

# Small Business Collective Action and Its Effects on Administrative Modernization in Putin's Russia

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From “Grabbing Hand” to “Helping Hand”?

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## Declaration

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**A note on transliteration:** this dissertation employs the “BGN/PCGN” transliteration system of the United States Board of Geographic Names (BGN) and the Permanent Committee on Geographical Names (PCGN) of the British government.

## Abstract

Throughout the 1990s and 2000s, epidemic corruption hindered Russia's economic performance. At the grassroots level, low-level administrative agents preyed on small- and medium-sized enterprises (SMEs), exploiting Russia's ever-changing and loophole-ridden legal codes to extort rents from these relatively powerless firms who lacked the political connections necessary to protect themselves from these predations. In contrast to larger, better-connected firms, SMEs suffered from this "grabbing hand" of the state. They lacked the resources to engage in the "capture" and "elite exchange" models of business-state ties that characterized interactions at higher levels of the politico-economic hierarchy. While some firms benefitted under Russia's systemic corruption, SMEs tended only to suffer under it.

This pervasive "grabbing hand" drove the consolidation of the SME interest toward the resolution of this common problem. But, given their individual weakness, SMEs' only means of systemic political leverage comes from pooling their resources into mechanisms of collective action. This presents a number of problems according to the theory of collective action as laid out by Mancur Olson. As a large, diverse, and geographically scattered interest, SMEs face significant organizational costs in achieving political outcomes when compared to smaller, sector-specific organizations.

However, the Putin administration has put SME development and the reduction of corruption at the center of Russia's modernization program. Through the creation and empowerment of "peak" SME business associations, the administration has in effect subsidized these increased costs of collective action for the SME community. The synergy of interests between Russia's "power vertical" and the SME community has resulted in a push for a more professional, accountable, and transparent administrative apparatus. This dissertation explores the thesis that the common administrative obstacles facing the SME community has driven the emergence of an "encompassing interest" in administrative modernization, which is more likely to produce results given the support of Russia's powerful president.

## Acknowledgements

This dissertation emerged from personal experience living, working, and studying in various towns and cities in Russia from 1996 to 2006. Small businesses, typically restaurants, shops, and local watering holes were a central feature of my daily life in Russia. I came to know many of the shops' owners and employees. To my untrained eyes, the small business community appeared vibrant and robust, and did not mesh with the picture often portrayed of Russia as a dreary place, run by mafia gangs, dominated by oligarchs, and subjugated under the thumb of an authoritarian leader. I wanted to reconcile these two perspectives. I wanted to know more about the entrepreneurial experience in Russia.

David Woodruff of the London School of Economics served as my supervisor for this project. His guidance was patient and supportive. His critical perspectives were always thoughtful and challenging. As a PhD student, one hears many horror stories about absent or uncaring supervisors. I consider myself lucky to have had David on my side.

For absolutely essential logistical support, I must extend my gratitude to the dedicated and ever-helpful women working at the international studies office at the Volga Academy of Civil Service in Saratov, Russia. Elena Samsonova and Nairya Ambaryan in particular made the daunting task of finding interview respondents in a town I did not know a manageable one.

I must also thank Alexander Kazakov of Saratov State University. Our informal conversations over beers on the banks of the Volga were some of the most illuminating (and fun) I had during my fieldwork time. He also provided invaluable contact with experts in SME issues in Saratov.

I also extend my thanks to the many representatives of the SME community who took the time to speak with me. Their stories were fascinating. I hope this dissertation does some justice to their rich accounts.

Finally, this dissertation is dedicated to my mother, Dr. Rebel Palm. She got her PhD late in life, and was only able to enjoy the fruits of her education for a few years before succumbing to her cancer. Unfortunately she did not quite make it to see me achieve my own. She taught me the value of education from an early age, and it was education that got me out of some very limiting circumstances. I am ever grateful to her for that.

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## CHAPTER 1: EMPIRICAL PUZZLE AND THEORETICAL CONSIDERATIONS

### Introduction

In May of 2000, camouflaged, balaclava-clad federal agents raided the offices of NTV, one of Russia's only remaining independent news channels, ostensibly to investigate a case of tax fraud. Pundits both foreign and domestic decried the move as a flagrant assertion of central authority against independent voices in the media by Russia's new president, Vladimir Putin, then only four days in office. NTV's owner, Vladimir Gusinsky, had long drawn the ire of the Yeltsin administration for using the channel as a mouthpiece to criticize the government and advance his own political aspirations. Within three years, this bold move was followed by proceedings against the YUKOS oil conglomerate, again for alleged tax evasion, and which resulted in the quasi-legal and politically-motivated breakup of Russia's most powerful company. Its chairman, Mikhail Khodorkovsky, had openly declared his political aspirations and had been a long-time supporter of the liberal Yabloko party. Although Putin denied direct involvement in either case, it was widely speculated that the YUKOS affair was a deliberate and politically-motivated attack carried out on orders from the highest levels of government (Gidadhubli 2003, Woodruff 2003).

These events represented the most dramatic manifestations of Putin's "equidistance" doctrine, in which he declared that Russia's infamous oligarchs would "cease to exist as a class" (Tompson 2005, 1). They would not be able to use their dubiously attained wealth for dominance over Russia's nascent political institutions. In combination with the deterioration of a number of liberal democratic principles during his term, such as the persecution and murder of journalists critical of the regime and the abandonment of democratic power transfers at the regional and federal level, Putin's actions against the oligarchs were seen as a reassertion of a vaguely characterized autocratic authority that had presumably been a part of Russia's political culture since the first tsars disenfranchised the boyars. The apparent influx of *siloviki*—i.e. individuals with backgrounds in Russia's security services—into the administration reinforced perceptions of a shadowy, "cloak-and-dagger"-style of governance that would presumably lead to a re-entrenchment of a totalitarian, police-state militocracy (Renz 2006, Rivera and Rivera 2006). "Because Russia needs its tsar" was the straw man

many pundits put up to explain this apparent shift. Putin, a stony-faced former KGB officer appointed to the office of president, appeared to validate this simplistic view (Ignatius 2007).

While they may make for good press, the *ad infinitum* discussions of the conflict between Putin and the oligarchs and of “*siloviki* politics” in academic and news media mask a remarkably different set of dynamics at the lower levels of the politico-economic spectrum. The Putin-oligarch conflict is far from representative of state-business ties developing throughout Russia. The number of business representatives in Russia’s political institutions has increased at a greater rate than that of the *siloviki* (Rivera and Rivera 2006, 130).<sup>1</sup> While he was distancing the oligarchs from the political process, small- and medium-sized enterprises (SMEs) enjoyed ever greater access to it. Independent small business associations had proliferated throughout Russia since the 1990s. In the early 2000s the state sanctioned the establishment of two Russia-wide SME associations, OPORA and *Delovaya Rossiya*, with the explicit intent to institutionalize SME access to the policymaking process. In 2008, President Medvedev continued to tout SME development as a cornerstone of Russia’s modernization goals. He stated that the growth of SMEs was “absolutely equivalent” to the growth of Russia’s middle class (Russia Today 2008). He declared that Russia intended bring SMEs’ contribution to GDP on par with that in mature capitalist economies, from about 17% to 60% or more by 2020 (ibid). Political leaders in Russia have expressed a belief that the SME sector is crucial to diversifying Russia’s resource-driven economy, as well as establishing a broad-based, grassroots source of job creation, consumer culture, competition, and local economic development (Bossoutrot 2005, 6)

Russia’s organized SME community in the form of SME business associations (hereafter “SMEBAs”) have been a crucial ally in the fight against administrative corruption plaguing the country. So too have unaffiliated small business owners who, largely informed by the public campaigns of SMEBAs, have been instrumental in curbing petty bribery and extortion “on the ground”. SMEBAs have lobbied for new legislative acts to empower small business owners vis-à-vis Russia’s ubiquitous officialdom. These represent the formal (and high-level) bases of institutional change in Russia. At the individual level, the small business owner who is willing to challenge an official represents the informal, grassroots level of

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<sup>1</sup> Renz (2006) argues that the role of the *siloviki* is more modest than often asserted. According to her, the influx of *siloviki* was more a result of an “under-institutionalized process of elite recruitment rather than by a strategic decision to increase [their] political influence” (2006, 905).

normative institutional change. During the Soviet era, private enterprise was illegal and the bureaucracy was the interface between a repressive, much-feared totalitarian police state and a subjugated public. The fact that these independent private actors are willing to confront the bureaucratic machine signals a shifting mentality that will likely affect the quality of Russia's political institutions in the coming decades.

### **Empirical Puzzle and Core Research Questions**

The empirical puzzle at the core of this dissertation is how, from the late 1990s, SMEs in Russia were able to overcome significant collective action problems to consolidate their interests into organized lobbying efforts to achieve political outcomes. A key strategy of the president's economic modernization agenda has been to exploit SMEs' anti-bureaucratic sentiments by enlisting them as allies in the fight against bureaucratic corruption (Markus 2007). The aggregate effects of SMEs' increasing strength in the political arena are evaluated in terms of the institutional outcomes of this increased presence. They will be presented from national, regional, and municipal levels of analysis. The hypothesis to be explored is that the nature of the SME interest tends to produce institutionally "modern" interactions between grassroots business and state actors. This "modernity" is defined in terms of the presence of institutions of "good governance" that characterize the bureaucratic administrations of mature capitalist economies. It is viewed from several perspectives. Max Weber viewed the emergence of a non-arbitrary, impartial bureaucratic apparatus as a key feature of a modern, legalistic state (Weber 1968). Tilly (2000), coming from a perspective of democratization theory, sees the emergence of institutional modernity in terms of the state extending institutions of "protected consultation" over the polity. These two perspectives, discussed below, form the basis of this dissertation's conception of institutional "modernity".

SMEs' relationship to its emergence rests in their need to pool their resources into mechanisms of collective action. This relationship is evaluated in terms of Olson's (1971, 1982, 2000) perspectives on collective action theory and the kinds of public goods SMEs tend to pursue under the conditions of transition to a market economy. The empirical analysis tends to illustrate that SMEs' desire for bureaucratic reform couples with attempts on the part of the state to co-opt them into organized political lobbies. In turn, the coordinated efforts of these two bodies tend toward the provision of the public good of administrative modernization as conceived herein.

## Businesses' Role in Advancing Modernity as "Good Governance"

Several scholars have found that larger firms are more likely than smaller to enjoy personal connections and informal influence in their dealings with government and in obtaining legislative, regulatory, and other administrative advantages. Haggard, Maxfield and Schneider (1997, 45) note that in economies such as Russia where business is highly concentrated, officials and powerful capitalists "can all sit at the same dinner table". This unequal balance in a firm's capacity to "capture" illustrates why smaller firms are compelled to pursue more broadly beneficial public goods, such as competent, non-corrupt administration, than their larger counterparts. *Smaller firms' only systemic political leverage can realistically come from pooling their resources into large-scale collective action.* This presents many problems according to collective action theory. An agreed-upon collective initiative in this context demands a relatively transparent and democratic process of agenda-setting. The fact that more have to agree on what public goods to pursue means that those public goods must serve the broad collective interest of the small business community. Obtaining firm-specific advantage in high-level regulatory frameworks is not possible. The broader the collective interest pursuing a public good—or in Olson's terms, the more encompassing the interest—the more likely we are to see a "spillover effect" of public goods serving a greater social interest. Small businesses' push for fair, accessible, and impartial administration and governance translates, if successful, into the social benefit of a fair and impartial system for a variety of actors, be they new entrants to the business community or other members of the public who benefit from improved government services. Furthermore, the institutions that emerge to accommodate their collective action are by necessity inclusive and representative of a wide-range of actors from the private sector. In this sense, SMEs can play an important part in the "rationalization" of public administration from a corrupt and dysfunctional remnant of a command economy to a legalistic, "modern" system.

In his discussion of bureaucratic authority under a legalistic system, Weber (1968, 223) notes that "the development of modern forms of organization in all fields is nothing less than identical with the development and continual spread of bureaucratic administration... Its development is... at the roots of the modern... state". Indeed, such a legalistic system characterizes the governance systems in most advanced economies of the industrialized world. According to Weber, under this system power is exercised "by virtue of the belief in the validity of legal statute and functional 'competence' based on rationally creates *rules*

[italics in original]... This is domination as exercised by the modern ‘servant of the state’ and by all those bearers of power who... resemble him” (ibid). Maxfield and Schneider (1997, 21) note that a Weberian bureaucracy is the best way to ensure state-business interactions do not degenerate into rent-seeking behaviors. Those societies that lack the institutions to support a Weberian bureaucracy can delegate the formulation and administration of policy to associations that are better able to monitor and restrain the potentially unproductive activities of their members (ibid, 21). Building a marketized society from scratch is one of the key foundational challenges of the new Russian state. Examining this transitional process gives us a unique and rather unprecedented opportunity to observe the genesis of institutions governing market exchange and the private sector, and how political and economic actors negotiate the process of transition.

Haggard, Maxfield and Schneider (1997, 3) note “the general presumption is that when business and the state have close congenial relations, democratic ideals, economic efficiency, and social welfare will suffer”, which they challenge after scrutiny: “To the extent that good relations between business and government contribute to policy effectiveness generally, they enhance governability and democratic governance...” (ibid, 20). Theories on the role of the bourgeoisie and middle classes in democratization informed the early hypothesis of this research, that the small business sector as a proxy for them would be an important determinant of a political trajectory toward democracy in Russia. Given the timeframe under analysis—just over 10 years of Putin’s Russia—it is difficult to fully support this hypothesis. Representative political institutions in mature economies have taken generations to develop, while Russia endured 10 years of virtual chaos in the 1990s, followed by heavy-handed measures to rein it in during the 2000s. However, we can see a tendency, especially at the local level, toward the creation of institutions of representation to accommodate the political interests of SMEs as an emergent commercial class.<sup>2</sup> The emergence of these institutions is a result of three primary factors as laid out in the model of this thesis: the interest of SMEs in curtailing the extortive rent-seeking behavior of low-level officials, the necessity of collective action SMEs must take in order to enact this change, and the interest of political actors in delivering economic growth as a pragmatic strategy to ensure their legitimacy to their constituents and to executive authorities closely tied to the power vertical, who tend to be the most ardent supporters—at least rhetorically—of the president’s modernization objectives

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<sup>2</sup> See chapter three.

### *Good Governance vs. Democratization in the Discourse of Modernization*

Today, “democracy” has become a byword for good governance in general (Coppedge and Gerring 2011). Notoriously difficult to measure, it connotes free and fair elections, a free press, political accountability and power transfers, a non-arbitrary judiciary, and freedom of association, among many other factors. In terms of democratic development, Russia is lacking in many of these regards. But if the ascendance of the SME sector continues, and it becomes part of a politically salient middle class, some tenets of democratization theory help to provide insights into Russia’s potential political trajectory.

Tilly (2000) bundles several elements of governance into a single concept, “protected consultation”. This represents a defining feature of institutional modernity as conceived in this dissertation. It encompasses a regime’s breadth, or the number of people who belong to the polity and who fall under its jurisdiction; its equality, or degree of access members of the polity have to government and its agents, as well as how they are treated under the law; consultation, or the degree to which government is bound to the will of the polity; and protection, which is whether members of the polity are protected from arbitrary government action. He says that “democratization means any net shift toward protected consultation” (2000, 6). Using this framework to analyze Russia’s SME sector’s influence on politico-administrative outcomes, clearly the collaboration between it and government indicates a movement in that direction.

Important to Tilly’s conceptualization, however, is the idea of *net* shift. The complexities of Russia as such a large, politically and ethnically heterogeneous country makes quantifying the net effects of such a shift difficult. Popular media and academic accounts point to developments at the highest levels of the political spectrum as indicators of a slide toward authoritarianism. State control of major television outlets, the harassment and assault of journalists under Putin’s administration, the curtailing of regional elections, and the simple fact of Putin’s quasi-constitutional presence as Russia’s leader for so long support this view. However, Russia’s regions are politically heterogeneous, with some governed by democratic procedure and rule of law, and others by strongmen (Petrov and Titkov 2010). Furthermore, Russia’s SME sector represents over 90% of its economic entities, and they have been given a significant voice in policymaking and holding bureaucracy and officials to account (Kubanskije Novosti 2009, RCSME 2013). The *net* effect of these disparate

tendencies may be impossible to quantify, but a fundamental thrust of this thesis is to add the SME sector to the equation.

A central conflict facing Russia in recent years has been how to both limit and reconstitute the state (Sakwa 2008, 81). In the 1990s, the lack of political control over the economy or administration encouraged widespread rent-seeking and bureaucratic extortion rather than productive activity to generate new revenue streams (Sakwa 2008, 293). The challenge facing Russia's leaders today is how to achieve the benefits of diversified, grassroots economic growth while attempting to reform an administrative apparatus whose employees' livelihoods have been based on rent-seeking and informal exchange for decades. Indeed, many authorities tasked with administering this reform process benefit from this system of corruption. Haggard, Maxfield and Schneider (1997, 3) pose the question, "How can poorly paid officials defend the common weal when they come into close, lasting contact with capitalists who have keen appreciation of self-interest, flexible scruples, and vast resources?" They offer several perspectives relevant to the Russian case:

An insulated, meritocratic bureaucracy is a first bulwark against corruption...but such bureaucracies are scarce...in the developing world...In their absence, self-policing business associations as well as encompassing firms and associations reduce, ex ante, the likelihood that collaborative relationships will degenerate into collusion and rent-seeking (1997, 5).

They note further that "most insulated, Weberian bureaucracies emerged under authoritarian auspices" (1997, 20). If the SME sector continues to grow as a salient political constituency, it may be central to encouraging the emergence of "modern" bureaucratic institutions under the authoritarian framework of Putin's pro-market statism.

Of course, anyone who has followed developments in Russia knows that official corruption remains one of the most significant obstacles to economic growth in the country. The effects of SMEs in the development of modern institutions is by no means a "positively sloped", deterministic process. But the process of administrative modernization as part of an effort to support Russia's SME sector is not just an abstract theoretical construct devised for the analytical purposes of this dissertation. Rather, it is part of an explicit strategy of President Putin and high-level officials in central ministries and at the head of regional governments.<sup>3</sup> "Strategy 2020" is the name given to Russia's long-term economic

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<sup>3</sup> "Debureaucratization" has been a long-standing feature of the economic development strategies of Russia's high-level decision-makers. German Gref, the liberal Minister of

development plan, originally ordered by then Prime Minister Putin and President Medvedev in 2006 (Ministerstvo Ekonomicheskogo Razvitiya Rossiyskoy Federatsii n.d.). Experts from various fields have come together to form twenty-one working groups to develop this plan. Group Four is tasked with developing a strategy for “strengthening market institutions, ensuring the stability of private property and the growth of a competitive environment, and the promotion of small enterprises” (RIA Novosti 2014). Group Four’s strategy is grounded in building a more favorable business climate for regional, smaller firms through reform of public administration (A. Yakovlev 2011, Ekspertnoi Gruppe No4 2011). It explicitly calls for increased empowerment of and dialogue with Russia’s “Big Four” business associations (OPORA, *Delovaya Rossiya*, the Chamber of Commerce, and the Russian Union of Industrialists and Entrepreneurs) in the creation of legislation and professionalizing the legal-administrative system as an aspect of Russia’s overall economic modernization (ibidem).

Business is at the nexus of the tension between sincere efforts to reform Russia’s institutions to modern standards and the incentives to perpetuate the system of rent-seeking and corruption. That business has an effect on politics—and vice versa—is well understood; less so is the extent to which firm size affects how firms shape the institutions of governance in the context of transition. SMEs’ increased influence in the political arena has been directed toward confronting epidemic, low-level rent-seeking and administrative corruption that has plagued smaller firms since the emergence of the private sector in the early 1990s. This examination also reveals continued difficulties for Russia’s smaller companies in the face of these obstacles despite their increased political presence. Examining the net institutional outcomes that emerge as a result of efforts to resolve this tension is central to the analytical focus of this dissertation.

The core research questions of this dissertation can thus be formulated:

- 1) Does the presence of a growing SME sector in Russia explain the emergence of “modern” forms of institutions as public goods at the federal, regional, and municipal levels?

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Economic Development and Trade from 2000 until 2007, was instrumental in building such a plan in the early years of the Putin administration. Core features of the program included regulating the number of inspections a government agency could conduct of a small business, reducing the number of activities requiring licenses, and easing the process of registering a business, all of which were avenues for officials’ rent-seeking (see chapter two) (Sakwa 2008, 308, Kontorovich 2005, 260, Delo 2007).

- 2) How does state co-opted SME collective action determine the nature and quality of political institutions to represent SME interests at those levels?
- 3) What are the mechanisms by which the SME sector can influence institutional arrangements and the provision of public goods at each level?
- 4) What variables intervene in or condition the success or failure of SME efforts to influence these outcomes at different levels of analysis?

A number of theories of state-business relations provide preliminary insight into these questions, which are discussed at length below. Collective action theory as formulated by Mancur Olson (1971, 1982, 2000) helps to explain why SMEs face such significant obstacles to organizing to obtain a political outcome. The circumstances of Russia's transition to a market economy and the ascendance of a pro-market statist to the presidency help to explain the extent to which SMEs have been able to overcome those obstacles. In their "natural" state, SMEs represent such a broad, diverse grouping of sectors and firms that they will remain "latent", which is Olson's (1971) term for a group in which no individual member has an incentive to act for the collective good of other members. However, Olson grants that these groups can be mobilized into collective action under certain conditions. The involvement of the state in mobilizing a latent group conditions the political outcomes of its collective action. The means by which SMEs mobilize—or *are* mobilized—into collective action determine the quality of the institutions that emerge to represent those SMEs. State involvement in subsidizing the costs of collective action is a key factor in securing regular channels of interest representation between the state and low-level economic actors. The need to bargain and build consensus amongst such a broad group of actors requires open, transparent forums of dialogue and interaction. Combined, these dynamics illustrate how trends in SME-state ties in Russia result in increased “protected consultation” for the private sector and a resultant push for administrative modernization.

This is a departure from a wide range of literature focused on high-level business-state interactions, which tend to be characterized by powerful business and political actors competing or cooperating to attain parochial objectives. Capture theories—those that explain the seizure of state institutions by business interests or the seizure of lucrative industries by an assertive state—help illustrate the incentive structure behind the systemic corruption that has defined Russian political and economic relationships for the past 20 years. They help to distinguish the differences in political interests between SMEs and their large enterprise (LE) counterparts. While utilized extensively to explain business-state relations in the context of the Russian transitional period (Frye 2002, Frye, Yakovlev and Yasin 2009, Slinko, Yakovlev

and Zhuravskaya 2005, Slinko, Yakovlev and Zhuravskaya 2002, A. A. Yakovlev 2006, A. Yakovlev 2009), it will be argued that these theories break down at the level of *small* business-state relations. In short, size matters. Small businesses are too small to be the target of state seizure and do not possess the resources to capture state offices. Rather than benefit under a lucrative “capture” model, their individual weakness makes them subject to the extortive, rent-seeking predations of low-level bureaucrats. This illustrates why the “business interest” in Russia can be distinguished along the lines of firm size.

### **Theoretical Perspectives and Literature Review**

These two main bodies of theory will guide the empirical analysis of this dissertation. Collective action theory is useful for understanding the relative weakness of the small business sector as a coherent interest. It provides insight into why SMEs may be more prone than their LE counterparts prone to advocate for an impartial administrative system and political accountability. It also illustrates the necessity of state involvement in subsidizing the costs of SME collective action if meaningful channels of representation are to be established. A critical perspective on capture theories provides a contrast to standard conceptions of business-state relationships in Russia. These theories tend to emphasize interaction at the middle to higher ends of the politico-economic spectrum. Capture tends to benefit participants via some kind of seizure or exchange. Smaller companies do not benefit from this system of corruption, but rather are victims of it. This may explain why they have an interest in advancing a reform agenda geared toward institutional modernization.

### **Collective Action in Action: SME Mobilization under Putin's Administration**

Collective action theory provides a useful point of departure for understanding the success and limits of SME mobilization in Russia. Olson’s theory of collective action begins with the premise that group behavior can not simply be explained as the amalgamated sum of the rational, self-interested preferences of a group’s constituents (Olson 1971). Just because a group of individuals share a common interest in an outcome does not mean they will efficiently organize to achieve that outcome. *Ceteris paribus*, smaller groups in which members share specific interests will organize more efficiently to advance those interests than larger groups, who face more significant costs in terms of reaching consensus among a larger amount of members. For Olson, the primary objective of collective action for groups of any size is the provision of public goods. Per Olson, “*the achievement of any common goal or the*

*satisfaction of any common interest means that a public or collective good has been provided for that group [italics in original]*” (ibid, 15).<sup>4</sup>

In his *Logic of Collective Action*, Olson (1971) argued that large groups face higher costs in organizing to provide public goods for their constituents than smaller groups. This is based on the logic that as groups become larger, interests become more diverse, and each individual actor has more incentives to “free ride” on the work of others. The public goods that are achieved via collective action are enjoyed by all, but pursued by few. Without strong selective incentives—i.e. benefits provided to group members for participation—few group members will actively participate in pursuing pursuing them. Russia’s SME community as a general grouping faces significant obstacles to collective action per Olson’s theory in its most reduced form: as a large, diverse, and geographically dispersed group lacking cohesive networks based on shared sectoral interests, organizing to achieve collectively beneficial goals presents significant challenges.

In Olson’s original formulation, the size of a group was a key determinant in whether individual, self-interested behavior would translate into effective group action and the provision of public goods for the group. The larger the group, the more fractional the potential individual benefit from collective action. The larger the group, the more likely it is to have members who “free ride” on the work of others. Anyone who has worked on a group project knows that certain members may not contribute as much as others, yet enjoy the benefits of the outcome produced (the ire of hard-working group members notwithstanding). Olson calls large groups in which no individual has an incentive to act because their action, or inaction, does not affect other group members, a “latent” group. Only coercion or the provision of “selective incentives”, or benefits that go only to group members, will members of latent groups be compelled to act in a group oriented way (ibid, 52). He states that “in a large group in which no single individual’s contribution makes a perceptible difference to the

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<sup>4</sup> Olson does not categorically distinguish the difference between a “collective” and a “public” good, and tends to use the terms interchangeably. This dissertation employs the terms somewhat interchangeably as well, although attempts to adhere to an intuitive understanding of each. A “collective good” refers to the relatively specific outcomes that are pursued by or serve the SME interest in particular, while a “public good” refers those outcomes that can benefit actors outside the SME community. However, a central argumentative thrust of this dissertation is that the collective goods pursued by the SME community encompass such a broad range of interests that “collective goods” for SMEs tend to manifest themselves as “public goods” for a broader constituency. In this sense, the distinguishing characteristics of each become blurred.

group as a whole...it is certain that a collective good will *not* be provided unless there is coercion or some outside inducements that will lead the members of the large group to act in their common interest” (ibid, 44).

Russia’s small business community in its current form represents what Olson calls a “mobilized latent group”. This is his term for a large group that has been co-opted to group action either by coercion or selective incentives (ibid, 51). Russia’s peak associations representing the small business community, OPORA, *Delovaya Rossiya*, and the Chamber of Commerce, are products of the state’s interest in mobilizing SMEs to achieve modernization objectives and reduce administrative corruption (Markus 2007). Membership in these organizations is voluntary, so SMEs are not coerced into participation. The selective incentives most often touted by these official organizations is the access they provide to the policymaking process and the legal support they can offer members faced with confronting administrative barriers and corruption (Yakovlev, Zudin and Golikova 2010).<sup>5</sup> Although notable outcomes have been achieved, as will be discussed in upcoming chapters, free ridership remains an issue. Many small business owners interviewed for the later sections of this thesis indicated that they had not even *heard* of these associations; those who had attributed little value to them or participated infrequently (Focus Group 2012, Small Business Consultant 2012, Medical Services Company Vice-Director 2012).

In Olson’s later works, he elaborated the nature of a so-called “encompassing” interest and its ramifications for society as a whole. Broad-based, non-sector specific associations would advocate policies more closely aligned with a general rather than particularistic interest (Olson 1982, Olson 2000). He discusses “peak associations”, or national confederations of interests, as “encompassing organizations” (Olson 1982, 50). These organizations “on average take a less parochial view [of public policy] than the narrow associations of which they are composed” (ibid, 50). Russia’s peak SMEBAs are at once manifestations of SMEs as a “mobilized latent group” and encompassing organizations,

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<sup>5</sup> According to OPORA’s website, the main objectives of the organization are to protect the rights and interests of entrepreneurs, to fight corruption, to create favorable business climates in Russia’s regions, to facilitate SME access to property and financial resources, and stimulate the development of entrepreneurial activity (OPORA Rossii(b) n.d.). *Delovaya Rossiya*’s mission statement is very similar, although it alludes to a democratizing function of business. Its objective is “in partnership with society and government, to achieve the development of Russia as a democratic country with a modern, diversified economy...” (Delovaya Rossiya n.d., para. 3).

comprised as they are of members of a large, non-sectoral grouping. They are “encompassing” in the sense that they are “special- interest organizations that encompass a substantial portion of the societies of which they are part” (ibid, 47). In 2013, there were more than 2.3 million entities in Russia that qualified as SMEs per the size definition of those companies employing up to 250 people (Russian State Statistics Service 2012). OPORA alone has 450,000 member firms representing about five million owners and employees (OPORA Rossii(a) n.d.). According to Olson’s theoretical perspective on these organizations, they have an incentive to consider the effects of their actions on society as a whole. The breadth of their interest as such a large grouping induces them to pursue outcomes that, in serving their interests also serve a greater social interest.<sup>6</sup> In the Russian case, the organized SME community’s push for impartial, non-corrupt administration as a public good for their collective interest serves both SME free riders and a the general public, who benefit from a more competent and accountable administrative structure.

Russia’s SME community has faced the problems of collective action as a latent group since the fall of the USSR, but the conditions of Russia’s transition prompted SMEs to both mobilize themselves and *be* mobilized. Incentives for mobilization came from above and below. Individual SMEs looked for ways to confront epidemic bureaucratic extortion rackets. At higher levels, forward-looking political authorities came to realize that a robust SME sector would be a key element in building a modern, innovative economy, and that Russia’s administrative apparatus was hindering this development. Political authorities at the regional and municipal levels became tied to Russia’s modernization agenda—be it substantively or rhetorically—as Putin consolidated authority around his power vertical. Tying the small business cause to this power structure incentivizes support for it among politicians across Russia eager to advance their careers within this domain. This confluence of interests from above and below has produced an alliance between high-level state actors and low-level private sector businesspeople. Skeptics may point out that this alliance is likely more rhetorical than substantive. As the analysis drills down to the municipal level, this criticism

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<sup>6</sup> Utilizing surveys of business association members and industrial enterprises, Pyle and Solanko(2013) tested Olson’s “encompassing interest” hypothesis. They found that members of less encompassing organizations were more likely to favor narrow government interventions in the economy—such as tax breaks, subsidies, tariffs, and competition-limiting regulations—than members of more broad-based coalitions. This finding led to their conclusion that the composition of a lobby group is related to the interests that group pursues. This carries the corollary implication that the more encompassing the organization, the more it will tend to favor government actions that serve a broader collective interest.

appears to have some validity. Many SMEs do not appear to participate in this alliance. But even if this SME support regime is purely rhetorical on the part of high-level authorities, it still gives ammunition to SME owners who increasingly appear to demonstrate resistance rather than acquiescence to the demands of rent-seeking officials. In this sense, the public goods attained through SME collective action are less about achieving a tangible political outcome such as a piece of legislation, but rather about creating a sense of empowerment and responsibility among this large group of citizens in the face of bureaucratic corruption.

#### A Note on President Putin

In the final work of his life Olson discussed the encompassing interest in terms of a single autocrat (Olson 2000). This perspective helps to explain the interest President Putin and his regional lieutenants may have in delivering economic prosperity and why they have ascribed such importance to SME development. Olson says that an autocratic leader “has an encompassing interest in his domain” because a prosperous society under his control is better able to provide benefits to the autocrat in terms of personal wealth and historical legacy (ibid, 10). “It is impossible,” he writes, “to explain growth under extravagant and self-interested autocrats without taking account of their encompassing interests” (ibid, 12). Autocrats are guided by what he calls “the other invisible hand” to provide prosperity to the general population, not because of altruistic intentions, but because it serves their self-interest (ibid, 13). Olson refers to findings that the longer the term of an individual autocrat, the more secure are the property and contract rights in a society. He attributes this to the autocrat’s interest in attracting capital, which gravitates toward areas with secure regulatory and legal frameworks (ibid, 43).

