

The state-owned company: “State failure” or “market failure”?[☆]

Alexander Radygin^{a,b,*}, Yury Simachev^{c,d}, Revold Entov^e

^a *Gaidar Institute for Economic Policy, Moscow, Russia*

^b *Russian Presidential Academy of National Economy and Public Administration (RANEPA), Moscow, Russia*

^c *Inter-Departmental Analytical Centre (MATs), Moscow, Russia*

^d *Institute for Applied Economic Studies, RANEPA, Moscow, Russia*

^e *Russian Academy of Sciences, Moscow, Russia*

Abstract

This article will analyze the activity of state-owned companies and their place in the structure of market relations from the standpoint of contemporary approaches to the study of “state failure” and “market failure”. It will also consider the implications of the systematic embedding of private property rights. In addition to considering the costs of the functions of state-owned companies, the authors address the actual experience of the Russian economy in the present day, the experience of forming state corporations and the risks associated with their operation. Particular attention will be paid to the inhibition of incentives to improve the general institutional environment and, conversely, to the increasing incidence of direct state intervention in matters that affect economic development. We will examine the various ways in which the growth of the public sector, de jure and de facto, reduces opportunities for implementing private property rights.

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1. Introduction

Contemporary economic theory maintains that there is no “universally appropriate” form of property—a form that can be considered superior to all other forms of property and be implemented in any country and in all branches and sectors of the economy, irrespective of specific historical conditions. Even the “pure” forms of property in the overwhelming majority of cases are, in reality, composite. At the same time, comparisons of the efficiency of different forms of property (entrepreneurship) in particular spheres of economic activity do

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* Corresponding author, *E-mail address:* arad@rane.ru.

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not discount and cannot discount, particularly in the circumstances of present-day “globalization”, the effect of mechanisms of central regulation.

The most acute problems of present-day economic development are influenced by the “structural interaction” of private and state-owned companies in different sectors of the economy.¹ The existence of one form of property relations or another in particular spheres of economic activity and the interaction of these forms are, as a rule, the outcome of lengthy processes of evolution. More often than not, these forms have been shaped by the particularities of historical development (“path dependence”), and they bear the imprint of the political and socio-cultural traditions that prevail in any particular society.

For example, A. Greif, in his detailed study of differences in the trading practices of the merchants of Genoa and the Maghreb during the Middle Ages, noted that in the period that followed, private entrepreneurs in the East were deprived of the opportunity to effectively defend themselves against state interference. Their activity was regulated by religious or secular authorities and sometimes, simultaneously, by both. Currently, the institutions of underdeveloped countries bear a resemblance to those of the Maghreb, whereas institutions of the developed West bear a closer resemblance to those of Genoa (see: Greif, 2006. P. 300–301, 396–397). For centuries in the East, huge economic enterprises were managed at the highest level of government, and in these circumstances, the productivity of workers, who in many cases were held in a condition of social subjugation, was low. For structures “of Oriental origin, the fact of being close to government or separate from government has always had great importance. Significantly, in Oriental societies, an unceremonious attitude towards the private property of those who did not stand in close proximity to the government has always been common. Unquestioning submission of the institution of private property and of property owners as a social stratum was the norm” (Vasiliev, 2010. P. 569).

The emergence of political-legal conditions that provide the optimal environment for intensive long-term economic growth has usually been associated with a contraction of the pre-existing (clan-feudal or administrative-command) system of all-pervasive regulation. However, new institutional theorists frequently refer to the “fundamental political dilemma” formulated by B. R. Weingast: “A government strong enough to protect property rights and enforce contracts is also strong enough to confiscate the wealth of its citizens” (Weingast, 1993. P. 287). In some contemporary, post-communist, developing states, the formula “growth in the shadow of expropriation” seems relevant as a description of the dilemmas encountered when constraints are placed upon the institution of private property (Aguiar and Amador, 2011).

Limiting the scope of government activity does not by itself ensure more efficient economic management or guarantee the emergence of market relations. Commenting about the logic of the transition of post-communist countries to a market economy, in his Nobel Prize speech in 1991, R. Coase justly remarked that without the appropriate institutions, no market economy of any significance can exist, adding that the “cultivation” of such institutions always requires time and effort (Coase, 1992. P. 714). This is why measures that augment the role of decentralized (“market-based”) regulation can, in developed countries, often turn out to be successful, whereas similar measures are inapplicable in the same form in countries that are still undergoing the effects of administrative command-type regulation. This circumstance serves to underline the priority that has to be given to the activation of competition mechanisms and the perfection of market institutions.

With regard to the costs incurred by the “failures” of state activity, it is not argued, and it cannot be argued, that every state activity is necessarily unproductive and that, accordingly, the state should be driven out of economic life by private enterprise. Adam Smith, who attached great importance to the “invisible hand” of the market, included amongst the direct

¹ Unless otherwise indicated, the terms “state-owned company” and “state-owned enterprise” are employed in this article synonymously to describe any economic entity that is more or less controlled by the state. The term “state corporation”, strictly speaking, refers to a small number of entities created in 2007–2008 by special federal laws.

obligations of the state: “...erecting and maintaining those public institutions and those public works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature, that the profit could never repay the expense to any individual or small number of individuals...” Noting the essential nature of “public works” and of state enterprises, the great economist emphasized that the fulfilment of these obligations required that a variety of expenditures be undertaken from time to time (Smith, 1801/1776. P. 238).

No more than acknowledgment of “market failures” implies a requirement to repudiate market relations should drawing attention to the “failures of the state” be taken to be a denial of its important economic functions. On the contrary, many negative phenomena and many inefficient and highly wasteful economic operations can be attributed to the insufficiency of state involvement in vital areas of the economy. Privatization or nationalization are, inherently and to a significant degree, technical processes; it is the systemic embedding of private property rights that engenders the relationships of trust that are essential if there are to be prospects for economic development.

The downside of state activity is the erosion of private property rights brought about by selective state intervention in relations between economic actors. Amongst the dangers lurking along this path, the great philosophers and economists have drawn attention to the assumption by the state, in violation of “natural” market norms, of the right to determine the transfer of property from one participant to another,² the state thereby acquiring legitimacy as a type of donor of the rights of ownership. We will touch upon this problem in our examination of the functioning of state-owned companies in Russia.

2. State entrepreneurship, “political markets”, and the market environment

In the theoretical literature, the expansion (or contraction) of state participation in the economy is most often linked with the need to overcome “market failures” (or, less frequently, “state failures”).³ Frequently, a complicated web of relationships exists between state enterprises and the market environment. It goes without saying that formal differences in property rights (and, accordingly, differences in status in the social or private sector of the economy) are of importance. However, these can be far less significant than differences in the structure of market relations and differences in the real status of companies and in their actual market behavior.

In some cases, the market is one of intensive competition, and it achieves optimal results through competitive interaction between state and private companies. In other cases, companies owned by the central government or by local authorities take advantage of their privileges, exploit their monopoly position, and place technical-organizational, administrative, and other barriers in the way of access to a particular branch of the economy.

In theory, state companies that have not been given any privileged status and are able to operate in an active competitive environment can be relatively immune to the vicissitudes of immediate circumstances, work to a longer planning horizon and be perfectly viable. However, most authors who analyze the mechanisms of regulation and control tend to assume not only that so-called “political markets” are inherent in democratic systems but also that these markets function unproblematically. The problem of the delegation of authority (the agency problem) is located not within the state but in the relationship between voters and politicians—and these relationships are then decked out in “market attire”. As a rule, the

² “Property must be stable, and must be fixed by general rules. Though in one instance the public be a sufferer, this momentary ill is amply compensated by the steady prosecution of the rule, and by the peace and order which it establishes in society” (Hume, 1817/1739. Vol. 1. P. 205). D. North has provided a somewhat different formulation of this law: Whenever the state has succeeded in creating the “best” (bringing comparatively greater advantages to the ruling elites) structure of property, one that maximizes the rent appropriated by the ruler (and his group), such property relations have usually entered into conflict with the need for intensive economic growth (see North, 1981. P. 25–26).

³ A detailed review of the theoretical aspects of this problem is provided in Radygin and Entov, 2012.

defenders of the relative effectiveness of the state sector take it for granted that the effects of competitive political markets are beneficial.⁴

In fact, there is a great deal of evidence that indicates that assertions regarding the relative effectiveness of political markets are not well-founded: Here, we are talking not simply of “market failures” but of an absence of the basic pre-conditions for the effective functioning of political markets. There can be few branches of political economy in which the gulf between theory and practice is so great.

In the present article, we will not be able to examine all aspects of this complex problem: Political markets in countries with different political systems have their own specificities. We will refer only to the interpretation of D. North, who has argued, for example, that it is much more difficult in democratic countries than in managed societies to impose a precise set of conditions on political markets and, in particular, to ensure the observance of these conditions. The difficulties arise primarily out of the particular relationship of “exchange of votes for promises” and with the lack of practical means for enforcing the conditions. The complexity of political arrangements can make for “fuzziness”. Moreover, as North correctly notes, it is institutionally impossible to impose credible commitments in relations between the principal and the agent. It therefore transpires that the political interactions involved are in fact simply not comparable with those of normal economic markets (North, 1991, 2005).

