hierarchisation of institutions. There are two sources for corporate ownership and corporate governance path dependency. Firstly, structure driven path dependency implies a direct impact of initial ownership structures on subsequent structures. It is based on rent seeking and efficiency consideration, this latter through sunk adaptive costs, complementarities, network externalities and endowment effect. Similarly, rule driven path dependency results from efficiency consideration or interest group politics. It explains how the ownership structure heavily influences the legal rules, thus reinforcing initial patterns of ownership. This analysis underlines how the initial political choice regarding the structure of the privatisation programme may affect the long term structure of ownership in Russia. It thus refutes the Panglossian argument that whatever ownership patterns prevail after the privatisation, competition and property right would lead to an efficient structure after a while. We are not in a purely Coasian world, and primitive capital accumulation (in both meaning) does matter.

Finally, the use of subjective game models helps to more subtly conceptualise changes in institutions, and more specifically the dialectic between stabilisation and evolution (Aoki, 2000, chap IX). Indeed, agents have only a subjective view of the game's structure they are playing. If they reassess this subset in a co-ordinated manner, this can lead to a new institution. Consequently, a new choice or rule of action has to be transmitted and integrated in a "critical mass" of agents' subjective games to induce a change. Therefore institutional evolution is characterised by long periods of stability broken by short episodes of rapid evolution. This characteristic of punctuated equilibrium conveys the possibility to have simultaneously path dependency and novelty and has been already used and applied to global capitalist evolution by **Danzau and North [1994] and Thurow [1994]**. A large external shock may induce the change. Current institutional balances impose constraints on the possible set, explaining path dependency. Nevertheless, at the time of critical changes in subjective subsets, there are various trajectories from the initial state of imbalance. The resulting one cannot be totally determined

This consideration of subjective games allows also to better understand three significant characteristics of institutions. Firstly, institutions have a double nature, as they need at the same time to be endogenous and exogenous, which is the basis of their efficiency and moreover of their authority This is illustrated by the analysis of the monetary institution made by Aglietta and Orléan [1982]. It also explains the "enabling" nature of institutions, or the institutions as resources. Indeed, the condensed representation of an institution as an equilibrium in the game may precede the establishment of such an equilibrium. We can use here the concept of focal points which allow to avoid indeterminacy in choices between different equilibria or conventions (Schelling, 1960). Finally, this perspective allows to underline the fundamental indeterminate and unstable characteristics of the "swinging" or "shifting" period. Once again, while central European countries seem to have a focal point in the EEC integration, the Russian transition may be much more indeterminate, and thus unstable.

These three remarks lead us to the conventionalist perspective. Indeed, we can complete or analyse further this perception of change by using the same evolutionary game theory literature as Aoki and interpreting in a conventionalist perspective (Boyer and Orléan, 1994). These authors adopt Sugden's definition of convention as a evolutionary stable strategy in a game where there are at least two such strategies [1989, p. 91]. In such a perspective, change is no more necessarily based on a general change in subjective games of actors. Four different types of change in conventions may consequently happen. A general collapse may result in an overall redefinition of prevailing conventions. This kind of evolution must certainly be considered in the transition as it can be compared to a global disorganisation, having the same radical impacts in terms of institutions as a war (Olson, 1982). Change may also occur through a progressive invasion mechanism and especially if the new convention is much more efficient than the preceding one. Moreover, a kind of compatibility may also develop

and fail to join the walk towards the glorious future of the "homo economicus".

⁴¹ This is similar to North's analysis of institutional change that can only be incremental as a result of embedded informal constraints (North, 1990).

through the translation of the new convention into the framework of the old one. This evolution will be facilitated by the degree of compatibility of the two competing conventions, and such changes may become cumulative. Finally, change may simply (!) result from an agreement between the agents, which might be framed or supervised by the State. Moreover, an endogenous diffusion is generally favoured by any kind of localisation effects in interactions.

These four types of evolution do coexist in the Russian transition. A general collapse occurred in inter-enterprises relationships, resulting in a disorganisation that triggered the search of new coordination modes, as new industrial associations relying mainly on local networks (Recanatini and Ryterman, 1999). More generally, the transition was perceived in its first years as an “institutional vacuum” (Murrell, 1992). The emergence of barter may also be analysed as a new kind of institution resulting from the collapse of the central planning. But its development during the transition may then be viewed as a mechanism of invasion by a more efficient institution than the monetary one in the prevailing environment. Wage arrears could be analysed as the translation of the new convention of hard budget constraint into the old framework of labour immobility. Finally, the absence of bankruptcy procedures for heavily inefficient and insolvent firms result sometimes from an agreement with local authorities when these firms are the main sources of employment and/or taxes.

V. An institutional autopsy of a the Russian transition failure

Based on this theoretical framework, we will tell the story of the Russian transition in terms of institutional linkages, both synchronic and diachronic ones. We can explain the successive failures in establishing a coherent and robust corporate governance regime in Russia by evidencing and documenting various institutional linkages between corporate governance and other institutions related mainly to the financial system, the labor market, supply relationships and product markets.