Putin’s motives in supporting Russia’s SMEs may be explained by this Olsonian conception. However, the intention of this thesis is not to examine the personal motives of the president. As such a polarizing figure, any action he takes is usually met with cynicism (especially in Western media), which is often grounded in subjective ideological or ethnocentric convictions. He has made countless declarations of support for Russia’s SMEs and supported billions of rubles in outlays to SME support programs (as did President Medvedev during his term).<sup>7</sup> He regularly meets with representatives from Russia’s SMEBAs

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<sup>7</sup> SME support funding derives from both federal and regional budgets. It is intended to support a number of areas of SME development, such as providing grants to start-ups, subsidizing interest rates on SME loans, developing microfinance, establishing business

and supported many legislative acts aimed at bolstering SMEs' economic standing. From his first years in office to the present day, President Putin has been nothing less than an ardent advocate of the SME cause and a frequent critic of bureaucratic barriers to business growth. In a meeting with representatives from the newly-formed OPORA in December 2001, Putin responded beseechingly to one participant's wish to build a constructive dialogue with government, saying "I implore you to do this [*Ya vas proshchu ob etom*]... We need concrete proposals, put forth in the form of legislation... We need just a few good suggestions to break through the Russian bureaucracy" (Strana.ru 2001, para. 14). Later that same month, in a meeting with the State Council on Small Business, Putin demonstrated a belief in the holistic value of the SME sector to Russia's economy:

Small business, which should be the foundation of the economy, developed spontaneously; and not because of, but despite the dedicated efforts of the state. Without the development of this sector, the Russian economy will not be able to get away from its excessive dependence on the energy sector and especially oil prices. If small business develops successfully, the state budget will grow regardless of fluctuations in the international market. This in turn will help the state address the social problems facing the population (RIA Novosti 2001, para. 11)

He noted in the same meeting that the main problem facing small businesses was "bureaucratic arbitrariness" [*chinovnichiy proizvol*], built on a dominance of "private auditing interests, working within the structure of the state" (ibid, para. 12). He expressed his consternation, saying that everywhere small businesses "are milked, but not fed [*doyat, no ne kormyat*]... Throughout the country the tyranny of the bureaucrats continues" (ibid, para. 18).

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incubators and clusters, supporting young entrepreneurs, in addition to a number of other areas. For a region by region, monetary breakdown of federal and regional SME support, see the Ministry of Economic Development's "Federal Program of SME Support" page at <http://smb.runetsoft.ru/measuresupport/programs/>.



“Milked”: This cartoon from a summer 2010 newsletter of the Moscow regional branch of OPORA shows an official happily walking away with his “fines” from a small business owner. The business owner is shown holding an “Inspection Result” certificate and with udders for easy “milking”.

Putin's ire at the situation for SMEs continued throughout his tenure as president and into his prime minstership. In a 2005 meeting with his ministers, the president criticized the government for not devoting enough attention to the SME cause. He was indignant at the continued difficulties entrepreneurs face in starting a business, saying "to register a company today is simply impossible...[it] is an affront to the people and to common sense... anyone who opens a new business, who registers their enterprise, should be given a medal for bravery" (Lashkina 2005, para. 3-6) In a resolution as prime minister in 2009, Putin called the SME sector "the most flexible part of the economy...it can quickly adjust to the demands of the market...The contribution of small- and medium-sized businesses to development, diversification, and modernization of the economy must continue to grow" (Altapress.ru 2009, para. 4)

Once again President in 2012, Putin established the office of business ombudsman as part of a campaign promise to strengthen the state's SME support regime (Rubchenko 2012). This office, filled by *Delovaya Rossiya* head Boris Titov, was specifically empowered to challenge bureaucratic infringements on the rights of entrepreneurs and small businesspeople.<sup>8</sup> In a meeting with OPORA later that year, Putin noted the constructive dialogue that had been built between government and SMEs, and emphasized the seminal

<sup>8</sup> See “The Ombudsman”, p. 79.

role of Russia's peak SMEBAs in its success. He commented that he remained committed to further SME growth: "In Russia, we have a large number of small- and medium-sized entrepreneurs, but it's still at a level far from what it needs to be... We have 21-22% [SME contribution to GDP]. In the US, it's 50%; China, 60% or more... We must move in that direction" (File-RF 2012, para. 3).

One does not need a theoretical framework to understand that supporting small businesses, even if just in a rhetorical sense, is simply good politics. A savvy, growth-minded politician of his status would never intentionally and directly take action *against* small businesses. Although Putin is certainly an intriguing historical figure, a central intention of this thesis is to move away from the *ad infinitum* discussions of his role in determining Russia's economic and political future. It is to move away from the "top heavy" state of social science research focused on business-state relations in Russia. This is not to say he is not an important figure for Russia's SMEs and will not feature in the following chapters, but for the sake of this dissertation, he will be referred to as something of a background character. He has shaped Russia's political and economic environment in a broad sense, and has consistently advocated for improved business climates at all levels. This is a rational and predictable strategy if we accept the tenets of Olson's theory of the autocrat with an encompassing interest (or just the common sense principles of modern politics). Like any country, Russia has complex internal politics and issues. No leader, no matter how powerful, can wave a magic wand and eliminate a hidden, deeply rooted system of corruption in a society; such is a process that takes generations. We will assume for the purposes of this dissertation that he has a genuine commitment to the principles of business growth as a function of overall economic development and leaving a lasting historical legacy. His controversial actions in other spheres, with which many pundits and activists take issue, are not the focus of this research.

### *Business Associations in Transition*

In our case, business associations (BAs) are the empirical manifestations of collective action theory. Prominent thinkers such as Adam Smith and Olson have derided the associational activities of businesspeople. Smith famously wrote in *The Wealth of Nations* that "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public..." (Smith 1776, Book 1, ch. 10, part 2). In *The Rise and Decline of Nations*, Olson sought to demonstrate that the amount of

special-interest groups and “distributional coalitions” in a country is inversely related to its economic growth. Olson’s classic formulation on the negative aspects of these business coalitions are: 1) they coalesce around their particularistic interests to form cartels (1982, 45); 2) they stymie innovation by using their collective power to inhibit the growth of competitive technologies which leads to sub-optimal outcomes for society at large (ibid, 65); and 3) as they grow in size and complexity, they reduce incentives to produce and increase incentives to capture a larger share of what is produced through organized lobbying (ibid, 72).

However, business associations have taken on a new theoretical significance as their role in the context of transition has been analyzed. Doner and Schneider (2000) examine a number of cases in which they serve as an independent source of policymaking expertise. Along with Pyle (2006), they challenge the view that BAs are inimical to the greater social interest. Pyle (2006, 492-5) states that “business associations have filled a post-communist institutional void” and that they “promote wealth creation by providing a rich array of services that facilitate investments in physical and human capital and the expansion of trade ties”. Doner and Schneider (2000, 262) echo this assertion, stating that BAs carry out “market-supporting” functions in that they “push underperforming states to provide the public goods only states can provide: property rights, uncorrupt administration, and infrastructure”. Furthermore, Frye (2002) found that in Russia, more than half of successful lobbying efforts by SME owners to achieve legislation favorable to their interest were carried out with the aid of a BA. A. Yakovlev (2009) uncovered a regional aspect of this model. A firm’s membership in a BA is an important condition of receiving various types of support from regional, as opposed to federal, authorities. If these firms were engaged in social development activities, such as contributing to the maintenance of public facilities and sponsorship of public-welfare campaigns, and what he labeled “modernization” activities, measured in terms of a firm’s participation in export markets, its capital investment and innovative activities, then the likelihood of support from regional authorities was further increased. These findings indicate that a firm’s lobbying activities via a BA mechanism have a greater likelihood of success if that firm contributes to the provision of the public goods generated from economic modernization and social development.

The conditions of transition are also crucial to understanding the dynamics of SME collective action in Putin’s Russia. Doner and Schneider (2000, 263) argue that BAs’ “market-supporting” functions

are most relevant in periods of creating and consolidating emerging capitalist economies...The context in which many associations operate is one of extensive state and market failures, and many association activities are designed to improve the functioning of both states and markets (rather than using their lobbying strength to distort well-functioning markets).

A common refrain among many analysts is that “business is not an interest group”, given the heterogeneity of its sectors and sizes (Olson 1971, 145, Hart 2002, Ziegler 1961). In mature capitalist economies with stable legal infrastructures, this certainly holds true. The business interest has diversified and need not concern itself with the provision of basic legal rights. But in post-Soviet Russia, diverse actors in the private sector have a common interest in favorable business climates built on a basic legal foundation of secure property rights and professional public administration (Pyle 2011, Pyle 2006, Markus 2007, Maxfield and Schneider 1997). Markus (2007, 302) says that in Russia, “the common outrage at the underdevelopment of market infrastructure and state predation...overwhelm[s] industry-specific differences”. The context of transition pushes the general business interest in Russia toward Olsonian “encompassingness”. From the perspective of a modernizing state with ambitious development objectives for the private sector, SME access to channels of political influence is crucial. Reliance on commodity exports has hurt Russia in the past during periods of economic shock; the growth of this sector represents a means to diversify out of that danger (Sutela 2005, Bossoutrot 2005, 6). Russia’s inefficient bureaucracy still hinders grassroots business growth, so providing SMEs with channels of access to challenge administrative abuse is a rational strategy to combat the obstacles to achieving Russia’s development objectives.

Markus (2007) argues that under the conditions of “debilitated dirigisme”—his term for describing the gap between the Russian state’s development aspirations and its capacity to induce its administrative agents to fulfill those aspirations—President Putin has enlisted the SME sector as an ally against the growth-hindering bureaucracy. This explains Putin’s delegation of authority to state-sanctioned SMEBAs (Markus 2007). Empowering the SME community, given they have distinct material interests to protect and are most often victimized by corrupt officials, is a means to bring independent local interests into the

modernization program with minimal state-cooptation. Under this regime, the SME community has achieved notable victories in legislation and judicial decisions.<sup>9</sup>

Two of Russia's main peak SMEBAs, OPORA and *Delovaya Rossiya*, were created in the early 2000s under the auspices of the Putin administration with the explicit intent to bring SMEs closer to the policymaking process and serve as a source of economic expertise (ibid). However, they are not "state agencies" as such but rather umbrella organizations to bring together Russia's myriad *independent* SMEBAs. OPORA is often described as "an association of associations" (OPORA Rossii n.d.).<sup>10</sup> They are forums to promote dialogue and provide a regularized channel of access to officials. By tying SMEBAs to his power vertical, the Putin administration induces local authorities to cooperate with SME interests.

Foster (2001, 84) discusses the various aspects of BAs co-opted by the state, noting that conventional wisdom suggests that BAs "closely linked with and penetrated by an authoritarian state are significant chiefly as symbols of state domination of society". He challenges this view, arguing that in many cases BAs are created to institutionalize the interface between the business community and the state to achieve specific development objectives. In many cases, independent business interests *actively seek* state sanction of their organizations. Achieving this has the effect of giving a business organization an "official" status. This dynamic can be seen when one compares the organizational capacities of small business groups in the democratic United States and those of authoritarian Mexico in the 20<sup>th</sup> century. In the US, small businesses struggled to create effective collective action organizations, and many groups actively sought government sanction (Bean 1996, Young 2010, Young 2008). Under the authoritarian regime of the *Partido Revolucionario Institucional* (PRI), Mexico's state-sanctioned SMEBA enjoyed regular access to policymaking authorities (Shadlen 2004). Pluralistic societies in which free and open competition among various groups is allowed and encouraged means that groups must devote more effort toward competing with each other rather than lobbying for actual political outcomes. State co-optation helps circumvent this effect. When Mexico democratized in the

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<sup>9</sup> Business interests are increasingly successful in local courts in cases against local administrative agencies. This will be examined in depth in subsequent chapters, but for a succinct list of accomplishments see CIPE and USAID, *Strengthening Local Democracy in Russia: The Case for Business Associations*, Case Study No. 505 (Washington, DC: Center for International Private Enterprise, 2006).

<sup>10</sup> OPORA is comprised of 102 branch unions, associations, and guilds (OPORA Rossii(a) n.d.)

late 20<sup>th</sup> century, its state-sanctioned SMEBA disbanded as it could not compete with the myriad SMEBA groups that emerged to vie for members (ibid). This is what Shadlen (2004) calls “democratization without representation”. In co-opting Russia’s small businesses to organize, Putin in effect subsidized their increased cost of collective action and ensured their representation in government.

### **Capture Models: Seizure, Elite Exchange, Grabbing Hand, or Helping Hand?**

“Capture” models have been the pervasive analytical tools with which many theorists have looked at business-state relations in Russia (Frye 2002, Frye, Yakovlev and Yasin 2009, Slinko, Yakovlev and Zhuravskaya 2005, Slinko, Yakovlev and Zhuravskaya 2002, A. A. Yakovlev 2006, A. Yakovlev 2009). “State capture” gained traction after Hellman, Kaufmann and Jones (2000) published their seminal work on the subject. They define it as “*shaping the formation of the basic rules of the game* (i.e. laws, decrees, and regulations) through *illicit* and non-transparent private payments to public officials [italics in original]” (Hellman, Kaufmann and Jones 2000, 2). Capture involves a firm paying for “*a la carte*” provision of legislation and regulations that benefit a particular firm. They distinguish it from “influence”, which is doing the same as state capture without recourse to illicit payments, and “administrative corruption”, which they define as the kinds of petty bribery involved in the implementation of existing laws. However, a capture strategy is beyond the reach or interest of many of Russia’s smaller firms. More often their interactions with the state are characterized by this conception of “administrative corruption”. The institutional outcomes of SME-state interaction thus begin with an altogether different impetus. Whereas relatively well-off firms, which tend to be larger, can devote resources to lobbying for parochial administrative concessions, smaller firms must suffer under a regime of widespread administrative corruption.

### **From “Grabbing Hand” to “Helping Hand”?**

The finding of this research is that the capture models used to analyze state-business ties in Russia break down at the level of smaller firms. One small business does not generate the revenues to incentivize outright seizure by the state. Those modest revenues also preclude it from systematically altering the “rules of the game” as stipulated under traditional state capture theory. However, some notable perspectives derived from the capture paradigm help to illustrate the incentives behind SMEs’ desire for a more modern administrative apparatus.

Yakovlev (2009, 1) notes that state capture is more applicable to relations between big business and higher levels of the state. He, along with Frye & Shleifer (1997) note that a “grabbing hand” model has traditionally afflicted those lower-level actors who do not possess economic leverage. Smaller firms are the subjects of extortion and corruption; they have little potential to benefit. The more substantial financial resources and political leverage held by higher-level actors allow them to play the capture “game” and win substantial rewards.<sup>11</sup> Frye, Yakovlev and Yasin (2009, 32) argue that Russian state-business ties at lower levels are caught between a “grabbing hand” and “helping hand” model of interaction. According to Frye & Shleifer (1997, 354), a “grabbing hand” model is characterized by an interventionist, but disorganized government whose bureaucratic officials pursue their own agendas and seek rents. Although they may give lip-service to economic development goals, they are by and large independent of the courts and can impose fines on business at will (Frye and Shleifer 1997). However, this could be giving way to a “Chinese-style helping hand” model as relationships between state officials and SME owners become regularized via interaction mechanisms such as BAs (A. Yakovlev 2006, A. Yakovlev 2009). In this model, bureaucrats “are corrupt, but corruption is relatively limited and organized” (Frye and Schleifer 1997, 354). Pervasive in Asian developmentalist states, this model is characterized by an interventionist bureaucracy that plays a central role in administering economic development programs and managing local-level economic growth (ibid). Analyzing the tension between these two models, *and the net effects of the forces driving them*, is a fundamental aspect of understanding Russian SMEs’ potential to influence the administrative apparatus from one characterized by systemic corruption to one built on a Weberian legalistic framework.

The reassertion of state authority under Putin’s administration vis-à-vis Russia’s strategic enterprises gave rise to the idea that instead of influential companies “buying the

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<sup>11</sup> This manifests itself frequently in the practice of “raiding” (*reyderstvo*), whose closest analogue in developed legal systems is the hostile corporate takeover. However, this practice goes far beyond that of its counterparts in other parts of the world. “Raids” are organized by political officials, bureaucrats, and businessmen, who target a lucrative enterprise for takeover. They then use the courts, security services, and bureaucracy—whose agents will receive kickbacks for their help—to seize the target property. Tactics used in raiding have involved everything from bribery and forgery to physical intimidation, violence, and kidnapping. The distinction between “state capture” by business and “business capture” by the state becomes blurred, as state and business actors work together to seize a target property. See Osipian, Ararat. “Corporate Raiding Russian Style: Hostile Takeovers via Corruption and Fraud.” Paper presented at the annual conference of the American Political Science Association (APSA). Washington DC, 2010.

state”, the state itself was capturing business (A. Yakovlev 2006). This was most dramatically illustrated in the effective nationalization of much of Russia’s oil industry as a result of the YUKOS affair. A more nuanced view of business-state relations in Russia has been put forward by Frye (2002) and Yakovlev (2006 and 2009), who find that *strategies of firms and government agencies vary by level of government and type of firm*. The capture dynamic is most apparent at the federal level, where the most lucrative strategic industries operate (ibid). But at the regional and municipal levels—where SMEs gain more relevance—the relationship is based much more on an exchange model (A. Yakovlev 2006, A. Yakovlev 2009). Yakovlev (2009) found that membership in a business association increased the likelihood of a firm obtaining administration concessions from regional authorities. This may indicate that these authorities are beginning to view BAs as a useful channel for interacting with local business forces.

In explaining the success and limits of SME mobilization in Russia as it pertains to influencing institutional development, capture theories are useful for understanding the negotiated process of institution-building and the incentive structure behind it. With institutions “up for grabs”, the incentives to influence how they are shaped are powerful. Fligstein notes that as countries develop, “the demand for laws or enforceable understandings is high, and that once such understandings are produced, demand decreases” (Fligstein 2008, 165). Advanced industrialized economies tend to have well-established norms and procedures for channeling business interests via legitimate lobbying mechanisms. Indeed, modern political lobbying can be thought of as little more than institutionally legitimized and regulated state capture. In Russia, the process of what constitutes “legitimate” political influence is still being negotiated.<sup>12</sup> However, as SMEs are largely subject to the “grabbing hand” model of business-state interaction rather a lucrative capture model, their incentives for political action are markedly different than those of larger firms. Furthermore, the way bureaucratic abuse induces SMEs to organize to resolve their common issues, coupled with state subsidization of the costs of collective action via state co-opted SMEBAs, tends to produce a different set of institutional outcomes than those produced by the capture activities of larger firms. Put crudely, the former produces transparent, inclusive institutions to

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<sup>12</sup> “Lobbying” in Russia’s carries a pejorative connotation as it is largely unregulated and is widely associated with nefarious backroom dealings between business interests and government officials (Bryantsev and Baranova 2008).

accommodate a wide array of interests while the latter exacerbates the clientelistic relationships that underpin Russia's systemic corruption.

### **SMEs, the State and Bureaucracy in Historical Perspective**

Gill's (2008) comparative historical analysis of bourgeois involvement in determining the nature of political institutions in post-Soviet Russia, the UK, the US, France, and Germany is grounded on the premise that it was how the bourgeoisie integrated into institutional structures that determined the political trajectory of the system. Echoing the seminal work of Moore (1966), he argues that the crucial determinant of how bourgeois classes influenced political institutions came from the nature of its relationship with the state. In many cases they had allied with the state and landowning classes at the expense of greater democracy, as was the case in Japan and Germany. In others, no such alliance existed. In England, as the bourgeoisie grew in economic clout beginning in the late 16<sup>th</sup> century, the state, still relatively weak compared to its modern form, had to make room for them in the political process via the institution of Parliament (Moore 1966).

Using this framework to analyze small business-state dynamics in Russia presents some unique theoretical challenges that have little precedent in history. Although parallels can be drawn, Russia's SMEs are not a "bourgeois" class in the strict Marxist sense. They resemble more the *petite bourgeoisie* of Marx's conception in that they are owners of capital, but do not control the means of production and their modest revenues prevent significant accumulation of capital (Marx and Engels 2008, 69). Russia's business classes did not emerge as a result of a long-term, organic evolution that paralleled the growth of a modern state (Gill 2008). Rather, they emerged suddenly in the early 1990s. Although it weakened significantly during that decade, the state remained a monolithic force in Russian life. For decades, it had been the guarantor of the population's welfare. A negotiated process of alliance building over the course of generations between state, bourgeois, peasant, and landowning classes to determine a political outcome was not possible. As Gill (2008, 268) notes, "The relationship with the state was fundamental to the emergence and development of Russian business [in the 1990s]". The key priority for the state was to regain its ability to govern. And for the private sector, the key priority was to shape the inchoate institutions of the early system as much as possible.

The state actors most closely tied to Putin's power vertical have made significant efforts to build a strong alliance structure between SMEs and the state. This is not to say that LEs do not enjoy practical—and often corrupt—relationships with powerful political figures within the power vertical, *but this is not at the rhetorical crux of the modernizing ethos of Putin's Russia*. Furthermore, it is important to distinguish “the state” as comprised of political figures elected or appointed to office and low-level bureaucratic agents responsible for the on-the-ground implementation of modernizing reforms. Acute principal-agent dilemmas have emerged as state “principals” within the power vertical struggled to induce low-level administrative agents to conform to the spirit of Russia's economic modernization by not extorting rents from Russia's relatively powerless SME sector (Markus 2007). According to Markus (2007, 278) the logic of “debilitated *dirigisme*” motivated “the state as the principal to seek non-state organizational allies as alternative vehicles to formulate and implement policy. The gap between the state's ambitions and the institutionally circumscribed capacity of its bureaucratic agents promotes formal mobilization of business forces”.

The officialdom has long been viewed with disdain in Russia, with the term *chinovnik*, meaning “official” or “bureaucrat”, carrying a pejorative connotation (Gimpelson, Magun and Brym 2009). Although the bureaucracy has grown under Putin's administration (A. Yakovlev 2006), this is likely more a function of its tendency to self-perpetuate rather than of explicit design. “The bureaucracy is expanding to meet the needs of the expanding bureaucracy” is a useful, if cynical way to explain this bureaucratic inertia.<sup>13</sup> The officialdom has become everyone's enemy. It stands in the way of the state's development objectives and is a continual obstacle to efficient business operations. At the 13<sup>th</sup> Congress of the Russian Union of Industrialists and Entrepreneurs in 2003, President Putin asserted his unequivocal sentiments pertaining to Russia's bureaucracy:

Active work is now in progress on optimizing the structure and functions of the still rather unproductive bureaucratic apparatus... We realize what resistance these reforms arouse in officials who have become used to giving their powers a broad interpretation and who only know how to authorize, distribute, restrict, and decide for others... Any excessive bureaucratic powers must be viewed as abuse (Markus 2007, 292).

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<sup>13</sup> This quote has been attributed to Oscar Wilde, although its origins are debated.

Russia is thus caught in a catch-22: the bureaucracy remains the only institutional apparatus capable of administering the process of modernization, while it is also the most significant obstacle to Russia's modernization.

Despite the argumentative thrust of this thesis, Russia's administrative system is still highly personalistic and corrupt. Mueller's (1989, 241) "iron law of rent-seeking" stipulates that "wherever a rent is to be found, a rent-seeker will be there trying to get it". Kickbacks (*otkaty*) and "a la carte" provision of subsidies and tax breaks to firms with close ties to the government are the higher level manifestations of this system. At lower levels, each bribe paid or extorted to a petty official further perpetuates it. The bureaucracy represents the nexus between government agents seeking rents and independent actors willing to pay them.

However, the emerging alliance between the state and small business may portend significant changes to grassroots relationships between the private sector and state officials. This is likely to be much more an evolutionary process than a revolutionary one. The institutions required to bring small business into the fore in the struggle against corruption require forums to represent an encompassing array of diverse economic interests. Pragmatic political officials understand that smaller businesses—confronted as they are by the collective action problem—must be given a legitimate voice in a public sphere to bring attention to administrative corruption. Business associations are crucial to aggregating and channeling those interests. The state's sponsorship of encompassing SMEBAs incentivizes local political support of SMEs from two directions. From above, supporting the SME community is a means to ascend Russia's power vertical. From below, it is a means to demonstrate a tangible commitment to local economic development, thereby increasing supportive politicians' political standing. As an element of Russia's nascent middle class, SMEs continue in the tradition of requiring representation in political institutions to advance their interests.

### **A Brief History of Small Private Enterprise in Contemporary Russia**

Considering that the collapse of the Soviet Union left millions unemployed as formerly state-owned enterprises were privatized or shut down, it should come as no surprise that there was considerable growth in the SME sector in the early 1990s. When the starting point is zero, the only place to go is up. In Soviet times, there were legal provisions for "individual labor activity", although the only work that was officially sanctioned was in the realm of traditional handicrafts and reached a small segment of the population (Buyske

2007). Gorbachev relaxed the situation for private enterprise through passage of a series of laws that made the regulations surrounding private economic activity more flexible and expansive (Ermakov 1996). However, the state command mechanisms of the economy made significant growth of the SME sector impossible.

This situation changed radically in 1991. With the collapse of the command economy and the rapid influx of market-based relations, the threat of poverty became a reality for many Russians. Bossoutrot (2005, 10) argues that “small-scale entrepreneurship emerged as a response... [and it] played a critical role in preventing low-income and/or unemployed individuals from falling into poverty”. In a decree by the Russian Council of Ministers entitled “On Means to Support and Develop Small Enterprises in the Russian Federation”, for the first time the state officially acknowledged the role smaller businesses would play in the future development of the Russian economy. This decree defined small business on the basis of number of persons employed, and provided tax incentives and other means of support for their development (Chepureenko and Vilensky 1996).

The decade following the USSR’s dissolution was when the tumult of the transition from a command to market economy was most painful. However, according to those interviewed by Buyske (2007), the two defining economic traumas of that period, namely the implementation of “shock therapeutic” reforms with the intention of invigorating the economy and the 1998 financial crisis actually ended up as economic boons for small entrepreneurs. Shock therapy was the policy prescription of “Washington Consensus” neoliberal economists who influenced Russian policymakers in the 1990s. It prescribed rapid price liberalization, privatization of state assets, and other forms of deregulation (Fish and Choudhry 2007). Implementing these reforms created a pool of unemployed workers as inefficient state enterprises were downsized in an effort to streamline their operations. The process of privatization pushed this pool of workers into “subsistence entrepreneurship”, but also encouraged local consumers to buy local products as opposed to expensive foreign imports (Rogers 2006, Gill 2008). The 1998 financial crisis illustrated SMEs’ resilience and adaptability (Bossoutrot 2005, Buyske 2007). Their diversification, relatively limited involvement with the banking sector, and preference for holding US dollars to rubles insulated them from the devaluations that characterized the crisis (Gill 2008). Although their reduced ability to import goods and their customers’ decreased purchasing power negatively

impacted their businesses, they emerged from the crisis relatively unscathed and in some cases, in even stronger positions than before (Buyske 2007, Gill 2008).

Public perceptions of Russia's business community in the 1990s and 2000s were largely informed by two factors: the unscrupulous machinations of Russia's oligarchs and a continuing commitment by many to the ideals of Soviet communism (Gill 2008, Sakwa 2008). In the 1990s, oligarchs who acquired billions through less-than-ethical means dominated the economy and politics. "*Biznes*" in Russia came to connote gangsterism and shady dealings with officials, which contributed to Russia's "Wild East" image in the 1990s (Sakwa 2008, 287). Many otherwise honest business owners had to resort to local mafia connections as a means to protect their property from seizure by more powerful actors, be they in government or a competitor in the private sphere (ibid). This reinforced the Soviet mentality still pervasive at the time—recall that in the USSR private enterprise was deemed illegal as "speculation"—that capitalism and free markets were unstable.<sup>14</sup> Furthermore, at this time there was no "power vertical" as would appear under Putin that put so much emphasis on small business development.

The Putin and Medvedev administrations prioritized SME development because they expected SME growth to promote economic diversification, increase employment, and ease regional disparities (Bossoutrot 2005, 6). During their times in office, the presidents have maintained their support of SME growth. However, leading members of the community were frustrated by the continued administrative harassment and infrastructural underdevelopment at the regional and municipal levels. This prompted SME owners to work collaboratively to improve their lot. SMEBAs such as the Union of Business Associations of Russia (OPORA, est. September 2002), *Delovaya Rossiya* (est. October 2001) and the Chamber of Commerce and Industry (CCI) emerged to advocate for SMEs throughout Russia (Markus 2007). Although created under the auspices of central authorities (the CCI was a Soviet creation), they represent independent interests and autonomous regional associations of all sizes (CIPE and USAID 2006). Critics charge that as state-sanctioned organizations, they can be too closely tied to Putin's power vertical and their leaders concern themselves more with

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<sup>14</sup> Sakwa (2008, 357) notes this perception, but also that it should not be overstated. Although there was disillusionment with free markets as they were perceived in the early 1990s, the problem many Russians had was not with markets themselves, but the way they were established in Russia.

advancing their political careers than a small business interest (Moscow Academic 2010). Whatever their weaknesses, Russia's SME community has gained significant attention as a result of these organizations' campaigns.

### **The Russian SME Community Today: Problems and Prospects**

The support of the presidency and increasing influence of Russia's SMEBAs improved the situation for SMEs when compared to the turbulence of the 1990s. Yet challenges remain. The bureaucracy and lack of financial services continue to inhibit SME growth. A well-intentioned tax structure that allows smaller firms to pay a flat tax—the Single Tax on Imputed Income<sup>15</sup>—actually encourages many small firms to stay small: because small companies enjoy this simplified system of taxation, companies with growth potential end up disaggregating into smaller units to retain the advantages of being a small company (Boussoutrot 2005).

Regional disparities also characterize SME development, with most new firm creation concentrated in the urbanized Central and Northwest Federal Districts (which include Moscow and St Petersburg, respectively) (Kontorovich 2005). Boussoutrot (2005) cites a study by the Russian SME Resource Center that found a correlation between the level of socioeconomic development and the number of small enterprises registered either as sole proprietors or incorporated as legal entities. She speculates that this is a reflection of the higher unemployment rates in less developed regions, where “forced entrepreneurship” is the only means of survival for many, in contrast with developed regions where more favorable business conditions encourage entrepreneurs to officially register their operations as incorporated entities (2005, 13).

The 2008 financial crisis had a negative impact on Russia's SME community, but they have grown beyond their pre-crisis level in most spheres (see quantitative indicators below). SME owners cited reduced demand as their most significant difficulty as a result of the crisis, followed by the lack of access to loans (Sharov 2009, Lopatin 2009). In Russia's less developed regions, the banking system has yet to establish itself as a reliable source of microfinance. This stems from the practical associated with establishing retail outlets in smaller, geographically isolated towns and villages (Bossoutrot 2005). Quantitative data on

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<sup>15</sup> ...“*Edinyy nalog na vmenenny dokhod*” or ENVD.

the growth rate of SMEs indicate that the sector grew steadily—at least in terms of absolute number of SMEs—despite the crisis (see Figure 1 below) (Russian State Statistics Service 2011).

Many indicators show the trend for SMEs will be one of growth in an improving business climate. Russia now leads the BRIC countries in the World Bank’s 2013 “Ease of Doing Business Index” (Adomanis 2013, Ostroukh 2013, World Bank Group 2014). In that index, it is lauded as one of the “most improved” economies out of the 189 economies surveyed. It is also the “biggest mover” in its peer group, moving a total of 31 places to 92<sup>nd</sup> (ibid). Surveys and interviews show that mafia-based transactions are no longer cited as one of the concerns of SME owners (OPORA Rossii 2008). They have expressed concern for the rising level of competition, which on balance is a positive development for the SME community (Shchetinin, et al. 2005, Bossoutrot 2005, Buyske 2007). New laws implemented at the national level aimed at reducing the number of bureaucratic inspections SMEs must undergo appear to have achieved notable results.<sup>16</sup> A 2003 World Bank study of twenty thousand SMEs in 20 regions in Russia showed that within six months of implementing laws to reduce bureaucratic obstacles to SME operations, the number of inspections was reduced by 26%, the number of licenses required to start a business was reduced by the same amount, while the average term for the license was lengthened and they were granted more rapidly (Bossoutrot 2005). SMEs’ contribution to Russia’s overall GDP still hovers around 20%, when in most advanced industrialized countries that number hovers between 60% and 70% (Sakwa 2008, File-RF 2012).

### **The “Large N”: Quantitative Evidence for SME Effects on Institutional Modernity**

In the years since Putin took office, the SME sector has been growing in terms of the absolute number of enterprises, revenues, and investment activity. While this research project has been carried out, SMEs’ contribution to GDP has risen from approximately 17% in 2008 to approximately 21% in 2012 (Russia Today 2008, File-RF 2012).<sup>17</sup> The below charts illustrate some key SME development indicators:<sup>18</sup>

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<sup>16</sup> See chapter two.