Of late, this conception has been looked upon as a mere theoretical “exercise” in the field of political economy. This does not mean, of course, that the influence (which is clearly beneficial overall) of democratic processes on the efficiency of economic processes is under question. The issue is, rather, related to the appropriateness of the analogy that is being drawn between the markets that function in the economic and political spheres.⁵ In addition, the strategies of the participants in such markets are determined by existing institutional structures and behavioral norms. Established socio-political traditions (conditions) can give rise to market situations when, as it were, conditions of “bad equilibria” prevail.⁶

From the point of view of empirical analysis, the following circumstance is important. As a number of research studies have shown, an important factor for increasing efficiency in the aftermath of privatization is not only the change in the form of the property of particular enterprises but the activation of competition within the appropriate branch structures (Donahue, 1989). Furthermore, in cases where a state company enters markets where intensive competition is present, and where—and this is particularly important—government does not provide the company in question with particular privileges or concessions (including almost a complete lack of transparency), its competitiveness in the industry branch in question can be fairly effective.⁷

Let us note the limits within which such comparisons are valid. In some important instances when we come to characterize the activity of state enterprises, different evaluative criteria can and must be applied, and these lie outside of the framework of the market principle of the maximization of net income.

In a number of countries in Western Europe (e.g., France, Great Britain, Norway), many state-owned or semi-state-owned companies do not differ greatly from private companies in their status or in the “nature of their activity”. For example, the demands made by the

⁴ As D. Wittman has noted, “behind every model of government failure is an assumption of extreme voter stupidity, serious lack of competition, or excessively high negotiation/transfer costs” (Wittman, 1989. P. 1421).

⁵ For further detail on the inter-relations of forms of political organization and economic efficiency, see Acemoglu and Robinson, 2006.

⁶ Describing the considerations that underlie the models that presuppose the predominance of “bad politicians”, F. Caselli and M. Morelli affirm that they have practical knowledge of the phenomenon described in the model in a particular country (of course, not named) where political life displays “self-sustaining bad equilibria” (Caselli and Morelli, 2004. P. 778).

⁷ In such cases, the accounting data published by a state company can provide a more or less unbiased picture of its efficiency. Conversely, in conditions of oligopolistic market relations, even a private company can manipulate its accounts and attempt to conceal relatively high costs.

government of state companies are not so much political but commercial or “market-based” in character. Their basic activity is, as it were, “embedded” in the general system of competitive relations. If the efficiency of such state companies declines significantly and they incur major losses, this provides grounds for fundamental reorganization and, recently, ever more often, for “divestiture” and the privatization of some components of the economic entity that previously had the status of a state-owned company.

In addition to nationalizing large companies that are of strategic importance to the economy, governments sometimes resort to the indirect regulation of their activity. Most often, this involves the regulation of the output prices of companies that are considered (with more or less justification) to be “natural monopolies”. In conditions of serious economic upheaval, regulation is extended to sectors of the economy that are characterized with “excessive” competition. In the first instance, the government usually tries to limit the extent of impending price (or tariff) increases.

This type of regulation, unquestionably, often has a positive effect. However, as Joseph Stigler has convincingly argued, concern for the defense of consumers from an excessive increase in the cost of living often gives the regulated companies a greater influence on government economic policy (Stigler, 1971). By introducing regulation, the government is essentially “protecting” these companies from the effects of market competition and presiding over an accelerated enrichment of top managers and private owners. (A number of authors, following Stigler, have written of a *de facto* “capture” of the state by the regulated companies.) In such circumstances, a significant decline in the efficiency of the regulated branch of the economy is inevitable.

The expansion of public ownership in the economy and the scope of government regulation inevitably come up against certain limits that are determined above all by a relative decline in productive and allocative efficiency. At this point, programs tend to be formulated for the reform, privatization and deregulation of state-owned companies. This particular change in direction was very marked during the last decades of the twentieth century. The very concept of “state-owned enterprise” and the policy of nationalization lost the sacrosanct status (their “thaumaturgic valence”) that had been conferred upon them even by representatives of the various elites (Toninelli, 2008. P. 4).

Some studies have paid particular attention to the factors that precipitated the reform of the public sector. H. Campos and H. Esfahani carried out a statistical and economic analysis of the factors that were conducive to the reform of state-owned companies in fifteen countries, most of which were developing countries. Of course, amongst such factors, we have to include the growth in the size of the public sector. Additionally, an assessment of the relevant probit regressions has confirmed that attempts at structural reform tend to be undertaken at a time when a country is experiencing serious economic difficulties: As the extent to which the decline in economic activity becomes greater, so does the likelihood, all other things being equal, that attempts will be made to reform the public sector. The propensity to undertake reform increases proportionately with increases in the dependence of the country upon external economic factors (Campos and Esfahani, 1996).

This last factor can be linked to the clear reaction in the past in South Africa to sanctions imposed by industrially developed countries. Recently, privatization processes have gathered momentum in Iran. For example, in May 2014, the Iranian authorities made public new proposals for structural reform. While retaining strict central control over the most important strategic installations, the government proposed starting at the end of 2014, selling 183 companies to private buyers, including a number of large electrical power stations. Already, a number of important privatization programs have been implemented in the Iranian metallurgical industry.⁸

⁸ According to the Iranian Deputy Minister for the Mining Industry, at present, steel and copper production in the country has been fully privatized, and almost half of the productive capacity of the aluminium industry has been privatized (Iran Daily. 2014. November 2).

The economic consequences of privatization have been examined in detail in a number of publications, including our own (see, for example, Radygin et al., 2014; Radygin and Entov, 2012). Let us consider only a number of the results of economic reforms aimed at encouraging competition and the removal of strict measures of state regulation. One example is the deregulation of air transport in the USA, which demonstrated how powerful the effect of increased market competition can be in bringing down tariffs and transport costs. In a number of works (Megginson, 2005, Ch. 2), it has been shown that during the years 1970–1980, the social losses associated with the state regulation of particular sectors of the economy increased steeply. Particular attention has been drawn to the dependence of the tariffs of monopolies upon political factors.⁹ In the new circumstances, the actions of legislative and executive branches of government have been aimed at liquidating (or weakening) pre-existing official constraints upon competition.

The essence of the process has been well described by E. Bailey: “Just as the regulatory movement of the 1930s reflected the view that market failure was pervasive, so the deregulation movement of the late 1970s and early 1980s reflected the view that economic regulation of prices and entry was a government failure, generating misallocations and inefficiencies” (Bailey, 2010. P. 189).

The significant reduction in air transportation costs in the USA was attributable above all to a freeing up of the forces of competition. The number of aviation companies operating air transportation between states increased from 36 in 1978 to 125 in 1984. Flights were more fully booked, and not only did aggregate costs fall, but so did the cost of various services. Between 1977 and 2006, the average tariff per mile of passenger and cargo transportation fell by over two times. According to the calculations of Bailey, despite a significant increase in the cost of aviation fuel, the average fare per passenger mile for air transport in the USA, expressed in 1978 dollars, fell from 10.08 to 4.20 cents between 1970 and 2006. The reduction in prices brought about by market competition delivered a value to consumers estimated at approximately 28 billion dollars per annum by 2005.

In the past few decades, a number of countries have implemented radical programs of deregulation of the production and supply of electricity. In the USA, companies that produced electricity were excluded from the distribution network and conditions were created for the emergence of a significant number of independent producers and for the development of competitive markets at the regional level. At the end of the 1990s, there was a comprehensive reorganization of property relations in the field of atomic energy: Private buyers were able to acquire 103 atomic reactors. The analysis of the results of these reforms (the data were examined for the last 40 years) showed that the coefficients of the operational efficiency of the use of electrical production plants increased on average by 10%. This was achieved above all by a transition to flexible regional arrangements and by a reduction in outages in electricity supply. Deregulation had a beneficial ecological effect estimated at a value of 700 million dollars a year.¹⁰

The abolition of a substantial number of administrative barriers significantly facilitated access to previously half-closed branches of the economy.¹¹ The expansion of the sphere of the operation of market mechanisms led to a marked improvement in efficiency and had beneficial effects on the health of economic structures. The transition to de-regulated air transportation in the USA enhanced competition in the world market and provided an im-

⁹ It has been shown that this type of price regulation always depends to a significant degree upon socio-political conditions and in particular upon the extent to which the mechanisms of political competition are effective. For example, in the USA, in states where the regulatory organizations are elective and depend, therefore, upon the opinion of the electorate, the average level of prices for electricity is, as a rule, lower than in states where the members of such organizations are appointed (Paul and Schoening, 1991).

¹⁰ A detailed analysis of these processes can be found in Davis and Wolfram, 2012 and also in Zhang, 2007. The economic consequences of the deregulation of atomic energy in the UK are examined in Taylor, 2008.

