Building Business in Post-Communist Russia, Eastern Europe, and Eurasia

This book examines the development of business-interest representation in the post-communist countries of Eastern Europe and Eurasia. The central argument is that abusive regulatory regimes discourage the formation of business associations. At the same time, poor regulatory enforcement tends to encourage associational-membership growth. Academic research often treats special interest groups as vehicles of protectionism and non-productive collusion. This book challenges this perspective with evidence of market-friendly activities of industry associations as well as their benign influence on patterns of public governance. Careful analysis of cross-national quantitative data that spans more than twenty-five countries, as well as the qualitative examination of the development of business associations in Russia, Ukraine, Kazakhstan, and Croatia, shows that post-communist business associations function as substitutes for state and private mechanisms of economic governance. They challenge corrupt bureaucracy and contribute to the establishment of effective and predictable regulatory regimes. These arguments and empirical findings put the long-standing issues of economic regulations, public goods, and collective action in a new theoretical perspective.

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Building Business in Post-Communist Russia, Eastern Europe, and Eurasia

Collective Goods, Selective Incentives, and Predatory States

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University at Buffalo, State University of New York
To my parents Svetlana and Sergey
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Preface

The 2004 government takeover of Yukos, Russia’s first fully privatized integrated oil company, “heralded a turn away from the liberalism of the 1990s towards an authoritarian corporatism” (“The Khodorkovsky Case” 2009). The takeover was neither a happy marriage between business and power nor a business-preserving bailout. It was preceded by the 2003 arrests of Yukos executives Platon Lebedev and Mikhail Khodorkovsky, who were later sentenced to eight-year prison terms, a legal battle over retroactive tax bills amounting to $34 billion, and an international bankruptcy dispute. In the meantime the company’s shareholders’ assets were frozen (BBC 2005; “The Khodorkovsky Case” 2009). The case culminated with the government auctioning off the company’s major production facility to a private firm for a meager US$9.35 billion. Later, the state-owned corporate giant Rosneft acquired the company.¹

The Yukos affair highlights aspects of the business environment that are central to this book. Perhaps the most crucial component of business operations in emerging markets, particularly post-communist economies, has been a general sense of uncertainty that goes beyond the risks that economic agents routinely face worldwide. In established capitalist economies such risks are associated with making decisions contingent on the anticipated actions of numerous economic actors whose circumstances and aspirations are coordinated by the market’s “invisible hand” and the government’s “visible hand,” which provides law and order. In emerging markets, as the Yukos case demonstrates, the government’s hand becomes less reliable and predictable. Also, the logic behind spontaneous economic coordination by the invisible hand becomes convoluted because property rights and contract enforcement cannot be taken for granted. Although Yukos is in no way a typical post-communist company, this example

¹ For a more detailed analysis of the Yukos affair and its consequences for Russian politics, see Hanson and Teague (2005), Tompson (2005), and Sixsmith (2010).
clearly demonstrates business’s vulnerability vis-à-vis the state, insecure property rights, and feeble laws that are symptomatic of emerging markets.

Although the plight of Yukos and its executives attracted strong international and domestic attention, we often know too little about practices and conditions that structure an everyday environment of an average post-communist firm. Because of much attention to large-scale privatization, corruption scandals, and renationalization, the experience of oligarch firms have skewed our views of post-communist business. Such firms, although of much political and economic importance, are rather atypical examples of the post-communist business. This book is not about oligarch firms like Yukos but rather about everyday firms. Still, the Yukos case helps appreciate the extent of business vulnerability: when one of the largest and most well-governed companies cannot defend itself against the state, an average business has even less of a chance.

The Yukos affair is symptomatic not only of the business environment but also of the patterns of business representation developing in the region. The only Russian public organization that publicly defended Yukos executives and later opposed partitioning of the company was the Russian Union of Industrialists and Entrepreneurs (RUIE), of which Yukos was a member. Shortly after Khodorkovsky’s arrest, the RUIE leadership petitioned President Putin to free Khodorkovsky. No liberal, proreform politicians or watchdog organizations joined the RUIE petition. Despite a rift among the RUIE leadership (only six of the twenty-seven board members went on record condemning the arrest), RUIE President Arkadii Volsky strongly criticized the government’s handling of the case. In 2004 the office of the procurator general (public prosecutor) accused Volsky of pressuring the court (Netreba 2004). Still, the RUIE turned out to be powerless in defending Yukos. It eventually conceded to the government with regard to Yukos and refrained from criticizing other renationalization moves. Surprisingly, the RUIE’s apparent failure to defend one of its members did not preclude the growth of membership and the continuing support from existing members, many of whom still believe that the RUIE remains a significant domestic force and stands by the private sector’s interests.