<sup>17</sup> These numbers are somewhat anecdotal. These sources refer to statements made by President Medvedev in 2008 and President Putin in 2012. The source of these indicators and

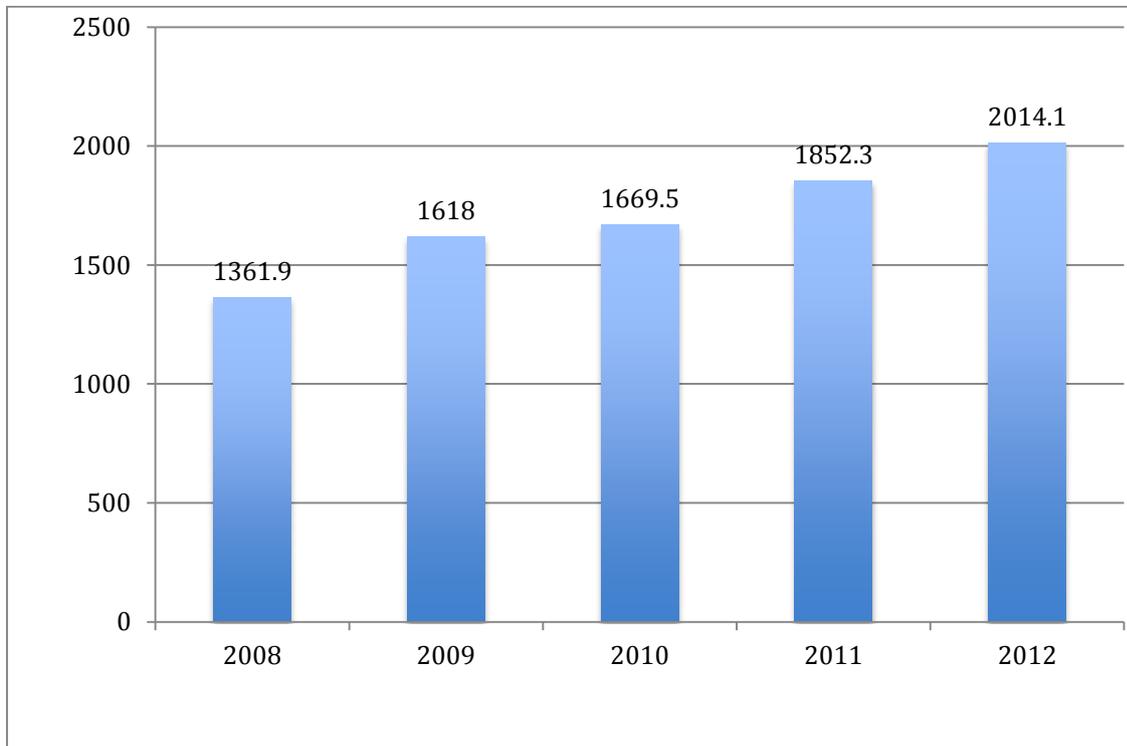


Figure 1: Number of SMEs in Russia 2008-2012 (including microenterprises), thousands, Russian State Statistics Service 2013

how they were measured were unclear. Figure 5 provides a visual representation of SME revenues as a proportion of Russia's GDP from Russia's State Statistics Service.

<sup>18</sup> Federal Law 209 "On the Development of Small and Medium-Sized Enterprises in the Russian Federation", which established medium-sized enterprises for the first time as a quantifiable entity, came into force on January 1<sup>st</sup> 2008 (RCSME 2009). For this reason data is provided from this year onward. Before this, small enterprises were categorized according to the 1995 law "On State Support of Small Entrepreneurship in the Russian Federation". They were those firms employing less than 100 people in industrial production, civil engineering, or transport; 60 or less in agriculture, science, or engineering; 30 or less in retail trade or consumer services; and 50 or less in other sectors. Ownership of an enterprise by state, municipal, religious, charity, or non-governmental organizations was also not to exceed 25% (USAID/RCSME 2004).

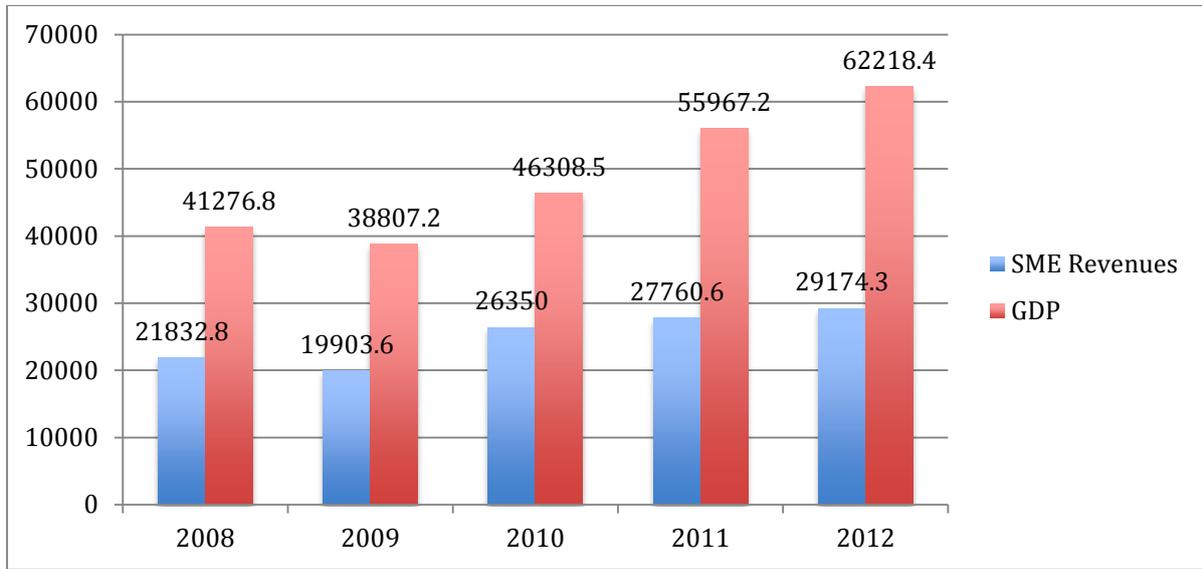


Figure 2: SME Revenues (value of sales of goods and services before VAT, excise, and similar payments) in Russia 2008-2012 (including microenterprises), compared to GDP at current prices, billions of rubles, Russian State Statistics Service

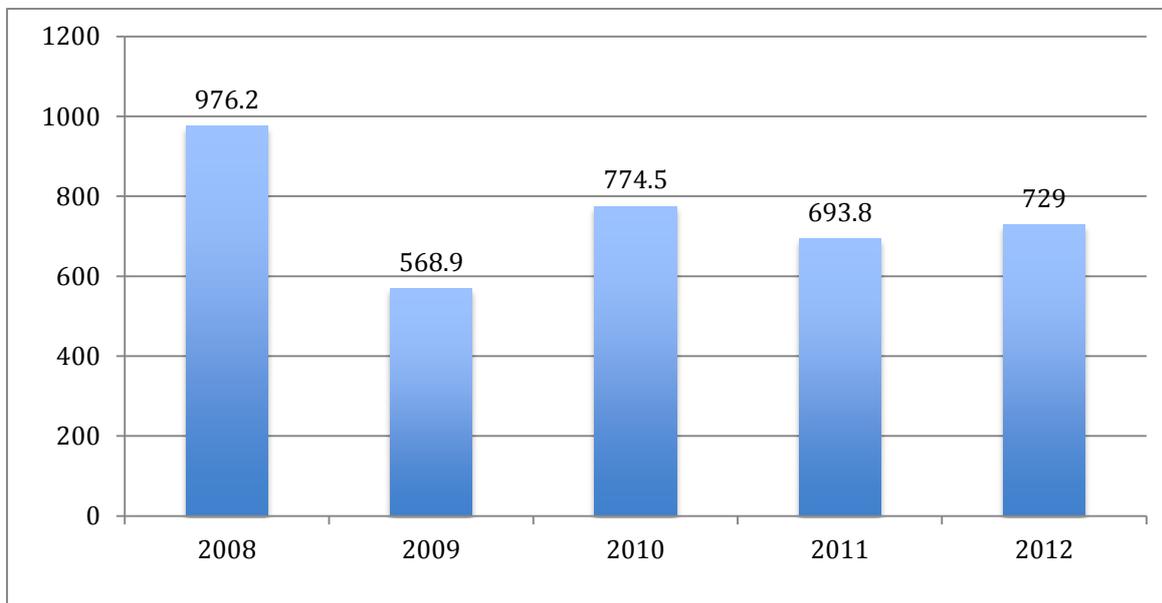


Figure 3: SMEs' Investments in Fixed Capital 2008-2012 (including microenterprises), billions of rubles, Russian State Statistics Service

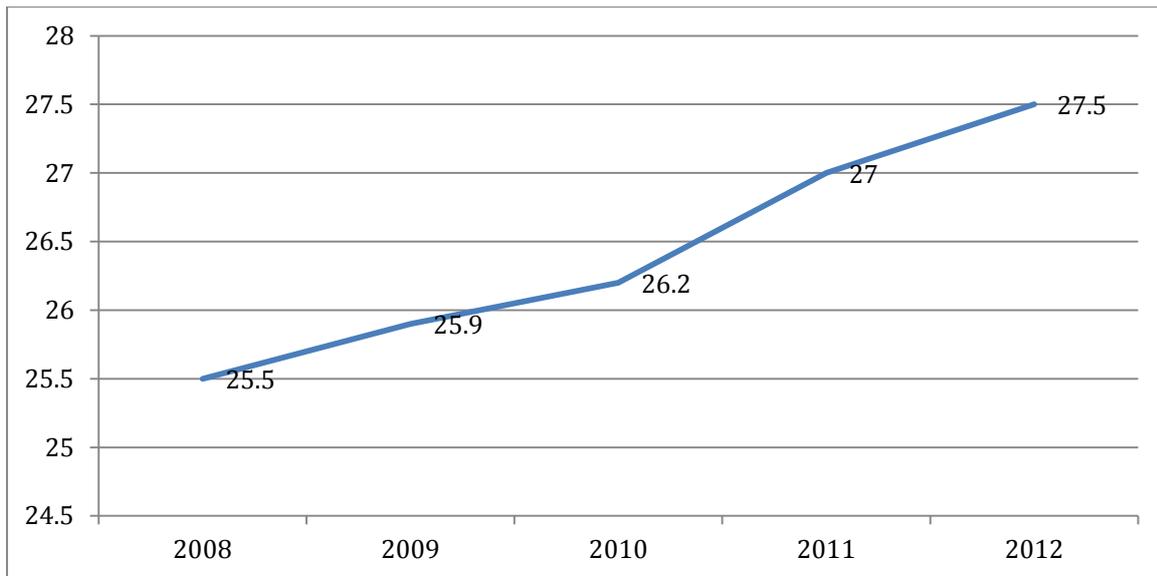


Figure 4: Percent of Russian Workforce Employed with SMEs (excluding part-time or contract workers), 2008-2012, Russian State Statistics Service

There is a fair amount of statistical evidence pointing to a relationship between the SME community and the quality of political institutions in Russia. O'Neal (2012) examined the relationship between the prevalence of small firms by region and Petrov's (2004) index of regional democratization.<sup>19</sup> She measured small firm prevalence in terms of the number of incorporated small companies employing between 15 and 100 people for each one thousand people in the labor force. She found positive, statistically significant correlations between small business prevalence and higher regional democracy scores on Petrov's index.<sup>20</sup> The role of SMEBAs was central to her research. She argued that they played a key role in promoting civic engagement among members of the business community, which in turn

<sup>19</sup> "Democratization" serves as her indicator of good governance and institutional modernity. Nikolai Petrov of the Carnegie Moscow Center has compiled two sets of democracy rankings for Russia's regions (N. Petrov 2004). The first (DemPetrExpert) comes from expert evaluations of 88 Russian regions based on data collected from 1991-2001. Out of 50 possible points, experts ranked each regions based on ten separate political spheres: 1) openness of political life; 2) practice of free, fair, and competitive elections; 3) extent of political pluralism; 4) degree of media freedom; 5) extent of economic liberalization and privatization; 6) civil society development; 7) political regime characteristics; 8) turnover of political elites; 9) degree of corruption; and 10) the extent of local, elected self-government. His second dataset (DemPetrElect) is based on electoral statistics from 1999-2002. The level of democracy in each region was assessed on regional and federal level indicators of voter turnout, the competitiveness of the races, negative voting, and reported violations of election law. The arithmetic mean of 11 rankings in these categories gave regions a composite score ranging from 2.4 to 8.3 (higher numbers representing less democratic regions).

<sup>20</sup> Her key finding shows that from 2005-2009, for each additional SME per thousand of the workforce, the democracy score for a region rises by .25 units (O'Neal 2009, 68).

explained how they may contribute to the strength of democratic institutions in the regions she surveyed. This finding helps to justify the core hypothesis of this thesis, that the “robustness” of the small business community affects the quality of political institutions toward “modernity” through the collective action process. Along these lines, Frye (2003) found that owners of private firms established after 1989 and that have never been under state ownership were more likely to support liberal politicians and democratic procedures. This may be tied to their generally weaker ties to state officials and thus a potential desire for a more fair, less clientelistic system of business-state interactions (Frye 2003, 27).

Duvanova (2007, 50) found a "positive, statistically and substantively significant relationship" between firms' perceptions of corruption and the likelihood of their being members in a BA. Her hypothesis is directly relevant to the empirical inquiry of this dissertation. She explores the idea that widespread corruption at lower levels of the economy actually increases BAs' strength as firms try to find ways to confront corruption and to build an infrastructure of legal support. She says that "the effects of bad governance not only impede economic growth and the functioning of markets, but also mitigate its negative effects on economic actors by stimulating institutional development from the bottom up" (2007, 442). Her findings show that corruption can actually increase bureaucratic probity, because it prompts businesses to organize to develop legal mechanisms to fight against it. This finding begins to shed light on a potential causal mechanism behind the thesis of this dissertation, that SMEs are inclined to pursue administrative modernity—or "bureaucratic probity"—because of the conditions under which they suffer as subjects of the "grabbing hand" of the state.

Kontorovich (2005) applies statistical analysis to analyze a number of “geographic” factors behind small business density in Russia. He finds that “agglomeration matters”, that urban environments create the most favorable conditions for small business development. In short, the more SMEs there are, the more favorable the business climate. Yakovlev, Zudin and Golikova (2010) find that members of business associations tend to be larger small firms located in regional capitals. Perhaps the positive effects urbanization has on SME density also affects regional business climates as a function of associations’ activity. Russia’s regions are quite heterogenous in terms of political and leadership structures (Petrov and Titkov 2010, Sakwa 2008). Business-friendly leadership may encourage a “helping hand” model in some regions, while in others the “grabbing hand” model prevails. Frye, Yakovlev and Yasin

(2009) found that business owners and managers of local firms who indicated they would likely re-invest some of their profits back into their businesses at the end of each fiscal year were also those more likely to report more favorable treatment from local administrative authorities. This indicates a financial dimension to small firm influence: the better off they are, the more likely they are to have a positive relationship with government.

This body of statistical evidence points to an association between smaller companies, better business climates, more productive interactions with authorities, and democratic governance. They provide a statistical rationale for the central thesis of this dissertation. The aim herein is to provide empirical depth to these "large n" findings, and to identify a potential causal mechanism underlying SME interests and institutionally modern forms of governance.

### **Hypotheses: Elaborating the Model**

From the outset, this research has been guided by the hypothesis that small businesses are natural “democratizers” in that they prefer democratic procedures and political accountability as a means of influencing institutional outcomes. To lobby for favorable legislation, SMEs must bargain and reach consensus with their peers, typically via a SMEBA mechanism, and act collectively to pursue a broadly appealing outcome (Olson 2000, Frye 2002, Pyle 2011, Yakovlev, Zudin and Golikova 2010). An individual small business owner, unaffiliated with a SMEBA, does not possess the kind of “soft leverage” necessary to dissuade an official from harassing her company or demanding a bribe. In contrast, LEs do possess that kind of leverage given their status in many regions’ economies, and are more inclined toward personal, informal pursuit of particularistic advantage from the state. From the days of robber baron capitalism in the US to those of the oligarchs in contemporary Russia, financially well-endowed interests influencing politicians conjures up images of smoke-filled rooms where powerful men in expensive suits make deals over cigars and whiskey. Countless examples illustrate the veracity of this popular perception, but the simple rationale behind it was summed up well when a Russian official from Pskov commented, “One factory provides more revenues than all the small businesses put together” (Gehlbach 2008, 12).

SMEs represent the independent variables of this research. SMEBAs and individual SME owners represent explanatory sub-variables. “Public goods” are framed in terms of “modern” political institutions, and represent the dependent variables. A “public good” is viewed according to the Olsonian conception that it is “any good such that, if any person...in

a group... consumes it, it cannot feasibly be withheld from others in the group” (Olson 1971, 14). Even those who do not pay for the provision of the public good can enjoy the benefits. Olson states that a “public good” does not have to benefit the general public (although he does not exclude that outcome), but rather provides benefits to the interest group who lobbied for its provision.

This dissertation focuses on how SMEs and their collective action within SMEBAs affect the provision of various forms of public goods. The evidence indicates that in seeking public goods, SMEs also affect the representativeness, responsiveness, and transparency of political processes in various forms. Borrowing the terminology of capture theories, how and why SMEs and SMEBAs work to reform business-state interaction from a “grabbing hand” to a “helping hand” model is a central feature of the analysis.

The empirical data collected to test this hypothesis demonstrates that the nature of the collective action problem induces the SME community in Russia to act as an “encompassing interest”, which is Olson’s (2000) term for a group that represents a wide array of interests, and is therefore more likely to pursue outcomes that serve a broad public good. These are organizations that are more likely to press for policies to promote growth throughout the entire economy than firm- or sector-specific organizations (Olson 1982, Olson 2000, Maxfield and Schneider 1997). Russia’s main SMEBAs represent what Olson dubs “peak associations”, which are national confederation of business that advocate for a general business interest (these will often be referred to as “peak SMEBAs” throughout this dissertation). Such interests contrast with narrow, sector-specific “distributional coalitions” that use their financial power and lobbying expertise for parochial aims (Olson 1971).

But the collective action problem only provides part of the explanation for the dynamics of small business mobilization in Russia. Classic collective action theory stipulates that SMEs represent such a broad array of interests, and is so large, diverse, and geographically scattered that they will face significant obstacles in organizing to pursue that interest. According to Olson (1971, 36), “the larger the group, the less likely it will be able to provide the optimal amount of collective goods to its members...the larger the group, the less it will further its common interests”. This is where the context of Russia’s transition comes in to further explain SMEs relative success in organizing for collective action. Following the Soviet Union’s collapse, Russia underwent a period of “neo-feudalization” (Sakwa 2008): central authority was highly debilitated and regional actors dominated Russia’s provinces. A

small group of oligarchs controlled most of the nation's wealth, which it could leverage against the state to attain even more.<sup>21</sup> The 1998 financial crisis demonstrated Russia's susceptibility to the vicissitudes of international markets. This was especially pronounced given its reliance on primary commodities exports (Sutela 2005). The state struggled to cope with these circumstances and to maintain legitimacy amongst the general population.

Enter Vladimir Putin in January of 2000. The state's dependence on the oligarchs, a debilitated and corrupt administrative apparatus, a highly fragmented political economy, combined with a vulnerable resource-based economy compelled his heavy-handed reassertion of state authority early in his administration. Following a long tradition in its history dating from Peter the Great, Russia once again had to play catch-up with the modern world. Once again, statist methods were the means by which it would.<sup>22</sup> However, the agents that had traditionally carried out the administrative aspects of Russia's modernization programs—be it during the tsarist or Soviet era—were part of the problem. Russia's bureaucracy had deteriorated into a complex of corrupt, rent-seeking officials who exploited its impenetrable and loophole-ridden legal code to extort local businesses. Smaller companies suffered the brunt of this, and it was smaller companies whom Putin would come to enlist as key allies in combating the systemic corruption that hindered Russia's development objectives (Markus 2007).

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<sup>21</sup> This was evidenced in the “loans-for-shares” affair, in which Russian commercial banks lent the federal government money in exchange for shares in Russia's largest companies. The government eventually defaulted on these loans, and the banks kept their shares. The resultant “fire sale” allowed those with enough capital to buy some highly lucrative industries at very low prices. This led to the emergence of Russia's fabulously wealthy and infamous oligarchs, who were complicit in developing the plan. This scheme and the oligarchs' other improprieties would eventually lead to the formulation of Putin's “equidistance doctrine”. This was a political maneuver on the part of Putin that exploited widespread public disaffection with the oligarchs' dubiously-attained wealth. This both increased Putin's public popularity and eliminated his most significant sources of political competition.

<sup>22</sup> This assertion draws from the seminal work of Alexander Gerschenkron, who argued that a country's relative degree of “backwardness” in terms of the timing of its industrialization determined the degree of state penetration into the economy. Those countries (Russia was central to his analysis) that had to “catch up” required significant, large-scale state investments to make the technological and engineering leaps necessary to compete with early industrializers (Gerschenkron 1962).

## A Qualitative Model<sup>23</sup>

SMEs represent the independent variables throughout this dissertation. In particular, *de novo* small firms are central to the analysis.<sup>24</sup> The dependent variables are defined in terms of the kind of public goods that emerge along the causal path illustrated below. Two sub-models—the *Status Quo* and the *Emergent*—illustrate the causal relationship under different historical conditions.

### Variables

Variables	Manifestation in Model	Description
Independent	<i>SMEs</i>	<i>de novo</i> small, private firms; per Olson (1971), SMEs represent a “latent group” in <i>Status Quo</i> model, a “mobilized latent group” in <i>Emergent</i> model
Antecedent Conditions	<i>Economic Crises</i>	the 1998 and 2008 financial crises
	<i>Context of Transition</i>	low level of formal and normative legal development; diminished central state capacity; autonomization of regions; scarce capital
	<i>Power structure and agenda</i>	President Putin and the “power vertical”; exigencies of economic development and SMEs’ role therein
	<i>“Inspectocracy”</i>	the “grabbing hand” of the state at lower levels of the politico-economic spectrum; the part of the bureaucracy responsible for monitoring firms as function of a public welfare mission, but at the nexus of <i>rentier</i>

<sup>23</sup> The model below is derived from the research structure laid out by Stephen Van Evera in his seminal *Guide to Methods for Students of Political Science* (1997, Cornell University Press). “Independent” and “dependent” variables will be understood by readers, but “antecedent condition” and “intervening” may be less so. According to Van Evera, an “antecedent condition” variable is one “whose presence magnifies the action of a causal law or hypothesis. Without it causation operates more weakly” (1997, 10). In this dissertation, these will typically be referred to simply as “condition” variables. “Intervening” variables fall between independent and dependent variables in the causal process (see Figure 1 below). According to Van Evera, these variables “are caused by the [independent variable] and cause the [dependent variable]” (1997, 11).

<sup>24</sup> These are firms that got their start after the fall of the Soviet Union, which contrasts with many firms which were in existence before the fall but were privatized (Hellman, Kaufmann and Jones 2000).

Antecedent Conditions (cont'd)	"Inspectocracy" (cont'd)	relations between SMEs and the lower levels of the state; serves as a proxy for corruption and a central factor hindering economic growth (a condition variable in the <i>Emergent Model</i> , and intervening variable in the <i>Status Quo</i> model; see box below)
Intervening	<i>Inspectocracy (Status Quo model)</i>	the emergence and proliferation of <i>de novo</i> small private firms and the <i>context of transition</i> , incentivized rent-seeking among public officials; the <i>context of transition</i> , absent institutional frameworks to regulate behavior, ensured this behavior would have few consequences
	<i>SMEBAs (Emergent model)</i>	Emerge as "peak" or "encompassing" organizations (Olson 1982) in early 2000s to mitigate the conditions of the <i>Status Quo</i> model i.e. to respond to the abuses of the <i>inspectocracy</i> , which in the <i>Emergent Model</i> is treated as a condition variable
Dependent	"A la carte" public goods <sup>25</sup> ( <i>Status Quo</i> model)	selective contract or regulatory enforcement premised of receipt of bribes or kickbacks on the part of a public official
	<i>Encompassing public goods (Emergent model)</i>	legislation, SME alliance with procuracy and state, reformed behavioral norms in SME-inspectocracy interactions, representative forums for <i>SME</i> collective action

### Variable Relationships

Figures 2 and 3 below are paradigmatic: they represent hypothetical baselines against which the empirical evidence from each chapter will be compared. Note that these are *models*, and therefore by definition abstractions of reality. As the empirical evidence will show in the following chapters, reality is more nuanced.

<sup>25</sup> This borrows the terminology of Hellman, Kaufmann and Jones (2000).

Condition Variables (combine with) Independent Variables (drive emergence of) Intervening Variables (leading to) Dependent Variables

Figure 5: Causal Path Variable Schematic

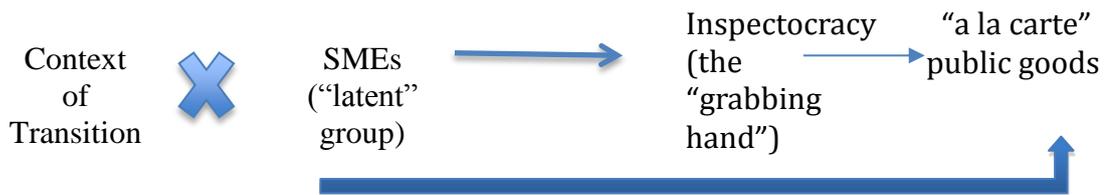
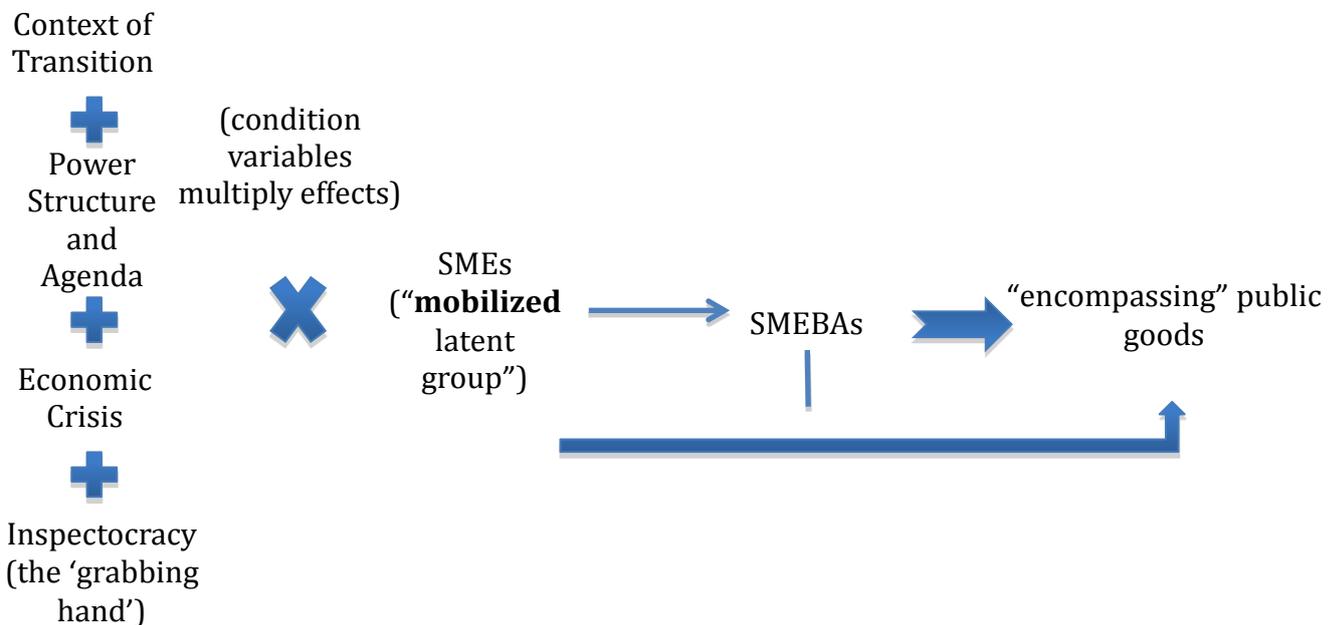


Figure 6: Status Quo Model 1991-2000

Status Quo Model (1991-1998)

This model emerged in 1991 as Russia began the transition from a command to market economy. It is characterized by the emergence and proliferation of *de novo* small private firms. The difficulties of collective action for SMEs meant they would remain “latent”. The *context of transition* was a key condition variable in determining the kinds of public goods provided to small firms. “Public good” is an imperfect term here, but is used to emphasize the contrast in dependent variables provided under the two different models. “Public goods”, which by definition are non-rival—i.e. they are provided to all members of a particular interest community whether they paid the cost of their provision or not—were provided “*a la carte*” (Hellman, Kaufmann and Jones 2000). This describes a system in which the public goods of government, such as contract enforcement or adjudication in a legal dispute, and which are typically non-exclusive, were provided only on the basis of some kind of bribe or exchange (ibid). Russia's loophole-ridden legal code meant that laws and regulations were "open to interpretation" on the part of officials. At the level of SMEs, this led to the emergence of a pervasive “grabbing hand” model of business-state interaction. SMEs suffered from a kind of “negative” public goods provision based on extortion: they had to bribe officials to "interpret" the rules in their favor. Pashtukov (2002, 68) commented that “It is not the violation of the law but its fulfillment that is paid for in Russia”. This

model pertained in particular to SMEs, whose limited resources precluded them from engaging in mutually—if not systemically—beneficial elite exchange. In this *Status Quo* model, the *inspectocracy* is characterized as an intervening variable along the causal path from SME influence to public goods provision because it emerged as a result of SMEs’ newfound, albeit modest, wealth under the *context of transition*. This wealth became a target for bureaucratic rent-seeking in the trying economic times of the 1990s. As this model still persists in Russia, it can also be described as an *underlying* model conditioning the *Emergent model*.



**Figure 7: Emergent Model 2000-present**

### ***Emergent Model (1998-present)***

The *Emergent* model overlaps and is a response to the *Status Quo* model. It began to emerge in 1998 as a result of that year’s financial crisis. The continued proliferation of SMEs combined with several elements, which are presented in this model as new condition variables. President Putin’s strong-handed reassertion of presidential authority in the early 2000s was induced by the need to mitigate the economically detrimental aspects of the *context of transition*, which in turn were exacerbated by the

*economic crisis*. These factors spurred the appearance of a formidable “power vertical” in the political structure. This need was driven by the political exigency of re-establishing the legitimacy of the office of the presidency, which in turn drove the establishment of the country’s economic modernization and development agenda. Central to that agenda was the encouraging the growth of the SME sector. *SMEBAs* are characterized as an intervening variable in this model, as they emerged with the support of the president to mitigate the deficiencies of the underlying model—i.e. the *context of transition* and the *inspectocracy*—by working to provide “encompassing” public goods demanded by their constituents. SMEs in this model are what Olson (1971) terms a “mobilized latent group”, in that they have been co-opted into organization by an outside force, which in this case is the central executive.

## Methods and Research Design

This dissertation is structured to begin with a macro-perspective and move down into more micro-levels in each subsequent chapter. The second chapter focuses on consolidation of SMEs as a political interest group in the late 1990s and its influence in Russia at the federal level. It examines the growth of the SME community from a disorganized set of actors scattered across Russia in the 1990s to an influential lobby with the ear of the president and who has become a cornerstone of his modernization program by the 2010s. *SMEBAs*’ involvement in lobbying for inspection reform via nationwide legislative lobbying demonstrates the genesis and scope of SME influence. In chapter three, four typical Russian regions were selected to illustrate the contrast between relations and the higher and lower levels of Russia’s politico-economic spectrum. Although Putin and his power vertical seem a monolithic, domineering presence over Russia’s political landscape, a focus on the regional level begins to show how local, grassroots organizations are working to shape local institutions and norms. Focusing in further, chapter four presents a municipal level analysis of the city of Saratov. For this last empirical chapter, twenty interviews conducted in the fall of 2010, and the spring of 2011 and 2012 with local journalists, business owners, managers, *SMEBA* leaders, a focus group, and academics were the data collection methods.<sup>26</sup> The concluding chapter reviews the findings of the research and discusses their greater theoretical significance.

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<sup>26</sup> See Appendix One: Interview Questions for Respondents in Saratov and Appendix Two: List of Interview Respondents.

The overall method employed in this dissertation has been in-depth analysis of parliamentary archives and journalistic accounts combined with analysis of data obtained from interviews with academic experts, journalists, and representatives from the SME community in Russia. It is premised on the assumption that how the press reports on and how the relevant actors communicate about SME issues illustrates general sentiment and trends. The goal of this approach has been to identify potential mechanisms linking micro-level phenomena with higher-level political events and quantitative findings that suggest a link between smaller firms and politico-institutional outcomes. In other words, it has been to demonstrate how macro-level phenomena are informed by local incentives and decision-making.

As far as searching and filtering data was concerned, extensive use was made of the Eastview database of national and regional publications in Russia. The database contains archives of local newspapers, business journals, and parliamentary stenographic records. The search was limited to data produced between 1996 and 2012, roughly the period from the 1<sup>st</sup> Congress of SMEs in Moscow to the end of President Medvedev's term as president. Every reasonable permutation (in Cyrillic) of "*malogo i srednego predprinimatel'stvo/predpriyatii*" (small and medium entrepreneurship/enterprise), "*ob'yedinenniye*" (union), "*assotsiatsii*" (association), "*korruptsiya*" (corruption), "*proverki*" (inspections) and "*modernizatsiya*" (modernization) was combined with the relevant geographic search operators to find data. This resultant "hits" were searched for evidence both confirmatory and contradictory of the hypothesis proposed in this dissertation, i.e. that SMEs have a positive (in the non-normative sense) effect on administrative modernization as conceived herein. Evidence from other sources, such as archives of local business journals obtained online was integrated where relevant.