¹¹ It was as a consequence of deregulation that the total of capital investment in the industry of developed countries (members of the OECD) substantially increased (see Alesina et al., 2005).

petus for privatization in other countries (e.g., the privatization of British Airways in 1983). The experience of deregulation once again showed that *the forms of state regulation that had been introduced during the previous period gave rise to more problems that they resolved*. At the present time, a debate is being waged over the extent of the economic and social risks involved. In this connection, we can point to the lively discussion in the USA over proposals for the privatization of many highways (see, for example, Winston, 2010, 2012).

The freeing up of the forces of competition, given the necessary conditions, has *contributed to the momentum in favor of the formation of an innovation economy*.¹² Measures for privatization and deregulation in recent decades have accelerated the advancement of scientific-technical progress in such network branches of the economy as telecommunications, air transport, electricity generation and others. Clearly, despite difference in their political systems, the drive in a number of states for the reorganization of existing institutions, with a view to improving economic efficiency, is making headway.¹³ The “Economic Freedom” index devised by the Canadian Fraser Institute stood at 6.7 on the eve of the crisis (2007), whereas in 1980, it did not rise higher than 5.5. It should be noted, however, that processes of deregulation, particularly in the financial sphere, have resulted in the formation of speculative “bubbles”, particularly in the onset of the destructive economic crisis in the USA from 2007–2009.

OECD experts have evaluated the average share of state-owned companies in the sales, assets and market value of the ten largest firms in a number of countries. The leaders in this list are The People’s Republic of China (96%), the UAE (88%), Russia (81%), Indonesia (69%), Malaysia (68%) and Saudi Arabia (67%). In industrially developed countries, the share is significant only in Norway (67%). Amongst the “leaders”, China and Russia stand out because in these countries, state-owned companies are of considerable importance not only in the extractive industries but also in a number of strategic branches of the processing industries (Kowalski et al., 2013). The extensive presence of state-owned companies and the extent to which they are embedded in the extractive industries of the Near East and of South-East Asia (at the beginning of the 2010s, the aggregate value of their sales was one and a half times greater than the GDP of Great Britain) provide clear evidence of the operation of powerful objective factors consolidating their position in the national economy. (These issues are examined in greater detail in, for example, Ross, 2012; Stevens, 2008; Nashashibi et al., 2001.)

In a number of cases, particularly during the implementation of long-term economic strategy, the operation of state-owned companies has made it possible to cushion the effects of the “failures” of world and/or national markets. State-owned companies can facilitate the operation of a branch of the economy where conditions of natural monopoly are present. Many economic complexes belonging to the state go out of their way to encourage a discussion of long-term programs for their own development. The adoption of long-term market strategies requires the enumeration of a range of objectives, and one consequence is the avoidance of a discussion of the inefficiency of these companies (Vogelsang, 1990. P. 61–62).

In certain conditions, the operation of state-owned companies can help to stabilize economic growth (for example, when they actively contribute to the implementation of government “anti-crisis programs”). Recently, in a number of countries, tendencies have manifested themselves that seem to illustrate this effect. At the same time, the long-term existence of ill-defined property rights and other political and economic factors that are damaging for the business climate can result in an open economy, in a massive outflow of capital abroad.

¹² For the relationship between innovatory development and the search for new rent income in different periods of historical development, see North et al., 2009.

¹³ Describing some of the results of privatization in the English economy, D. Martimort et al. note: “... a new price cap regime was adopted with the requirement of identifying clearly profit lines and losses. This more efficient mode of regulation was not adopted during the 40 years of public ownership, and this fact appears as an evidence of a more pronounced capture in public ownership” (Martimort et al., 2005. P. 173).

This tendency was particularly marked in a number of countries, including Russia, following the economic crisis of 2008–2009. In such circumstances, state-owned companies can act as a type of “pillar”, creating conditions for a more stable (albeit in some circumstances not particularly effective) development of the economy as a whole. Even so, the experience of successful economic development in China shows that the existence of an extensive public sector does not detract from the need to radically improve the general investment climate and, in particular, conditions for the investment of foreign and domestic capital.

State-owned companies necessarily face the need to coordinate their programs with overall government strategy, including financial strategy. Analyzing the general structure of state institutions, J. Tirole has correctly noted that state-owned enterprises have to obey at least two masters: “...a ‘spending ministry’ with the mission of developing the industry and a finance ministry instructed to reduce the budget deficit” (Tirole, 1994. P. 20). In cases where state-owned companies are particularly solidly established, a conflict of these types of objectives can be attenuated by the allocation to them of generous funding facilities and by a substantial relaxation of central control over the expenditure of such resources.

For approximately thirty years, there has been a discussion in the theoretical literature of the subjects and mechanisms of management in this sphere. After all, if we consider the state-owned company to be an “agent” called upon to implement political and economic tasks that are so important that they generate conflicts not only with the Finance Ministry but with a number of other ministries, then who, in this scheme of mutual subordination, acts as the “principal”? (See, for example, Levy, 1987; Aharony, 1986.)

New companies organized by the state receive privileged access to profitable economic operations, particularly to export contracts and to “deficitary” components of the existing transport infrastructure, including pipelines, and they establish “special relationships” with the tax authorities and others. As a result, the mode of operation of such companies assumes *particular state-monopoly characteristics*, even when other producers are operating in the same branch.

We would emphasize the following circumstance: In such conditions, the activity of state-owned companies in effect avoids the constraints of the competitive environment and of market discipline. In particular, their inability to make use of data that describe the competitive costs of production and of competitive prices deprives their managers of vital information relating to social demand and opportunities for effectively satisfying that demand. The role of estimates and of calculations that describe the specificities of current economic processes is taken over by value judgments, by prescribed tasks and by programs, “supported” by the flexible assessments of experts. No less significant are the motivational problems that are created and the mechanisms of collaboration that come into existence between individual economic subjects: The managers of state-owned companies are able, with impunity, to neglect strategy for innovation and/or for the lowering of production costs.

The experience of state-owned companies in many countries demonstrates that when they succeed in reinforcing their unique position in the economy, then they and their top managers more often than not strive to achieve this by employing a variety of methods for the realization of rent. These methods are most evident in the fixing of prices for the goods and services that state companies deliver to the government or to particular ministries. In such cases, the competitive struggle is in essence replaced by competition of a different order—the company that possesses a comparatively greater administrative resource prevails. These factors can have a negative effect on the economic effectiveness of a company (or branch).¹⁴

¹⁴ It is sufficient to refer to the results of research on the political connections of 1630 directors of state-owned companies in Italy. Calculations show that companies whose directors had close connections with government consistently demonstrated a lower level of efficiency (Manozzi et al., 2012). The studies of state companies in the People’s Republic of China (most of which are managed by local authorities) report a comparatively lower level of efficiency for companies whose management has established close links with influential political figures (Wu et al., 2012; Fan et al., 2012; You and Du, 2012).

In circumstances in which the number of participants in the market fluctuates, the inefficiency of state-owned companies inevitably results in a diminution of social welfare (see, for example, Cato, 2012).

We have already drawn attention to the particularities of public choice in situations when actors participating in decision-making exploit an administrative resource and promote the interests of particular regions or entrepreneurs. Here, the very logic of collective decision-making (and the characteristics of Nash equilibrium associated with such decision-making in the relevant formal models¹⁵) guarantees a *loss-making* outcome for the projects adopted; consequently, the results promised by various state enterprises simply cannot be delivered in full. The actions of “bureaucrats” (including the senior managers of state-owned companies), who advocate as priority objectives an increase in the scale of activities and a maximization of financial resources, produce analogous results.

The managers of these companies tend to explain the inefficiency of their economic management in terms of the limited nature of the powers they have been given and of the insufficiency of resources allocated to them. They then seek to resolve their problems by expanding their “economic empire”, with proposals for both horizontal and vertical integration. Efforts to “extract” and “appropriate” budget funds earmarked for the support of state-owned companies also play their part. One can easily show that in a number of cases, regional and municipal institutions responsible for transport infrastructure and communal services have found that the simplest means of “resolving problems” is to increase budgetary assignments and expand the volume of non-completed construction works, for example, the construction of transport and other means of communication. In such cases, it is usually possible to “bury” any trace of the misappropriation of local monopoly revenues.

The question of time-inconsistency merits particular attention with regard to both the general development of the public sector and particular initiatives taken by state-owned companies.¹⁶ Within political institutions, there are no real powers capable of ensuring a consistent compliance by the government with the commitments it has undertaken. In the case of private agents, the state and, above all, legal institutions are required to monitor the implementation of contractual commitments and to impose sanctions in the event of non-compliance. However, it is for this very reason that there cannot exist a mechanism for either the automatic or discretionary enforcement of government commitments.