To do so, we will divide the Russian transition into three sub-periods, from 1992 (first part of the privatization program) to the summer 1995 (loan-for-shares), then before and after the August 1998 financial crisis. We will do three analogies to enlighten the evolution in the corporate governance domain. These analogies are of course not strictly delimited by the defined periods, they do not correspond in an homothetic manner. Moreover, they do not have the same analytical status. Indeed, the first analogy compares the first period with the German co-determination model. Nevertheless, this model was not aimed at by reforms. The second analogy is with the contingent corporate governance model, and was explicitly aimed, at least officially. It corresponds precisely to the second period and exploded with the 1998 crisis. Finally the Anglo-Saxon stockholder model was explicitly aimed since the beginning of the transition, consciously or unconsciously, while it was by far the most distant from initial conditions. Based on these three rudimentary analogies, we will analyze and detail further Aoki's characterization of the over-all institutional arrangements in the Russian transition as shown in Appendixe 1. Without developing extensively each analogy (we refer the reader for that to previous work, Mesnard, 1999), we will focus on institutional deadlocks due to synchronic or diachronic linkages between institutions. We will especially evidence how the Russian proto-institutions regarding the political, social, and industrial system prevented the evolution towards a globally coherent model of corporate governance.

A. *The impediments to the establishment of an owner-control model*

More specifically, we will first show how the insider dominated firm triggered by privatization failed to evolve towards an owner-cum-employees control model. This could have evolved towards the German model of co-determination as the ownership structure could have led, a priori, to such an evolution. We will first show on which aspects the German model was the closest model to the emerging Russian one. We will then evidence how labor, financial and industrial institutions prevented to converge towards the German model.

1. Elements of similarity

Indeed, from 1992 to 1995, the ownership structure could have led to a share of control between inside managers and employees, as they respectively controlled 18% and 40% of firms' capital on average in 1996.

This ownership structure differs from the German codetermination as this latter is not based on ownership by employees, but on legal obligations resulting from political history⁴². These legal obligations were somehow

⁴² German co-determination originates in the 1918 Parliament's will to tame revolutionary strengths by balancing capital's influence over firms. The present form of co-determination was later institutionalized by Allied after the WWII in coal and steel industry in order to break authoritarian behaviors prevailing in these industries. When they have been put under the German legal status in 1950, co-determination was maintained for

subverted by the development of a “semi-private” governance with a bloc ownership structure, as 85% of German firms have one stockholder with more than 25 % of ownership (Franks and Mayer, 1992). Thus, the first element of comparison with the German model is the resulting block ownership structure combined to the *de jure* power of employees. Moreover, the *de facto* power of Russian employees was much weaker due to various factors. Firstly, they often do not have the exit option given the inherited industrial structure, labor immobility and social system. The wage arrears just evidence this total lack of alternatives for the vast majority of Russian employees. Secondly, managers have used various tactics, from blatant intimidation to more sophisticated seduction ones to prevent employees to exercise their control right or to sell their shares (Mesnard, 1996). Thus, the effective control structure of Russian firms is also one of “semi-private” control, mainly by insiders.

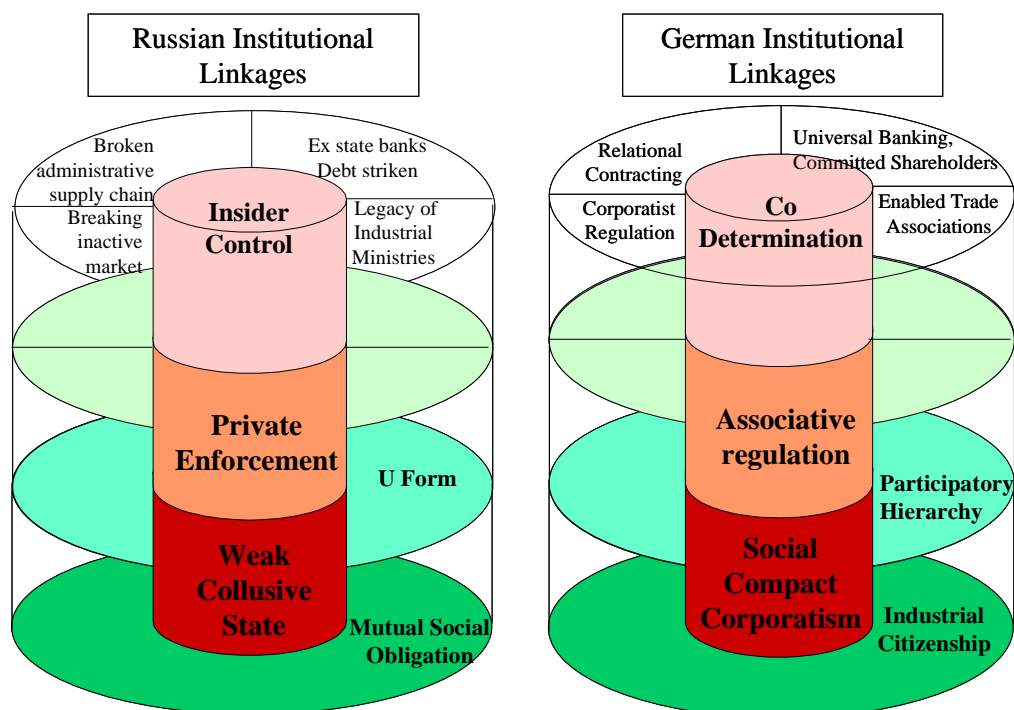
The second point of comparison with the German model could precisely have been the role of banks. Indeed, in Germany, the development of a two-level banking system was driven by Bismark’s will to develop the industry through bank financing. Big banks were in fact conveying instructions from a very interventionist state (Gerschenkron, 1962, p.14-15). In the beginning of the transition, emerging banks were also playing such a role as they in fact distributed subsidized credits.