## Variables and Method

The variables under examination take different forms at different levels of analysis. "Small business" as a quantifiable entity only emerged in the 20<sup>th</sup> century as governments developed the capacity and interest to monitor such things. Before the emergence of large-scale industrial capitalism, nearly all business was "small". Quantification of the term "SME" varies by country, although generally the upward limit is a business that employs no more

than 250 people.<sup>27</sup> Russia follows a fairly standard model. There, a business that employs up to 15 people is considered a “micro” enterprise, one that employs between 16 and 100 a “small”, and up to 250, a “medium-sized” enterprise (World Bank Group 2007). As much as possible this research program has attempted to focus on those companies within the “small” range, with the underlying logic that these are these companies “big” enough to have engaged with local administrations, but small enough to still have modest revenue streams which prevent them from engaging in a systematic “capture” dynamic; that is, they still can’t “capture” a public office, and the state has little strategic interest in “capturing” them. Their relationship with Russia’s officialdom can be characterized by a “grabbing hand” mode of interaction; it brings them no benefit. Where LEs (and indeed many well-off medium-sized enterprises, especially in manufacturing) enjoy the *quid pro quo* aspects of these relationships—most often in the form of kickbacks (*otkaty*)—small enterprises are simply sources of rent for the low-level officialdom; they receive no illicit benefit (Local Lawyer and Business Director 2012).

However, journalistic accounts do not restrict their narratives on the experience of Russia’s SMEs by rigid, numerical definitions of size. “Small” is a more nebulous term in this context. The interview as a data collection method further exacerbates this. The exigencies of being a lone researcher trying to set up interviews with busy businesspeople in a foreign country means that one takes what he can get. Interview data was obtained from sources at companies employing from one to approximately 50 people. Let it suffice that in the context of this qualitative research, the terms “small” and “smaller” business carries the relatively expansive connotation of a journalistic account. “SME” is a term utilized more frequently to signify the broader community of business interests that are non-oligarchic and can find representation in Russia’s official SMEBAs.

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<sup>27</sup> Federal Law 209 "On the Development of Small and Medium Business in the Russian Federation" of 2007 established the status of medium-sized enterprises for the first time. Along with the employee size criteria above, which is roughly comparable to EU size qualifications, SMEs are also categorized along the lines of firm revenues. These criteria are updated every five years as stipulated by FL-209. Currently, microenterprises are those earning less than 60 million rubles in yearly revenue, small companies between 60 and 400 million, and medium-sized between 400 million and one billion rubles. Also, ownership by an outside entity that is not an SME cannot exceed 25% (Russian State Statistics Service 2013, European Investment Bank 2013).

## Theoretical Summation and Dissertation Plan

The consolidation of the SME community into formal lobbying organizations through state co-optation of the SME community into “peak associations” and the legislative outcomes of their campaigns can be viewed according to the tenets of Olsonian collective action theory. How SMEs tend to interact with state agents at the local level can be viewed in terms of a derivative of capture theory. “Capture” for SMEs entails the “grabbing hand” of the state taking what it wants, when it wants, with little formal or informal leverage to change the arrangement. While these theories provide perspective, a formal theory of *small* business-state interaction does not exist as such. Businesses’ involvement in politics is a central feature of interactions between the state and private sector in any country. But the character of the *small* business interest is one that has yet to be examined with much theoretical rigor. The capture arrangement to which they are subject encourages them to favor more professional, impartial administration. Given the nature of the collective action problem—that is that large groups face more significant obstacles to organization and influence than small—it would seem that small businesses would have relatively little effect in reforming this domain. But they represent the vast majority of economic entities in Russia, and have found powerful allies at the highest levels. Their prevalence combined with this alliance structure must have some aggregate effect. At least this has been a guiding assumption of this research.

The following chapters examine the relationship between the Russian small business community and the public goods that have emerged in response to their interests. The institutional by-products of the push for these public goods are also analyzed as aspects of the dependent variable. SMEs as a practical matter are conceptualized generally as businesses employing less than 250 people. SMEBAs serve as a proxy for the collective, “mobilized” small business interest.

Chapter two focuses on national-level SME-state interactions. It utilizes process-tracing to examine the consolidation of the SME community as a coherent interest in the late 1990s to its push to mitigate the effects of the 2008 financial crisis. Particular attention is paid to the formulation of the legal infrastructure surrounding the conduct of inspections by government officials of small businesses. Inspections represent key opportunities for officials to extort bribes. Until 2001, they were virtually unregulated. This was and remains one of the most important issues to confront in legitimizing the relationship between small business and

the state in Russia. The formal legislation that emerged to regulate these interactions represents the central public good of this chapter. How the law has been implemented “on the ground” also features, based on the understanding that the adoption of policy is merely one aspect of policy institutionalization; implementing it is another matter. Changes in behavioral norms and reforming “cognitive maps” (Hall and Taylor 1996) regarding what is acceptable, ethical practice as a manifestation of formal policy are arguably more important social aspects of building the institutions of a Weberian state.

Chapter three introduces the regional dimension of SME influence in Russia. Linking SMEs to formal lobbying outcomes as public goods becomes problematic at this level of analysis. Although some initiatives began at this local level and became national level issues, the main focus of the chapter is on institutions of representation and small business empowerment and how they manifest themselves at the local level. These are viewed as the “by-product” goods of SME collective action. The collective action problem may be a significant obstacle to influencing national level outcomes, but at the regional and municipal levels, SMEs have a much more prominent voice in forums of SME representation. Analysis of local business journals and media was the primary data collection method, although it is complemented by data obtained from interviews with local experts.

Chapter four centers on municipal-level dynamics. It is based on a set of twenty interviews and a focus group conducted in Saratov and Moscow in 2010, 2011, and 2012. The respondents were comprised of small business owners and managers, SMEBA leaders, journalists, academics, and local political leaders. All respondents had direct experience with many of the issues presented in this dissertation. They discussed the relative importance of SMEBAs to their firms. They had participated in the preferential privatization schemes for SMEs that will be presented in chapter three. They had undergone inspections and several were able to discuss the impact changes in inspection law had on their firms and the local business environment. Public goods as “political institutions” in this context are based on an understanding of institutions as representations and products of individual normative beliefs and the transmission of those beliefs to others to create a shared behavioral construct. For example, the belief that the state no longer holds totalitarian authority over the private sector is one reason many business owners now feel comfortable challenging government agents as they inspect their premises. In the aggregate, this may portend a reshaping of expectations of behavior from both sides. It may push officials to be nothing less than fair in their

assessments (to forgo being challenged), and it may push private business owners to further push for equitable and professional standards of behavior from government services.

The empirical thesis of this research can then be formulated as follows: given the nature of the collective action problem and the context of Russia's transition, SMEs are likely to pursue administrative modernization as a key public good for the aggregated SME interest. In seeking public goods, the SME community is more likely to produce net social benefits as a result of their politicking than firms of larger sizes. The convergence of the encompassing interests of the president and high-level officials in delivering diversified economic prosperity and those of the small business community in a fair and impartial administrative system signals a potential for significant institutional modernization in the coming decades. For its part, small business collective action increases the transparency of political influence due to the fact that small firms' individual weakness compels them to act collectively to achieve political objectives; they must publicly campaign and bargain to achieve them. SMEBAs' close ties to Putin's power vertical encourages accountability on the part of political and bureaucratic officials, whose job security depends on adherence to the spirit of Russia's modernization objectives. SME development is a key element in the creation of a middle class. In turn, a middle class has long been argued to be a key element of the democratization process. In short, the health of Russia's SMEs is an important indicator of the trajectory of Russia's political development.

However, the intention here is not to argue that "SMEs equal democracy", but that their form as a large, empowered collective suffering from pervasive corruption compels them to pursue non-arbitrary rule of law for pragmatic rather than ideological reasons. Their success in achieving political outcomes has been real, but limited. Russia is still rife with official corruption. Important freedoms such as freedom of the press and pluralistic power competition are still lacking. But beneath the veneer of high-level politics centered on the maintenance of a resource-driven economy, signs of diversified, public business-state interactions are taking place all over Russia. Open forums have been set up by local SMEBAs in which SME owners can express grievances against government corruption and incompetence.<sup>28</sup> SMEs' plight features prominently in local news media. Such expressions are a de-politicized way for independent voices to respond to administrative abuse. SME owners themselves—many of whom are not members of formal SMEBAs—benefit from

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<sup>28</sup> See chapter three.

their public campaigns to increase awareness of SMEs' legal rights. They have shown a willingness to confront officials on the spot, to demand *officials'* documents that ostensibly give them the right to conduct an inspection or otherwise oversee an SME's operations.<sup>29</sup> Smaller, independent SMEBAs at the local level typically act as intermediaries between SME owners and local politicians, the latter of which have an open-door policy to individual SME concerns (Olimpieva 2009). They regularly take on individual casework in instances of distress caused by administrative organs (Small Business Association Representative 2012). At the higher levels, national SMEBAs, notably OPORA, *Delovaya Rossiya*, and the Chamber of Commerce, have successfully lobbied for legislation to strengthen SMEs' rights vis-à-vis government corruption, among several other empowering pieces of legislation.

The small business community is far from a monolithic force in today's Russia. Much support from the political community is rhetorical. SMEBAs may have the ear of the president, but the centralization of authority in Putin's power vertical means that it would be unwise for most actors to pursue politically activist campaigns. Economic development over political liberalization remains central to the SMEBA agenda. Although the influence of modernization theory has waned in recent decades, important questions remain as to the influence of economic development on political outcomes. Traditional explanations point to a Marxist "bourgeoisie" and its relationship with the state and dominant classes as a determinant of political regime type (Moore 1966, Gill 2008). Russia's SMEs do not fit neatly into this conceptualization, but important patterns are evident from this research program. Under the conditions of post-communist transition, the central state is tasked with reestablishing its legitimacy while at the same time restructuring the economy and delivering economic growth. Yet the remnants of the Soviet-era administrative mechanism perpetuate the systemic corruption of its institutional founding. For local, independent businesses this arrangement is stifling. For the high-level political stratum looking to produce a legacy of economic growth and higher standards of living, this arrangement is stifling. The higher and lower orders of the politico-economic spectrum would seem natural allies in the struggle to reform it. How closely the organized SME community remains to the power vertical is an important consideration if the existing dominance of Putin and United Russia does not continue. If SMEs remain central to Russian leaders' development objectives no matter who is in charge, and they continue to accumulate capital and influence, then we may see the

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<sup>29</sup> See "Perspectives on Inspection Reform", p. 137.

emergence of well-represented and financially well-endowed commercial class with the resources to influence political authority.

## **CHAPTER 2: THE CONSOLIDATION OF THE SME COMMUNITY IN RUSSIA 1996-2010**

### **Introduction: SMEs and the Push for Inspection Reform**

A key issue at the forefront of the SME community's formal agenda since the late 1990s in Russia has been inspection reform. In 2007, it was estimated that small businesses were devoting approximately 10% of annual revenue to illicit payments (Delo 2007). In 2008 state control bodies conducted approximately 20 million inspections across Russia, at a cost of nearly 162 billion rubles (~US\$5.6 billion) (Delo 2008). Three agencies are responsible for the vast majority of inspections conducted in the Russia: the Emergency Control Ministry, responsible for management of fire and rescue services; Rospotrebnadzor, responsible for maintenance of trade and health safety standards; and Rosreester, or the Federal Service of State Registrations, Cadastre, and Cartography, responsible for property registrations and other forms of civic land management. These agencies are tasked with ensuring public welfare, consumer protections, and responsible development. Yet they are at the nexus of the pervasive bribery and corruption that continues to plague Russia. Beginning in the late 1990s, the SME community began to consolidate its interests, and reining in corrupt inspectors touched a chord with politicians and the public. It began to establish the businessperson as a victim of Russia's maladministration rather than complicit in it. Inspection reform served as a rallying call to many SMEs victimized by the predations of local officials. Important alliances between high-level political actors and local representatives from the SME community began to take shape as the importance of the SME sector became apparent in the wake of the 1998 and 2008 financial crises. This chapter presents the story of how and why SMEs were able to consolidate their interest into a unified lobbying effort for inspection reform as a public good for the SME community.

### **Empirical Puzzle and Theory**

The consolidation of the SME community as a coherent political interest group despite the obstacles to collective action SMEs face is the empirical puzzle to be explored in this chapter. From a theoretical perspective, this macro-level analysis of SME consolidation can be seen as SMEs' transition from a "latent" to "mobilized latent" group. Olson (1971, 50) argued that a latent group is one that has a collective interest, but it so large that individuals

in the group have no incentive to lobby to satisfy it. Per Olson, three factors keep larger groups “latent”:

First, the larger the group, the smaller the fraction of total group benefit any person acting in the group interest receives, and the less adequate reward for any group-oriented action... Second... the larger the group... the less the likelihood that any small subset of the group, much less any single individual, will gain enough from getting the collective good to bear the burden of providing even a small amount of it... Third, the larger the number of members in the group the greater the organization costs, and thus the higher the hurdle that must be jumped before any of the collective good at all can be obtained... very large groups normally will not, in the absence of coercion or separate, outside incentives, provide themselves with even minimal amounts of a collective good (ibid, 48).

Olson here is essentially saying that the dispersed interests of the latent group in an outcome of collective action produce fractionally smaller benefits to individual members of the group. For example, a small, sector-specific group lobbying group pursuing a tax break or subsidy for their industry can derive concrete, significant monetary benefits from their collective action. In contrast, a large, non-sector specific interest—one that is much more likely to be latent—can in theory pursue a similar tax break or subsidy for their constituents, but the monetary value of that concession is distributed to a larger group, and thus less valuable to individual members. In turn there is less incentive to pursue it in the first place. A one million dollar subsidy for ten oil companies is much more valuable to those ten individual interests than a one million dollar subsidy for one million SMEs. But the value of the concession the state is willing to provide to either group, *ceteris paribus*, will remain the same. Each oil company would get one hundred thousand dollars, but each SME would get only one. Thus, the incentives to pursue the public good outcome for each group are very different.

Free-ridership also becomes an issue in larger groups as the incentives for participating in a lobbying initiative become diluted. For example, ten passionate individuals lobbying for the public good of cleaner air will be more able to see which group members may not be participating in the initiative—and take appropriate action—than in a group of one million passionate individuals lobbying for the same public good outcome.

According to Olson (2000, 80), large groups will not obtain collective goods simply through “voluntary and unsubsidized individual behavior” and that only if an outside force were to pay for the costs of collective action, then large groups could achieve their collective goals. He noted that, given the numerous sectors and industries represented by business, the business community as a whole represented a latent group despite the common perception

that “business” as such occupied a privileged place in interactions with government (ibid, 146). Large groups such as the SME community in Russia, representing millions of firms ranging from small retail and service kiosks run by a single person to local manufacturing plants employing up to 250, are “latent” because “they have a latent power or capacity for action, but that potential power can be realized or ‘mobilized’ only with the aid of ‘selective incentives’” (ibid, 51).

Yakovlev, Zudin, & Golikova (2010, 8) argue that one of the most important selective incentives the state offers to SMEBAs and their members is preferential access to and influence in governmental decision-making processes, so they might contribute to the overall effort to improve business climates through better governance. In short, *the selective incentive for SMEs to participate is the ability to provide themselves with the collective goods of better governance and favorable business climates.*<sup>30</sup> And given their encompassing interest under the conditions of transition, these collective goods for the SME community also serve as public goods for actors outside of it.

Through the creation of Russia’s peak SMEBAs, members of Russia’s SME community have been given select access to the policymaking process simply by virtue of their status as SMEs. This is part of the state’s effort to enlist this grassroots business interest in the creation of business-friendly policies; it has subsidized their increased costs of collective action to pursue public goods. Olson discusses associations such as Russia’s peak SMEBAs as “encompassing organizations”, which tend to take into account the greater social and economic effects of collective action, and that they advocate for policies more closely

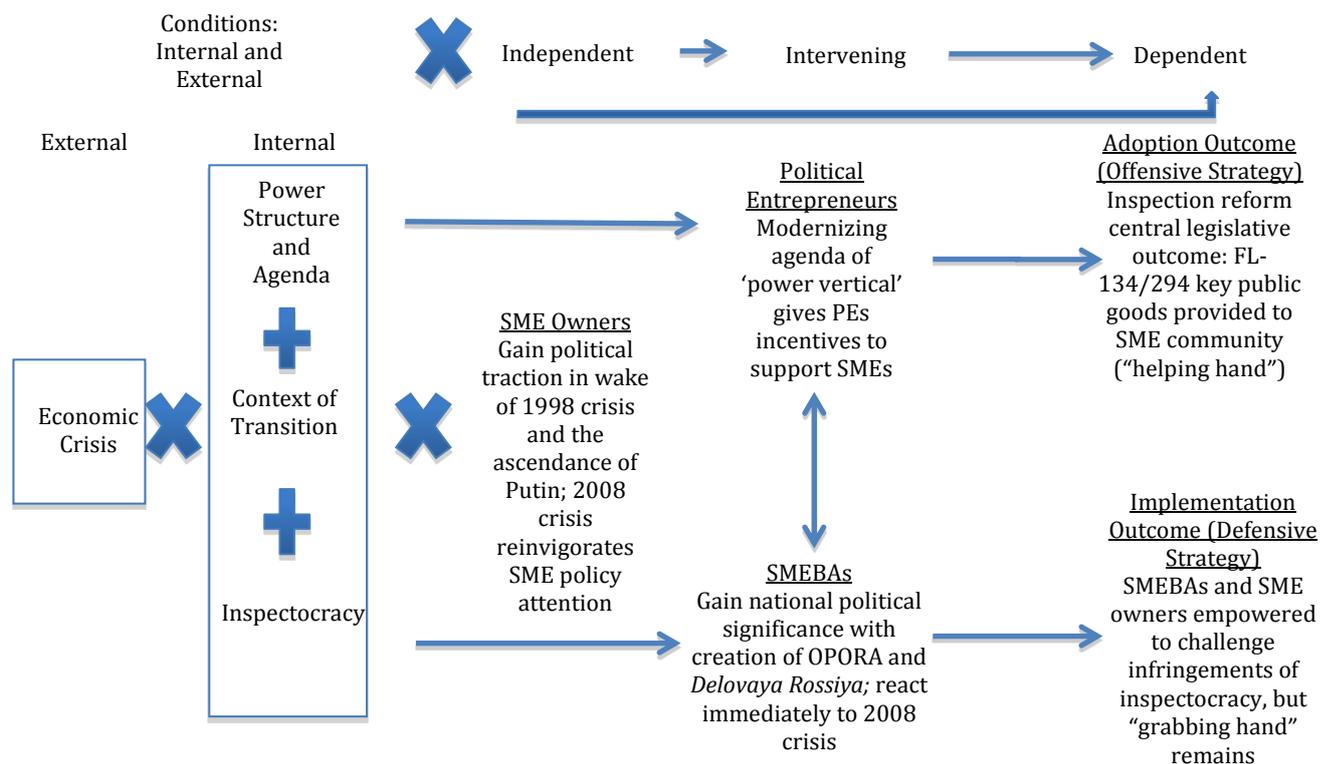
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<sup>30</sup> A selective incentive is presented here as an inducement to participate in group action offered only to members of a particular group. Selective incentives are typically cast as rewards or punishments for members of a group that are distinct from the group's lobbying activities. "Access to policymaking" may appear as a function of the lobbying process itself. However, the preferential access granted by the state to SMEs means that there is a certain "prestige" factor associated with participating in state-sanctioned SME collective action. And this is a factor that lends an exclusive value to participation that extends outside of the lobbying process. Olson (1971, 51) notes that “selective incentives are defined to be greater in value, in terms of each individual’s preferences, than each individual’s share of the cost of the collective good. Sanctions and inducements of smaller value will not mobilize a latent group”. Indeed, the value individual SMEs place on the “selective incentive” of preferential access to the policymaking process may not be enough to mobilize them out of their latency. Many in fact do not participate in the lobbying work of SMEBAs. However, SMEBAs also offer legal support and access to authorities for an individual SME facing a particular administrative issue, which may be more powerful selective incentives for SMEs to join a SMEBA. These kind of selective incentives and value SMEs place on them are discussed in chapters three and four.

aligned with a general public interest than a narrow special interest (Olson 1982, 51, Olson 2000). Furthermore per Olson (1982, 48; 2000, 24), encompassing interests tend to be more concerned with long run considerations for their constituency than narrow interests, and have an incentive to consider the effects of their policy initiatives on the overall health and productivity of an economy given the wide array of interests they represent. Empirically, these theoretical contentions can be seen in Russian SMEBAs’ push for more efficient administration and inspection reform as such initiatives benefit the range of constituents from the smallest micro-enterprises to the “largest” medium-sized firms. Indeed, such initiatives, if successful, can be a force driving the professionalization of the bureaucracy as a whole, which can provide benefits to a wide array of social actors outside of the business sector.

### Hypotheses and Model

The model presented in this chapter aligns closely with the paradigmatic models presented in chapter one. It can be seen as an integrated version of the *Status Quo* and *Emergent* models, with the former transitioning to the latter:



Model 1: National Level Modified Model

The empirical thesis of this chapter as derived from this model can be stated as follows: economic crises coupled with the context of transition and the modernizing agenda put forth under Putin's power vertical compelled political authorities to ally with SME interests to exploit the synergy of interest both sectors had in reining in the corrupt bureaucracy. In the late 1990s, Russia's nascent SME community could not overcome the costs of collective action to influence policies in their favor. Their character as collective action entities remained highly localized. The "grabbing hand" of low level officials to which so many SMEs were subject represented a common threat that SME owners were interested in confronting, but the adoption of policies at the national level to do so could not be achieved until the dire political and economic exigencies of the 1998 financial crisis demanded substantive action from political actors. The creation of Russia's state sanctioned SMEBAs represented one such action. Comparing the lobbying successes of the SME community in the aftermath of the 1998 and 2008 crises, it is apparent that they were achieved much more quickly in the case of the latter event. With official SMEBAs occupying a prominent role in policymaking by the time of the 2008 crisis, the public good of inspection reform for SMEs came in a matter of months, not years.

The central hypotheses to be explored in this chapter can be stated as follows:

**H1:** As a latent group, SMEs will only be able to pursue collective action outcomes when mobilized by an outside force. SMEs were only able to gain political traction in the wake of the 1998 and 2008 crises because the president and his close political colleagues recognized the strategic necessity—in terms of international market strength and domestic political legitimacy—of building a strong domestic economic sector. These crises motivated Russia's leadership to mobilize Russia's SME community.

**Explanation:** The circumstances of transition brought about Putin's modernization program, which produced a conflict with the inspectocracy on one side, and SMEs, the president, and procuracy on the other.<sup>31</sup>

**H2:** The "encompassing" quality of the SME interest, once mobilized for effective collective action, produces a reform agenda that focused on the provision of

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<sup>31</sup> This outcome is not argued to be universal or deterministic. Many actors on the SME and presidential side perpetuated the old system, while many in the bureaucracy worked to enable modernizing reforms.

encompassing public goods. For Russia's mobilized SME community, the first crucial reform initiatives would be directed toward the "lowest common denominator" problem: administrative abuses taking place during inspections.

**Explanation:** The fight against inspections was to become a proxy for the fight against corruption. This gave the issue more political and economic relevance, prompting state co-optation of the SME community to form SMEBAs. This in turn strengthened the hand of SME interests against the "grabbing hand" of the inspectocracy.

In sum, economic crisis demonstrated the necessity of domestic economic development. It incentivized support for SMEs among high-level political authorities. It brought to the fore the rapacity of the inspectocracy at the SME level, which struck an emotive and political chord with politicians and the public.

The first half of this chapter will focus on federal level initiatives and coalition-building while the second will examine the implementation of inspection law on the ground. Adhering to the analytical framework guiding this research, the SME community is treated as the independent variable: SMEs' push for the provision of public goods drives the emergence of formal legislation, and in doing so, reshapes behavioral and cognitive norms "on the ground" as "modern" socio-political institutions of protected consultation. It is important to note that the high level coalition-building between SMEs and the state represents the highly visible, public face of the battle between SMEs and the bureaucracy. However, as the latter half of this chapter will demonstrate, implementation of inspection law is another matter.

The dependent variable of this chapter is represented in two ways, one formal and one less so. The legislative outcomes of inspection reform represent the former. Behavioral norms represent the latter. It is one thing for a formal organization such as the Duma to adopt a piece of legislation in favor of SMEs, and quite another to implement and enforce that legislation at the grassroots level. This chapter examines institutional change as a result of the campaign for inspection reform as a public good for the SME community, from the formal adoption of new rules to the enforcement and implementation of those rules on the ground. The logic of this design is to cover as well as possible the breadth and depth of institutional reform as it relates to the interactions between individual SMEs, political actors, and SMEBAs.

The adoption and implementation stages can be viewed in terms of offensive and defensive strategies to protect the interests of SMEs. At the adoption stage, actors representing the small business community will lobby for legislation to serve those interests. This is a proactive, *offensive* strategy. Three sets of these actors are apparent at each stage, and represent the key explanatory sub-variables of this chapter. The first is the SMEBA. It continues to serve as a proxy for the organized small business community. The political entrepreneur (hereafter “PE”) represents the second. These actors are the legislators, prosecutors, and SMEBA leaders at the local and national level who have made a name for themselves as supporters of small business. Delivering real growth in their jurisdictions has become key to their political survival. The intent is not to cynically characterize these actors as ambitious self-seekers who only serve SME interests as a means to advance their careers within Putin’s power vertical. Many appear to be motivated by a conscientious desire to improve business climate and living standards. However, career security and advancement is an important by-product for them if they can deliver on their motivations. SMEBAs and PEs are the central players in the adoption stage.

SME owners themselves represent the third explanatory sub-variable. They have been instrumental in challenging inspection officials on the ground, and thereby advancing the grassroots, behavioral aspects of institutional change. They are most active at the implementation stage, which represents the *defensive* stage of institutional reform. At this stage, institutional reform tends to be reactive, and grounded more in protecting SMEs through enforcement of existing laws rather than making new ones. SMEBAs are also key players at this stage. Interview evidence has shown that their “legal support” function is the main reason many SME owners join an association (Shop Owner 2011, Medical Services Company Vice-Director 2012, Olimpieva 2009). As interview evidence has also shown, many small business owners are not members of one of Russia’s large, encompassing SMEBAs. Indeed, many interviewed had not even *heard* of them (Focus Group 2012, Manager of Beauty Salon 2012). Yet they are the front line in the battle against the systematic corruption that still plagues Russia today. Increasingly, they are becoming more assertive against corrupt officials who come to “terrorize” (*koshmarit*) their businesses.

SMEBAs, PEs, and small business owners themselves have been presented as key sub-variables internal to the system of institutional reform in Russia. Economic crisis serves as the main variable *external* to it. In the past 15 years, Russia has suffered two major crises

that have had the paradoxical effect of strengthening its SME community. The first was the 1998 financial crisis. Catching the “contagion” from East Asia, Russia was forced to default on its debts and devalue the ruble (PBS 2002). Although this period was certainly no easy time for SMEs, the devalued currency forced many consumers to turn to less expensive domestic products (Gill 2008, Bossoutrot 2005, Buyske 2007). Growth was largely off the table for them, but they were able to weather the crisis better than their larger counterparts. Their enterprises were not as directly effected by the crisis as those firms tied to international markets.

The second external shock came in 2008. Detailing the emergence and spread of the 2008 financial crisis—rooted as it was in the bursting of America’s housing bubble—is beyond the scope of this research. Let it suffice that Russia’s resource dependent economy was hit hard by the global financial collapse as commodity prices fell. Russia also maintained large investments in the US housing market (Landler 2008). Average Russians and small businesses felt the effects of unemployment, inflation, and a decrease in consumer spending power (ibid). The crisis again underscored Russia’s vulnerability as a resource-centered economy and the need to diversify growth across the depth and breadth of the socioeconomic spectrum. A robust small business sector was central to achieving this aim.

The 1998 and 2008 crises each inspired a spate of executive decrees and legislative initiatives to support SMEs. The results of the campaign for inspection reform is treated as a proxy to represent one institution that has emerged as a result of SME efforts to provide themselves with a public good as a mobilized latent group. The laws on inspection reform, FL-134 and FL-294 (the latter is an updated version of the former), “On the defense of legal entities and individual entrepreneurs during the conduct of state and municipal control (supervision)” were designed and implemented to control the amount of inspections government agencies are allowed to conduct in a given year. Up until the early 2000s, inspection regimes were virtually unregulated. Extorting bribes from small business owners was (and still remains) a key source of rents for local officials. Curbing this practice represents a key aspect of modernizing Russia’s bureaucracy from a cumbersome, growth-inhibiting administrative apparatus to an efficient and impartial monitor of public health and safety regulations. This modernizing process involves empowering the SME community to challenge government by holding its agents accountable to the laws that ostensibly govern them.

Inspection law is one example of a tangible outcome of small business lobbying efforts. It is widely discussed in published sources, such as newspapers and SMEBAs' online discussion forums.<sup>32</sup> Interview evidence confirmed that many SME owners—SMEBA members or not—were well aware of it (Manager of Beauty Salon 2012, Owner of Clothing Shop Chain 2012). The strategies to create a legal infrastructure regulating inspections required lobbying tactics on the part of PEs and SMEBAs at the “adoption” stage of reform, and protection tactics on the part of SMEBAs and SME owners themselves at the “implementation” stage. The politicking involved in adopting these laws is undertaken at higher levels of the political spectrum, usually spearheaded by a coalition of PEs from the Duma and national SMEBAs.

The implementation, or defensive, stage of this process tends to involve SMEBAs and SME owners at the lower levels of the political spectrum. It is during this stage where we can see the emergence a second, corollary manifestation of a public good outcome: a change in behavioral norms. Aggregate behavior at the grassroots level is not only an important indicator of the success of formal institutional reforms, but a crucial public good in itself. Commentators repeatedly cite poor enforcement of existing legislation as a key factor explaining the slow pace of institutional reform in Russia (Ivanchenko, 2009a, para. 7). The formalized processes for creating new, “good” laws are well established and broadly speaking follow basic democratic procedure (Sakwa 2008, 454); what is not is respect for those laws by actors on the ground once they are adopted. This is where coalitions of SMEBAs and their members play a role in remolding expectations of behavior from actors both within the SME community and within government itself. Examples of the small business community challenging officials via official mechanisms are becoming more common. Instead of paying a bribe, business owners are challenging government at the point of contact and in the courts. Often just eliciting the aid of a SMEBA is enough to have an issue resolved for a business owner (Small Business Association Representative 2012). While it is certainly a less tangible form of “public good” than a piece of legislation, in the aggregate such shifting expectations of behavior in business-state interactions toward professionalism and impartial “protected consultation” may be one of the most powerful forces for institutional modernization in Russia in the coming decades.

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<sup>32</sup> See OPORA's discussion forum at [opora.ru](http://opora.ru), where the significance of 294 is apparent by the number of comments and discussions compared to other issue areas.

## The Organizational Consolidation of Russia's Small Businesses and the Fight for Inspection Reform

The 1990s were a period of wild instability for Russian businesses of all sizes. The small business community was disorganized and its members were individually weak. Russian political leaders concerned themselves more with the immediate strategic significance of negotiating relationships with interests at higher levels of the economy. Only a rudimentary framework of legislation existed to serve the SME community, but the central state possessed little capacity to enforce it. In 1991, legislation had passed giving tax breaks to SMEs in an effort to encourage their proliferation. According to Radaev (2000), it was not until 1995 that the SME community gained traction in the legislative sphere. A framework or “umbrella” law, “On state support of small businesses in the Russian Federation”, was passed in June which determined SME policy for the next several years. It mandated the creation of the State Committee for the Support and Development of Small Entrepreneurship—a kind of “Ministry of Small Business”—and allocated funds for SME development. By December the simplified system of taxation for small firms was introduced (Radaev 2000). They continue to enjoy this arrangement today. These developments marked the first systematic efforts to improve conditions for SMEs via business-friendly policies (ibid).

At this stage, SMEBAs played a small, local role in policymaking. Liberal deputies working in the Duma at the federal level played the most significant part in building a legal framework of SME support, small as it was at the time. Duma deputy Ivan Grachev—then of the liberal Yabloko party and who has been one of small businesses’ most vocal proponents since his election to the Duma in 1993—stated that “objectively not one party consistently supports small business” and went on to say that one must look to the voting records of individual deputies to see if they actually push for policies friendly to SMEs (Ozdemirov 1999, para. 22). Grachev and others regularly commented on how every politician is ostensibly a champion of small business, but few actually pursue policies favorable to it. Radaev (2000) notes that the party then most closely associated with small business support, Fatherland-All Russia, a centrist party formed in 1999 by Yevgeny Primakov and then Moscow mayor Yuri Luzhkov, suffered a crushing defeat in the 1999 Duma elections.<sup>33</sup> He attributes the lack of social and political support for SMEs at this time to

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<sup>33</sup> Fatherland-All Russia merged with the Unity Party to form United Russia in 2001.

a lack of influential institutions adequately representing their political interests. The words of literally everyone—liberals and communists, right-wing and left—support small entrepreneurship. It's become a fundamental part of the political rhetoric. But when it comes to an actual vote in the Duma on a relevant issue, actual support comes from a indispensable minority of deputies (ibid, para. 8).