At the highest levels of the legislative and executive branches of government, where there is a regular turnover of personnel, tactical considerations of one type or another make for a recourse to socio-political maneuvering. State-owned companies inevitably become hostage to this type of politics at a government level. Amongst the most frequent temptations in the regulation of the institutional structures of society include efforts to resolve complex problems by expanding the sphere of indirect government regulation and by creating new state-owned companies tasked with resolving these very problems. Thereafter, this type of company will naturally exploit every available method, including the effective technologies of “bureaucratic games”, to ensure its survival and, if possible, to strengthen its position. This can give rise to symptoms of “dynamic inconsistency”, whereby state-owned companies that were operating optimally under previous conditions can become inefficient and serve as instruments for the dissipation of resources.

Risks associated with the state incorporation of private companies are increased by uncertainties in the realms of property rights and laws of contract. These give rise, specifically,

¹⁵ We are referring to the comparative characteristics of different equilibria in game models describing the coordination of actions within society (Myerson, 2009).

¹⁶ Noting this type of dynamic inconsistency between the setting of political objectives and the realization of these objectives (with particular reference to monetary policy), Kydland and Prescott (1977) have identified the problems to which this gives rise. We would add that this type of inconsistency can also be present in circumstances where a political strategy, implemented over shorter time intervals, can be considered optimal.

to the “hold-up problem”. These risks can also measurably weaken the incentive to adopt long-term strategic planning and, in particular, to make additional capital investments. Some of the above issues are of relevance to Russia today.

3. Growth of the public sector and the palliatives of Russian privatization

Despite a radical market transformation of the Russian economy during the 1990s and the rapid progress of privatization, at the end of that decade, the state in Russia retained a major presence in many branches of the economy. By the start of the twenty-first century, there was a significant deceleration in the rate of privatization, and this had already become noticeable towards the end of the period of “mass” privatization. The “monetary” privatization of the second half of the 1990s, aimed at supplementing budget revenues and restructuring production by encouraging investment, did not have a satisfactory outcome. During the 2000s, the process of reducing the volumes of property owned by state and municipal authorities continued, with varying degrees of intensity.

A more ambiguous measure of the place and role of the state sector emerges from the fact that during the last decade, there was no clear tendency for the state sector to decrease in size; if anything, its dimensions increased if we take into account the processes of the formation of integrated structures involving state participation. The policy for securing the management of disparate state assets through the creation of holding companies emerged as early as the 1990s, when it was applied in the fuel and energy sector. During the 2000s, holding companies were formed primarily in the defense industry, and during the years 2006–2008, integrated structures were formed that encompassed entire branches of the economy (atomic and aviation industries, ship-building) and a segment of the output of civil production. The formation during 2007–2008 of a specific institution designated as a “state corporation” marked a new stage in the development of integrated structures (see below).

According to a number of estimates, the share of the state in the market capitalization of Russian companies during the period 2007–2012 oscillated between 50 and 65%, but in any case, it was dominant. According to an estimate for 2011, state-owned companies accounted for 63% of the aggregate capital of companies included in the MSCI index (The Economist, 2012. P. 4). Significantly, on 15 April 2014, 1,618,067 entities were registered with *Rossmushchestvo*, which is approximately 10% (or 146.3 thousand) more than on 1 January 2013 (1,471,782 entities). At the same time, the state property complex at the federal level consisted of 2049 economic societies (OAO, ZAO, OOO) and 1785 FGUP (Federal State Unitary Enterprises), compared with 2337 AO and 1795 unitary enterprises at the beginning of 2013, according to the new privatization program for 2014–2016.

In the current ‘Conception for the Long-Term Socio-Economic Development of the Russian Federation for the Period up to 2020’, the limits of the state sector for the contemporary Russian economy are defined, and the importance of state entrepreneurship is acknowledged. The financial and economic crisis of 2008–2009 prompted a debate over the need for a new “big privatization”, and in the course of this debate, the difficulty of defining the limits of the state sector and issues relating to its management came to the fore. The announcement of the intention to implement a new stage of “structural privatization” as of 2012 was to a significant degree influenced by an awareness of three fundamental problems:

- the fact that during the crisis period, the participation of the state in the economy had increased. This was now understood as being an undesirable consequence of the strengthening of the indirect influence of the state on the property relations of state-controlled banks and of structures that acted as agents of the state during the implementation of anti-crisis measures;
- the low level of competitiveness of a number of large companies belonging to the state sector and their need for restructuring and technological modernization;
- the limited competence of the state in managing state property (in its existing scale).

The new government program of the Russian Federation “Management of Federal Property” (adopted by a decision of the Government of the RF of 16 February 2013, No. 191-r), like almost all previous government documents concerning property relations, stresses the need to reduce as much as possible the participation of the state in the economy. It is at this point that a *conflict between declared aims and real interests arises*.

An increase in the participation of the state in the economy creates opportunities for the appropriation of private benefits in a variety of forms, including substantial income in the form of rent, and this (combined, of course, with other factors) can result in the development of a sort of external technical asymmetry in the behavior of the state. For example, proposals for the de-nationalization of large enterprises necessarily result in lengthy procedures for discussion, coordination and preparation. At the same time, decisions for the creation of new “closed” state-owned companies or for the compulsory cartelization of government-controlled enterprises and strategic branches of industry are addressed as “measures for implementation” without being debated at the legislative level.

If we compare the processes that have governed nationalization during the past few decades with processes that have governed privatization, we discover a marked asymmetry. Huge state-owned companies or associations tend to be created “in one fell swoop”, in most cases without preliminary public debate. In regard to privatization, the picture is very different. Fiscal and other positive advantages are debated for years on end (and still continue to the present day¹⁷). Plans for the “partial privatization” of particular state-owned companies (enterprises) are deferred year after year and amended, often with the effect of negating the original purpose.

This asymmetry betrays a traditional attachment to administrative methods of management and can also reflect the reluctance of the ruling élites noted earlier to let go of the levers of power and lose the sources of income to which they have become accustomed. In the theoretical literature of the beginning of the twenty-first century, we encounter the term “reluctant privatization” (Bortolotti and Faccio, 2004). This attitude is entirely compatible with a stubborn commitment (a form of inertia) actually to increase the role of the state in the economy.¹⁸

Frequently, this attitude is accompanied by what is known as the “short-sightedness effect”. The unpleasant consequences (for example, unemployment) of putting a company on a market footing are felt very rapidly: The number of unemployed individuals increases, and the wages of those who retain their jobs are reduced. The response in some cases has been a repeated extension of deadlines for privatization, accompanied by veiled allusions to the existence of “political constraints”. A. Ghosh and P. Sen, who devised a general equilibrium model for analyzing processes of the denationalization of the economy, have argued that an optimal solution to this particular problem would be to accompany privatization with a significant reduction of the barriers that hinder the international movement of goods and capital (Ghosh and Sen, 2012).

Measures for the reorganization of production and improvement in economic efficiency have been in train for an even longer period, and usually, they are bound up with other “background” measures. However, the government does not go out of its way to stimulate a broad-ranging debate as to why state property has to be retained in one form or another in so-called strategic companies.¹⁹

Many projects for the selling-off of strategic blocks of shares include a condition for the retention of a “golden share” by the state. In most cases, the limits of the state prerogative

¹⁷ See, for example, Radygin, 2003; Megginson, 2005, 2010; Bergh and Henrekson, 2011; Estrin et al., 2009; Bortolotti and Siniscalco, 2004; Roland, 2008.

¹⁸ For further detail, see Radygin and Entov, 2013.

¹⁹ “I find it surprising that privatization advisers or international development agencies often do not challenge or question governments when they classify a long list of companies as strategic and plan to keep them in state ownership” (Anderson, 2004. P. 102).

are ill defined, and legal bodies tend to resolve disputes in favor of the executive. All of this provides civil servants with ample opportunities to impose their own preferences (restrictions) when management decisions have to be made. Research has shown that the retention of a “golden share” by the state has had a negative effect upon the efficiency of corporate governance in “mixed” companies (see, for example, Borisova et al., 2012). It is far from the case that the types of “reluctant privatization” that we have mentioned to any significant degree enhance the status of this approach. How efficient is the activity of companies where the state has retained the predominant (or a significant) share of property and control? Empirical research shows that the retention of a preponderant number of shares by the state, following this type of “privatization”, has in many cases significantly held back the growth of efficiency (see Boubakri et al., 2004). Manifestations of “reluctant privatization” are most frequent in developing countries, where governments, for reasons that can be understood, are particularly apprehensive about the effect of market forces upon the inward and outward flows of capital.

Returning to the situation in Russia, let us note that the years 2011–2014 witnessed a considerable degree of activity in the sphere of privatization.²⁰ At the same time, proposals for bringing some order into the growth of the state sector and for the referral of any initiatives in that direction to a “red zone” of economic policy²¹ figured only as intentions in the program documents of 2011–2013, and with privatization aside, they have not found their way into law. However, questions such as the need for the disaggregation of conglomerate state structures (the separation of holdings), the removal of non-core assets from them, the setting of legislative limits on the formation of state-integrated structures in the future, the acquisition of new assets by state-owned companies and structures dependent upon them, and in particular their participation in privatization as buyers remain relevant today.