2. Institutional drawbacks

Nevertheless, in order for such a model to develop, numerous institutions were lacking. In fact, almost all complementary institutions that would have allowed an owner-cum-employees controlled firm model were lacking.

In order to evidence institutional deadlocks, we will briefly compare the two stylized over-all institutional arrangements using Aoki’s table and our own hierarchisation. We will show successively the deadlocks resulting from the median institutions, and briefly evidence how these deadlocks are rooted in proto-institutions. Thus, this analysis, even though brief and rough, will illustrate our two main points :

- the legal explanation, as it focused on formal property rights enforcement, is utterly insufficient.
- the problem of complementarity with other institutions refers to more deep institutional evolutions that have been neglected in the reforms. Moreover, these deeper institutional evolutions can not be neither rapid nor totally voluntary or decided from the top.



3. Labor institutions

The newly privatized firm was indeed embedded in a social norm of mutual social obligations that could have

these industries once again by the Parliament under the threat of a miners’ strike. Finally, co-determination was generalized to other industries in 1976 (Aoki, 1984, p.152).

evolved towards a corporatist regulation system. Nevertheless, this evolution was impaired by the combination of collapsing unions and an inherited strong vertical management power inside the firm. Moreover, the persistence of the informal norm of mutual social obligations combined to unclear and somewhat contradictory political orientations placed the labor institutions in a kind of institutional vacuum.

Indeed, a corporatist regulation system would require powerful and centralized unions that are able to negotiate structural agreements on the nationwide scale. The legacy of soviet unions make them almost disappear in the transition. Indeed, former unions were more representatives of managerial hierarchy as well as of the party hierarchy than of employees. Only very few local and firm unions succeeded to transform themselves or to emerge as real counter-power to the management one (Clarke, 1996 a and 1996b).

Moreover, the transition was widely perceived as leading to some unavoidable and radical industrial restructuring, and consequently to massive redundancies. In this perspective, the consolidation of a union movement strong enough to negotiate on a nationwide scale was perceived as a danger and even as a deadly threat to reforms. Thus, instead of facing this question and work on union transformation, full power was led to managers. The tactic was to let them, as new owners, make the bad work of laying off workers. Indeed, their new status of owners should have given them the incentives to such a move. But, here again, the social norm of mutual social obligation was neglected. Even if abusive managers did laid off and stripped their firms, a vast majority of them still considered themselves as responsible for the “collective” of workers, and have not adopted the typical capitalist nor entrepreneur behavior that would have required massive lay-offs⁴³. Moreover, with the massive distribution of vouchers to employees, the privatization program blocked the formal power of managers to decide.

Thus, the situation is an in-between or a vacuum where there is no unionized regulation of working relationships, neither a labor market, neither a working democracy where employees could really act as owners of their enterprises. What is left is the absolute de facto power of managers, while they do not have the formal or legal power to decide by themselves.

Indeed, the corporatist regulation is also based on a participatory hierarchy inside the firm. This is in contradiction with the strongly vertical organization of the Soviet firm. Indeed, “Stalin learned his economics in the 1920’s when the secret of capitalism was supposedly to be found in vertical integration and gigantic economies of scale” (Thurow, 1994, p.56)⁴⁴. While such gigantism was latter revised in capitalist countries, the socialist system had not adopted this later evolution, as an example of its difficulty to innovate (Berliner, 1988). Moreover, this vertical integration had been even reinforced in successive reform periods in the USSR, in an attempt to rationalize planning.

Indeed, the process of increasing power and autonomy of firms’ directors had begun before the privatization. During the *perestroika*, with the Law on State Enterprises of 1987, directors were elected by the collective of employees for five years, but this decision had yet to be ratified by the administration. Progressively they consolidated their autonomy and directors ended up controlling fully their nomination as well as their election. With accounting autonomy and self-management reforms, directors had really acquired a significant degree of autonomy in the management of firms. At the eve of the transition, directors *de facto* controlled enterprises. This power weighted in the privatization scheme and they consecutively acquired a *de jure* power through ownership. Once again, the attempt at widening their power to employees were vain.

Thus, the inherited norm of social obligation, the logical collapse of unions and the even more increased power of managers inside the firms impaired the transformation of labor institutions into corporatist ones, even if such an evolution could have been considered more logical on a political point of view.

4. Financial institutions

Banks that emerged in the first stage of the transition were either pocket banks, founded by industrial firms in a way to have access to cheap central bank credits, either ex state banks stricken by bad debt. They did not have significant financial resources to foster restructuring and development of newly privatized enterprises. They did not have either nor the competency nor the willingness to develop credit activity as their main source of profit

⁴³ Nevertheless, regarding the brutal collapse in production, it was economically sensible to keep workers in the perspective of an economic recovery.

⁴⁴ This is perceived by Thorow [1994, p.??], as one of the main explanation for the relative success of the Chinese reform, as the Chinese socialist economy was much more oriented towards smaller scale production units. This point is also underlined by Blanchard and Kremer as specificity and complexity were lower in China than in Russia [1997, p.1122].

was, between 1992 and 1995, short-term operations on the exchange market (Calvo and Coricelli, 1993).