At this time the small business community remained relatively disorganized. Although many SMEBAs existed at the local level, they lacked a consolidated national presence.

### **SME Congresses and Crisis: Rhetoric Becomes Reality**

This began to change in 1996. SMEs started to consolidate around national level policy initiatives. Following a directive from President Yeltsin, representatives from Russia's numerous local independent SMEBAs organized the 1<sup>st</sup> All-Russia Congress of SMEs in Moscow. This was the first conference that brought together high-level government officials and thousands of representatives of the SME community (Dokuchayev and Karpenko 1996). In attendance were President Yeltsin, Moscow mayor Luzhkov, members of the State Committee on the Support and Development of Small Entrepreneurship, the Chamber of Commerce, and approximately 4,000 representatives from local governments and SMEBAs across Russia. Some cynicism surrounded the timing of the conference, as it just preceded the 1996 national elections (ibid). Yeltsin was desperate for support as a poorly functioning economy and general maladministration and corruption drove low approval ratings. He was in danger of losing to Russia's Communist Party (Frye 2010). One organizer of the conference dismissed this cynicism, saying that the business community had reached a critical mass and now was ready to move into organized political lobbying: "different sectors of the economy in the regions have branched out to form networks of small businesses which have united millions of people. These social organizations have organized, and delegated their representatives to send to Moscow" (Dokuchayev and Karpenko 1996, para. 4).

The 1<sup>st</sup> Congress for the first time brought to light in the public sphere the plight of small businesses in relationship to Russia's officialdom. In a 2002 Duma debate on the adoption of Federal Law 134—the precursor to 294 regulating inspection regimes—Deputy Grachev traced the roots of the legislation to this 1<sup>st</sup> Congress (Stenogramma zasedanii Gosdumy 2002). There, officials and SME representatives

came to the conclusion that...the development of small business is one of the most important conditions for normal economic growth and that there are well-defined positions that prevent entrepreneurs to live and work...[and one of] the most important things that concerns [them] and prevents them from growth and

development is, in their language, “bureaucratic racketeering...and thuggery”. In smoother, parliamentary language, it is the “unresolved relationship between business and government, between entrepreneurs and officials” (ibid, 43).

For years the Russian government concerned itself with the problems of macroeconomic stability. This Congress marked the first organized efforts by independent, grassroots economic actors to address the common problem of “bureaucratic racketeering” via official channels. Illustrating the commonality of the business interest in a transitional society, one conference organizer stated that “the delegates hold many political views, but they share common professional problems. The time has come to formulate and promulgate our corporate interest” (Dokuchayev and Karpenko 1996, para. 5).

Time showed however, that the cynicism surrounding this 1<sup>st</sup> Congress was well-founded. The discussions translated into little substantive legislation. President Yeltsin did issue a decree that directed specific funds to SME support, but suspended it after his re-election (Kostyuk 1999). In another decree in 1998, “On measures to reduce administrative barriers to business development”, he tasked the legislature with developing a package of laws to reduce corruption. By the time of the 2<sup>nd</sup> Congress in 1999, nothing had materialized (Krayniy 1999). As Deputy Grachev put it, “the First Congress and presidential decree were candies that quickly melted away after the elections. In the years following the Congress, virtually nothing was done for small business” (Kostyuk 1999, para. 11). The State Committee for Support and Development of Small Entrepreneurs had been disbanded (Buyske 2007, 84). The legislation that did release funds to support regional SME growth was worded generally and abstractly. Those funds did not reach their intended recipients, but instead went to unnamed officials involved in their distribution (ibid). Politicians were understandably hesitant to allocate further funds to such programs. Programs of SME support were caught in a procedural catch-22 as authorities responsible for creating the federal budget bickered with the Duma over who was responsible for them. The budget authorities argued that they could not include funds for SMEs in their budget proposal without approval from the Duma. The Duma countered that they could not debate on—much less adopt—such programs if they were not included in the budget proposal (Interfaks Vremya 1999). Grachev expressed frustration that

the results of the 1<sup>st</sup> Congress were zero or negative...most of the initiatives that were declared were not implemented. There are no active federal programs to support entrepreneurship, the fiscal situation has worsened...Declaratory decrees signed by

President Yeltsin were buried a few months after the election. There are many reasons for disappointment (Ozdemirov 1999, para. 3).

In the 18 months following the 1<sup>st</sup> Congress of February 1996, the fate of the SME community was in limbo. The nature of the relationship between the state and SMEs remained unresolved. Would the state be an ally of the small business community or would Russia's SMEs have to endure the circumstances of transition alone?

### *The 1998 Crisis*

The financial crisis of August 1998 dramatically altered the environment for the formulation of Russia's small business policy. At the 2<sup>nd</sup> All-Russia Congress of SMEs in October 1999, Russia's SMEs had the ear of decision-makers like never before. The specificity of the discussions and immediacy of outcomes following the meeting indicate that Russian authorities were ready to genuinely commit to improving conditions for small business growth. It had been nearly 3½ years since the 1<sup>st</sup> Congress, and one of the reasons behind the 2<sup>nd</sup> was for government to report back to SME representatives on the efficacy of their programs since then (Komsomol'skaia Pravda 1999, para. 2). Cynicism again surrounded the congress, as there was little "efficacy" to report and Russia was again in an election season.

The 2<sup>nd</sup> Congress seemed marginalized from the start. The Russian Chamber of Commerce debated whether or not to even have another one, given the dearth of results from the 1<sup>st</sup> (Buyske 2007, 84). It was attended by about a quarter of the delegates (about 1,000) of the 1<sup>st</sup>, was held not in the Kremlin, but in the House of Unions, and its budget—about \$240,000—was derived solely from the contributions of SMEBAs and SME owners themselves rather than from federal funds, as was the first (Levinskiy 1999, para. 2). President of the Russian Agency for the Support of SMEs Victor Ermakov—one of Russia's first independent SMEBAs—noted that the Congress was organized solely at the initiative of Russia's various independent SMEBAs, entrepreneurs, and the Chamber of Commerce, and not a result of a "political decree" as was the 1<sup>st</sup> (Komsomol'skaia Pravda 1999, para. 10, Interfaks Vremya 1999, para. 3). The Congress was built on the outcomes of seventy-two regional congresses in previous years at which proposals to address to the state were solidified (Buyske 2007, 84). Going into the meeting, criticism was raised that it would once again be little more than a platform for politicians to make empty overtures of support to SMEs as a means to advance their immediate political objectives (Interfaks Vremya 1999,

para. 2). But it quickly became clear that attendees were wary of such beguilement, and were intent on achieving concrete results. For the first time, the politicians were on the same page as Russia's SMEs. The financial crisis was affecting them all. Ermakov again weighed in, saying that SMEs' survival in the 1990s was premised "on their proximity to the regional power elites engaged in distribution of financial flows" (Krayniy 1999, para. 6). However, these elites, especially from Russia's depressed regions, had come to the realization that a genuinely healthy local economy—not one built on promises of development but on actual growth—was crucial to their political survival. When asked if the results of the 2<sup>nd</sup> Congress would be different than those of the 1<sup>st</sup>, Ermakov said they would, "for one simple reason: many regions are now on the brink of a social explosion. The widely-held belief that someone would suddenly arrive, build a big factory and start making profits for the region is simply absurd. This means that people must be given the capabilities to realize this themselves" (Zveryev 1999, para. 6). It was apparent that SMEs *and* politicians were becoming desperate for measurable results.

Wary of empty declarations, disappointed with the results of the 1<sup>st</sup> Congress, and reeling from a national financial collapse, the delegates in attendance of the 2<sup>nd</sup> established a markedly different tone compared with the first. Under discussion would be *specific* measures. At the top of the agenda was a discussion of draft versions of three laws: "On special tax regimes for small businesses", "On mutual credit societies", and "On the defense of legal interests of entrepreneurs" (ibid, para. 8). The latter took center stage as the infringements of local officials (*chinovniki*) against the rights of entrepreneurs were presented (Levinskiy 1999, para. 5). The egregious nature of those infringements struck an emotional chord with those present, which was subsequently transferred to the public via the media outlets covering the event. One small firm held the unenviable distinction of being the apparent record-holder for having the most inspections in a year, at 402 (Levinskiy 1999, para. 4). Yevgeny Primakov, then president of the Russian Chamber of Commerce and one of Russia's elder statesmen, commented how in the early 2000s, the challenge for SMEs became how to protect themselves *from* the state rather than seeking protection *by* the state (Buyske 2007, 83). While the first two draft laws were relatively technical and specific to the needs of small business owners, the law on inspections became conflated with the popular struggle against corruption and maladministration.

The outcome of this 2<sup>nd</sup> Congress was a stark contrast to the 1<sup>st</sup>. By the following month, a special meeting of the Presidential Cabinet was called to discuss the proposals put forth (Antipina 1999). Victor Ermakov was ebullient about this result:

The government has given very serious attention to the issues raised, and I must say we did not expect such an understanding of our problems and such full support of our ideas. The package of priority measures to support small businesses and entrepreneurs proposed at the Congress was fully approved. Fifty million rubles was allocated to small business development. A special council of the Prime Minister for small business issues was set up. The federal program of small business support until 2000 was adopted. We were supported by everyone, including tax officials...I am proud of the outcome of this Congress” (ibid, para. 5).

This special cabinet meeting was held in November 1999. Vladimir Putin assumed the presidency the following month. Despite the battle he would wage against Russia’s oligarchs, his support for the vast majority of Russia’s business community was unwavering. At a follow-up conference held in March 2000, just five months later, minister of Antimonopoly Policy and Support for Entrepreneurship Ilya Yuzhanov announced that 80% of the resolutions proposed at the 2<sup>nd</sup> Congress had been adopted (Buyske 2007, 84). German Gref, appointed minister of the newly-formed Ministry of Economic Development and Trade, earned a reputation as one of Russia’s most ardent liberal reformers. In 2001, he proposed an oft-cited “anti-bureaucracy” package of reforms for debate in the Duma designed to cut the red tape of starting and running a business (Biznes Organizatsiya Strategiya Sistemy 2001). In addition to measures to regulate the amount of inspections a government agency would be allowed to conduct of a small business, this “debureaucratization” package included reducing the number of activities requiring licenses and easing the process of registering a business, which were also avenues for officials’ rent-seeking (Sakwa 2008, 308, Kontorovich 2005, 260). SMEs’ organizational efforts were beginning to produce results.

After several months of debate in the Duma and three readings on the floor, FL-134 was adopted in August 2001. Two main provisions of the law were the most important to SMEs. It set the limit of one inspection every two years of one firm by one inspection agency, and that agency had to limit the length of its inspection to 30 days (Zubareva 2008). The adoption of 134 was a major victory for the small business community. Two surveys

conducted in 2002 of 2,000 SMEs in twenty regions showed that the number of inspections per enterprise had decreased by 26% (Zamulin 2003, para. 3).<sup>34</sup>

Despite this apparent success, at the time few mechanisms existed to enforce FL-134. In late 2001 after a meeting with president Putin, Duma deputies and prominent business owners officially registered *Delovaya Rossiya* (DR), the first national-level, cross-sectoral business association dedicated to the overarching problems of doing business in contemporary Russia (Delovaya Rossiya 2013). *Delovaya Rossiya* was not created specifically for SMEs, but in focusing so heavily on the problems of corruption and reducing administrative barriers its efforts were naturally weighted to solving their problems. In September 2000, the inefficacy of SME interest articulation at the national level was discussed at the conference “The Role of Associations of Entrepreneurs in the Development of Small Business”. Participants discussed the benefits of consolidating Russia’s myriad SME interest groups under one banner (Buyske 2007, 86). The event was organized by the Institute on Entrepreneurship and Investment, the Russian Chamber of Commerce, and the Eurasia Foundation (ibid).<sup>35</sup> About one year later, with the close involvement of the president, OPORA, Russia’s first business association dedicated solely to SME concerns, was established (OPORA Rossii n.d.). Rather than having to organize ad hoc conferences, Russia’s SMEs now possessed a formalized and sustained conduit to channel their interests and concerns to the highest levels of power.

Enforcing and adapting Russia’s law on inspections was to become a key function of SMEBAs’ activities. In 2003, OPORA conducted a survey in which nearly 75% of respondents complained that they were still inspected more than once a year, and with 30% saying once a month or more (Borozdina and Sokolovskaya 2003, para. 6). One of the main loopholes in the inspection law was that inspection authorities retained the right to conduct unscheduled inspections given probable cause. Furthermore, FL-134 did not stipulate which agencies had the right to carry out which supervisory and inspection functions (ibid). It did not standardize a set of infractions by which an SME could be inspected; this judgment remained at the discretion of the inspecting authority (ibid). A lawyer from the Independent

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<sup>34</sup> However, many companies reported that the fines that were given were not based on official standards (Zamulin 2003, para. 3).

<sup>35</sup> The Eurasia Foundation is an NGO founded in 1992 under the auspices of the United States Agency for International Development to support development projects in the former Soviet Union. See <http://www.eurasia.org/about-us/faq#8>.

Council of Legal Experts noted these shortcomings, saying that “In practice, haphazard, unpredictable inspections will continue despite the adoption of [FL-134], and [SMEs] will continue to have their business hampered and incur losses, and their rights again will be violated” (ibid, para. 11). By 2007, Mr. Gref cited statistics indicating that SMEs still devoted nearly 10% their revenues to illicit payments to officials. According to him, this demanded further changes to Russia’s laws on inspections (Delo 2007). Speaking at a hearing of the Duma in 2008, then *Delovaya Rossiya* head Nikolai Ostarkov said that despite extensive political efforts to reform the system of inspections from 2001 to 2003, nothing actually changed and inspections remained one of the key hindrances to business growth (Delovaya Rossiya 2008).

### *The 2008 Crisis*

From the adoption of FL-134 in 2001 to the onset of the global financial crisis in 2008, lack of enforcement of Russia's inspection law continually frustrated SME owners and executive authorities. The economy was doing well, so therefore complaints failed to register with much resonance (Business Journalist 2012). However, by 2008 it was clear that Russia would not be immune from the effects of the crisis. A spate of decrees and legislative initiatives were put forward as its effects became more clear. In March, Yuri Chaika, Russia’s federal prosecutor, issued order 53 “On the organization of prosecutorial supervision to enforce the rights of entrepreneurial entities”. This decree made protection of SME rights a central mission of regional and federal prosecutors’ offices (RCSME 2009). They worked with the Chamber of Commerce to review and adjust regulations that were contradictory with others or otherwise contained loopholes. Annulled and adjusted acts numbers in the hundreds, to thousands, in some cases (ibid, 4). A central tenet of the decree was that regional prosecutors’ priority was to protect SMEs from corrupt inspection regimes. Key to this was to prosecute offending inspectors and agencies (Antonenko 2009, Delovaya Rossiya 2008). They became responsible for approving requests for inspections and with publishing the schedules of planned inspections (RCSME 2009). Cooperation agreements were established between OPORA, *Delovaya Rossiya*, and the federal prosecutor’s office (Delovaya Rossiya 2008).

Two months later and within a week of taking office, President Medvedev issued decree 797 “On urgent measures to eliminate administrative barriers in business activities” (Rossiiskaia Gazeta 2008). The decree explicitly focused on reforming the inspection regime

to curb bureaucratic abuses. It tasked the Duma with developing a number of draft laws to strengthen and enforce anti-corruption measures such as those stipulated by FL-134 within two months of its issue (ibid). It required a further reduction in the amount of times an inspection agency could visit a given firm on a planned inspection, from once every two years to once every three (RIA Novosti 2008). The decree also mandated devolution of oversight of inspection agencies to municipal officials. In December 2008, after two readings in the Duma, FL- 294 was adopted as a replacement to FL-134. Its more important amendments included a reduction in the amount of planned inspections an agency could conduct (from once every two years to once every three), a reduction in the time an agency could be present at a firm from 30 to 20 days, and prohibited a kind of “double jeopardy” in that a firm could not be inspected by more than one agency for the same reason (Zubareva 2008). It established the Council for the Protection of SMEs which was to coordinate efforts between federal and regional authorities to combat corrupt inspections, and was explicitly ordered to include representatives from SMEBAs (Delovaya Rossiya 2008, Rossiiskaia Gazeta 2008). Chairman of the Duma committee on political economy Yevgeny Fyodorov commented, “All of Russian business has been waiting for this bill. Now that we’re in a crisis, the president, government, and Duma must pay special attention to strengthening the position of [SMEs]...” (Granik 2008, para. 6).

The crisis clearly brought SME issues to the forefront of the modernization agenda. Before its acute onset, Russia’s new institutions of small business lobbying, notably OPORA and *Delovaya Rossiya*, had been actively campaigning to improve regulations in this sphere, but with few results. In 2007, federal law 209 “On the development of small and medium entrepreneurship in the Russian Federation” was passed. In addition to adding “micro-“ and “medium-sized” enterprises to the SME classification system, the law was intended to devolve SME support functions to regional and municipal authorities (legis.ru n.d.). Sergei Borisov, the longtime head of OPORA, noted how it was passed after numerous consultative meetings with his organization and other SMEBAs, but was mostly a “law of compromise...a framework. [It] is indirect and encourages rather than prescribes the actions of state authorities” (Delovaya Perspektiva 2008, para. 3). Indeed there is no shortage of vaguely titled laws pertaining to SME support on the books in Russia, just as there is no shortage of cooperation agreements that have been signed between SMEBAs and local inspection agencies and authorities. The crisis galvanized actors at all levels away from these

declaratory gestures which represented little more than an opportunity for some good press toward passing and implementing concrete measures.

After the passage of FL-294 in December 2008, Borisov commented on how the law was a significant step forward for the SME community, but fell short in accommodating many of the recommendations of his and other SMEBAs. While hailing some of the specifics of the law, the SMEBA community wanted an official federal mandate to support SME owners at the point of inspection (this had taken place sporadically at the local level). The law's most important shortcoming according to Borisov was in the "ideology" behind it, that it did not contain wording that mandated prosecutorial and public oversight of the inspection agencies themselves: "In the practice of inspections, there are—as there should be—'punitive' actions. Along with this function of the inspection agencies there must be an inspection of administrative offenses" (Soyuz Promyshlennikov i Predprinimateley Novorossiyska 2008, para. 17). He wanted a mandate for oversight and enforcement, but instead received a marginal "strengthening" of the wording of inspection law.

Solving the problems of implementing FL-294 then took precedence over adopting new legislative measures of SME support. In 2009, despite these legislative reforms, it was estimated that small businesses regularly had to deal with inspections from more than forty different agencies (Ivanchenko 2009d, para. 5). Each agency was still entitled to conduct fifty hours of inspections per year of one small business (ibid). This amounts to over 2,000 hours of inspections which a small business was theoretically obligated to endure (ibid). In 2009 the Russian Duma adopted a program of anti-crisis measures which stipulated the strengthening of oversight of inspection agencies as one of its top priorities (Parlamentskaia Gazeta 2009). Local branches of OPORA across Russia were granted the right to be present during inspections of their members (Orlova 2009, para. 7, OPORA Rossii 2010a).<sup>36</sup> *Delovaya Rossiya*, Chambers of Commerce, and OPORA allied with local independent SMEBAs to conduct seminars on business owners' rights vis-à-vis inspectors (ibidem). Information was widely published in local and national newspapers. Although problems remained, the campaign to reform Russia's inspection regime had shown manifest results.

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<sup>36</sup> See "Oversight", p. 99.

## Inspection Reform: From Legislation to Implementation

Throughout the 1990s and 2000s, Russia's entrepreneurs had to endure unchecked inspectors who had the implicit right to arbitrarily search and seize their private property. Evidence from interviews corroborates that obtained from news archives, indicating that administrative arbitrariness was as much a hindrance to small business in "business-friendly" Moscow as it was in Saratov.<sup>37</sup> The following pages will discuss the implementation of FL-134 and FL-294 at the grassroots level. Saratovskaya *oblast'* provides evidence of the challenges of implementing these new laws, with reference to corollary developments in other cities and at the national level. Saratov illustrates how a coalition of SMEBAs, PEs, and small business owners has worked to curb bureaucratic excess and improve government service provision in the past 10 years. The threat to business presented by the crisis strengthened their position vis-à-vis the *chinovniki*. Although many small business owners are not involved with SMEBAs, it is apparent that they are influenced by their public campaigns to increase business owners' "legal literacy" and have become more assertive in their interactions with local authorities. This three-pronged threat to bureaucratic excess represents a significant critical juncture in the development of grassroots institutions of representation of Russia's local commercial classes.

### The Inspectocracy: The "Grabbing Hand" at Work

Besides extortion, arbitrary seizure of property and merchandise was a significant worry for Russia's small business owners. One representative story took place in the capital, involving the owners of a small crepe (*blini*) stand outside Moscow's Shabolovskaya metro station (Aliakrinskaia 2011). With little explanation or regard for the stipulations of FL-294, unnamed officials drove up to the back of their stand, cut the power cable to the generator powering it, seized the generator and drove off. Later the same evening more officers arrived in a large truck to seize the entire stand, but could not do so as the owners refused to vacate. The ordeal of the owners gained notoriety as they placed placards around their popular stand with slogans such as "Moscow officials terrorize family with many children" and admonishments such as "Prosecutor intervene! Stop this madness!" (ibid, para. 10). When pressed, a local Rospotrebnadzor representative said that the couple had not participated in the appropriate competitive tenders to trade in that location. The husband countered that

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<sup>37</sup> Kontorovich (2005) found that population density was a significant factor in explaining the density of smaller firms in Russia. Thus, Moscow and St. Petersburg tend to have relatively robust small business sectors when compared to the rest of the country.

under FL-294, which simplified the registration process for starting a business, he did not need to obtain permission via that channel. But according to him, “the principle of free enterprise in this country does not apply if business gets in the way of the self-interest of bureaucrats” (Aliakrinskaia 2011, para. 14). As the report of the story went to press in 2011, the issue was tied up in the local court. The couple estimated, however, that they had lost about 190,000 rubles (~\$6,000 US) in revenues and capital just confronting officials (ibid). Once it became apparent that the owners would not go easily, authorities placed portable toilets next to the stand in an ostensibly unconnected move.

Another representative example of this official harassment was detailed in the story of a fabric dealer near Moscow in 2011. His successful firm was charged with copyright infringement for allegedly stealing the patterns for five styles of fabric (Yaffa 2013). Police officers confiscated 527 rolls of fabric, nearly 80% of his inventory. Denying officials’ requests to plead guilty in exchange for a reduced sentence, the dealer was jailed, joining the nearly 100,000 entrepreneurs in jail in Russia (ibid). After nearly a year in jail during which the dubious accusations of his case were examined by Russia’s new federal SME ombudsman (see below), the dealer was finally released. When he attempted to recover his goods, officials could only point him to rolls of fabric with production stamps from November 2012, nearly 10 months after his arrest. The dealer suspected the fabric was sold during his incarceration (ibid).

One interviewee in Saratov cited similar circumstances of a “war on entrepreneurs” which drove him to join the local Chamber of Commerce (Shop Owner 2011). Property was apparently being seized in a similarly peremptory way.<sup>38</sup> Even Saratov’s local Chamber of Commerce branch was not immune from harassment by officials. In 2001 the Chamber became embroiled in a bitter fight to protect their office space which was granted to them for “permanent and uncompensated use” by Governor Ayatskov in 1997 (Smirnova 2001). Their building, which was given to them in much disrepair, was renovated over the course of four years at a cost of nearly six million rubles (~\$200,000 US). In 2001 the grant for use of the premises came under review as accusations were raised that the building’s dilapidated sections had become a haven for drug addicts and dog fights, which the former head of Saratov’s Chamber Vladimir Davydov vehemently denied (ibid). In July of 2001, Ministry of Internal Affairs officers forcibly blocked entry to the building. After further review, city

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<sup>38</sup> See “The Chamber of Commerce”, p. 128.

officials left the Chamber with only 400 square meters of office space of their original 1800, giving the rest to the Investigations Department of the regional prosecutor's office. The city police vowed to keep pressing the Chamber with inspections, which Davydov attributes to the lawsuit the Chamber filed against them (ibid).

While it could not be verified how much the prosecutor's office was involved in pushing the Chamber out, what can be is the dramatic shift of alliances toward the end of the decade. By 2009, just following the adoption of FL-294, the prosecutor had become one of the Saratov small business community's most important allies. It took up the fight against bureaucratic "arbitrariness", often with little or no prompting from small businesses or SMEBAs themselves (Andreyeva 2009). One of the main stipulations of FL-294 was that inspection authorities had to obtain permission from the local prosecutor's office to conduct unplanned inspections (ibid 2009, para. 10). The prosecutor's office refused permissions to the State Fire Inspectorate as well as Rospotrebnadzor for unscheduled inspections of numerous firms in 2009 due to insufficient grounds for inspection (Prokuratura Saratovskoi Oblasti 2010, Novosti Saratova 2009). Local sources reported that such permissions were denied to inspection authorities more than 50% of the time (ibid 2009, para. 11, Vestnik Torgovo-Promyshlennaya Palata Saratovskoi Oblasti 2009, para. 4).<sup>39</sup>

In Trisha, a small town in Saratovskaya *oblast'*, Rospotrebnadzor inspected a funeral services firm at the request of an unnamed competitor. The prosecutor intervened *without request for assistance* to successfully stop Rospotrebnadzor under the stipulations of FL-294 (Andreyeva 2009). Furthermore, the prosecutor's office responded to complaints from the business owners themselves against Rospotrebnadzor for improper handling of the case (ibid, para. 6).

In another case, prosecutors cited police inspectors after it was revealed that they had seized nearly 90 bottles of vodka from local shop owners without reporting where those bottles had been taken (ibid). In a more high-level case, charges were brought against a deputy head of the city administration for using inspections to exploit Russia's small privatization scheme for personal profit (Andreyeva 2009). Under the scheme, ownership of

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<sup>39</sup> These sources reported during different times in 2009. Andreyeva reported in September that 437 requests for unplanned inspections, of which 52% were denied. Vestnik Torgovo-Promyshlennaya Palata Saratovskoi Oblasti (the Journal of the Saratov Chamber of Commerce) reported in October 500 requests for inspections, of which 55% were denied.

state-owned property can be sold at subsidized rates to citizens who demonstrate need or long-time residence (this is essentially the same scheme given to SMEs to be discussed in chapter four, but for individual citizens). According to the prosecutor, this city administrator conspired to exploit the inspection regime to facilitate the transference of a property to a relative, who then sold the property for an unknown profit margin to a neighboring business looking to expand (Andreyeva 2009).

Saratov implemented an “anti-corruption” plan in 2006, nearly three years earlier than Russia as a whole (Kokhovets 2011, para. 18). Regulating inspection regimes was a key aspect of this plan. In 2009, under the stipulations of FL- 209, the Russian federal prosecutor, and the president, the city of Saratov established the local Council for the Protection of SMEs. The council would meet quarterly, and would consist of eight members, seven of which would be representatives from local universities, public and business associations, including OPORA and the Chamber of Commerce (Novosti Saratova 2008, Glivenko and Zakharova 2008). According to local Duma deputy and entrepreneur Viktor Markov, the first priority of the Council should be to protect SMEs from inspection authorities, not necessarily through strengthening laws but by ensuring compliance with existing laws (Glivenko and Zakharova 2008). Indeed, point three of the Council’s charter explicitly mentions utilizing its authority to enforce FL-134 (this was just before FL-294 was adopted) (Torgovo-Promyshlennaya Palata Saratovskoi Oblasti 2008). With the participation of the Council, the oblast’s Ministry of Economic Development and Trade established a telephone hotline for entrepreneurs to register complaints about unlawful inspections. Following the highly publicized adoption of FL-294 in 2009, the Ministry reported an increase in complaints via this hotline (Torgovo-Promyshlennaya Palata Saratovskoi Oblasti 2009).

The effect of this campaign against corrupt inspections is quite remarkable. In the six months following the adoption of FL-294, the number of police checks had be reduced by a factor of seven (Torgovo-Promyshlennaya Palata Saratovskoi Oblasti 2009). In 2010, the first full year with FL-294 in effect, Saratov’s public prosecutor reported other notable results. They challenged 1520 violations by inspection authorities. Seventy-seven agencies and officials were taken to court. In all, disciplinary action was taken against 364 officials (Torgovo-Promyshlennaya Palata Saratovskoi Oblasti 2011). For the first three quarters of 2011, the numbers were similarly notable. Approximately 1,000 violations were reported. Courts handled 191 cases regarding these violations (ibid). Disciplinary action was taken

against 377 officials. Furthermore, the prosecutor received 163 requests from inspection agencies to conduct unscheduled inspections. It denied 110 of them (ibid). Chairman of Saratov's Chamber of Commerce Maxim Fateev publicly thanked prosecutors for their diligence in implementing FL-294, noting that his organization saw a significant reduction in complaints from members regarding unfair inspections since the adoption of FL-294 (ibid). These outcomes reflected Russia-wide developments: the federal prosecutor reported that 45% of all requests to conduct unscheduled inspections in the months following the adoption of FL-294 had been denied (Torgovo-Promyshlennaya Palata Saratovskoi Oblasti 2009). By 2011, a World Bank analysis of results from the Business Environment and Economic Performance Survey (BEEPS) of regional firms in Russia showed that 48.8% of firms reported visits from inspectors, down from 63% in 2008. The average number of inspections per firm for that year was 2.6, down from 3.2 in 2008 (World Bank 2013).

### *SME Rights versus Consumer Rights*

A tension remained between protecting consumer rights and those of business owners. A 1992 law "On the protection of consumer rights" allowed citizens to form consumer advocacy groups which were given the right to conduct inspections and report infractions to relevant authorities (Prokuratora Saratovskoi Oblasti 2009). Disgruntled employees and local competitors often exploited this right of "independent inspection". They could simply slander the firm by telling an inspection authority that the merchant was selling expired goods (Vestnik Torgovo-Promyshlennaya Palata Saratovskoi Oblasti 2009). This would bring the bureaucratic extortion machine to bear on the target firm. Boris Titov, Russia's federal ombudsman, reported that nearly 80% of all improper legal cases against business owners arise from disputes between competitors (Yaffa 2013, para. 18). A dispute occurs, and one side informs the authorities. Mr. Titov noted that those involved in the accusation and investigation "have learned very well how to take advantage..." (ibid 2013, para. 18). The tension between public welfare on one hand and defending the rights of small business owners in the face of corrupt officials on the other became one of the most intractable problems in this sphere.

Ostensibly to involve the public in protecting fellow consumers from shoddy or dangerous products, this law encouraged these "civil society" groups to become informants as a means to extort bribes from small businesses. One interviewee in Saratov indicated that this was a common scam, and at times it seemed as if "these guys" were coming several times

a month (Manager of Beauty Salon 2012). A lawsuit in Saratov against one such group, the Committee for Public Control in Consumer Rights Protection and Human Welfare, illustrated how these groups exploited small business owners' fear of inspection using thuggery and deception. As described by the head of a local Head of Business Development, Consumer Market, and Trade Administration Natalia Ermeeva, "four stout guys came in and intimidated the sellers...those who did not pay were given subpoenas" (Vestnik Torgovo-Promyshlennaya Palata Saratovskoi Oblasti 2009, para. 6). Local prosecutor Grigorri Archtyrko continued, "[these subpoenas] were from the 'Office of the Ministry of Justice of the Saratov Region'. They couldn't be disobeyed. But upon closer examination of the documents they did not possess the proper seals or signatures" (ibid, para. 7). The trial resulted in a shutdown of the offending committee. Saratov's head legal advisor for the Federal Service for Supervision of Consumer Rights and Protection of Human Welfare noted that of the "huge number" of citations her agency receives from these independent organizations, only about 5% are acted on (ibid, para. 8). She said that this was a result of two factors. First, most of the citations are improperly written-up. Second, her agency simply does not have the capacity to check every instance of a merchant "selling expired yogurt" (ibid, para. 9).

Indeed, there are many instances of small retailers neglecting to maintain reasonable health and safety standards. In an illuminating Q&A with the Deputy Head of Saratov's local Rospotrebnadzor office, Olga Kozhanova responded to questions from local consumers on everything from merchants selling expired cheeses and milk to restaurants not maintaining clean restrooms (Sarinform Elektronnaia Gazeta 2012). The complexities of inspection reform are apparent from the discussion. On the one hand, unscrupulous inspectors—both official and unofficial—hinder the growth of Russia's small business sector. On the other, many small companies cut corners to make a quick ruble at the expense of the consumer. Finding a balance between protecting the rights of consumers in the face of unscrupulous business practices and protecting the rights of business owners in the face of "overprotective" government requires a prolonged period of formal and informal negotiations between actors at all levels of the socioeconomic and political spectrums.