With regard to the largest Russian companies, for a considerable time, there has been a debate over the “safest” approach from the standpoint of the interests of the administrative leadership, i.e., that of selling a certain quantity of the shares of privatized companies to private buyers while retaining a manifestly preponderant number of normal (voting) shares for the state. This would mean that receiving dividends (and current income) would be strictly demarcated from rights of governance and control over the activity of the company, which, as before, would remain with the state.

An important feature of the privatization program adopted in November 2010 for the period 2011–2013 was the identification of groups of the largest companies deemed to be of national economic importance, in relation to which such measures could be adopted on the basis of special decisions of the President of the RF and of the RF Government (with the participation of investment consultants in the organization of the sale of shares). The initial program covered 10 such companies: *Rosneft*, *Rushydro*, *FSK*, *Sovkomflot*, *RZhd*, the United Grain Company (OZK), *Rosagroleasing*, *VTB*, *Sberbank* and *Rosselkhozbank*. The intention was to sell, in most cases, holdings of blocking and minority shares. In 2012, there was a serious radicalization of privatization plans for the largest companies: additions to the list of companies to be privatized, a significant reduction in the share of the state in their capital and the termination of state participation in the capital of all companies until 2016, and the right to have a decisive vote (“the golden share”) in a number of them was granted. In the new privatization program for the period 2014–2016 (adopted in 2013), privatization plans for the largest companies once again underwent significant modification but this time in the

²⁰ We refer to the following legislative innovations: the Federal Law of 31 May 2010, No. 106-FZ “On amendments to the Federal Law ‘On the privatization of state and municipal property of the Russian Federation’”; the state program of the RF “The management of federal property” for the period 2013–2018 (confirming the directive of the Government of the RF of 16 February 2013, No. 191-r); political statements on the need to speed up the process of privatization; innovations introduced in the sphere of electronic trading and in the plan for drafting the strategy for FGUP; the removal of state officials from boards of directors; and additions to methods for transforming unitary enterprises.

²¹ See, for example, Mau and Kuzminov, 2013, Vol. 2. Ch. 20. P. 187–215.

opposite direction. However, the list of assets designated for privatization remained basically the same. Even so, in comparison with the privatization program for 2011–2013, a reduction in the share of the Russian Federation in the basic statutory capital of many of the largest companies envisages a retention of corporate control, that is, the ability to influence the processes of corporate governance, by means of the ownership of a blocking shareholding (25% of shares plus one).

Of course, the issue here is not only that of “reluctant privatization”, at least as far as the largest companies are concerned: We are also handling the manifestation during the last decade of an emerging asymmetry between the processes of state incorporation and those of privatization. Without examining in detail the entire spectrum of related circumstances and motives, let us consider the risks that relate to the period 2011–2014, following a series of official declarations, legislative initiatives and new long-term programs aimed at accelerating the processes of privatization. These are:²²

- a systemically ambivalent and contradictory attitude towards the role of the state (as legislature and a regulator and direct shareholder of companies);
- an expansion of the autonomy and interpretative discretion of the law enforcement agencies in regard to evaluating the efficiency of the performance of private and state-owned economic subjects. This places severe external constraints upon all initiatives and innovative measures on the part of government authorities, including in the sphere of privatization;
- an expansion of the state (and quasi-state) sector, notwithstanding the continuation of the privatization process, and the penetration of the state sector into the competitive arena;
- the inadequate development of conditions for fair competition, including the enhancement of the investment activity of private business in sectors with a high level of state participation and, conversely, a low level of competitive potential of a number of large companies that belong to the state sector;
- a disparity between the ambitious plans for privatization that have been announced and the organizational capabilities and sources of funding that are available;
- the particular role played by political decisions, notably a distinct periodicity in the strengthening (or weakening) of the influence of “interest groups” upon decision-making in the sphere of privatization. Such rivalries damage the decisions that are made and make for incomplete and contradictory implementation;
- a substantial risk that the existing model of management of state property will be preserved. In this event, any measures adopted would be mere palliatives, and the effectiveness of whatever denationalization measures were adopted in the future would be undermined.

Judging from all of the evidence, we can state that privatization as it is being implemented in Russia today (within the framework of the national economy) has become a purely technical process, the dynamics of which do not reflect the qualitative and quantitative dynamics of the development of the state-owned sector. This means that the evaluation of the role of the state sector (state-owned companies) in property relations must be viewed from a particular perspective, one that bears a closer relation to “political markets”, making all due allowances for the application of this term to the present-day Russian realities.

4. “State corporation”: What does the future hold?

Seven years have passed since state corporations (SC) actively began to be formed in Russia. It is difficult to provide a straightforward evaluation of their performance, if only because of the profound differences that exist between them. The formation of each individual SC has served as a means of overcoming contradictions between certain priorities for economic development (diversification, transition to an innovation-based form of development) and the

²² For further detail, see, for example, Radygin et al., 2011.

limited mechanisms available to the state for overcoming these contradictions, the low caliber of the administrative apparatus, and the particularities of a system of state management oriented primarily towards the solution of current and traditional problems. Even so, we can draw a number of conclusions that can serve to guide future policy and identify a number of institutional “traps”.

Given the availability of substantial financial resources to the state, a debate took place during the pre-crisis period over the need to utilize these resources to stimulate economic development. This circumstance strengthened the position of those who favored a more active and direct participation of the state in the economy and who extolled the advantages of a project approach over an institutional one. The creation of the SC became to a significant degree an instrument of preventive “institutional fixation”, creating a framework for embedding a number of priorities in the conduct of government policy and for the personification of accountability—this is made clear in the individual legislative status of each SC. This explains the allocation to some of them of a substantial amount of property, of long term finance, and also the elevated position they were granted in the administrative hierarchy.

The organizational-legal form of the SC was chosen largely because it provided greater flexibility in the utilization of financial resources and simplified (accelerated) the processes of restructuring and consolidating state property in particular sections of the economy. The formation of each SC served as a precedent in the working out of new approaches to the formation and expansion of the activity of developmental institutions (*Vneshekonombank*, ROSNANO), for improving outcomes in the delivery of state programs, in the execution of particular state functions (*Olimpstroi*, the Fund for Supporting the Reform of Communal Services), and in the allocation to particular state authorities of responsibility for particular strategic objectives (*Rostekhnologii*—now *Rostekh*, *Rosatom*).

The formation of the SC was severely criticized by the expert community and by representatives of the state administration. Three types of concerns were expressed: The first, the least important, deplored the growth of direct state participation in the economy; the second objected to the concentration of decision making in individuals and the extension of the model of manual or ad hoc control by the state; the third, the most important criticism, noted the inadequacy of the legal-organizational form of the SC.

When the regulation of the activity of the SC was completed by the end of 2007, many problems and defects became apparent: These related primarily to the fact that many of their tasks and functions had been defined in isolation from each other; to the weakness of mechanisms for internal control; to the lack of transparency in both management and financial decision-making; and to the absence of procedures for the resolution of conflicts of interest between members of management bodies. In practice, the management of the largest state assets that had been handed over to SC was handled in a manual regime. Owing to the excessively general and structurally fragmentary nature of the laws that had been adopted in setting up the SC and to the low caliber of their legislative reclamation, the following problems arose: delays from the outset in the real work of the SC in implementing their basic tasks; an extension of opportunities for “shadow” lobbying by various interest groups; a risk of “conjuncturalism” in decision-making at the expense of strategic planning and consistency; and apprehension in business circles, sometimes involving a hyperbolic estimation of the risks involved in working with the SC.

Changes in the legislation governing the SC in 2010–2011 were aimed primarily at fixing the deficiencies and omissions of the legislation of 2007. The innovations of 2010–2011 significantly improved the legal regulation of the SC with respect to the transparency of financial activity, and there were improved measures for monitoring their activity. However, the fundamental anomalies inherent in the model of “corporation” that had been adopted were not eliminated, and the risks of conflict between the interests of those state officials who had been appointed to management positions were not reduced. The absence of transparency in the appointment of the management personnel of the SC was not attended to.

In our opinion, the emphasis in the criticism of the SC was misplaced. The main problems resided not in the inadequacy of the legal-organizational form but in the fundamental inadequacies of the management of the state sector. The replacement of the SC by other forms of organization of public law, by a more effective form of SC such as “state company”, would amount to be no more than a charade, a formal shying away from the controversial term “state corporation”.

In general, at the present time, with a number of exceptions, one can talk of the existence of a single legal-organizational form of a non-commercial organization that carries out a variety of socially important activities based on state property, which is under state control but which is not a “corporation”. The “state company” model is practically indistinguishable from the SC model; thus, its emergence cannot be considered to be a transformation and even less an evolution of the SC model. There has been a proposal for the introduction of a “public legal company” and for the legal regulation of its activity, but in essence, this would merely be a renaming of the SC and state company and would not involve any substantive changes to the existing model. Even the transformation of the SC into a joint-stock company would not resolve the fundamental problems and contradictions that arise in the management of state property.