Meanwhile, the lack of credit finance due to the stabilization monetary policy triggered barter development that reinforced the context specificity of human as well as physical assets. This development weakened banks capacity to influence over enterprises, as their monetary liquidity or solvability did no more have a direct impact on their real functioning and production capacity.

Finally, the weak State as well as already mentioned social norms made impossible any significant development of bankruptcy. Legal problems did play a role in this impossibility to engender bankruptcy mechanisms. But this was more fundamentally the social norm combined to, here again, concentrated industrial structure that rendered such procedures unfeasible on a wide scale. The weak state that could not trigger the development of a social safety net nor to force the tax payers to pay their taxes, or that was the first bad payer, strongly participated to this impossibility to develop bankruptcy procedures.

Thus, once again, a combination of social norms, weak state, inherited industrial structure and poor property rights impaired the transformation of the financial system into one that could have fostered the development of a co-determination model of corporate governance.

5. The industrial supply and product market institutions

The disappearance of central planning and the breakdown of Soviet Union resulted in a total collapse of supply networks. This breakdown combined with lack of financial liquidity resulted in barter. Barter has been somewhat considered as a very specific kind of relational contracting, as it indeed allowed to maintain some industrial relationships rooted in previous ones (Rizopoulos and Maroudas, 1999). Nevertheless, barter is de facto very far from presenting the same advantages as relational contracting as it is very rigid, and based much more on crude strength relationships than on trust (Mesnard, 1999b).

Here again, it was the inheritance of industrial structure, combined to low property rights enforcement and weak state that contributed strongly to barter development. Indeed, the disorganization that resulted from collapse of supply networks was even more significant in the ex soviet union as the former industrial structure was one of bilateral monopolies with an extreme degree of asset specificity, combined to a complex productive structure. Consequently, “disorganisation has been much more important in the former Soviet Union” (Blanchard et Kremer, 1997).

Nevertheless, the emergence of business associations is analyzed precisely as a way to survive adversity and to fight against the dramatic output decline. As complex organizations, such associations are a spontaneous response to create order in face of disorder. Recanatini and Ryterman [1999] precisely study the emergence of such associations during the first phase of transition (their data concerns 1994). What is significant for our general argument are the following points:

- this form of complex organization was chosen partially due to an historical legacy⁴⁵, even if emerging associations significantly differed from their antecedents, and more specifically have a more enlarged role;
- these associations allow firms to “leap instead of walk” in their search of new partners. According to their model, this acceleration in the search for new partners allows to pass faster from a robust state biased towards non production toward a new robust state biased toward production.

Thus, there were two contradictory though linked tendencies as for supply relationship and market product institutions were concerned in the first phase of the transition. The first phenomenon, barter development, was a perverse and disabling supply and trade relationship, while associations that developed sometimes through these very barter schemes represented a enabling way to go out from the production collapse trap. For these two phenomenon to become fully virtuous, a less vertically integrated industrial structure would have been necessary, as well as a more efficient enforcement of property rights, not based only on private or local strength relationships, but also on a stronger and more impartial state. Thus, institutional evolutions necessary to the evolution towards a co-determination model of corporate governance were impaired by inertia or inefficiencies in proto-institutions.

B. The failure of the contingent governance model

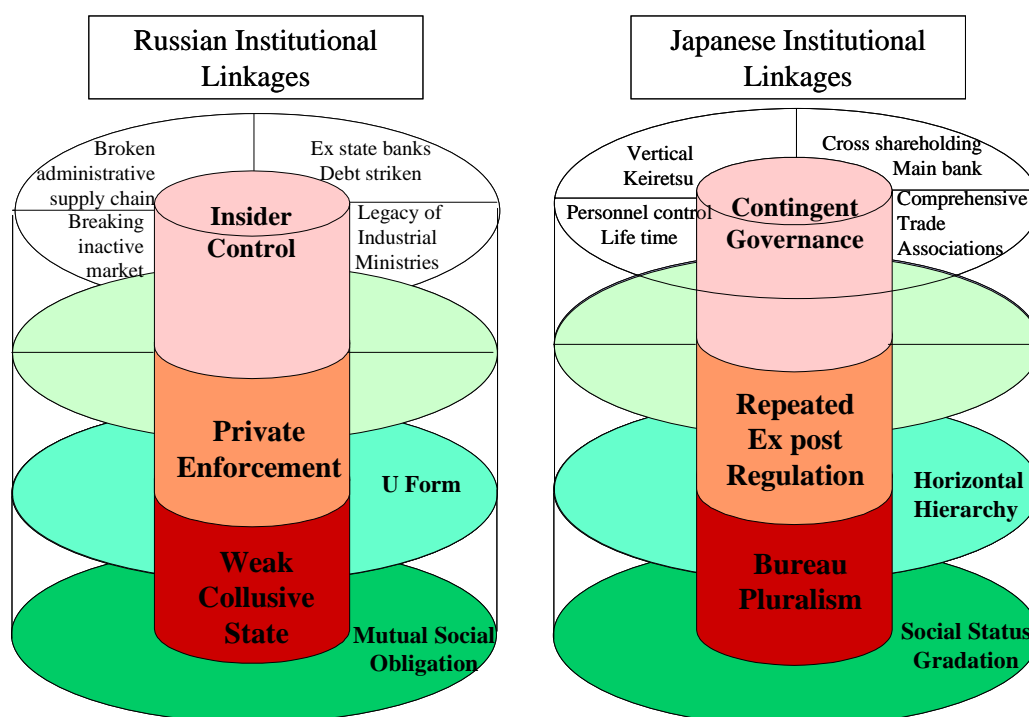
⁴⁵ This is evidenced by the fact that half of the organizers of new business associations are former ministerial officials (Recanatini and Ryterman, 1999, Table 2)