### *The Ombudsman*

In June 2012, fulfilling a campaign promise to further protect the rights of entrepreneurs (Rubchenko 2012, para. 2), President Putin established a national ombudsman

for entrepreneurial rights that would have direct access to him (Rubchenko 2012, Yaffa 2013) Speaking at the St. Petersburg Economic Forum, President Putin acknowledged entrepreneurs continuing plight, saying:

Entrepreneurs continue to face violations of their rights, bureaucratic pressure, corruption, and administrative barriers, all of which need to be addressed today... That is why a new ombudsman for the rights of entrepreneurs has been created... He will have the right to defend the interests of business and suspend official actions against entrepreneurs until they have been tried in court (Rubchenko 2012, para. 2)

Candidates for the position were drawn from Russia's SMEBA community (ibid). Ultimately, Boris Titov, then head of *Delovaya Rossiya*, ascended to the position. He noted how Putin created the position at the explicit urging of the heads of Russia's main SMEBAs, OPORA and *Delovaya Rossiya* (Kommersant Online 2012). Each organization imparted on Putin that the main problem facing Russia's SMEs was corruption, and in particular the seizure of property through coercive inspections (ibid, para. 2). One of the ombudsman's primary goals would be to resolve this continuing problem. His support structure for doing so derived from cooperation with SMEBAs of all sizes, but in most cases with OPORA, *Delovaya Rossiya*, and the Chamber of Commerce (ibid).

Titov echoed the view that new legislation was not needed to improve conditions for business in Russia, but enforcement of existing legislation, calling it a "management issue" rather than one for lawmakers (Rubchenko 2012, para. 7). Along with ascending to the position itself, Titov also ascended to the highest echelons of *Nezavisimaya Gazeta's* "Top Lobbyist" list on the premise that the new ombudsman was given unprecedented powers to suspend investigations and legal actions against entrepreneurs until the case could be examined by his office or other independent authority (Melnikov and Toloknova 2012).

Since the establishment of the office, it has received several hundred thousand pleas for assistance, but has only been able to respond substantively to a few hundred (Yaffa 2013). One of Mr. Titov's major achievements was an amnesty for those jailed for so-called "economic crimes" (ibid). Of the nearly 100,000 entrepreneurs incarcerated, only 1500 have been freed, and only on paper. Of those 1500, only 116 have actually left the place of their imprisonment (ibid, para. 33). Furthermore, the amnesty did not apply to those accused of "fraud", a general legal term used to keep nearly 70% of Russia's incarcerated entrepreneurs behind bars (ibid, para. 34).

## Conclusion

Clearly then, the achievements of Russia's SME community must be understood in context. Although inspections are still a problem throughout Russia and entrepreneurs often face harsh administrative treatment, the curbing of bureaucratic excess in the area of inspections has been a remarkable achievement for Russia's SME community. One interviewee in Saratov cited this explicitly, praising authorities for adhering to the new regulations and posting the inspection schedule online (Owner of Clothing Shop Chain 2012). Unscrupulous inspectors from both official and "consumer protection" organizations now largely appear to prey on new small businesses who have less experience with the law and asserting their rights (Olimpieva 2009, 206). Reforming Russia's inspection regime has been central to the organizational mission of Russia's SME community. It was a key issue in the initial efforts to consolidate a disparate group of SME owners into a coherent lobbying interest. Combined with the 1998 crisis, which drove PEs to deliver concrete measures to support local business communities, the rampant abuse of power and rent-seeking on the part of officials provided a compelling rationale for establishing a close relationship between the centers of political authority and small business actors.

By 2008, two Russia-wide SMEBAs provided a channel of institutionalized access to policymakers. For most of the 2000s, Russia's economy prospered and small business development appeared to take secondary significance to Russia's overall economic development. Economic shock altered this trajectory for the second time in Russia's post-Soviet history. The 2008 global financial crisis again demonstrated Russia's susceptibility to the vicissitudes of the international marketplace. In the wake of the crisis, inspection law was further tightened in favor of SME interests. With the aid of Russia's main SMEBAs, legislative changes took a matter of months, not years.

PEs and SMEBAs have been central to the formal stages of legislative reform. Lobbying efforts and the adoption of official legislation represent the high-level aspects of institutional change. However, especially in transitional societies or those where government penetration into society is superficial, implementation and enforcement of formal legislation is arguably a more important aspect of institutional reform. If state agents do not respect the letter and spirit of a new law, then little will change. If societal actors do not respect the capacity of the state to enforce its laws and protect its citizens, little will change. In this

regard, it is the small business owners themselves who represent the social aspects of institutional change. This is the focus of the remaining empirical chapters of this dissertation.

### **Theoretical Perspectives on SME Consolidation and Inspection Reform**

The evidence in this chapter illustrates the transition from the *Status Quo* model to an *Emergent* model as presented in chapter one. The model presented in this chapter fits closely with the paradigmatic *Emergent* model, but provides a more nuanced perspective on the genesis of the dynamics underpinning the transition. The following empirical factors help to explain why Russia's SMEs were able to consolidate as a coherent political interest:

- 1) Russia's low level of legal and institutional development meant that the "business interest" was a general one. Providing basic legal protections and understandings in state-business interactions was a fundamental concern to a wide array of SMEs, from small retailers to medium-sized manufacturers. Many of these *de novo* private firms did not have the resources to build exclusive, mutually beneficial "elite exchange" relationships with officials. They by-and-large were not lucrative enough to be the target for "capture" by the state, nor did they possess the financial capacity to "capture" a state office. They were subject simply to the "grabbing hand" of the state. They paid bribes in order to avoid costlier legal proceedings or fines; in essence, to have Russia's ambiguous legal code interpreted and applied in their favor and only in one-off, particular circumstances.
- 2) The economic shocks of 1998 and 2008 were crucial turning points in consolidating the SME interest. The 1<sup>st</sup> All-Russia Congress of SMEs in 1996 produced little if any tangible outcomes for SMEs. However, following the 1998 financial crisis, the necessity of diversified domestic economic development became apparent to Russia's political leaders. The role the inspectocracy played in hindering that development was publicized during the (much smaller) 2<sup>nd</sup> All-Russia Congress of SMEs in 1998. Yet the effects of the economic shock multiplied the effects of the 2<sup>nd</sup> Congress. The participants were wary of empty declarations, and political leaders were ready to give the SME sector what it needed if it could contribute to economic stability.
- 3) The emergence of a presidential "power vertical" underneath Vladimir Putin incentivized support for its economic modernization agenda. Central to this agenda was the growth and development of Russia's SME sector. The state sanctioned the creation of Russia's two national SMEBAs, OPORA and *Delovaya Rossiya*, and tied

them closely to the power vertical to provide them with a regularized channel of access to the policymaking process. This created a group of political entrepreneurs both within and outside these organizations who advanced the SME interest in conformity with the spirit of the modernization process. Political actors and the organized SME community were then able to spearhead a campaign against the most immediately salient SME concern: inspections.

When understood in terms Russia's transition, Olsonian collective action theory provides an explanation as to why Russia's SMEs were able to overcome the problems they faced as collective actors. The state co-opted the encompassing interest of the SME sector into two "peak associations" as one strategy to address the economic concerns facing the country. External financial shocks exposed Russia's vulnerability as a resource-driven economy. Internal bureaucratic corruption exacerbated this vulnerability as it stifled prospects for diversified economic growth. Maxfield and Schneider (1997, 25) and Markus (2007) note that in many cases, political and economic actors will invest in collaborative relationships when they feel threatened. Each economic crisis called into question the capabilities of those in charge, and at the same time exacerbated the difficulties low-level private sector actors were already facing in their relationship with state agents. The institutional effects of this dynamic are further discussed by Maxfield and Schneider (1997, 29):

...when government elites seek business cooperation because they feel threatened, their policies may be more credible. When the threat is apparent to business participants as well, they know to which political pressures government officials are responding. Such threats make governments more transparent and in this sense help authoritarian regimes resemble more inherently transparent democracies.

In short, the difficulties SMEs faced as a collective interest, coupled with an increasingly assertive but debilitated central state pursuing an economic modernization agenda, and low-level state agents who hindered the achievement of that agenda, drove the central state and SMEs into a synergistic coalition to rationalize state-business interactions. The reform of Russia's inspection regime was one public manifestation of this. The encompassing interest of SMEs, whose influence was magnified through state co-opted collective action and by the effects of economic crises, drove the push toward institutional "modernity" in one area of the bureaucracy by pursuing the encompassing public good of inspection reform. As the next chapter will demonstrate, the by-products of SMEs' pursuit of their collective interest tend to produce "modern" institutional arrangements as well.

## **CHAPTER 3: INSTITUTIONAL OUTCOMES OF RUSSIA'S SME MOBILIZATION: A REGIONAL PERSPECTIVE**

### **Introduction: The Institutional By-Products of SME Collective Action**

A central argument of this dissertation has been that the central state's efforts to mobilize the SME community are part of a strategy to enlist the SME sector as an ally in the fight against bureaucratic abuse. The SME sector's natural proclivity to support impartial, Weberian-style administration means that the state's empowerment of the SME sector is in effect a tactic of promoting administrative modernization. As an individual SME rarely takes the fight against bureaucratic abuse to the national stage, it is a battle waged at a grassroots level. It takes place during gatherings of SMEs in municipal halls. It is voiced in local media outlets. Such local-level forums represent institutional "by-products" of protected consultation that have emerged as a result of high-level efforts to mobilize the SME community.

### **Empirical Puzzle and Theory**

The empirical puzzle of this chapter centers on why these institutional arrangements have emerged in Russia's regions and how this emergence is conditioned by high-level support for SMEs through Russia's peak SMEBAs. This regional-level analysis helps to illustrate the "on the ground" manifestations of SMEs working as a "mobilized latent group". When compared with that of the previous chapter, the model of SME influence on the provision of public goods is not so "neat" and linear. The "latent" aspect of SMEs as a collective interest reveals itself more prominently, de-emphasizing the previous chapter's focus on the "mobilized". In this chapter, public goods outcomes are not viewed in terms of SMEs mobilizing to achieve victories in the legislative arena or against local administrative barriers. Indeed, the evidence to be presented indicates frustrated efforts in these areas. However, SMEBAs advocating on behalf of their SME constituents dominate much of the discourse on SME issues. They organize conferences that bring together SME representatives and administrative authorities. They oversee the implementation and enforcement of federal level legislation in cooperation with their SME constituents and local administrative bodies. They research their constituents' concerns, which in turn help to inform the policy initiatives they put forth.

In terms of the overall hypothetical model presented at the outset of this dissertation, by-product institutions of protected consultation represent manifestations of the dependent variable of Olsonian “public goods”. This borrows from Olson’s (1971) own terminology. He argues for a “by product” theory of collective action, in which an interest group engages in other activities or provide other benefits besides lobbying for collective goods for the group. This theory applies specifically to large or latent groups, because within such groups individual members have fewer incentives to participate in group action than in smaller groups with more defined objectives (ibid, 134). They must either be coerced into participating (which is not the case in Russia as membership in BAs is voluntary) or persuaded to participate through the provision of attractive selective incentives to group members. According to Olson,

an organization that did nothing except lobby to obtain a collective good for some large group would not have a source of...positive selective incentives it could offer to potential members. Only an organization that also sold private or noncollective products, or provided social or recreational benefits to individual members, would have a source of these positive inducements (1971, 133).

In Russia, the by-products of SMEBAs’ lobbying activities that induce SMEs to participate are the forums of interaction between state bodies and SMEs that allow members of the SME community to voice their concerns with administrative issues, check the infractions of officials, discuss common problems and otherwise build networks and solidarities within the community. In this sense, SMEBAs provide forums for interaction for SMEs that act as a "social benefit" by-product of SMEBAs' formal lobbying activities.

These “by-product” institutions act as channels by which the encompassing interests of Russia’s SMEs are directed toward the provision of public goods. However, they do not fall into an immediately intuitive conceptualization of a public good as they did not emerge as a result of a specific campaign by SMEs as a collective interest. In this sense they do not represent an explicit “achievement of a common goal or the satisfaction of a collective interest”, but, given their inclusivity toward all members of the SME community, they fall under the definition of a public good as laid out in Olson’s original conceptualization in that they are beneficial to the group and cannot be withheld from any members of the group (1971, 15). In short, SMEs may not have campaigned for these institutions’ *specific form* as they would for a legislative outcome; rather they emerged as institutional by-products to accommodate SME mobilization within the framework of Putin's modernization agenda.

They are manifestations of high-level political interest in providing SMEs with a regular channel of access to policymaking and influence in the administration, which is one of the selective incentives the Russian state has offered SMEs to mobilize them out of their latency (Yakovlev, Zudin and Golikova 2010).

### **From Regional Autonomy to a Standard of Protected Consultation**

The high degree of regional autonomy in Russia means that regional authorities are faced with the task of implementing the national modernization plan. Yakovlev's (2006) emphasis on the regional and municipal levels stems from his argument that the federal government has provided all it can in terms of legislation, and the onus of ensuring enforcement and tailoring policies to the needs of their localities falls on regional and municipal administrations. At a 2003 regional development meeting, Putin noted that "the creation of a favorable environment for the development of small- and medium-sized enterprises depends on regional and local authorities, and on their ability to provide the necessary support to entrepreneurs" (ITAR-TASS 2003, para. 2). Yakovlev (2006, 1052) contextualizes the regional ramifications of this, emphasizing how Putin's power vertical incentivizes support for SMEs among regional leaders:

new [regional] leaders have long-term ambitions and consequently want to foster growth in their regions. Some of them understand they will not be able to gain promotion to the federal political elite...unless they achieve a genuine improvement in the standards of living in their regions. This will demand a pragmatic and constructive interface with the business community.

Many terms have been used by scholars to allude to Russia's weak central control over the peripheries—"debilitated dirigisme" (Markus 2007), "segmented regionalism" (Sakwa 2008, 255), and "neo-feudal" (Sakwa 1999, 194). But the empirical evidence indicates that the accommodation of the SME interests in the political arena appears to generate a standard set of institutional mechanisms to support their campaigns for public goods provision, despite Russia's significant cross-regional institutional heterogeneity. Yakovlev, Zudin and Golikova (2010) argue that BAs have become an important element of the "system of exchange" between business and the state at the regional level. This exchange involves BA members supporting regional and municipal authorities with the social development of their respective localities, and in return the BA members are much more likely to receive state support for their initiatives and interests (ibid). The authors added that no such system is apparent in federal level interactions between (big) business and the state.

A. A. Yakovlev (2006) argues that the strategies of collective action undertaken by smaller businesses at the regional level will likely be a more effective countermeasure against the bureaucratic consolidation that took place under Putin in the 2000s than the activities of a few large-scale financial-industrial groups with increasingly supranational roots. Despite the abundance of rhetorical derision directed at the bureaucracy by political authorities, under Putin the bureaucracy grew considerably and almost exclusively in Russia's regions. The number of *chinovniki* in Moscow grew from 38,000 in 2000 to 42,500 by 2006, while the number of *chinovniki* in the regions grew from 483,700 to 786,000 in the same time period, an increase of 62% (Huskey 2009, 222).<sup>40</sup> At local levels and among smaller firms, business communities' response to this bureaucratic consolidation takes on a different character than at higher levels of analysis. Drawing analogies from Hirschman's (1970) concepts of "exit" and "voice", Yakovlev (2006) argues that smaller Russian companies will be more likely to undertake collective action measures to improve local business conditions (i.e. to "voice" their concerns) than larger, who often internationalize their operations through sales of company stocks to foreign investors as a strategy to "exit" a market where the dynamic of "state capture" by business is increasingly giving way to "business capture" by the state (ibid). Small businesses' modest resources preclude the "exit" option. If they are impelled to respond to administrative problems, it would be through "voice" and a mechanism of collective action.

Although significant progress has been made in consolidating and exercising authority at the federal center vis-à-vis the regions under Putin and Medvedev, politics in Russia can still be characterized by a high degree of regional autonomy. Regional leaders emerged to assert control over regional political economies with varied outcomes: within some regions political regimes took on an authoritarian character, while within others parliamentary-democratic decision-making mechanisms developed (Petrov and Titkov 2010, 20; Sakwa 2008, 255). In such an environment, acute principal-agent dilemmas emerged as the federal

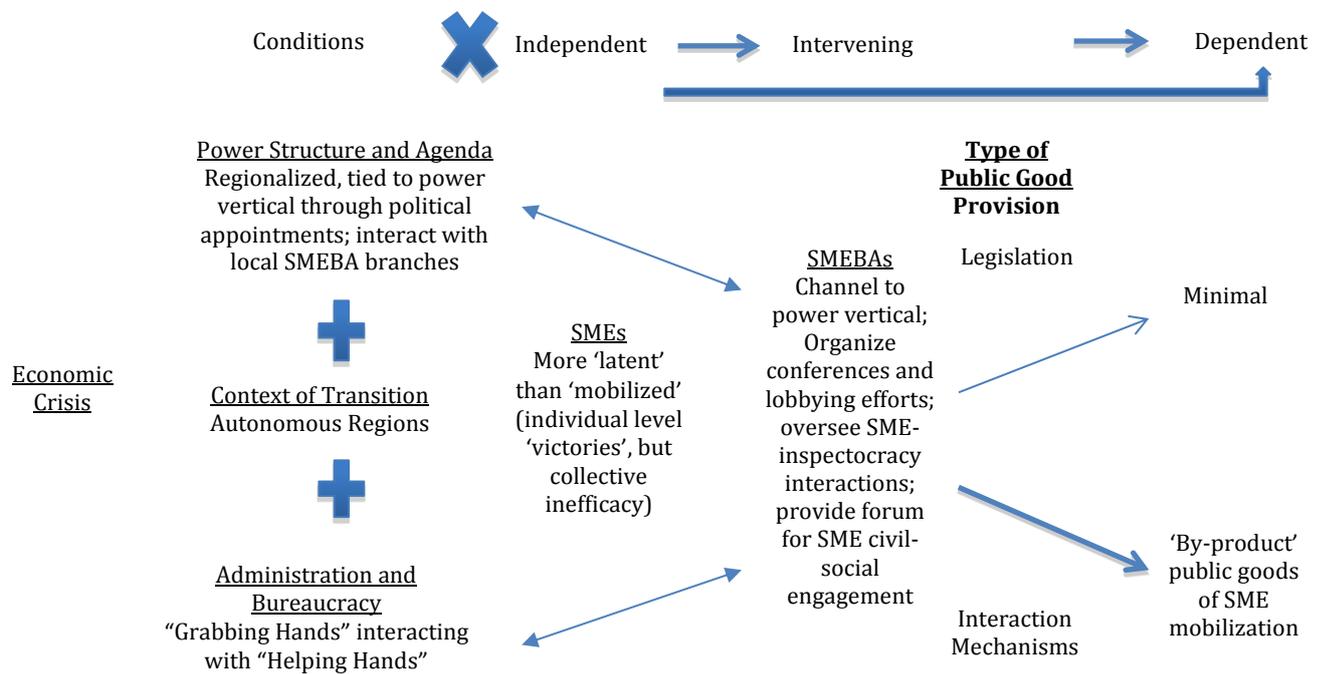
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<sup>40</sup> This may seem to counter the argumentative thrust of this thesis and indicate an increasingly difficult battle for SMEs. However, the hypothetical relationship examined in this thesis pertains to what has been dubbed the *inspectocracy* in previous chapters, which is a sub-unit of the overall bureaucracy and against which SMEs' collective efforts have been directed. More importantly, the argument advanced in this thesis is not that SMEs "destroy" bureaucracy by limiting or reducing the number of *chinovniki* employed by the state, but rather that their efforts as a state-empowered encompassing interest are directed toward professionalizing and "modernizing" the bureaucracy as defined at the outset of this dissertation.

executive-as-principal tried to compel its bureaucratic agents to enforce its mandates (Markus 2007, 278). For their part, these agents had to evaluate the risks and rewards associated with satisfying their parochial interests, and those associated with implementing federal modernization programs, whose anti-corruption bent could deprive them of a significant part of their livelihoods.

## **Hypotheses and Model**

The model presented in this chapter represents a deviation from the paradigmatic model presented in chapter one, and to which the modified model presented in chapter two largely adhered. As the level of analysis is scaled down to the regional and municipal levels, the channels of SME influence on readily apparent political outcomes—e.g. formal legislation—are not as “neat”. Arguably as important however, are the “by-product” public goods that have emerged to foster SME influence both in the development of formal, legal acts and in normative behavior of actors on the ground. These institutions are the focus of this chapter. At this level, SMEs’ effects on political institutions are less about formalized lobbying for a particular outcome—although these are a factor at the local level to a degree—than they are about a socially negotiated set of relationships between local firms and administrations that have emerged as a result of the practical need to grow regional business sectors. The forums that have emerged to represent SME interests, the empowerment of individual small business owners, and their growing participation in civil society will all be discussed as representative of SMEs’ participation in grassroots institutions of protected consultation. In this sense SMEs can reinforce the push toward institutional “modernity” as conceived in this dissertation at the local level. Behavioral norms on the part of independent business and the officialdom are being renegotiated in a variety of social spheres toward a more active role for these independent actors and a more responsive, service-oriented role on the part of local administrations.



**Model 2: Regional Level Modified Model**

The empirical thesis of this chapter can be stated as follows: the SME community, as an encompassing interest, must work within broadly representative institutions to accommodate its wide range of constituents in their pursuit of public goods. These “by-product” institutions to channel SMEs’ collective pursuit of formal public goods *in themselves* represent key public goods of regularized institutional access to the state decision-making apparatus. As institutions representing Russia’s nascent commercial class, they are manifestations of the “modernizing” dynamic at the theoretical crux of this dissertation. The state’s interest in mobilizing the SME community and the political incentives for local political leaders to support the nation’s modernization agenda encourage their emergence and proliferation. As the empirical evidence of this chapter will demonstrate, accommodating the SME collective interest produces a relatively standard set of “modern” institutional outcomes.

The primary hypothesis to be explored in this chapter is formulated as follows:

**H1:** Despite a high degree of regional institutional heterogeneity and difficulties achieving formal political outcomes, SME collective action as a state-subsidized

endeavor will result in the provision of a relatively standardized set of “by-product” public goods of SME representation throughout Russia’s regions.

**Explanation:** The significance of local economic development to the federal modernization plan, coupled with the lack of institutional alternatives at the regional level, prompts political actors and SME interests to engage in these representative forums of interaction.

In this model and at the regional level of analysis, SMEs’ individual weakness as latent group actors becomes more apparent as their frustrations with administrative barriers and corruption are revealed. SMEBAs interact directly with regional political authorities and administrations. Many accounts illustrate “victories” against local administration and bureaucracy, but this largely appears to be on an individual level. Olimpieva (2009) explores this view, finding that a primary function of many SMEBAs is to act as intermediaries between local administrations and individual business owners to solve particular problems, rather than as interest lobbying organizations for the SME community as a whole. This view holds even more relevance in chapter four. It drills down deeper into a municipal level of analysis, and reveals that widespread “free-ridership” on the part of individual SMEs and their interactions with administrative authorities are largely carried out on an individual basis. These factors may be part of the explanation for SMEs’ continued “latency” as a collective interest.

However, the tension between this “individualistic” model of administrative service provision and that of a “modern”, impartial system of protected consultation illustrates the dynamics at play as the *Status Quo* model of business-state ties is influenced by the *Emergent* model as discussed in chapter one. There is evidence for the emergence of a standardized interface of SME-state ties which serve to balance local-level needs with federal-level objectives. In many regions across Russia, local Chambers of Commerce, branches of OPORA, and other smaller, independent business associations have routinized their participation in meetings with regional political leaders. For federal authorities, the condition of the SME community in each region provides a more accurate gauge of the sincerity and effectiveness of regional leaders’ efforts to improve standards of living and business climates than do the myriad proclamations of regional leaders’ support for business growth (Yakovlev 2006). Speaking to an assembly of small business owners in Tver, Duma deputy Vladimir Vasiliev stated, “You [the small business owner]...see where there are empty words [from

authorities], and where there is action” (Ivanchenko 2009a, para. 2). In contrast to their larger counterparts, who have the resources to fend off irksome inspection regimes and to lobby for individualized legislative advantage for their enterprises, small business owners experience the “real” business climate in their respective regions. Their collective experiences, when aggregated in and channeled through a SMEBA, become a measure by which regional leaders can assess and improve the business climate for this broad range of actors.

## Method

The following pages present a story of SME-state interactions in four regions in Russia. Analysis of local business journals, media, and parliamentary archives, largely carried out through the Eastview database of regional newspapers and governmental records, was the primary data collection method. The primary case selection rationale was based on OPORA’s 2009 index for quality of business climate for SMEs (OPORA Rossii 2009).<sup>41</sup> Irkutskaya *oblast’*, Tverskaya *oblast’* and Krasnodar *Krai* were the three lowest-ranking regions on the index. Saratovskaya *oblast’*, whose capital city, Saratov, was the focus of an in-depth case study to be presented in the following chapter, did not feature in the OPORA indices. However, much of the data gathered for the case study are more relevant at this regional level of analysis, and are therefore presented in this chapter. Irkutskaya *oblast’*, Tverskaya *oblast’* and Krasnodar *Krai* also ranked quite low on the World Bank’s rankings of Russia’s regional business climates as derived from the 2009 Business Environment and Economic Performance Survey (see Table 1 below).<sup>42</sup> The assumption behind this case

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<sup>41</sup> The OPORA Indices from 2009 and 2011 ranked selected regions based on extensive surveys of SME owners in those regions. They were asked to rate their perceptions of the quality of the business climate in five areas: property and infrastructure, human resources, financial resources, administrative climate and security, and the system of suppliers and business services.

<sup>42</sup> A team from the World Bank derived these indices from the 2009 Business Environment and Economic Performance Survey (BEEPS) of businesspeople in Russia’s regions. The “Administrative Obstacle” index utilized responses to questions regarding perceptions of how much the regulatory environment was an obstacle to a business’ operations. The “Administrative Corruption” index was created from respondents’ answers to questions about the frequency of “additional payments or gifts” to officials in order to obtain administrative services. The “Graft” index is similar, but measures respondents’ actual experience with paying bribes—i.e. how often their firm has had to pay one to obtain an administrative service—while the ACI is a composite measure of respondents’ perception. The “State Capture” Index is derived from respondents’ answers regarding the extent to which private payments from a firm was able to affect the “rules of the game” in terms of legislative outcomes or governmental decrees (World Bank 2013).

selection was that these would be the regions in which the difficulties of the business climate would be the most acute, and therefore the hypothesis proposed herein—that SMEs have an affect on the quality of institutions—would be most likely to manifest itself. This in turn would illustrate more general incentives behind SME-state ties in the broader context of the difficult national-level Russian business climate.

An issue of representativeness in the case selection arises given that Russia is the world's largest country, with over 80 *oblasti*', *krai*, semi-independent republics, autonomous and federal districts. The method employed in this chapter—i.e. qualitative analysis of local business journals and parliamentary archives—coupled with limited research resources meant that the analysis could only focus on a small number of cases. However, with these limitations, efforts were made to select regions that were similar in terms of their primary economic indicators, population and geographic sizes, and SME presence (see below). They should not be taken as representative (necessarily) of similar dynamics taking place in Moscow, or in the far reaches of Siberia in the Jewish Autonomous *oblast*', for example (although hopefully the analysis can provide certain insights into SME-state ties in Russia in general).

A critique can also be raised that these regions with the poorest rankings on the OPORA index would not be representative of regions that performed better on the index. This is a valid critique, and should be borne in mind as one proceeds through the chapter. However, with official corruption still rampant throughout Russia, and with Russia's main SMEBAs, OPORA, the Chamber of Commerce, and *Delovaya Rossiya* operating in nearly all of Russia's regions, a reasonable assumption can be made that the dynamics of SME-state ties in these selected regions, conditioned as they are by the presence of these SMEBAs, are likely similar to those in many other regions. But other intervening factors such as geographic location, resource wealth, and political characteristics may affect the relative strength of SME influence on local institutions in different areas.

### The Regions: Overview and SME Indicators<sup>43</sup>

Tverskaya *oblast*', located on the well-travelled road between Moscow and St Petersburg, was ranked 35<sup>th</sup> out of the 35 regions surveyed in the OPORA 2009 Index for

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<sup>43</sup> Unless otherwise indicated, key indicators were taken from the OPORA 2011 index. Note that the index provides indicators for *small* enterprises (SEs) (see footnotes on pages 37 and 49).

quality of its business climate for SMEs. Irkutskaya *oblast'*, a largely rural province in eastern Siberia famous for its proximity to Lake Baikal, ranked 34<sup>th</sup>. Krasnodar *Krai*, on the northeast shores of the Black Sea, was 33<sup>rd</sup>. This region's main city is Sochi, which hosted the 2014 Winter Olympics. Preparing for the event cost Russia approximately US \$50 billion—the costliest Olympic games in history (Yaffa 2014)—and may account for its meteoric climb to the number two spot in OPORA's updated 2011 index. Saratovskaya *oblast'* straddles the southern Volga River and borders Kazakhstan, and did not feature in the OPORA indices. But the region has been at the forefront of initiatives to monitor the effectiveness of legislation aimed at reducing administrative corruption (Torgovo-promyshlennaya palata Saratovskoi oblasti 2010a, Benina 2010). Following Saratov's example, pilot programs have been established in eight other Russian regions (Benina 2010).

Table 1 illustrates each region's business climate according to a number of indicators (those in bold indicate cases selected according to their OPORA 2009 Index rankings):

	Russia Total	<b>Krasnodar <i>Krai</i></b>	<b>Irkutskaya <i>Oblast'</i></b>	<b>Tverskaya <i>Oblast'</i></b>	Saratovskaya <i>Oblast'</i> <sup>44</sup>
Area	17,098 thousand km <sup>2</sup> <sup>45</sup>	75.5 thousand km <sup>2</sup>	774.8 thousand km <sup>2</sup>	84.2 thousand km <sup>2</sup>	100.2 thousand km <sup>2</sup>
Population	142.5 million <sup>46</sup>	5.2 million	2.5 million	1.4 million	2.5 million
Gross Regional Product per Capita 2011**	~ US \$13,324 <sup>47</sup>	157,586 rubles (~ US \$3,906)	182,199 rubles (~ US \$4,516)	143,292 rubles (~ US \$3,550)	190,500 rubles (2012) (~ US \$4,721)
Proportion of Population Employed in SMEs	27% (2011) <sup>48</sup>	14% (SEs only)	13% (SEs only)	13% (SEs only)	24.8% <sup>49</sup>
Number of SEs per 10,000	170	104	73	91	89

<sup>44</sup> As Saratovskaya *oblast'* did not feature in the OPORA index, key indicators were calculated according to statistics provided by the Russian State Statistics service ([http://www.gks.ru/bgd/regl/b12\\_14s/IssWWW.exe/Stg/priv/saratov.htm](http://www.gks.ru/bgd/regl/b12_14s/IssWWW.exe/Stg/priv/saratov.htm)) and the Ministry of Economic Development (<http://delovoysaratov.ru/business/medium/>).

<sup>45</sup> From the CIA World Factbook: <https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html>, accessed October 15, 2014.

<sup>46</sup> Ibid.

<sup>47</sup> 2011 data from the World Bank: <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD>, accessed October 15, 2014.

<sup>48</sup> This indicator distinguishes along the lines of SMEs as data for SE share of employment could not be found (see footnotes on pages 37 and 49) and was obtained from the Russian State Statistics Service.

<sup>49</sup> This indicator distinguishes along the lines of SMEs as data for SE share of employment could not be found (see footnotes on pages 37 and 49).

Major Economic Sectors (% of GDP/GRP)	Services: 58.3%	Construction: 19.4%	Transport and comms: 17.8%	Manufacturing: 21.3%	Manufacturing: 18.6%
	Industry: 37.5%	Wholesale and retail trade, auto repair: 16.4%	Manufacturing: 15.4%	Wholesale and retail trade, auto repair: 15.3%	Agriculture and Forestry: 12.6%
	Agriculture: 4.2% <sup>50</sup>	Transport and comms: 15.1%	Mining: 13.2%	Construction: 10.9%	Wholesale and retail trade, auto repair: 12.3%
		Agriculture and Forestry: 12.6%	Wholesale and retail trade, auto repair: 11.2%	Transport and comms: 10.3% <sup>53</sup>	Transport and comms: 11.8% <sup>54</sup>
		Manufacturing: 10.5% <sup>51</sup>	Agriculture and Forestry: 6.3% <sup>52</sup>		
<b>OPORA Index Ranking 2009 (/35)</b>	n/a	33	34	35	n/a
OPORA Index Ranking 2011 (/40)	n/a	2	40	36	n/a
Ease of Starting a Business Rank (/10) <sup>55*</sup>	n/a	n/a	3	3	n/a
Forbes.ru 30 Best Cities for Business*	n/a	3	7	> 30	10
BEEPS Administrative Obstacle Index 2009 (/37)	n/a	34	4	24	n/a
BEEPS Administrative Corruption Index 2009 (/37)	n/a	32	33	36	n/a
BEEPS Graft Index 2009 (/37)	n/a	35	28	19	n/a
BEEPS State Capture Index 2009 (/37)	n/a <sup>56</sup>	34	36	33	n/a

**Table 1: Business Climate Indicators for Selected Regions**

\* indicates ranking of regional capital city  
\*\* at 2014 exchange rates

<sup>50</sup> 2013 estimates from the CIA World Factbook:

<https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html>, accessed October 15, 2014.