Prior to the crisis of 2008–2009, the SC in general succeeded, up to a point, in improving the quality of corporate governance, introducing a strategic dimension (programming) into their work and enhancing the transparency of the principles and outcomes of their activity. They carried out their work in compliance with the goals they had been set. However, with the onset of the economic crisis, the government made increasing demands of the SC to assume executive functions as agents for the implementation of anti-crisis measures, and their functions as institutions of development receded into the background. An increase in the forms and in the scale of the agency functions of the SC was accompanied by a decline in the systematic nature and transparency of their activity and by a narrowing of the circle of stakeholders who exercised real influence in the decision-making process.

However, the influence of the crisis of 2008–2009 on the post-crisis direction of the development of the SC was not one-sided. For one thing, one of the pronouncements made at a government level was that the state sector was excessively large, that there was a need for contraction, and that investments should be sought to support structural change. The importance of encouraging innovation to improve competitiveness was acknowledged, as was the need for mechanisms to stimulate innovation and to perfect the system of state institutions of development. On the other hand, the work of some SC during the crisis (in particular, *Vneshekonombank*) and their contribution in implementing anti-crisis measures were appreciated. This provided ammunition to the supporters of manual control, notably during the phase of modernization and post-crisis development. Variations in government policy during the post-crisis period have manifested themselves most clearly at the level of the SC because each considers itself to be in some way an exception, and the likelihood of diverging from “mainstream” policy is, in their case, particularly high.

For example, both *Vneshekonombank* and ROSNANO are financial developmental institutions, but their paths of development have diverged. *Vneshekonombank* has preserved its former gravitational model— attracting additional functions— with compact and operational control on the side of the government. It has become an important instrument for the implementation of political-economic tasks within the system of overall state administration, a mechanism for the launching of major projects with all associated risks. The question of dividing *Vneshekonombank* into subsidiary institutions has been put off until the indeterminate future.

ROSNANO has developed along different lines. Even before it was transformed into a joint-stock company, this SC was active in outsourcing a number of its functions and in creating a number of subsidiaries. Following upon its transformation, it immediately began to attract capital and invite private investors. Another example is the SC *Rostekh*. Both before

and during the crisis, it actively sought to acquire additional functions and assets. After the crisis, it made a priority of capitalizing its sub-holdings (even admitting private investments into a number of them).

It is difficult to provide an unambiguous assessment of the economic effect of the SC. Government approaches to the stimulation of growth have varied, but even the very formation of SC remains controversial: Some commentators have serious doubts about the need for such separate instruments for the realization of government policy; others put forward arguments in favor of them that lack a firm base.

The results of their activity are even more dubious. Certainly, three to four years ago, our own assessments were more neutral: We indicated that there would be both opportunities and risks and that these were more or less in balance. However, we have now reached the conclusion that many of the risks have realized and that serious problems and disproportions have arisen, whereas few of the available opportunities have been taken.

Given an overloaded system of state administration and a lack of flexibility in the use of budgetary resources, the SC have become a magnet for the transfer of additional tasks and functions, and this has led to an increase in demands by the SC for additional resources. It has turned out not to be possible to place limits on the growth in the size of the SC. The SC have served as a new, elevated springboard for the ambitions of institutions and of individuals. The risk that the SC would actively and successfully lobby for additional financial resources has been realized. Practically all SC, irrespective of their special function, have acquired resources in addition to the initial state investment. They have exploited their elevated status to acquire additional powers and functions as processes of consultation and decision-making with state representatives have become even less transparent. The opportunities for competition and external audits have become very restricted due to the specificity of the functions of each SC and the “reciprocity” of audits—the representatives of one SC will assess the performance of another and vice versa, and thus is formed a closed circle of assessors.

The most negative effect of the activity of the SC is the growing conviction that this is a normal and convenient instrument for the implementation of government economic policy. A consequence is a *weakening of pressure for the development of the institutional environment. Government authorities have become less active in their efforts to improve the indirect instruments for stimulating socio-economic development.* The best example concerns the regulation of state procurements and investments and the drafting and implementation of Federal targeted programs. At one time, problems in this area necessitated the creation of the SC *Olimpstroï*. The process of reform of regulation has now come to a halt, and many questions hang over the operation of the Federal system of procurement.

The creation of the SC was bound up with hopes for drafting and implementation of an economic policy that would be geared towards diversification and innovation. These hopes have been realized only in part, primarily in the sphere of developmental institutions. Both *Vneshekonombank* and ROSNANO have acquired a reputation for their work in the formation of economic policy and have put forward proposals for improving the system of regulation. However, the co-optation of SC into the process of formation and implementation of government policy, without any change in the methods of consultation and decision-making that are customary within the system of state administration, has resulted in the creation of a new bureaucracy, the work of which is to a significant degree not regulated.

A number of improvements that we considered to be important have not come to pass, for example, greater autonomy, less dependence on the political conjuncture, and long-term planning. On the contrary, the concentration of different types of resources within the SC, their elevated status and their operational potential have transformed them into an arena for inter-institutional struggle, and government representatives have come to look upon the SC as a means of achieving short-term objectives.

There has been no significant progress in the sphere of public-private partnership, least of all in the definition of priorities and of mechanisms for cooperation; on the contrary, the

system of state administration has enforced its own “preferences” in this sphere. Finally, with regard to the personification of accountability for the attainment of development goals, although there have been some advances in the case of some SC, these have been due more to the previous experience of managers than to the performance of the institutions for which they are responsible.

Of course, if there are to be improvements in the effectiveness of the SC, a number of changes have to be introduced that will not be mere palliatives. Given that any transformation of the SC will not take place quickly and will involve significant expenditure, we propose here a number of mechanisms for improving their performance in the medium term.

1. A system for setting limits on the growth of the SC must be established. Any proposals for the acquisition of additional functions or goals must be subjected to a comparison with alternative means of achieving the same objectives. Rules for the regular, say, annual assessment of the performance of the SC in relation to the “failures” of the market or of the state must be agreed, and projects that could be realized without the participation of the SC must be handed over to other enterprises.

2. A key measure for the assessment of the performance of the SC must be the analysis of their effect on the market environment, conditions for competition, and entrepreneurial initiative. The SC must not be given total financial responsibility for particular projects. This provides grounds for the state to grant additional investments and, given the inadequacy of the extent of their interaction and partnership with private businesses, makes for an increasing distortion of the markets and for an increase in the number and seriousness of “market failures” rather than the reverse. It also makes for a growth of the direct participation of the state in the economy. Long-term considerations are important in this respect. A total or almost total “blocking” of free access to a branch of industry has the effect of impeding its optimal functioning and above all inhibits the potential for innovation.²³

3. The performance of the SC has been improved by the use of agency schemes, the use of the “fund of funds” model and by projects for cooperating with the regions. Here, there are opportunities for combining resources and competencies and for clamping down on the opportunism of managers. Drawing up a typology of this type of cooperation and the creation of a legal framework will facilitate the exchange of best practice and encourage competition to achieve the best results.

4. Procedures for cooperation between the SC and the state must be clearly defined. They must be given the type of autonomy that will enable them to make decisions irrespective of the political conjuncture and to pursue strategic objectives without apprehension over possible changes in management or state representation. This autonomy must not increase the risk of the unaccountable expenditure of the resources of the SC. Therefore, in the system of external control, the audit of the utilization of resources must be replaced by the audit of the quality of realization of strategic goals.

5. It would make sense to extend to the SC all substantive changes in the management of joint-stock companies with state participation. In particular, the objective appraisal of the performance of the SC would benefit from the appointment of independent directors to their supervisory councils. It would also be useful to draw up within the SC plans for the development and improvement of their performance and evaluate these according to the procedures that are used in joint-stock companies with state participation.

In our opinion, there is an urgent need for more decisive action in the transformation of the SC. Following a period of fairly intensive and productive improvements in the quality of corporate governance in the SC, and after a number of amendments and supplements to the Law on Non-Commercial Organizations, the potential for further evolutionary improvement in the performance of state corporations has been largely exhausted. The SC, exercising

²³ Some analysts consider this to be amongst the most important arguments in favor of the privatization of state companies (see, for example, Anderson et al., 1997).

their functions as institutions of development, must be transformed into joint-stock companies, and strategic private investors should be encouraged to participate in their capital. (This would not preclude the state from retaining a significant degree of participation for some period of time.) SC that have short-term functions should be wound up or, in circumstances where their performance has been positive, transformed into joint-stock companies and then privatized. Finally, the performance of SC that have been given agency functions should be analyzed with reference to the legal barriers that they were set up to overcome. On this basis, clear and regulated plans for the improvement of the institutional environment should be drawn up. At a later date, these SC can be wound up, transformed into other forms, and privatized.

In transforming the SC, the creation of monopolies should be avoided, as should any excessive concentration of particular functions. To this end, it is essential that the rationale for dividing the SC into separate problem-oriented enterprises and measures for the transformation of the SC must be linked to institutional changes in the relevant spheres or sectors. The costs and benefits to privatization policy should be taken into account.