The tale of Yukos and the RUIE points to the contradictory nature of formal organizations uniting business and industrial interests. On the one hand, business associations – voluntary-membership nonprofit organizations of businesses or their owners – appear to be important social institutions. On the other hand, their political influence is limited due to the nature of organizational structure, the diversity of members’ interests, and the organizations’ often overtly apolitical stance. Although some believe that business associations primarily protect particularistic moneyed interests at the expense of public interest, others cite such associations’ socially and economically benign activities (e.g., resisting government encroachment on private business, compensating for underdeveloped mechanisms of economic coordination, and reducing transaction costs). This book demonstrates that although post-communist business associations engage in both kinds of behavior, lobbying for narrowly defined goals has not
been the primary reason for associational formation. A more important reason for business associations’ growth has been their ability to improve the business environment through self-regulation, information-sharing, and resistance to bureaucratic encroachment. This work helps unpack perplexing issues of business environment and business strategy by providing an integrated analysis of misunderstood, stereotyped organizations that I refer to collectively as “business associations.”
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Abbreviations

ACE  Association of Croatian Exporters
ADSMB Association for the Development of Small and Medium-Size Business, Russia
ARB  Association of Russian Banks
AZZZ  Asociácia Zamestnávateľských Zväzov A Združení (Federation of Employers’ Associations of The Slovak Republic)
BEEPS  Business Environment and Enterprise Performance Survey
CAC  Croatian Association of Cooperatives
CEA  Croatian Employers’ Association
CEC  Coordinating Expert Center of Business Associations of Ukraine
CCE  Croatian Chamber of Economy
CCEO  Coordinating Council for Employers’ Organizations, Russia
CCI  Chamber of Commerce and Industry, Russia
CIS  Commonwealth of Independent States
CPI  Corruption Perception Index
CTA  Council of Trade Associations, Ukraine
CTC  Chamber of Trades and Crafts, Croatia
CTI  Chamber of Trade and Industry, Kazakhstan
EBRD  European Bank for Reconstruction and Development
ECR  electronic cash registers
FCP  Federation of Commodity Producers, Russia
GDP  gross domestic product
GI  Global Integrity
IEI  Russian Institute for Entrepreneurship and Investment
IIPA  International Intellectual Property Alliance
IMF  International Monetary Fund
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<tr>
<th>Abbreviation</th>
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<tr>
<td>PARTAD</td>
<td>Professional Association of Registrars, Transfer Agents and Depositories, Russia</td>
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<td>RAICP</td>
<td>Russian Association of Ice Cream Producers</td>
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<td>RATEK</td>
<td>Association of Trade Companies and Producers of Consumer Electronics and Computers (Russian acronym)</td>
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<td>RUIE</td>
<td>Russian Union of Industrialists and Entrepreneurs</td>
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<td>SAA</td>
<td>Stabilization and Association Agreement</td>
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<td>SIU</td>
<td>Scientific–Industrial Union, USSR</td>
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<td>UALCE</td>
<td>Ukrainian Association of Leasing Companies and Entrepreneurs</td>
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<tr>
<td>UCCI</td>
<td>Ukrainian Chamber of Commerce and Industry</td>
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<tr>
<td>UEF</td>
<td>Ukrainian Employers’ Federation</td>
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<tr>
<td>ULIE</td>
<td>Ukrainian League of Industrialists and Entrepreneurs</td>
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<tr>
<td>UNADTS</td>
<td>Ukrainian National Association for the Development of Trade and Services</td>
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<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
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<tr>
<td>USMPE</td>
<td>Ukrainian Union of Small, Medium, and Privatized Enterprises</td>
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<tr>
<td>VAT</td>
<td>value added tax</td>
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<td>WB</td>
<td>World Bank</td>
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Note on Translation and Transliteration

I transliterated Russian and Ukrainian words using the simplified Library of Congress system (diacritics and two-letter tie characters are omitted), except for names of well-known people for whom a different spelling has become conventional, for example Yeltsin. I transliterated all Kazakh names from their Russian spelling. All translations from Russian, Ukrainian, and Croatian original documents and records are my own.