After the “loan-for-share” operations in the summer 1995, big financial and industrial groups emerged (Johnson, 1997; Mesnard, 1999a). There were two kinds of FIGs, formal ones with a specific legal status but a weak economic significance on the one hand, banking ones which acquired a significant economic, mediatic and political power on another hand, at least until their collapse with the 1998 financial crisis. We will now concentrate on these banking FIGs and show how they failed to transform themselves into structures allowing to implement a contingent governance on their industrial members. Indeed, the 1995 Law on FIG explicitly aimed at creating Russian keiretsu or chaebols, as such models of groups have long been considered as very performing for emerging capitalist economies. Nevertheless, this model of corporate governance is not free from pitfalls, which were especially evidenced in the recent financial crisis and the global Japanese economic turmoil. Moreover, the emerging informal banking FIGs were perverse copies of these models. We will not enter into too much details to explain how and in which way they happened to be such bad copies, as we have already developed this point in another paper (Mesnard, 1999). We will just here underline how the lack of complementary institutions may be to a great extent related to proto-institutions inherited from the former system.

1. An *a priori* more consistent model

The contingent governance model may seem *a priori* close to the Russian institutional environment in the beginning of the transition in two aspects. Firstly, the labor markets are inactive, and there is an informal norm of life time employment, at least in big companies at the center of the keiretsus. Secondly, a majority of keiretsu are vertically organized, with successive circles of suppliers on one side, while on the final product side trade associations play a significant role. These labor and industrial institutions were probably very attractive for Russians who could see in them a closer institutional framework and consequently a more politically acceptable one.

Nevertheless, these are not the reason why, according to Aoki [2000], this form of governance may seem adapted to Russian firms in transition. The two main advantages concern the ownership structure and the banks' incentives. Firstly, this form of governance may be coherent with diverse ownership structures. It is less determined by a specific ownership distribution, as are the other governance models. This could consequently allow to neglect the quite serious and political constraint of initial ownership structure, while remaining adaptable to subsequent evolutions. This is indeed a much valuable characteristic in such a intrinsically uncertain and unstable period. Secondly, and this could have been quite significant, Russian banks could theoretically have been motivated by significant potential rents, mainly market power and informational ones, regarding the stringent underdevelopment of the banking sector at the beginning of the transition. Nevertheless, this would have required at least medium term perspective from these banks, would have been able to make fortune on very short term and somehow non risky businesses.



We will show in the following section first how the apparent proximity concerning labor and industrial structure

was a fallacy, and that a closer look reveals subtle but fundamental divergence. We will also how bank incentive structure led to a totally divergent and perverse path. Indeed, the “big” and above all well connected banks which drove these emerging groups committed at the same time the two pitfalls of contingent governance, namely insufficient monitoring and abusive bankruptcy. Thus, we will attempt at describing how Russian institutions contributed to accentuate these pitfalls, while impeding the effective materialization of contingent governance advantages. Once again, the combination of deficient property rights and of a collusive State, resulting in grossly corrupted privatization and a failing prudential regulation of the banking sector, resulted in the total failure of these groups.

2. The labor institutions and the industrial structure

The emerging Russian FIGs could not transform themselves in Japanese keiretsu as they inherited from labor in industrial institutions which were not only different, but often symmetrically opposed to the Japanese ones. As labor institutions are concerned, life tenure is the only apparent similarity. As for industrial organization, nor the former industrial associations grouping similar firms, nor the new FIGs regrouping unrelated enterprises could compare to the Japanese keiretsu.

In order to enlighten this dissimilarity, we will use Aoki’s typology of the A and the J firm. This typology establishes a strong link between the labor relationships and the industrial structure. Consequently it is quite in line with our argument of institutional complementarity. Therefore we will study the divergence together. Using Aoki typology, the soviet firm appears somehow as an extreme case of a hierarchical firm, even if in an intrinsically paradoxical and contradictory manner.

- The total separation between research, conception and production was a characteristic of the soviet industrial organization. Research and development units were different entities that appeared in the former economy as firms as such. They were linked to production units in industrial associations. This was considered as one of the major obstacles to innovation (Aganbeguian, 1987).
- The official industrial organization was extremely specialized, reflecting the already referred focus on scale economies in the stalinist industrialization. Nevertheless, a progressive tendency to de-specialize upward and downward appeared to counteract the bottlenecks and shortages resulting from planning failures.
- Production coordination was done by planning, resulting in a theoretically huge taylorist factory, thus a extremely vertical coordination where all information transmission were also supposed to be vertical.
- The labor organization was also managed in a very vertical and authoritative manner. The problems generated by bottlenecks and shortages made impossible the same level of “scientific management” as in the Taylorian organization. Nevertheless, this was the model, even if its implementation was very problematic. A significant part of wages were yet piece rate, which seems in complete contradiction with the prevailing ideology.