5. “Private state-owned companies”

The existence of various structures, de jure under state control (SC, various vertically integrated structures, strategic enterprises and associations, various enterprises in the mixed sector) provides an important, though not complete, picture of the role of the state sector in a specific institutional environment. There is no need in the present article to discuss the *raison d'être* of a substantial (at least quantitatively) state sector or of its role in delivering public goods and “global public goods”, in compensating for “system failures” and in catering for geopolitical interests in accordance with the specific conditions of the national economy. This belongs also to the discussion of the prevailing model of state capitalism, the stages of its development and the particularities after the crisis period of 2007–2009.²⁴

As in other countries that possess a large state sector (and/or countries that are proceeding along the path to state capitalism), in Russia, the formation of large state companies and their transfer to substantial resources (assets) would not have been possible without the ascription to them (often concealed from society) of ambitious objectives (including geo-political ones). However, imprecision in the definition of the functions given to state-owned companies and uncertainty as to the qualitative results that they were to achieve have prevented them from acquiring rational performance indicators. It is sometimes argued that accelerating the transmission of resources to compensate for “market failures” can almost automatically produce positive externalities. However, an emphasis on the acquisition of resources creates a predisposition towards rent-seeking behavior on the part of recipients. Such a policy inhibits the motivation to produce the type of demonstration effects that will serve to attract private investment. As a result, state-owned companies accumulate significant risks for the inefficient expenditure of resources and generate a need for additional resources to be allocated to themselves.

The example considered above (of the formation of the SC—one of the most resource-hungry forms) represents only one form of their evolution. The process of the formation of integrated structures with state participation has been underway for some time, and the network of state-owned financial developmental institutions has been expanding. The activities of these institutions are for the most part aimed at compensating both for “market failures” (*Vneshekonombank*, as the Development Bank, serves this purpose) and for “state failures” (the Skolkovo Foundation is the prime example). Although Russian developmental institu-

²⁴ See, for example, Radygin, 2004; Kondratiev, 2012; National Intelligence Council, 2009. P. 38–42; Bremmer, 2010; Musacchio and Lazzarini, 2012; *The Economist*, 2012.

tions have delivered a number of positive results, the poverty of demonstration effects — that is, of effects on external behavior — is evident (see Simachev et al., 2012b)²⁵.

Efforts to solve institutional problems by means of direct state involvement in the economy and by the concentration of financial resources produces only temporary benefits, and from a strategic point of view, they generate a tightly knit and stubborn set of problems: Exceptional measures, intended to be temporary, for the creation of state-owned companies (“national champions”) came to be regarded as positive practice and as an integral part of an active government policy. *Motivation to improve the institutional environment is further weakened, and the inclination towards, and habit of, a direct intervention of the state in the pursuit of economic development is strengthened.* In all of this, the question of the role of the legislative, executive and legal branches of the state in consolidating private property rights merits special consideration, as does their role in supporting a favorable investment climate.

In the meantime, *civilized property relations are being eroded*, as are opportunities for the attainment of private property rights, *given the expansion of the state sector de jure and de facto.* In our opinion, the concept “private state-owned companies” (albeit a contradiction in terms) best sums up these processes²⁶ insofar as in the Russian economy of the present day, it makes little sense to distinguish between the two categories. There have been a number of developments in this area.²⁷

1. The expansion of state entrepreneurship causes the re-emergence in some sectors of the economy of the old state-based power relations between entrepreneurs. They drive decentralized, market forms of cooperation into the background and discriminate against private property rights. As a consequence, further barriers to economic growth are erected.

Recently, a number of theoretical and econometric studies have been published that show that an insecurity of private property rights can contribute to the relative ineffectiveness of the investment process and act as a brake on the average rates (and quality) of economic growth. The authors of a number of microeconomic studies of the investment process in developing countries have come to similar conclusions.²⁸

Previously, the theory of the dynamics of economic growth gave an important role to technical-economic factors, for example, to the capital-employment ratio. Without denying the importance of this factor, current analyses give priority to the institutional aspects of development and above all to the effect of various forms of property upon the efficiency of the functioning of the economic system.

In recent decades, researchers have tried to quantify the effect of state activity in various areas on rates of economic growth. This is, of course, an extraordinarily difficult task — the dynamics of economic life are dependent upon a huge and varied number of factors, and the results of the functioning of various links in the state sector can be varied. All of the aggregated econometric calculations rest, unavoidably, upon a number of simplified assumptions and, of course, have to be qualified in many ways. Even so, one cannot ignore the coincidence of the results of these calculations, which are based on the experience of different countries and periods and employ a variety of methodologies.

²⁵ In this connection, we draw attention to the popularity in Russia of the idea of “innovation lift”, narrowly understood as a type of transfer of innovation projects, as they approach completion, from one state institution to another. It is further argued that large state companies should from now on ask for the results of projects that have been supported by state developmental institutions. There is something to be said for all such proposals: Large state enterprises are not receptive to innovation, and there are many “market failures” and shortcomings in the interactions of many of the participants in innovation projects. However, this approach creates conditions for the persistent transfer of risk, for a distortion of the motivation of state entities to work in market conditions, and for the preservation (and perhaps even extension) of existing “market failures”.

²⁶ As in the expression cited above, “growth in the shadow of expropriation”.

²⁷ There are many striking examples in Russian legal and business practice, but we refrain from providing case-studies to avoid selectivity and subjectivism.

²⁸ See, for example: Besley, 1993; Knack and Keefer, 1995; Svensson, 1998; Zak and Knack, 2001; Rodrik et al., 2004; Acemoglu and Johnson, 2005; Butkiewicz and Yanikkaya, 2011.

For example, M. Justesen, studying panel data for over 60 countries (for the years 1970–1999) and applying the “Granger causality test”, concludes that a lesser participation of the state (taxes and expenditures) makes for higher rates of economic growth (Justesen, 2008. P. 656). According to the results of panel data calculations for 15 countries of the EU (in calculating the parameters, the Generalized Method of Moments was employed), state consumption and transfer payments from the budget negatively affected economic growth rates (Romero-Avila and Strauch, 2008). In another survey, researchers indicate the existence of a negative correlation between the aggregate dimensions of the state and economic growth in rich countries. According to these calculations, a 10% increase in the dimensions of the state (the growth of aggregate state expenditures and/or of overall tax revenues in GDP) correlates to a decrease of average annual rates of growth by 0.5% to 1.0% (Bergh and Henrekson, 2011. P. 885). The effects of an expansion of state consumption in developing countries are particularly negative (Butkiewicz and Yanikkaya, 2011; Devarajan et al., 1996).²⁹

Given that the increase in state participation in social life over the last few decades and the increase in volatility of macroeconomic parameters have coincided in time, the increase of the former is often attributed to the state’s need to exercise a stabilizing influence.³⁰ However, how effective has this regulation been? Of course, in the absence of counter-measures by the state, some crises could evidently have had destructive, perhaps even catastrophic consequences. However, no hard and reliable evidence has been produced to show that the growth of the state by itself produces a long-term reduction in the volatility of the most important macro-economic indicators. On the contrary, econometric research points to the conclusion that state expenditure has a destabilizing effect and that there are no grounds for the conviction that the “big state” is capable, by virtue of its size alone, of reducing macroeconomic risks (Carmignani et al., 2011. P. 785, 789).

2. A significant expansion of the system of centralized regulation and the formation of giant economic complexes in the ownership of the Russian state have further restricted the sphere of operation of market processes (by contrast with the experience of a number of countries where state enterprises have in a more or less limited fashion “entered into” existing competitive framework). This has the effect of significantly increasing the losses to society owing to monopolistic or oligopolistic methods of economic management that enable state-owned enterprises to deliver goods or services of comparable quality but at a relatively higher price.³¹

3. The transition to state property creates the conditions for ignoring budgetary constraints and makes possible a radical re-tooling of companies or branches of industry. However, as the experience of many countries has shown, the long-term operation of state-owned companies results, in most cases, in the growth of wasteful expenditure (judged by the criteria of market efficiency). Many studies have examined the factors that explain the inadequate flexibility, “technical-economic conservatism” and lower efficiency of state-owned companies when compared with those that are privately owned.

It is precisely the special (state-owned) status of such companies (irrespective of the legal form of property), combined with the strategic position that they occupy in the system of economic links and other factors, that provides them access to the most favorable and

²⁹ One research study sees the trust of economic actors in the actions of state institutions and enterprises as being a fundamental factor. A mistrust of official pronouncements and programmes and of bureaucratic behaviour often produces negative consequences (Aghion et al., 2010).

³⁰ Without wishing to dismiss this argument out of hand, we note that many of these circumstances can be interpreted in terms of an opposite relationship of cause and effect: The very increase in the size of the state increases the instability of the economy and gives rise to a multitude of additional risks. Much of the empirical research referred to below confirms this.