<sup>51</sup> 2011 data from the Russian State Statistics Service regional indicators database:

[http://www.gks.ru/bgd/regl/b13\\_14s/IssWWW.exe/Stg/yug/kr\\_dar.htm](http://www.gks.ru/bgd/regl/b13_14s/IssWWW.exe/Stg/yug/kr_dar.htm)

<sup>52</sup> 2011 data from the Russian State Statistics Service regional indicators database:

[http://www.gks.ru/bgd/regl/b13\\_14s/IssWWW.exe/Stg/sibir/irkut.htm](http://www.gks.ru/bgd/regl/b13_14s/IssWWW.exe/Stg/sibir/irkut.htm)

<sup>53</sup> 2011 data from the Russian State Statistics Service regional indicators database:

[http://www.gks.ru/bgd/regl/b13\\_14s/IssWWW.exe/Stg/centr/tver.htm](http://www.gks.ru/bgd/regl/b13_14s/IssWWW.exe/Stg/centr/tver.htm)

<sup>54</sup> 2011 data from the Russian State Statistics Service regional indicators database:

[http://www.gks.ru/bgd/regl/b12\\_14s/IssWWW.exe/Stg/priv/saratov.htm](http://www.gks.ru/bgd/regl/b12_14s/IssWWW.exe/Stg/priv/saratov.htm)

<sup>55</sup> Based on a World Bank survey of ten major Russian cities. See

<http://www.forbes.ru/ekonomika/vlast/17602-moskva-vredit-rossii>.

<sup>56</sup> Data from the European Investment Bank:

[http://www.eib.org/attachments/general/events/2014\\_03\\_12\\_luxembourg\\_sme\\_financing\\_enc\\_a\\_safonov\\_en.pdf](http://www.eib.org/attachments/general/events/2014_03_12_luxembourg_sme_financing_enc_a_safonov_en.pdf), accessed October 15, 2014.

For the most part, the above indicators show a set of regions with similar economic characteristics and facing significant obstacles in terms of administrative barriers and corruption for their SME communities. While useful in an aggregate sense, such indicators cannot illustrate the details how actors on the ground are working to reform their local business climates. The qualitative review of local business and organizational archives that follows reveals an abundance of “town hall”-style interactions and bargaining efforts among SME, political and other social actors. It indicates an emergent, accessible, and transparent institutional structure in which the broad range of actors engaged in SME operations can influence politics and society in their respective regions. These have been dubbed the “by-product” institutions of efforts to mobilize the SME community in Russia. For analytical utility, they have been categorized into five themes ranging from more formal sets of institutional arrangements to more general, “by-product-ish” institutional outcomes.

The first theme is “Lobbying”, and most closely represents the paradigmatic model of SME collective action to obtain a formal politico-institutional outcome as laid out in chapter one. It is a formalized set of actions that illustrate the organized and concerted efforts on the part of SMEBAs to enact specific legislative change or to protect specific interests. While the most apparent lobbying efforts take place at the national level, as described in the previous chapter, several initiatives began at the local level and moved into the national sphere of discussion. The second is “Oversight”. It illustrates how SMEBAs and their members are working to defend their rights under new legal frameworks, many of which are well-intentioned but poorly enforced. The third theme, “Empowerment”, shows how SME owners as independent citizens of modest financial and political means are becoming more confident in their actions against political authority and bureaucracy. “Dialogue” illustrates the transparent and regularized meetings that occur between government political leaders and independent small business actors. Often this takes place in a “town hall” setting, but there are many examples of internet “webinars” during which participants can voice their concerns. Finally, “Civil Society” demonstrates how small business communities and the SMEBAs who represent them are becoming vital drivers of social development in their respective regions, transcending utilitarian “state-business” relationships. They participate in charitable campaigns, fight for “green” initiatives, and provide other benefits to society beyond their economic function.

## Lobbying

“Lobbying” involves a concrete expression of interest in a specific political outcome, accompanied by the utilization of any number of “carrots and sticks” on the part of the lobbying interest to affect that outcome. In Russia, local politicians who support the SME community’s initiatives stand to benefit from the broad base of political support this creates as well as from demonstrating a commitment to the federal modernization program. Those who do not draw the ire of small businesses, who are more able to voice their frustrations in public fashion. Although not all lobbying efforts are successful, the evidence presented in this chapter shows a strong belief on the part of politicians and the SME community in the process of grassroots mobilization and interest channeling. To quote Duma deputy Vladimir Vasiliev of Tverskaya *oblast*’, “The more active you [the small business owner] are, the better the chances that your position will be reflected in legislation” (Ivanchenko 2009b, para. 11).

SMEBAs serve as nodes of interest aggregation in local networks of SMEs, which is channeled toward political outcomes. OPORA and Chambers of Commerce regularly conduct surveys and interviews of SME owners to establish what issues need to be addressed in local and national legislatures. The results of these efforts are used to generate policy positions and direct lobbying efforts of BAs (Armavirskii Sobesednik 2010). “Hotlines” also play a vital role in this regard. Business owners experiencing problems can call their local BA to complain or report officials who may be overstepping their authority.

### *Taking the Legislative Initiative*

The legislative assemblies in each region have signed cooperation agreements with local BAs which stipulate that no piece of legislation on economic policy would be put forth without their input. In Irkutskaya *oblast*’, SME concerns took a prominent place in policy discussions in the run-up to the 2011 Baikal Economic Forum. A recent agreement signed between the legislature and Chamber of Commerce mandates that all legislation under consideration concerning economic development, entrepreneurship, and trade policy must first be submitted to Chamber experts for independent analysis. Furthermore, Chamber members are formally invited to participate in official debates and hearings pertaining to their constituents’ concerns. In return, the agreement tasks the Chamber with providing analysis of the effectiveness of legislative initiatives (Zakonodatel’noe Sobranie Irkutskoi oblasti 2010).

In the other regions reviewed, local legislatures have granted the SME community, via their SMEBA proxies, a formal “right of legislative initiative”. On the 40<sup>th</sup> anniversary of the establishment of the Chamber of Commerce in Krasnodar *Krai*, chairman of the regional legislative assembly, Vladimir Beketov, said in his welcoming speech, “...we have seen how many interesting ideas have arisen from businessmen, how many interesting questions have been discussed in the presidium of the chamber...and for this reason we have given the Chamber the right of legislative initiative. Today we already work together in the examination of bills” (Press-sluzhba Zakonodatel’nogo Sobraniya Krasnodarskogo kraya 2009, para. 3). He urged business representatives to exercise this new right to improve the region’s legal framework. He also stated that his colleagues in the legislature were prepared to propose changes to laws at the federal level after they had been adopted and implemented at the regional. Chairman of the regional Chamber of Commerce, Yuri Tkachenko commented that “this practice, where the Chamber can introduce bills to the regional legislature, is unprecedented for Russia” (ibid, para. 4). In an interview with *Kubanskije Novosti*, he said that “[local] entrepreneurs can be confident that with the help of the chamber...the views of the business community will be heard and taken into account as regional laws are prepared which affect its interests” (Kubanskije Novosti 2009, para. 21). He explained that the right of legislative initiative meant that Chamber members could propose new laws and amendments to existing laws, which would then be discussed with regional authorities and community representatives at regularly held round-table meetings. The proposals developed in this process would then be sent to the Legislative Assembly for potential ratification (ibid, para. 25).

In Irkutskaya *oblast’*, the local Chamber of Commerce and local SMEBA “Partnership of Producers and Entrepreneurs” organized a meeting with local authorities, including the region’s governor, entitled “Cooperation between Business and Power: Conditions and Opportunities” (Antonenko 2009). The discussion centered largely around agriculture and agro-forestry, which are two primary drivers of the local economy, and how to support the rural farmers whose livelihoods depend on them. These farmers’ operations are typically small. The SMEBAs representing them at the meeting conveyed to the authorities the difficulties they are now confronting. The market price for basic agricultural products like corn and eggs had risen approximately twenty times since 1990, while the prices for the goods needed for agricultural production, like gasoline and diesel, have risen 89 times and 171 times, respectively (ibid, para. 5). The cost of the “Yenisei” combine, produced in Russia

and used widely across the country, had risen 201 times (ibid, para. 5). The SMEBAs lobbied for increased state subsidies for agricultural production, noting that in other regions the local government allocates anywhere from 700 million rubles, as in Omsk, to 2.7 billion rubles, as in Krasnoyarsk, while in Irkutsk the number stood at only 300 million (ibid, para. 6). They also complained about the lease rates offered by the regional government for agricultural land (SMEs enjoy preferential rates), which are almost two times higher than those offered in comparatively similar regions. Hearing this, the region's governor Dmitrii Mezentzev tasked the SMEBAs, in conjunction with the local Ministry of Economic Development and institutes of higher education, directed the SMEBAs to prepare a package of bills aimed at supporting small businesses in the region's rural areas (ibid, para. 14).

These types of cooperative arrangements abound in the regions reviewed. In Angara, a city in Irkutskaya *oblast'*, the municipal legislature along with the Regional Agency for State Procurement signed an agreement with the local Chamber of Commerce which stipulated that all bills related to economic development must first be approved by local businessmen via the Chamber mechanism (Argumenty i Fakty: Irkutsk 2010). In the towns of Shelekov and Usol'e Sibirskoe, also in Irkutskaya *oblast'*, local OPORA branches signed a similar agreement with municipal authorities which made it a partner in the creation, adoption, implementation and amendment of municipal laws affecting the SME community (OPORA Rossii 2011a, OPORA Rossii 2011b). In Krasnodar, the local Chamber signed an agreement with the state-run "Kuban Agricultural and Consulting Center" to create a forum for businesspeople at all levels to participate in the creation of legislation favorable to agricultural and agro-industrial development (Priboi 2008). Each agreement indicates an emergent set of formalized relationships between diverse business communities and regional authorities which, should they continue to develop, represent significant steps toward "modernizing" business lobbying practices in Russia through the creation of transparent mechanisms of interaction and accountability between local private sector and state actors.

### **The "Black Box" Campaign**

Some efforts address local issues and remain at the local level. Some start local, and become national. In 2005, the local OPORA branch in Tverskaya *oblast'* began actively lobbying to change laws pertaining to the mandatory use of cash registers with record-

keeping “black boxes” (Ivanchenko 2009c).<sup>57</sup> These secure boxes keep an electronic record of all transactions and are intended to assure the security of businesses’ records for government tax audits. Business owners are required to maintain them, as well as submit and replace them each year at their own considerable expense. In 2009 this amounted to 8200 rubles (approximately \$300 US) after three price hikes in the previous year (ibid, para. 2). They are also required by law to purchase updated registers every seven years. According to Sergei Borisov of OPORA, the maintenance costs associated with these devices costs Russia’s small business owners approximately 10 billion rubles (US\$350 million) per year (OPORA Rossii 2009b, para. 6). The complaints raised by entrepreneurs largely via the aforementioned “hotlines” set up by OPORA in Tver and other regions have since translated into federal level initiatives to eliminate these cash register requirements for all payers of the “Single Tax on Imputed Income,” which was a simplified tax established to reduce the tax burden on small enterprises. In 2006 and 2007, the first readings of a bill were presented in the State Duma in Moscow which stipulated that small enterprises could utilize a standardized, handwritten form for their exchanges (Ivanchenko 2009c). Although not ratified at the time, the continued lobbying efforts of the SME community prompted the Ministry of Economic Development to join the cause. In July of 2009, President Medvedev signed into law amendments to the initial 2003 law requiring the use of cash registers which stipulated that payers of the single tax are not required to use them, but rather a simplified—and much less expensive—receipt form for their transactions (OPORA Rossii 2009a). National OPORA head Sergei Borisov called this “a major achievement for the small business community” (OPORA Rossii 2009b, para. 2).

### ***Fighting Tax Increases***

Another major lobbying effort on the part of regional SME communities undertaken in recent years confronted the entrance into force of Federal Law 212. This law would repeal the Unified Social Tax SMEs enjoyed, thereby increasing SMEs’ tax burden from 14% to 34% in order to better fund Russia’s pension and welfare system. In Saratovskaya *oblast*’, representatives from local branches of OPORA, the Chamber of Commerce, local SMEBAs such as the Saratov Association of Barbers, Beauticians, and Household Service Providers,

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<sup>57</sup> ...*chernyy yashchik* (“black box”) informally, or *elektronnaya kontrol’naya lenta zashchishchënnaya* (“protected electronic cash register tape”). This is colloquially known as the EKLZ (pronounced “ehkehlz”) law.

the Saratov Regional Union of Consumer Associations, youth entrepreneurship groups, and individual entrepreneurs met in December 2010 to discuss their campaign of opposition (OPORA Rossii 2010c). They collected signatures to petition lawmakers and the president himself to postpone implementation of the reforms. In Irkutsk, representatives of the SME community in the local Chamber of Commerce discussed the implications of the law as part of their preparations for the Baikal Economic Forum and prepared a joint letter to send to lawmakers (Delo 2010b). In Krasnodar *Krai*, the local OPORA branch teamed up with the newly formed SMEBA Center for the Defense of Entrepreneurial Rights and the Development of Small and Medium Businesses for the Entrepreneurs of Kuban (the name of a sub-regional unit within the *Krai*) to collect their constituents' signatures in opposition to the measure (OPORA Rossii 2010a, Petrova 2011). Similar efforts were underway in the other regions analyzed. In each, representatives voiced their concerns that the reforms would drive SME owners back into the shadow economy. These concerns were expressed in the form of "open letters" published in local newspapers and sent to decision-makers at all levels of the power structure. In one public appeal to entrepreneurs by the Saratov branch of OPORA to sign the petition of opposition, an impassioned plea was made: "Entrepreneur! Do not think that your voice will not be decisive and that your voice will not be heard. Our signatures will be presented at the national level. Come and sign!" (OPORA Saratov 2010).

Unfortunately for Russia's small enterprises, their lobbying efforts did not bear fruit. In January 2011, FL-212 entered into force. Natalia Labynina, head of the Tverskaya *oblast'* OPORA branch, lamented, "[SMEs] were only beginning to recover and cope with the economic crisis, and now like a blow to the head we get this news" (Argumenty i Fakty: Tver' 2010, para. 2). However, the simple fact that SMEs were able to organize a national campaign against the increase demonstrates the democratic quality of SME collective action and politicking. Public pleas were made via media outlets. SMEs openly voiced opposition to high-level proposals rather than acquiescing to decrees "handed down" to them from Russia's ostensibly authoritarian political superstructure. Although the struggle for a supportive legal framework for Russia's SMEs continues, and SMEs' campaigns are not always successful, in many ways SMEs are in better positions to change other "rules of the game" than they have been in previous decades.

## Oversight

Implementing the new laws for which the SME community has lobbied brings up new sets of challenges for regional actors. In most regions in Russia, authorities have significant capacity to draft new laws, but less capacity to actually enforce them. The diversity of groups struggling in each region to protect their livelihoods often find themselves at odds with each other. Bureaucratic agents look to maintain the rents generated from its revenue extraction regimes. The difficulties in reforming inspection and property leasing laws exemplify this. The SME community is naturally averse to these regimes. As the previous chapter demonstrated, it aims many of its mobilization efforts at confronting them. The political elites find themselves somewhere in the middle. Its bureaucratic agents are vital administrators. Yet they often abuse their positions, and stifle the independent business growth that is a cornerstone of the federal modernization program.

As noted above, the organized SME community has been granted an increasingly influential role in the creation of new legal infrastructures in Russia's regions. It does not exercise this influence only at the creation stage, but also in the implementation and enforcement stages. SMEBAs have not only been given the right of legislative initiative, but also the right to oversee how new legislation is put into practice. Natalia Labynina, head of the Tverskaya *oblast'* branch of OPORA, noted that the main problem for Russia's SMEs is "bad enforcement of good laws" (Avdyeeva 2010b). In August 2009, OPORA representatives from across Russia, including Ms. Labynina, participated in a meeting with President Medvedev to discuss how to confront the administrative barriers which continue to hinder SME growth. She expressed her frustration that in Tverskaya *oblast'*, of the 200 applications from SME owners to purchase state property the preferential rates mandated by Federal Law 159 (FL-159), only 15 were accepted in 2008 (Ivanchenko 2009d, para. 7).<sup>58</sup> Sergei Borisov, national president of OPORA, cited a specific example of an extreme administrative barrier to SME operations: bakeries have to purchase a permit to utilize an "explosive object" (*indul'gentsiyu na polucheniye razresheniya na vzryvoopasnost' ob'yekta*)—i.e. their oven and peripheral parts—at a cost of 600,000 rubles (approximately US \$20,000) to legally

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<sup>58</sup> ... "On state- and municipally-owned fixed properties leased to small- and medium-sized enterprises in the Russian Federation", which is often called the "small privatization" law. It allows SME owners who have leased a property from a municipality for five years the right to purchase that property at a preferential rate. It is discussed more extensively in the following pages.

operate their businesses (ibid, para. 9). Then President Medvedev expressed his consternation at this situation, saying

...the general prosecutor's office and supervisory authorities must bring the price for [this permit] in line with the market, rather than with the needs of various governmental ministries...[What a situation] it is for small business! Travel abroad, and you will see that nowhere do small enterprises pay [this price]...No one even gives 600 euros! Instead of 600,000 rubles it should be 60..." (ibid, para. 10).

In the same diatribe, Medvedev railed against the seemingly intractable problem of inspections, noting that at tens of thousands of dollars to comply with official regulations, it was no surprise that business owners pay bribes to have officials look the other way, and that officials seek out those bribes (ibid).

In response to these problems, SME communities across Russia have organized within SMEBAs to monitor and enforce the "good laws" on the books which, due to various informal institutional forces and parochial interests, are often poorly implemented. Inspection regimes have become the focal point of SME communities' "oversight" function. As in many countries, businesses in Russia must be "up to code" in areas such as fire safety, maintenance of health and sanitary standards, and possession of appropriate licensing and permits to engage in their respective business activities. And as in many countries, the fines generated from violations become a significant source of income for sometimes "overzealous" inspectors. In Russia this situation is exacerbated by what Karl Ryavec (2003, 65) dubs Russians' "paper fetishism". Perhaps a remnant of the overbearing Soviet bureaucracy, it—for lack of a better categorization—amounts to a cultural practice whereby citizens must not only possess, but "officialize", duplicate, triplicate, stamp, and notarize even seemingly insignificant documents. Anyone who travels to Russia is likely to notice restaurant menus authoritatively stamped and signed by administrative bodies. The number of codes and procedures to which a small business owner must comply is often overwhelming. The myriad laws and by-laws on the books in Russia—and the legal loopholes created by them—creates a situation in which inspectors can cite a business owner for a violation of code almost at will (Business Journalist 2012). The difficulty in contesting these citations within the judicial system (an unwelcome burden in any country) prompts business owners to pay "on the spot" fines—i.e. bribes—to sidestep more bureaucratic and legal headache. Furthermore, SMEs can spend up to 7 million rubles (US\$240,000) per year just to obtain the necessary permits and

other services (connecting to the power grid is notoriously expensive) from various government agencies to make sure their businesses are up to code (Delo 2010a, para. 1).

At the Second Congress of Entrepreneurs of Tverskaya *oblast'* in 2009, Duma deputy Vladimir Vasiliyev called entrepreneurs the key allies in the fight against corruption in the economy (Zakonodatel'noe Sobranie Tverskoi Oblasti 2009). Although FL-294 allows business owners to challenge the number of inspections they undergo or the citations they receive, in practice this demands resources which most SME owners do not possess or do not wish to devote to a lengthy arbitration process (Torgovo-promyshlennaya palata Saratovskoi oblasti 2010). This is where SMEBAs play a seminal role in protecting and advancing the interests of their constituents. Local Chambers of Commerce, branches of OPORA, and other smaller, industry-specific associations have signed participation agreements with inspection agencies and police forces which allow SMEBA representatives to be present at a business during an inspection. In Irkutsk in November 2009, officials from the local branch of Rospotrebnadzor met with a number of local BAs in a meeting dedicated to the creation of a public council to protect the rights of small business owners in the region (Delo 2009). OPORA, the Chamber of Commerce, as well as industry-specific organizations such as the Union of Food and Food Processing Entrepreneurs, the Association of Alcohol Producers, and several associations of restaurateurs and farmers, all came to the meeting to discuss ways to effectively monitor and enforce sanitary and epidemiological safety standards while not infringing on the rights of business owners (ibid). In November 2010, Krasnodar's legislative assembly passed ordinance 2248-P, the "Action Plan for Small Business Development in Krasnodar *Krai*", which tasks several SMEBAs with specific responsibilities related to monitoring and improving the climate for small businesses in the region (Zakonodatel'noe Sobranie Krasnodarskogo Kraja 2010). For example, the Chamber of Commerce is responsible for collecting data on the effectiveness of municipal programs of SME support, monitoring the implementation of regulatory acts and streamlining the process by which small business owners can learn about, conform to, or provide feedback on any new regulations. It is also tasked with making information and legal resources available to SMEs at a consultation center, online, and via print media to aid both start-ups and established businesses in their interactions with government (ibid).

SMEBAs in the other regions surveyed have also made significant strides to protect their constituents against overbearing inspection regimes. In Krasnodar, the local OPORA

branch has signed cooperation agreements with Rospotrebnadzor, the police department, and the legislative assembly which mandate the BA's participation in local inspection regimes (OPORA Rossii 2010a). Vladimir Vasiliyev, head of the Tverskaya *oblast'* United Russia party, spoke of a meeting he had with Natalya Labynina, head of the local OPORA branch, regarding the "nightmarish" (*koshmaryashchiy*) inspections about which members were complaining. A common complaint from business owners was that different inspectors and agencies interpreting the same regulations differently (Ivanchenko 2009d). After both parties met with local regulatory authorities, an agreement was reached which stipulated that a business owner subject to inspection had the right to request an OPORA representative be present (Orlova 2009). This serves two functions: the representative provides any relevant legal advice to the business owner as the inspection is being carried out; and it serves as a kind of psychological check on the inspector who may be reluctant to cite the owner in the presence of an expert witness for anything less than an unambiguous violation of code. Chairman of the Council for Small Business Development of the Regional Administration Vasily Toloko cited "legal illiteracy" among business owners as one of the main problems exacerbating problems in inspection regimes (Avdyeeva 2010a). They often do not possess the knowledge to defend themselves against unsubstantiated claims. He went on to say that this new inspection agreement between regulatory agencies and OPORA was a significant step in alleviating this problem (*ibid*).

Vladimir Buktarev, an officer working in the Tver police department's "Office to Combat Crimes in the Consumer Market," commented on the dubious reputation inspectors had earned among business owners in a 2008 interview (Avdyeeva 2008). Enumerating the most common violations found by inspectors, such as counterfeit food, beverage, and consumer products and unlicensed business activity, he argued that his office served a vital public welfare function. However, he welcomed local SMEBAs' participation in the inspections he and his colleagues regularly conduct. He viewed them as a means to overcome the poor reputation of his office. He estimated that since OPORA began participating in inspections, 90% of all citations given were not disputed (*ibid*). Underscoring the utility of this cooperation, he stated that his office planned "to work more closely with industry associations of entrepreneurs in order to make inspections more open not only to the public, but also as useful as possible to SME owners and the consumers of their goods and services" (*ibid*).

The fight against corruption—and especially the legal loopholes that encourage it—has become the focus of a new program spearheaded by the Saratov Chamber of Commerce in conjunction with the American NGO Center for International Private Enterprise (CIPE) entitled “Advocacy for Small- and Medium-Sized Business” (Torgovo-promyshlennaya palata Saratovskoi oblasti 2010a, Benina 2010). The goal of the program is to educate a body of independent experts in a standardized method for evaluating the potential for corruption in a given regulation. These experts, who typically have backgrounds in law, although they can come from any professional background, receive training from two prominent local universities, the Volga Regional Academy of Civil Service and the Saratov State Law Academy. Upon successful completion of the program, these experts are accredited by the Russian Ministry of Justice to conduct investigations into potentially corrupt relationships between local businesses and inspection authorities. Their accreditation also makes them a member of the Expert Council of the Regional Chamber of Commerce for the Evaluation of the Propensity for Corruption in Legal Acts and Projects. Local government officials, representatives from the Ministry of Justice and Chamber of Commerce, university scientists, and these independent experts meet in the Council to discuss findings, make suggestions, and draft new regulations to close any legal loopholes that may encourage an inspector to extort money from a business owner. Although still relatively new (the Council was established in 2007 and the training program was started in 2009), pilot programs have been started in seven other Russian regions, with the aim to implement the methodology for training and evaluation at the federal level. This is the first time in Russia that a coordinated, independent effort to evaluate the practical implications of regulations has been undertaken (Torgovo-promyshlennaya palata Saratovskoi oblasti 2010b). Head of the Saratov’s Chamber Maxim Fateev cited one example in which it was found that business owners were subject to unfavorable (although quasi-legal) delineations in the cadastral registration of their land, with the implication that inspectors were doing so either to extort a bribe to give a more favorable outcome or to increase the revenues of their agency at the expense of business owners (Torgovo-promyshlennaya palata Saratovskoi oblasti 2010c, para. 5). Experts on the council were able to identify the infraction and the regulation under which it occurred (ibid).

In a February 2011 meeting with representatives from the regional prosecutor’s office and regulatory agencies, Mr. Fateev discussed the results of the Chamber’s efforts to reduce corruption (Torgovo-promyshlennaya palata Saratovskoi oblasti 2011). Mr. Fateev stated that the primary objective of the Chamber’s recent efforts was not necessarily to prosecute every

infringement on the part of inspection agencies, but to establish why such infringements occurred under the law, and to take measures to amend or eliminate regulations that promote unreasonable citations (ibid, para. 7). Those present at the meeting agreed to take these findings into consideration as the council began work on drafting a series of amendments to Russian inspection law (FL-294) (ibid).

SMEBAs' "oversight" function is intended to provide a check on the ubiquitous Russian bureaucracy. Working alongside growth-minded politicians whose reputations and advancement prospects depend on delivering real improvements in the standard of living to their respective regions, SMEBAs have become a vital ally in the struggle to ensure that corruption does not continue to impede development. Sergei Aristov, head of the Department of Economic Development of Tverskaya *oblast'*, declared, "An official who interferes with the work of business will himself be subject to administrative pressure" (Tverskaya Zhizn' 2010b, para. 1). The increased influence of the SME community via SMEBAs in the political sphere illustrates how a profound differentiation of relationships is taking place in Russia. Once a monolithic extension of state authority, the bureaucratic apparatus is for the first time subject to the demands of a grassroots polity.

## Empowerment

Until recently, small business owners were either passive subjects of a tsar or coerced out of existence due to the ideological constraints of Soviet communism. Now they organize within SMEBAs with the explicit support of the highest authorities in power. This important class of economic actors has a natural interest in shaping the local political arena to suit their interests, and is newly empowered to do so. Once an all-powerful extension of state authority, the bureaucracy is becoming a distinct interest group, separate from the political process and subject to the demands of this organized business community. Across the regions reviewed here, SME owners have expressed confidence in their ability to protect their interests against the encroachments of administrative authorities. And SMEBAs have played a seminal role in building this confidence.

Statements from local business owners in the regions reviewed here illustrate this newfound confidence.<sup>59</sup> After the regional prosecutor's office publicized the list of planned inspections to be carried out in Irkutskaya *oblast'* in 2011, the director of a local construction

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<sup>59</sup> This "empowerment" theme was also demonstrated by interview respondents in Saratov. See "Perspectives on Inspection Reform", p. 137.

company commented to a journalist that, “We are certainly not afraid of the inspectors...” (Delo 2011, para.11). A manager at a local financial services firm expanded on this, saying, “You just have to be able to assert your rights. For example, sometimes if we do not agree with a ruling of the inspecting agency, we will contest it in an arbitration proceeding ... I am sure that if entrepreneurs were no longer afraid to contest obviously superfluous rulings, then officials would no longer make them” (ibid, para. 12). In January 2011, one local businessman in Irkutsk was mired in a struggle to obtain the necessary permissions to improve the municipal lands immediately bordering his auto parts business. He wanted to add additional driving lanes to improve access to his business and relieve congestion at the intersection where it sits. He also wanted to improve pedestrian sidewalks. However, the city administration impeded his efforts to purchase the lands. In response to this situation, he stated to a journalist, “As a member...of OPORA, who defends the rights of [SMEs] in the field, and advises [them] with the backing of the governor of the *oblast*’, I am ready to defend our position” (Gorban' 2010, para. 12).

The “empowerment” theme manifests itself in other ways as well. By helping business owners improve their legal literacy, SMEBAs equip them with the tools to protect their property rights and redress grievances. The local branch of the Chamber of Commerce in Armavir, a small town in Krasnodar *Krai*, publicized a memorandum from the regional prosecutor’s office informing business owners of their rights as they undergo inspections (Armavirskii Sobesednik 2010). SMEBAs have also worked with the prosecutor’s office to place complaint boxes in towns’ administrative headquarters so that business owners can report inspectors and other city officials who overstep their authority (Petrova 2011, Petrova 2010). With the help of the Krasnodar Chamber of Commerce, the Association of Black Sea Architects organized a conference in October 2010 in Sochi. The aim of the conference, entitled “Protection of Copyright and Intellectual Property Rights in Architectural Work”, was to bring judges, lawyers, and professional experts from local associations together with working architects to give them practical advice on how to work various legal levers to ensure that their work is protected (Sochi-24 2010). In Tver, the Regional Association of Builders, OPORA, and representatives from local government and construction industry met in December 2009 at a round-table conference, “Small and Medium Businesses in the Construction Industry: from Licensing to Self-Regulation: Practice, Problems, and Perspectives on Development under Current Economic Conditions”, to discuss measures to cooperatively ensure the region’s housing needs are met in the wake of the global financial

crisis (Karavan: Tverskoi Oblastnoi Yezhenedlnik 2009). In January 2009, the regional administration eased licensing rules on the construction industry. This permitted more enterprises to engage in a broader range of general contracting and construction activities, and also access to government subsidies dedicated to regional housing development. The industry has since organized into a legally recognized self-regulatory organization (SRO). With the participation of OPORA and its constituent member associations, the SRO meets regularly not just to monitor itself, but to represent the industry in its dealings with local government (Ivanchenko 2009b). Igor Klebnikov, president of the Regional Association of Builders, stated at the conference, “If we consider that in the Tver region, of the 930 construction companies, 830 represent small business, and 65 represent medium, it becomes clear how important it is for entrepreneurs today to define the rules of the game in this market” (Karavan: Tverskoi Oblastnoi Yezhenedlnik 2009).

The foundation of this newfound sense of empowerment among small business owners stems from the public campaigns of SMEBAs to increase small business owners’ awareness of their rights. It manifests itself in the confidence and assertiveness with which business owners such as those mentioned above deal with government officials. Organizational corpora have taken shape, be it at the behest of the president determined to achieve developmental objectives, or through organic, grassroots interaction of smaller firms seeking to protect their operations from arbitrary political authority and to transparently advance their interests in open political forums. This is a far cry from the days when deals were made and contracts enforced only with the backing of violent criminal gangs. Business communities across Russia now utilize legitimate mechanisms of collective action, such as the association or the self-regulatory organization, to make their voices heard.

## Dialogue

This theme is most evident in the numerous round-table (*kruglyye stoly*) discussions that take place across Russia on a regular basis, and which are most reminiscent of the “town hall” motif. In August 2009, President Medvedev, campaigning on behalf of SMEs, attended one of these meetings in Sochi to address the concerns of local entrepreneurs (Sochi-24 2009). This was quite typical of Medvedev, and this example is one of many such appearances to emphasize SME development as a cornerstone of Putinite Russia’s modernization program. During the meeting, entrepreneurs complained of a number of problems that plague SMEs across Russia. One such problem relates to SMEs’ legally

mandated right to purchase state-owned property at preferential rates. The well-known law “On state- and municipally-owned fixed properties leased to small- and medium-sized enterprises in the Russian Federation” (FL-159) was designed to allow SME owners who have been leasing property from the state for five years to purchase that property at discounted rates. However, this law deprives regional and municipal coffers of a stable source of income, as the rent payments for the property stop and is replaced by a low one-off payment. SME owners across Russia have reported widespread stonewalling from local officials resistant to this new law. Small business owner Tatiana Kostrova complained to the president that she could not arrange purchase of her business space because local officials could not (or would not) tell her who was in charge of administering the property (ibid). After several other complaints, the president called on local public organizations to call out officials who stand in the way of legitimate business and engage them in the courts and through the media (ibid).