Nevertheless, it is well known that this extreme hierarchical organization was theoretical, and that a lot of horizontal bargaining was de facto necessary for the effective, if not efficient, functioning of the economy. Nevertheless, the overall picture is one of strong hierarchy and in this sense seems absolutely opposite to the J firm with its horizontal coordination, horizontal information sharing and where “plan” vertically elaborated are only indicative. In the J firm, specialization is sacrificed in favor of efficiency in using ex post information and flexibility facing demand.

This extreme vertical organization of the soviet firm, for the coordination as well as the incentive structure, leads us to two observations :

- firstly, the soviet firm did not respect the first “duality principle” stated by Aoki according to which either the coordination either the incentive structure must be horizontal (and respectively vertical) in order to have an efficient organization. The de facto adjustments to such an excessive hierarchy or the attempted reforms both aimed at establishing some form of horizontal relationships between economic agents. They may be analyzed as tentative implementation of the first duality principle stated by Aoki.
- Secondly, and this concerns us more directly, this extreme hierarchy also explains the intensity of the production decline in the Russian transition. Indeed, the transition constitutes a major instability and implies an decrease in the oligopoly power of firms. Thus, this comparison with the firm J allows to enlighten Blanchard and Kremer’ s analysis of the output decline.

Consequently, this quite brief and partial description of crucial differences between emerging Russian groups and Japanese keiretsu evidences how these differences are rooted in at least two proto-institutions inherited from the Soviet era. These are above all the U form of the industrial enterprise, and also the social norms prevailing in working relationships.

3. The financial institutions : no financing and insufficient monitoring

As for the role of banks in the emerging groups, we have already developed in another paper how these banks were not able or willing to finance nor to monitor the industrial firms of which they had acquired control in the loan-for-share scheme (Mesnard, 1999a). Moreover, this judgment has been later even more evidenced with the disintegration of these groups after the 1998 financial crisis. Indeed, their industrial components did not suffer from the disappearance of the banking founders (Mesnard, 1999b).

The fundamental explanation for this ineffective, or even perverse role of banks within the groups lies in the condition of their emergence. Russian “big banks” were the off-springs of the collusive and corrupted political system. Briefly speaking, it was a theater play in three acts. They first developed thanks to short-term speculation on the exchange market and import-export business, on the basis of preferential treatment and access to such markets. They then acquired controlling stakes of strategic industrial firms through heavily corrupted and sweetheart deals. Finally, they swallowed financial resources from their industrial partners to invest them on the GKO market. None of these steps was possible nor imaginable without a high level of state corruption combined to state weakness.

The somehow surprising limited impact of the financial crisis on the real sector was, of course, partially due to macro-economic considerations (with the decrease in real exchange rate allowing a phenomenon of import substitution). But it may only be understood by taking into account the deep demonetization of the Russian economy. Here again, we will not develop further on this crucial aspect of the Russian transition. We will just remind that barter and surrogate money development may be analyzed as the evidence of a fractionated monetary order (Aglietta and Orléan, 1982). This monetary order developed here again on the basis of a weak central state and resulted in the extreme difficulty to enforce or even define property rights on the one hand, and on an increasing conflict between the center and the region on the other hand, thus on an even more weakened state (Mesnard, 1999b).

As for the banking sector, the post crisis scenario derives also from the collusive and weak state. Indeed, a large scale transfer and carving up of banking assets took place in a total opacity. Some banks benefited from significant short term or urgency support measures on a totally discriminatory basis. The specialized body set up for the restructuring of the banking system, ARKO, took several months to get organized and elaborate a program that was hardly implemented. The serial of announced, denied, implemented and finally given up bank bankruptcies already described does not only result from the ineffectiveness of the legal system. It was based on the fluctuating balance of powers between the concerned oligarchs and their connection within the political sphere.

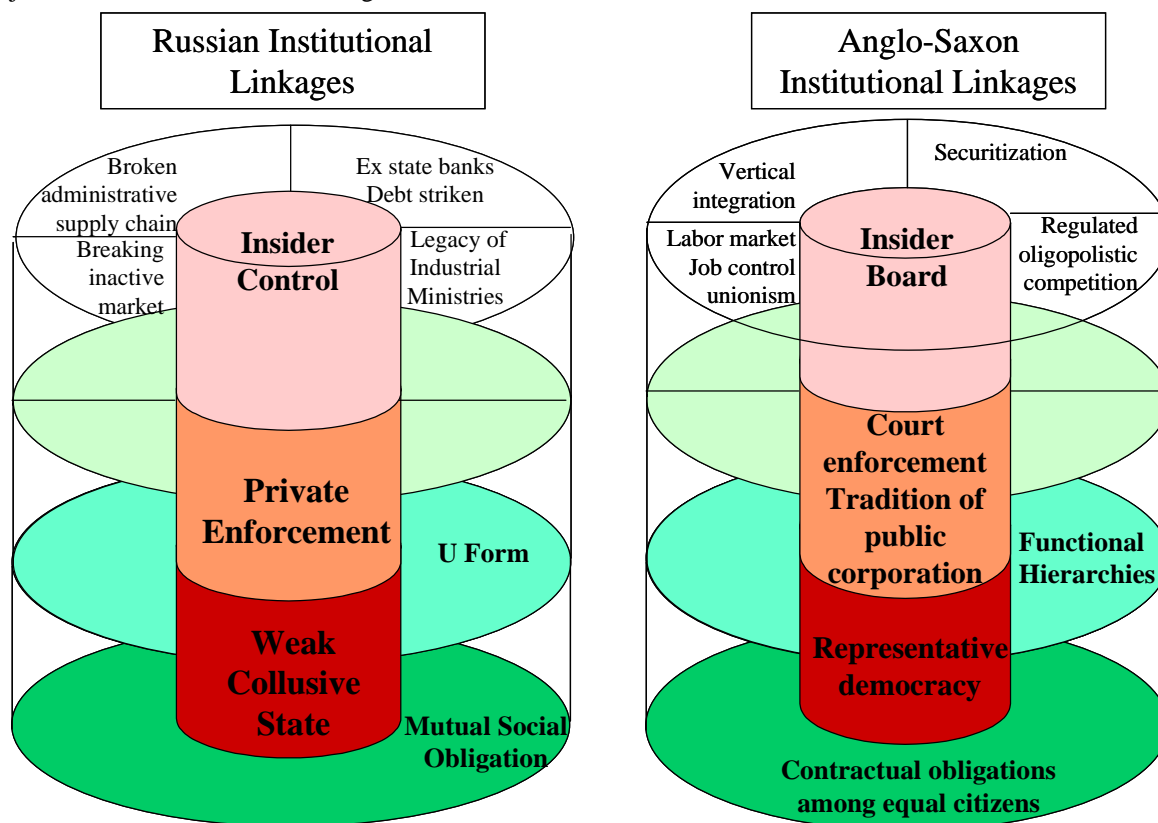
As for abusive bankruptcy, they developed after the 1998 financial crisis, as we already exposed in the third part of our paper. They resulted more from the apparent or formal implementation of the standard stock-holder model. So we will develop this aspect in the following section.