³¹ According to available estimates, the total of such economic losses is on average 1.34% of GDP in the sphere of the Russian trucking industry and 0.4% of GDP in the gas industry. The losses deriving from superfluous restrictions on the access of Russian markets to foreign goods are particularly high (Shastitko et al., 2013).

“inaccessible” private sources of credit. However, the consequences of this massive utilization of borrowed funds are a matter of serious concern. The receipt of multi-billion currency loans has not, in a number of cases, resulted in real accumulation—capital investment in machinery and equipment or in the construction of production facilities turns out to be disproportionately small.³² The prospects for commercially recouping such expenditures are far from clear. Consequently, when the deadline for repayment arrives, these companies attempt to restructure their loans and look for possibilities for re-financing in the capital markets. When such efforts are unsuccessful, they invariably turn to the state for assistance. A paradoxical situation arises: Companies that dispose of powerful “financial levers” experience, not only during times of crisis but during normal circumstances, an acute need for resources and demand urgent support from the state.³³

4. What has taken place is in fact a nationalization of *de jure* private entrepreneurship. At the federal, regional and municipal levels, *de jure* private enterprises are *de facto* looked upon as state enterprises from the standpoint of the allocation of their goals and social obligations. The result is a distortion of decentralized (market) mechanisms that are capable of contributing to a growth of productive and allocative efficiency.

5. The trend in recent years towards an increase in the number of public-legal entities and for the expansion of the state sector has been accompanied by an increase in the severity of policy towards particular private companies. These trends essentially undermine property rights and provide evidence of the existence of double-standards: In the real world, the “rules of the game” for state-owned companies and for private entrepreneurs differ markedly.

All of the findings of modern economic theory point to the conclusion that the legal system and judicial practice of a country should help to uphold property rights and not assist in the dispersal of these rights or contribute to the growth of bureaucratic entrepreneurship. Of course, this does not mean that the state should not, in times of severe crisis, provide targeted and, as a rule, short-term support to private business.

6. A state strategy of support for raiders can undermine the basic conditions for the stable existence of private enterprise. In an effective market system, it is only in exceptional circumstances that the state will not sell or lease out plots of land and/or productive capacity at market prices but just “confer” upon individual participants the property rights to such assets.

With the assistance of mechanisms of mergers or acquisitions, financial markets can impose an important degree of discipline upon private corporations: Of course, if the losses of companies increase and the market value of their shares goes into steep decline, then the likelihood of their acquisition increases. In Russian practice, during recent years, this process has, as it were, been “turned inside out”: The state, and often raiders, which are actively supported by high-ranking officials in federal institutions and in the regional administrative apparatus, selects for acquisition of the most dynamic and highly profitable private companies. The implications of such a transformation of property are evident.

7. The actions of interested recipients of all types of “political rent” frequently violate actual laws pertaining to state property. For example, the entrusting of the administration of the shareholder (property) rights of the state to higher echelons of management, in conditions in which the accountability of such individuals (and even of the state companies themselves) is unclearly defined, can result in the transfer of assets out of the corporation or their diversion towards the provision of a variety of private benefits.

³² Official statistics describing the investments of many SC and of their funding have not, as far as we know, been published. Even so, “guesstimates” suggest that the gulf between their financial borrowing and their actual accumulation is greater than is the case, for example, for private industrial firms. We also note that expenditures associated with the formation of production capacities of the conglomerate type and/or the expansion of an “economic empire”, incurred by one company or another, are not included in the expenditures that contribute to the real accumulation of the national economy.

³³ A number of studies have noted similar tendencies, citing the need for soft budget constraints in the funding of state companies in China (Tian and Estrin, 2007).

The successful operation of state-owned companies requires the absolute transparency of the relevant economic structures. Considerable efforts and financial resources should be directed not only towards the effective utilization of state property but at the very least towards the defense of that property. Unless this is done, the activity of these enterprises risks being directed towards the enrichment of their managers.³⁴

This aspect of the functioning of existing political and economic institutions can give rise to “Directly Unproductive Profit-Seeking Activities—DUP”,³⁵ which, more often than not, causes the further expansion of state activity in the economy. What is important is that aspects of the non-market economic operations or the “quasi-market” activity of the state-owned sector are often the source of specific (additional) externalities, which inevitably result in a comparatively less efficient allocation of resources.

8. A group of companies has come into existence that practice manual control, irrespective of whether they belong to the public or to the private sector. These companies follow certain rules, for the most part informal, of interaction with the state to obtain either additional resources or broader responsibilities, and such “exchanges”, at the micro level, of state support, preferences and behavior (for example, in providing employment, or technical modernization) are as a rule not transparent.

It is sufficient to recall the list of so-called “system-forming” enterprises that was drawn up in Russia at the height of the crisis of 2008–2009.³⁶ The principal criteria for inclusion in the list were influence on employment, an infrastructural profile, and the possession of unique technological competencies. As of 2014, it seems that a new criterion will be the capacity to implement compensatory measures (measures of support) in response to the economic sanctions of the EU and the USA.

9. What is taking place is a pseudo-privatization. The reduction of the direct participation of the state in particular companies is being accompanied by an increase in the role of quasi-state investors in the management of their activity. At the same time, the influence of the state over these companies, the principles upon which decisions are based and the extent to which the interests of society are taken into account are becoming less transparent and moving into an area that is poorly regulated. Under the guise of privatization, assets are being de facto transferred into the state sector (into state-owned companies), and this is tantamount to another turn of the screw in the governmentalization of the economy.

10. In the medium and long term, in the absence of adequate measures for the branch regulation, the privatization of large companies will result in intensification of informal pressure upon them from the state. Given the underdevelopment of regulation in particular sectors, a circumstance that was previously “compensated for” by the direct participation of the state in the management of a number of large companies, the state, under the new arrangements, will need different instruments for the attainment of socially important goals. The principal problem in this area is the increasing lack of transparency in the definition of what the public interest is with respect to these companies and the emergence of conditions in which social interests can be replaced by narrow sectional interests (both institutional and private). Furthermore, delays in the introduction of “external” measures for improving the investment climate can significantly limit the structural effect of privatization.

None of the above is meant to argue, of course, that private enterprises will always and in all circumstances be more efficient than state-owned enterprises. We repeat that in circumstances where the state has genuinely succeeded in turning state corporations into “develop-

³⁴ The comparative characteristics of state and private entrepreneurship have been analyzed using theoretical models. This analysis showed that in some situations and with the strict observance of all legislative norms, the amount of private benefits acquired by the managers of state-owned companies could significantly exceed the value of rental income they would have received in the event that their companies were privatized (Laffont, 2005. Ch. 3).

³⁵ This term is introduced in Bhagwati, 1982.

³⁶ For further details, see Simachev et al., 2012a.

mental institutions”, they are capable for a certain period of time of making use of their special status, including their access to government financial support, to speed up the transformation of conservative economic structures and create more favorable conditions for the development of high-tech branches of the economy.

The creation of companies with state participation and of state-owned developmental institutions to a considerable extent reflects the efforts of the state to establish more effective instruments for the implementation of industrial policy. As it happens, the governments of many developed countries have, in recent years, also adopted a more active policy, aimed in particular at re-industrialization. However, an important pre-condition of such initiatives has been the exhaustion of measures of the classical type (privatization, the defense of property rights, the development of competition, and the improvement of the investment climate). In Russia, the potential for the implementation of such institutional-structural reforms is far from having been exhausted (see Kuznetsov and Simachev, 2014). In circumstances in which positive institutional change has been inadequate (the very direction of policy is unclear) and where precise measures for changing the branch structure of the economy are lacking, industrial policy is increasingly concentrated in the state-owned sector and depends upon the efforts of a small group of large state-owned companies. Meanwhile, efficient medium-scale projects and dynamically growing businesses are left out in the cold.

7. Conclusion

The arguments deployed above may bear witness to an inadequacy of comparison (even a somewhat primitive one) of the institutions of state and private property. The limitation of such abstract classifications became abundantly clear during the period when open joint-stock companies with a strategic state participation and common (one might almost say communal) property were widespread. The structures that are taking shape in Russia at the present time display, in our view, a rather complex combination of the features of state and private enterprise. A deeper theoretical analysis of the issues in question will enable us to better understand the nature of property in the contemporary economy, to distinguish between stationary and non-stationary modes of appropriation of assets, to analyze the relationships between property and power and in particular to examine the functioning of mechanisms that can genuinely enforce property rights.

These issues will be just as relevant in regard to drafting short-term and medium-term applied regulatory measures and designing a long-term economic policy for Russia. At a time when many governments are significantly revising their thinking with regard to the types of measures that will be needed if stabilization and growth are to be achieved, the primary goals and rationale of the activity of practically all state companies should be reappraised. Simultaneously, we should bring into practice new mechanisms for the evaluation of government policy, based on the concept of complementarity, whereby the effect of a particular instrument is compared with alternative means of utilizing government resources and property. Particular attention should be paid to the need to achieve optimal proportions between state and private property in different sectors of the economy at a time when we are moving towards a new innovation-based type of economic development.

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