Thus, the attempt at building groups that could theoretically be the engines of industrial development ended up in a complete fiasco. Once again, this fiasco is rooted in the political, social and industrial proto-institutions characterizing the Russian transition. They prevented the development of complementary institutions guaranteeing an efficient if not virtuous functioning of a contingent governance model. Their had been no governance, and there was contingency only in the sense of arbitrary and discriminatory decisions from the State and regulatory institutions, above all the one in charge of monitoring the banking system.

C. The illusion of the establishment of a stock-holder model

The reformers nevertheless had always in mind the Anglo-Saxon stockholder model, even though this latter was utterly distant from the departure situation. This resulted, as we already exposed in our first part, from the ideological domination of the property right perspective that had emerged precisely as an ideological tool against communism or socialism. This reflect also the lack of comparative perspective in the field of corporate governance, which is paradoxical as the question had emerged in the 70 in the literature with regards to the decline of US economic performance in comparison with the German and the Japanese one. This questioning of US performance led to the development and support of a stockholder model that was very distant from the German and Japanese ones. But this was only in a second step, from 1990's, that this comparative perspective began to be taken really seriously. Nevertheless, with the collapse of socialist system, the total ideological success of the property right perspective led to a somehow blind focus on the stock holder model as the “right” and really capitalist one.

This model of stockholder governance is difficult and reluctantly adopted in already developed capitalist economies. There also it has been strongly advocated, but many institutional obstacles have still to be passed. (for the French case, see Mesnard, 2001). Indeed, the stockholder governance mode requires very specific institutions that are extremely far from Russian initial institutions. This is obvious for the labor institutions, as the newly privatized firms were indeed embedded in a social norm of mutual social obligations that prevented any evolution towards an active labor market with efficiency wages. But this was also true for financial institutions, as the banks that emerged in the transition, the new ones or the old transformed ones, where no real banks and did not become real banks (Berstam and Rabushka, 1998). Meanwhile, the newly created financial markets could not logically develop so quickly in terms of volumes as well as institutional infrastructure in order to become efficient mechanisms for financing (which they are not even in the most advanced capitalist countries), for evaluating (regarding the global lack of transparency), nor and even less for controlling (regarding their narrowness, lack of liquidity, etc.). Here again we will not enter into details as how these institutions differed from the objectives of the reformers, as we developed this point in another paper (Mesnard, 1999). We just illustrate it with the following scheme:



D. *The Russian transition institutional deadlock*

Thus, as far as institutions were concerned, the debates tended to focus both on financial institutions, as the symbols of capitalism, and on property rights, as the principle of capitalism. Indeed, difficulties in the building of a financial system and in the choice of financial system (market-based or bank-based) have been extensively debated, from the very beginning of the reforms (...) till the latest evaluations (...) and especially after the 1998 financial collapse. As for property rights, the second part of this article reviewed and discussed the somehow maniac, even if justified, focus on such institutions. The quasi exclusive focus on these two institutions, the financial system and property rights, is the result of the a priori adoption of the stock-holder model in the mind of reformers. Indeed, in such a model, an exclusive emphasis is put on firms' owners, excluding thereafter other stakeholders. Moreover, the financial system is the place where and the mechanism through which these property rights are acquired, evaluated and exchanged. The stockholder model may thus limit institutional considerations to the financial system and the property rights.

This ideological, conscious or unconscious, adoption of the stockholder model led logically to the neglect of other institutions, and above the one concerning the main other stakeholders of the Russian firm, namely the employees, the suppliers and the State. The privatization could not make them disappear, by creating owners who were not even capitalists in the traditional sense of the term, nor entrepreneurs in the Schumpeterian sense. This illusion of creating *ex nihilo* owners and making disappear other stakeholders resulted in a total neglect of

political, industrial and labor institutions.

We will now just dress a gross and brief sketch of the resulting deadlocks in the Russian transition, which are well-known and discussed but less often analyzed in a global perspective. Without a transition in the labor institutions, the restructuring of firms is practically, socially and politically impossible. Without restructuring of the industrial structure, the price liberalization combined to a tight monetary policy may only trigger barter development. With barter development, the State loses any lever for monetary policy, becomes tax impotent and is even more under the domination of sector or private interests. The working out of a social safety net is therefore absolutely out of reach for a fiscally, monetary and budgetary paralyzed State.

As for the neglect of the political institution, this was a more tricky one and somehow less apparent. Here the focus was put on “democracy” considered as the battle against the coming-back of communism. Thus the advocated and supported democratic institutions came to be not only formal ones, but above all incarnated in specific political leaders, whatever their *de facto* behavior towards democracy. Without entering more into this discussion regarding the role of western countries in supporting the Eltsine administration, we need just here to underline the once again narrow consideration of the political institution that was retained. A democratic election process and a working parliament are not the only necessary (and perhaps not even necessary) political institutions for an efficient market economy. An efficient State, not too much corrupted, not too much arbitrary, and with the necessary administrative and financial autonomy is just essential. Obsessed by the liberal idea of a minimum state, reformers have destroyed the Russian State without which, whatever its defects and inheritance, a global transition of such a scale was only undoable. The Russian transition therefore entered into a vicious circle where the only way out is considered to be the re-establishment of a strong State. Those who were so impatient at destroying the “evil” state interventionism tend to accept now its reconstruction at a high political, moral and human price.

This neglect of institutions has been too lately acknowledged by main actors and above all by the very multinational organizations that advocated for the stockholder model. The main failures of the Russian transition are social, industrial and perhaps above all political. Compared to the other Central European transition trajectories, the Russian transition was qualified as “dis-instituted”. In this analysis, Russia has not yet entered the second phase of the transition, after the first one that only led to the primitive accumulation of monetary fortunes. This first phase does not guarantee the path to the second phase of a real capitalist system, whatever theoretical framework is adopted, Weber, Marx or rational expectations. The capital has not yet become a “rapport social” nor the capital account an instrument for economic calculation (Sgard, 1997, p.106).

An illustration of this last point lies in the newly adopted criteria for bankruptcy, which are not based on the balance account. The increasing number of bankruptcies in which some see the evidence of an improvement in the property rights enforcement and in the legal system is just a new way of capital accumulation or asset redistribution. The only difference is that this new way of capital accumulation adopts the formal mechanisms of market capitalism. It is the third step in this first phase of capital accumulation. The first step had been the privatization and the banks’ monetary accumulation till 1995. The second one has been the “loans-for-shares” program and the building of groups. The current and third one is the carving up of defaulted banking assets and the appropriation of industrial assets through fake bankruptcies.

VI. Conclusion

Thus, we have shown in our paper that the corporate governance fiasco characterizing the Russian transition have been widely acknowledged, but mainly explained through a narrow openness to institutionalist arguments. Indeed, the focus has been put on the deficiencies of the legal system. We documented how the consideration of legal problems in the Russian transition is indeed crucial and enlightens numerous problems and specificities of economic behaviors. Nevertheless, even if highly relevant, the legal arguments can not by itself allow to understand the deadlocks of the Russian transition, even if we restrict ourselves to the question of corporate governance.

Indeed, in order to really understand the Russian transition and its difficulties, we have to adopt a wider and deeper institutionalist perspective, and especially focus on the role and consequences of institutional complementarity for institutional change. Moreover, we tried to hierarchize the institutional linkages evidenced by Aoki in its recent work “Toward a comparative institutional analysis” in order to propose an interpretation of the Russian transition failure. In the hierarchy of institutional linkages, corporate governance appears as the institution allowing or structuring the coherence between other institutions, the labor, financial, industrial and market ones. Moreover, these institutions are based on and embedded in proto-institutions both economic ones, as property rights and organizations, and non-economic ones as the political and the social system. This analysis

allow to illustrate how a global process of transition has to be based on the evolution of proto-institutions on the one hand, and how the emerging corporate governance have to result from the building of the coherence between the other complementary institutions.

On these basis, we very succinctly described the Russian transition concerning corporate governance. We divided the transition into three period and show successively how each period could be analyzed as the attempt to build a specific model of corporate governance. In this paper, we just provided brief illustration of how these attempts failed due to the neglect of proto-institutions as well as lack of consideration of the complementary institutions.

This rapid institutional autopsy of the Russian transition failure allows to illustrate and underline three main points, which are not original, but can not be too much emphasized:

- the political system is crucial for the global institutional evolution, as emphasized in Kornai's work. Nevertheless, the State needs not just be "private property friendly". We thus combine somehow Aoki and Kornai's positions and adopt a stronger position concerning the political determinant of transition.
- the negligence of social aspects of transition in reform programs was a major source of deadlock.
- the reforms did not either took enough account of the peculiar industrial structure prevailing in the Soviet system. This reflects the economists' focus on exchange to the detriment of productive dimension.

These three concluding remarks are just a hint into how the transition may force economics to evolve and improve at least in the consideration of social, productive, and political dimensions. I hope that our paper contributed to demonstrate the validity of the institutionalist program not only for analyzing the transition, but also to understanding capitalism in general.

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VIII. Appendixes