Naturally the president cannot personally attend to each problem affecting each local business owner. In most circumstances local legislative leaders, business owners, and SMEBA representatives organize and attend these meetings to address local issues. And much of the discussion focuses on the implementation of FL-159. The local OPORA branch in Tverskaya *oblast'* publicized a set of interviews in which entrepreneurs complained that local officials would call in their own appraisers to estimate the value of a given property when the estimate of an independent appraiser was deemed too low (Biznes Territoriya 2010). This situation played out in the small town of Belyy Gorodok in the eastern part of the *oblast'* (Tverskaya Zhizn' 2010a). At a meeting in fall of 2010 organized by the Regional Interdepartmental Commission on Eliminating Administrative Barriers for Small- Medium-Sized Enterprises, regional OPORA head Natalia Labynina admonished town administrative head Ludmila Zvezdin on behalf of two entrepreneurs who had been petitioning for two years to purchase their business premises at the discounted rate mandated by FL-159. The argument centered on the municipality's equal weight in the decision-making process to determine how its property was allocated and the entrepreneurs' right to purchase the property, both of which are protected under the law. Ms. Zvezdin argued that there were few other sources of revenue in Belyy Gorodok aside from lease payments from local businesses (ibid, para. 8). Ms. Labynina countered that only through the growth and development of small businesses in the locality would regional coffers be assured not just a steady, but growing source of revenue (ibid, para. 10). She criticized the myopia of regional authorities in not selling their premises

to these entrepreneurs, as the tax revenues generated from their business, as well as the network of economic relationships and revenues that spring up as businesses grow, would provide for more revenue to the municipality than would their rent payments (ibid, para. 10). Although no indication that the situation was resolved could be found in published sources, the regional head of Tver University's Department of Economics said the situation was a typical example of the administrative barriers small business owners face. He said that if evidence continues to emerge that there are systemic problems implementing the law in Belyy Gorodok, it would be resolved through the regional prosecutor's office (ibid, para. 13).

Such debates are typical of meetings between local government officials and the small business community. Small business owners and their SMEBA representatives frequently and quite publicly voice their frustrations with how laws are implemented and whether or not anything can change. But they do express optimism about the simple fact they are able to voice their concerns. "Entrepreneurship Day," held every year on May 26<sup>th</sup>, has become a popular forum for local business owners, political leaders, and banking firms to meet to discuss their interests and coordinate their efforts. Established by President Putin as a professional holiday in 2007, these "festivities" take place in virtually every region in Russia, and present opportunities for business owners and association representatives, NGOs, and political authorities to network, make presentations, and engage in public discussion. At an event organized by the regional Chamber of Commerce in Saratov in 2009, small business owners, members of the press, and BA representatives directed a flurry of complaints at the local politicians (Blokhina 2009). Journalist Alexandr Urievskii began by saying the only result Saratov's SME community has seen from regional initiatives for its support is an increased regularity of politicians "running their mouths" (*biyeniye po khvostam*) about how they support small businesses (ibid, para. 2).<sup>60</sup> The regional Minister of Economic Development and Trade, Alexandr Ulyanov, was visibly agitated by this and other complaints brought against local authorities. He countered, commenting that state support for SMEs has increased three-fold in the four years since 2006; that a number of provisions have been put in place to directly aid SMEs, such as subsidized loans, a venture capital fund, and a program to provide grants up to 58,000 rubles. The complaints continued, and after a number of officials left the meeting (ostensibly to attend to other matters), local businessman Anton

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<sup>60</sup> An imperfect translation, "*biyeniye po khvostam*" translates literally to "wagging the tongue". The comparable English colloquialism is provided here.

Komarov received a great deal of applause when he stated: “We have met here today in vain, because nothing will change... We’ve gathered here because things have [gotten out of hand]” (ibid, para. 5).<sup>61</sup> Although a popular sentiment in the room, several participants did not share Mr. Komarov’s pessimism, saying that the very forums in which they were interacting was in themselves noteworthy. Local business owner and professor of economics Dmitri Udalov pointed to the establishment of a “Public Council” at the regional prosecutor’s office in which representatives of the small business community can work with local officials to craft, implement, and monitor local regulatory regimes: “Try to imagine such a council existing 10 to 15 years ago,” he stated optimistically (ibid, para. 5).

These events exemplify the growing spirit of public debate taking shape in regional forums. And much of it has taken on a sharp, highly critical character. Another example occurred in the Lazarevskii region of Krasnodar *Krai*, which comprises Sochi and its environs. An entrepreneur, after winning the right to develop a stretch of beach for a new camping ground in a local civic development and beautification contest, fell prey to “raiding” (*reyderstvo*) by several bureaucratic organizations who apparently did not view her enterprise as the best use of such prime real estate (Sochi-24 2011a).<sup>62</sup> After nearly six months of continued harassment, inspections, fines, and even seizure of her property, she took her case to the editors of local newspapers, and enlisted the help of a legal consultancy. In the article detailing the case, she explicitly named five high-level municipal officials and the departments in which they worked in connection with activities that went directly against Sochi Mayor Pahomov’s initiatives to support SME development in the region (ibid). At the direct order of the mayor, her land was released back to her. In response to the charade, Mayor Pahomov established the Coordination Council for the Support and Development of SMEs. In the council, regional officials work alongside independent local entrepreneurs and BA representatives to liaise between inspectorates, legal bodies, business representatives, and political authorities in an effort to coordinate activities toward more productive ends (Sochi-24 2011b).

The theme of “dialogue” demonstrates how public debate is becoming institutionalized in Russia’s regions via these various forums. Individuals with small amounts of political capital, but with concrete interests to protect, are publicly asserting themselves

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<sup>61</sup> ...“*no sobralis', potomu chto nakipelo*” literally: “We’ve gathered, because things have boiled over”.

<sup>62</sup> See footnote 11, page 29 for a description of the practice of *reyderstvo*.

across Russia. Their newfound economic interest inspires their political action. This, in a society where private enterprise was illegal little more than 20 years ago. The benefits of collective action for Russia's SME community take on a great deal of significance when Russia's underdeveloped legal framework and the degree of institutional heterogeneity across its regions are taken into consideration. Core laws and institutional practices take shape as the SME community's many voices find expression in the forums required to accommodate them. Although SMEs lack the resources to "capture" the state, in this emergent space it can change "the rules of the game" in a broad set of issue areas that affect this diverse sector of Russian society. The forums themselves are a highly significant development for this part of the world, where for 70 years totalitarian command of the entire society dominated every political and economic relationship.

## Civil Society

A robust civil society, the amorphous social sphere in which individuals and special interest communities voluntarily interact outside of the structures of the state or the strictly commercial structures of the market, is a vital component in the development of a modern polity. For more than 70 years, while many nations of the modernizing world evolved socio-political and economic systems out of the crucible of great world wars and anti-colonial movements, Russian society was subjected to a singular ideology which subsumed all social and economic relationships under the political framework of Soviet communism. The voluntary associational interactions that characterize notions of civil society in the advanced industrial world in Russia were coerced out of existence by the Communist Party.

Today, although many of Russia's largest SMEBAs came into existence with the active participation of the central government, Russian businesses now have the constitutionally protected right to independently organize.<sup>63</sup> Small, independent associations often partner with larger, such as OPORA, *Delovaya Rossiya*, or Chambers of Commerce to take advantage of their expertise, networks, and political clout. While their primary aim is to advance SMEs' political and economic interests, the scope of their activities has begun to spill over into the realm of advancing their communities' social development. In this respect

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<sup>63</sup> "Everyone shall have the right to association, including the right to create trade unions for the protection of his or her interests. The freedom of activity of public association shall be guaranteed." –Constitution of the Russian Federation, Ch. 2, Art. 30

we can see how the distinction between the realms of the political, the economic, and the social blurs when examined empirically.

In the regions reviewed, SME communities via their SMEBA proxies create and utilize civil-social mechanisms to empower themselves and better their communities. In early 2011, representatives from local and national SMEBAs, political parties, and the city administration, met in Tver to discuss and adopt of code of ethics to promote better business practices among the region’s entrepreneurs. One of the primary principles of the code is that entrepreneurs must not give bribes. Sergei Mitroshin, representing the “Yabloko” political party, said, “An experienced bureaucrat can always bypass any anti-corruption law given the passivity of [Russian] society,” and went on to say that this systemic insecurity in Russia’s economy can only be countered through the development of new civil social institutions and practices in combination with legal reforms (Avdyeeva 2009). The discussion continued around this theme, with the participants agreeing that the struggle against corruption must begin at the grassroots level, i.e. with the individual business owner.



“Bribes are for fools”: A representative from the Perm Coalition of Entrepreneurs hands a shirt with this maxim to a member of the Altai Coalition. Photo courtesy of the Center for International Private Enterprise.

Such codes of ethics have become quite common in Russia. They exist in some form in each of the regions reviewed. Chambers of Commerce, branches of OPORA and *Delovaya Rossiya*, and other smaller associations have organized with NGOs and government representatives to draft these codes as a part of their respective programs of socioeconomic development. Each code mandates that members behave fairly and in a socially responsible manner with each other, their customers, their competitors, government, employees, and within associations. Commitment to charitable works is also an important element. The adoption of these codes illustrates how SME communities have formally, yet voluntarily, extended the scope of their operations to contribute to local social development projects. SMEBAs provide the organizational forums for their efforts, thus widening their function beyond the economic and political. To quote from the *Delovaya Rossiya* code of Saratov *oblast'*: “We [entrepreneurs] recognize the social responsibility of business in job creation, in the realization of social development projects, and in the improvement of living standards...Our activities are guided by democratic values and the ethics of the business community” (Delovaya Rossiya Saratovskoi Oblasti n.d., para. 1).

SME owners utilize their collective strength in SMEBAs to lobby for environmental and civic improvement initiatives, promote youth entrepreneurship, and to support various charitable causes. In Krasnodar, banks have teamed up with the local Chamber of Commerce to produce a guide for students on the principles and practices of starting a business (Armavirskii Sobesednik 2010). The Association of Young Entrepreneurs of Kuban organizes meetings between successful small business people and young entrepreneurs, and also youth entrepreneurship competitions (Zakonodatel'noe Sobranie Krasnodarskogo Kraia 2010). Youth groups showcase their achievements at regional observances of Entrepreneurship Day on May 26. Their representatives often attend round-table discussions with their older counterparts. In Krasnodar, it was estimated that each year small business owners contributed an average of 12 thousand rubles per capita (~\$400 USD) to civic improvement and other charitable causes (Tretyakov 2010, para. 6). In December 2010, representatives from business, education, media, and science organized through the Chamber of Commerce in Saratov to discuss measures to improve city parks and infrastructure, encourage environmental responsibility, and to develop programs to teach microeconomics and principles of entrepreneurship to recent graduates of secondary and higher education institutions. The discussions led to the drafting of a set of proposals which were submitted to the city council and regional legislative assembly (Torgovo-promyshlennaya palata

Saratovskoi oblasti, 2010). In November 2010, the Saratov Chamber created the Committee on Environment and Ecology of the Saratov Region. The committee, comprised of approximately two dozen representatives from business and NGOs, is tasked with encouraging the relationship between business and environmentalists in the region. At their first meeting, members expressed their concern that the SME community did not appreciate the importance of environmental responsibility, and would begin a campaign of awareness program to encourage it. The committee is also responsible for evaluating current environmental legislation, and the drafting of proposals to improve it (Balakov 2010).

The measures discussed here represent a small sampling of the civil society building activities in which the SME community regularly engages. Although sometimes state authority plays a role in supporting a given measure, by and large individuals and interest groups with a genuine commitment to socioeconomic development undertake these efforts independently at the grassroots level. SMEBAs serve as key hubs in networks of myriad civic actors. They instill these independent efforts with threefold legitimacy, for they represent the interests of the small business community as an economic, political, and social actor. Economically, the growth of the sector contributes to improved living standards and the achievement of the president's modernization objectives. This translates into political legitimacy for supportive local politicians and for the broad-based interests of the SME community. The former benefit in that they advance the interests of the president while representing a large constituency who for the first time in Russia can hold them accountable for their actions in transparent, open forums. The improved living standards associated with the economic growth of the sector naturally carries implications for social development. A growing SME sector can employ more workers and contribute more to government coffers. SME owners who enjoy relatively stable and predictable profit margins are better able to engage in social pursuits outside the sphere of their individual enterprises. SMEBAs present them with an opportunity to associate with other entrepreneurs and advance socio-political agendas. The evidence presented here indicates that they are taking advantage of this political empowerment to pursue greater social and economic ends.

## Conclusion

These accounts represent a small sampling of developments taking place in Russia. The "by-product" institutions of state co-opted SME mobilization are represented by the various forums and channels of influence that have emerged in the past decade to further

SME interests. Although they were not lobbied for as formal public goods, they are by-product public goods of efforts to mobilize the SME community in the political arena. The exigencies of SME collective action under the conditions of Russia's transition have shaped these institutions to represent a broad range of actors. In this sense, they take on a "modern" character. The nature of state co-opted SME collective action as an encompassing interest under the circumstances of transition results in an empowered SME community. Given SMEs natural proclivity for fair, non-arbitrary administration as long-time victims of the state's "grabbing hand", this in turn increases administrative accountability. This is not by direct design, but is a natural result of SME collective action within these state-sanctioned by-product institutions. These factors represent the rationale and mechanism by which SMEs are able to push for institutional "modernization" in accordance with the argumentative thrust of this thesis.

However, as will be discussed in the following chapter, this empowerment has limitations. Many SMEs do not participate in this new paradigm. Many are not members of a SMEBA. If they are, they do not attribute much value to membership. Despite the support the central government has given to organizing the SME community, free ridership remains an issue. Most interviewed were more concerned with the day-to-day operations of their businesses than with lobbying for changes to the systemic changes to the policy environment. However, although many small business owners were not active participants in SMEBA-led lobbying campaigns, *all* were familiar with the common problems of the small business community as explored in this thesis. Complaints about inspections were voiced by a majority of respondents. Some participated in preferential privatization schemes, to varying degrees of success. The respondents demonstrated that the problems discussed in news media and to which so many political leaders direct their rhetoric were real issues that affected business owners everywhere. In this sense, "legal literacy" represents another important by-product public good of state-sanctioned SME collective action. This indicates that the nature of the "encompassing interest" as elucidated by Olson (1982, 2000) produces public goods for members outside the immediate organized SME interest lobby.

## CHAPTER 4: LOCAL SME EFFECTS ON ADMINISTRATIVE MODERNITY: A MUNICIPAL PERSPECTIVE

### Introduction: Saratov: Economy and Business Environment

Saratov is in many ways a typical Russian city. The regional capital of Saratovskaya *oblast'*, it sits along the banks of the lower Volga River approximately 860 kilometers southeast of Moscow. It has a population of nearly 837,000. Engels, its sister city just across the Volga on one of Russia's longest bridges (nearly three kilometers), has a population of about 207,000, bringing the population of the greater metropolitan area to just over one million (Russian State Statistics Service 2012). Regionally, about 75% of the population live in urban areas (ibid). The major contributors to gross regional product are manufacturing (18.6%), agriculture (12.6%), and wholesale and retail trading (12.3%) (ibid).

Small businesses represent approximately 47% of all enterprises in the *oblast'* (ibid).<sup>64</sup> They employ approximately 180,000 people, or about 26% of the population (Dryakin 2012). Touring Saratov, the visitor will notice a vibrant small business presence. The large central market area houses hundreds of individual stalls selling everything from freshly butchered meat to chocolates and household sundries. Along the nearby Prospect Kirova, a long pedestrian-only avenue, dozens of more substantial retailers sell anything one would expect in a shopping district: clothing, sporting goods, mobile phones, jewelry, and much more. The tree-lined avenue is dotted with small cafes, bars, clubs, and take-away stands. Other districts around the city appeared to have similar characteristics in terms of small business presence. The impression one receives is of a quaint and provincial city with an earnest and lively business atmosphere.

In April 2012, then President Medvedev sacked Saratovskaya *oblast'* Governor Pavel Ipatov, who presided over one of the largest regional debt increases in Russia in the last 5 years and had one of Russia's lowest approval ratings for a governor (The Moscow Times 2012). He replaced him with United Russia apparatchik Valery Radayev, who in his inauguration speech touted small business development as his number one priority for the region (Small Business Association Representative 2012). Governor Radayev, appointed to

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<sup>64</sup> These are companies employing from 15 to 100 people. The Russian State Statistics Service from which this data was obtained only distinguished along the lines of "small enterprises" and "all registered enterprises" in the region.

his office by the president, is a typical example of a regional leader tied to the modernizing mission of Russia's power vertical. He has supported the creation of a number of state-supported business clusters, such as technology and industrial parks, and two small business incubators (Levenets 2012). These provide consulting services as well as discounted rents and telephony services to new entrepreneurs. Governor Radayev stated in an interview that, "when we talk about creating a positive image of the region, about attracting investment and innovation, we are primarily counting on the development of small- and medium-sized enterprises. The future health not only of Saratovskaya *oblast'*, but of the entire country, depends on the successful development of entrepreneurship" (ibid, para. 7).

### Empirical Puzzle and Theory

The empirical puzzle to be examined in this chapter rests understanding the extent to which the encompassing public good of administrative modernization has emerged in Saratov despite the pervasive free-ridership on the part of SME owners that became apparent from the interview evidence. It is about reconciling the realities of widespread non-participation in this SME support regime on the part of low-level SMEs with the public goods outcomes of high-level support for SMEs from peak SMEBAs and the president. With many SME owners not actively participating in campaigns for systemic administrative reforms, and indeed continuing to pay bribes as the easiest way out of administrative headaches, it would appear that at the grassroots level, SMEs remain a latent collective interest, perpetuate the *Status Quo* model of business-state ties, and are still subject to the "grabbing hand" of low-level officials.

At the municipal level of analysis, it becomes difficult to neatly fit the collective action of Russia's SMEs into the theoretical perspectives on business collective action framing the empirical analysis of this dissertation. The view presented within the "capture" literature posits that businesses in a transitional context take advantage of the weak institutional environment to "capture" state offices to attain "a la carte" provision of public goods (Hellman, Kaufmann and Jones 2000, A. A. Yakovlev 2009, A. A. Yakovlev 2006, Slinko, Yakovlev and Zhuravskaya 2002, Slinko, Yakovlev and Zhuravskaya 2005, Frye 2002). This view sits within the generally negative perception of business collective action advanced by Adam Smith and Mancur Olson in his early works, which posit that business communities serve particularistic interests with little concern for public welfare (Olson

1971).<sup>65</sup> This contrasts with the “encompassing interest” view advanced by Olson in his later works (1982, 2000), which is supported by the works of Doner and Schneider (2000), Pyle (2006), and CIPE and USAID (2006), which argue that BAs often serve the general welfare by inducing underperforming states to deliver collective goods such as fair and enforced property rights, transparent business-state interactions, and a non-arbitrary legal system. Both theoretical perspectives hold a certain utility when looking at SME-state interactions at this municipal level of analysis. On one hand, the average Russian small businessperson only appears to use a SMEBA or otherwise appeal to the legal-political system to fix a particular problem on an individualized basis. SMEBAs serve more as intermediaries between an individual SME owner and a single official rather than as a collective action organization aiming to provide systemic reforms. While this may be a strong selective incentive for an SME owner to join a SMEBA, it does not necessarily validate the hypothesis of this dissertation, that SMEs intrinsically work to provide the encompassing public good of administrative modernization for all SMEs. On the other, facilitating this kind of interaction is part of the process of building a constructive dialogue between SMEs and authorities. The aggregate effect of officials working with the SME community likely provide some kind of collective goods once these officials realize what the actual problems of the small businessperson are. The problems of one small businessperson are likely the problems of thousands of others, and they are now empowered to go banging on doors. Small businesspeople looking to solve particular problems related to their individual enterprises reveals general inefficiencies in the local politico-administrative system. But at this municipal level of analysis, it becomes less clear whether SMEBAs work more as intermediaries between an individual business owner and authorities or as formal lobbying organizations.

## Hypotheses and Model

The model presented in this chapter represents a significant deviation from the paradigmatic model presented in chapter one, which presents SME effects on institutional modernization as a relatively straightforward process of SME interest agglomeration within a SMEBA and a subsequent campaign to achieve a tangible collective good outcome, such as a piece of legislation expressly created for the purposes of administrative modernization (e.g.

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<sup>65</sup> Recall Smith’s axiom on business collective action from *The Wealth of Nations*: “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public...” (Smith 1776, Book 1, ch. 10, part 2).

inspection reforms). As victims of the state's "grabbing hand", the empowered SME community in this paradigmatic model, mobilized via Russia's state co-opted peak SMEBAs, will naturally pursue reforms aimed at a more professional, less corrupt, "modern" administration. This national-level perspective illustrates the very "public face" of the struggle to build a better business climate for Russia's SMEs through administrative modernization. However, at the municipal level of analysis, it becomes apparent that many SMEs do not participate in this campaign. Collectively they appear much more as a "latent" than a "mobilized latent" group. The interview evidence presents a more nuanced picture of the effects of state subsidized SME collective action than does the national level of analysis. Small business influence appears to be real, but limited to individual interactions between an official, an SME owner, and a SMEBA representative. The public good outcome resembles a kind of "a la carte" public good as described by Hellman, Kaufmann and Jones (2000, 3), which includes "individualized protection for...property and contract rights in environments where the state continues to under-provide public goods necessary for effective entry and competition". A key distinction should be made here: in contrast to the activities of "captor" firms, who proactively seek unfair administrative advantages, the smallest firms tend to seek out officials as a *reaction* to a particular administrative barrier or bureaucratic headache. And this is largely done through SMEBA intermediaries. This is a key finding of Olimpieva (2009, 218), who concludes that "the main purpose of business associations is to assist businessmen in adjusting to an unfavorable or constantly changing institutional environment rather than to improve it". She notes that BA intermediaries provide legitimate consulting services to their members as well as "shadow functions" of facilitating access to officials (2009, 210). A representative from a local small business association in Saratov indicated that facilitating these kind of interactions comprised the majority of her daily work (Small Business Association Representative 2012).<sup>66</sup>

A less direct form of influence between SMEs and state institutions can be found in the relationship between officials and what are termed here "activist free riders": small business owners who do not participate in SMEBAs, but are empowered by their "legal literacy" campaigns to challenge officials. The aggregate effect of millions of informed SME owners challenging officials at the point of potential infraction would be difficult to measure, but if it were to bear out (which it is not argued here it has), it would likely result in a

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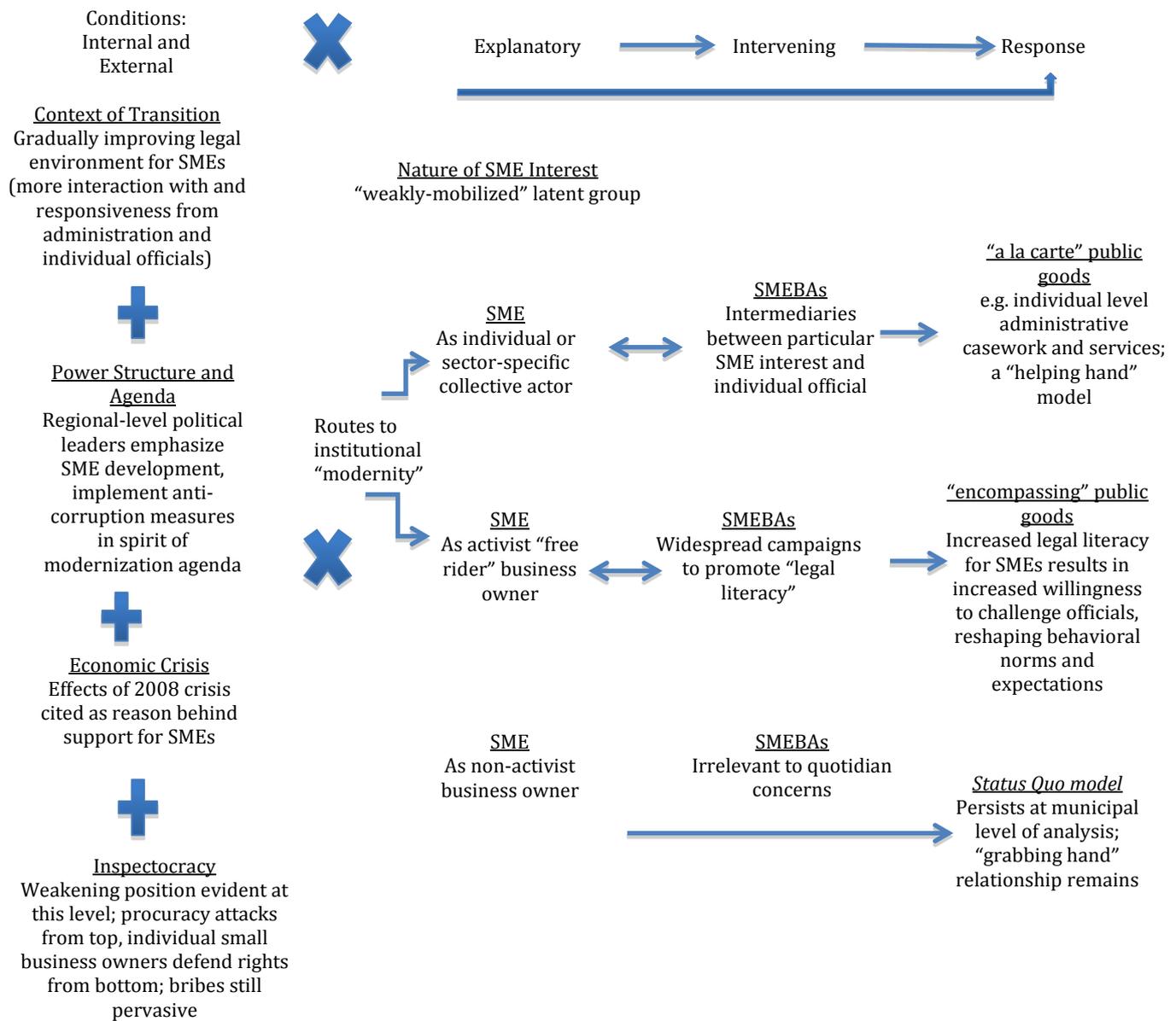
<sup>66</sup> The openness of this respondent's answer indicated that this kind of activity was not seen as nefarious or "shadowy", but rather as a normal function of her role and organization.

significant decrease in the prevalence of corruption and rent-seeking on the part of officials. It would increase the costs of rent-seeking. This is presented in this chapter as a potential encompassing public good outcome of SME collective action. In essence, the high level, state co-opted campaigns of SMEBAs “trickle down” to the level of individual business owners who, as the interview evidence demonstrates, increasingly resist rather than acquiesce to officials’ demands.

However, there appear to be many “non-activist” SME owners who perpetuate the *status quo*. They do not participate in SMEBAs. They continue to give bribes to the “grabbing hand” of the officialdom. Interviewees indicated that this was still very common. This was done largely because it was simply easier to pay an “on the spot fine” rather than to seek adjudication through the court system. Several interviewees noted the theoretical utility of a SMEBA in advancing SME interests and defending their statutory rights, but said that in reality, SMEs utilize SMEBAs rarely (even if they are members); they are often viewed as vehicles for ambitious businesspeople to build a career in politics (Moscow Academic 2010, Government Services Consultant 2012, Medical Services Company Vice-Director 2012).

Rather than conceptualizing small businesses’ influence on institutional outcomes as a unidirectional movement to lobby the incumbent regime to for advantageous political concessions, it can instead be viewed as a nuanced set of interactions and understandings between the higher and lower ends of the politico-economic spectrum. From the lower end, the small business community has struggled for change in the region’s legal and administrative framework, to varying degrees of success. Often these changes begin at the level of an individual business owner who, having become newly empowered with an increased knowledge of her legal rights, challenges an official at the point of initial interaction. In the aggregate this appears to have had a significant effect on the perceived quality and legitimacy of officials’ work (Owner of Clothing Shop Chain 2012). From the higher end, politicians who support the small business community, either through proposing initiatives or, as often seems to be the case, through individual casework with the assistance of a SMEBA, may be more likely to bolster their political status within the power vertical. For their part, bureaucratic officials appear to be encountering increasing resistance from SME owners who are both aware of their rights and have the support of political authorities attached to the small business support regime of the power vertical.

“Informal” relations persist, but they appear to be giving way to a degree of institutionalized interaction between these forces. As the previous chapter demonstrated, “by product” institutions of SME collective action channel SME concerns into a broader discourse with political authorities. SMEBAs serve as nodes of SME interest aggregation, which manifest themselves in such institutions, and encourage the development of SME-state ties, personalistic as they may be. In her discussion the role of blat—the use of personal networks which emerged in Soviet times as a means to circumvent tedious or obstructive formal structures to obtain scarce goods and services—in Russia’s modernization, Ledeneva (2009, 261) notes that “If you claim the influence of blat has declined and the term has become obsolete, people overwhelm you with examples. But if you argue that blat continues to operate, they reply that the term is out of fashion...”. Such a dynamic became apparent from the field research conducted in Saratov. Formal lobbying efforts of the small business community were fairly rare (Business Journalist 2012). Formal institutions such as SMEBAs appear to be most often utilized on a personalized, ad hoc basis. A system of *blat* still seems to persist, but is conditioned by the presence of a high-level economic development agenda with a core aim to build a more modern administrative system. The general impression from the interview evidence was that although interactions may have been personalistic, *they were geared toward the resolution of an administrative problem and not toward the provision of individual administrative advantages to the SME petitioner*. This indicates another potentially strong selective incentive for SMEs to join a SMEBA, which is that SMEBAs can provide access to officials as a benefit that non-members would not necessarily enjoy. It also demonstrates how a “helping hand” model of SME-state interactions may become a key feature of the *Emergent* model in the coming decades should such relationships proliferate and become routine. The aggregate effects of thousands of SMEs working with thousands of officials to alleviate thousands of individually small administrative issues may portend a “death by a thousand cuts” of Russia’s *Status Quo* model of SME-state interactions.



**Model 3: Municipal Level Modified Model**

The empirical thesis of this chapter is derived from this model, and can be formulated as follows: despite widespread “free ridership” and many who perpetuate the *status quo*, a “spillover effect” of high level SMEBA campaigns and the centrality of SME development to the federal modernization program results in both an increasingly empowered small business community and an increasingly responsive local administrative apparatus. Both outcomes are

viewed as manifestations of the encompassing interest of the SME community. These outcomes represent aspects of institutional modernization at the crux of this dissertation's overarching hypothetical assertion, that state subsidized SME collective action *intrinsically* results in campaigns for "modernizing" institutional reforms. As a bottom-up aspect of institutional modernization, SME owners are now able to resist rather than acquiesce to the demands of corrupt officials. From the top-down, the federal modernization program has incentivized support for SMEs which manifests itself in local officials' willingness to act on behalf of SME interests. These interactions may occur on an individual, "a la carte" level, but they signal the beginning of a reshaping of behavioral norms and expectations on the part of private sector actors and public officials. They are a substantive deviation from the *Status Quo* model of business-state interactions that has been a significant part of Russia's post-Soviet history.

The primary hypothesis to be explored in this chapter can thus be formulated as follows:

**H1:** The formal, high-level campaigns of SMEBAs, as encouraged by the federal modernization program of the presidential power vertical, have "spilled over" into the realm of non-SMEBA members at the lowest levels of the economic spectrum. This encourages institutional reform from two sources: from high-level regional authorities and from newly empowered individual SME owners.

**Explanation:** 1) The exigencies of economic development, crisis, and building a local base of political support encourage politicians to support SMEs on an individual basis through dialogue with SMEBA intermediaries and carrying out casework for individual business owners; and 2) the aggregate effects of SMEBA representatives acting as intermediaries between SME owners and political and administrative authorities provide a framework for understanding the inefficiencies of the administrative system. Action to ameliorate those inefficiencies may or may not be taken, but they illustrate common problems to resolve.

The evidence presented in the following pages indicates that the tension between pressures to conform to the *Status Quo* model and to a variation of the *Emergent* model as presented in chapter one appears to be significant. Conclusive determinations as to which trajectory will prevail cannot be made from such a small sampling of SME representatives. However,

combined with the higher-level perspectives presented in previous chapters, it may be safe to say that the *Emergent* model is gaining ground.

## Method

Twenty interviews were conducted with local small business owners, association leaders, lawyers, academics and business journalists in Saratov and Moscow in 2010 through 2012.<sup>67</sup> One focus group with managers of local SMEs in Saratov who were taking courses from a local university's business and management program was also conducted. These represent the primary data collection methods for this chapter. They are complemented by preliminary analysis of archival resources from local business journals and SMEBAs.

### Preliminary Insights: Experts' Views on SME-State Ties

The interviews conducted with academics working in the field of business-state relations in Russia were carried out in the fall of 2010 with representatives from prominent universities and institutes in London, Moscow, and Saratov. The perspectives they provided tended to emphasize the differences in capabilities between SMEBAs and associations of large enterprises and single large enterprises. They described a situation in which the SME community pursued an “accommodationist” policy with Russia’s power vertical as part of a pragmatic strategy to achieve specific collective objectives. It bears reiteration that Russia’s largest SMEBAs, OPORA and *Delovaya Rossiya*, were created by the state as part of an effort to institutionalize a dialogue between higher echelons of power and the independent small business community. This is something of a double-edged sword: on the one hand, close links with the state give small business interests the opportunity to voice their concerns to powerful officials. On the other, taking an activist stance against entrenched party lines could result in less access and influence.

Although SMEBAs would logically seem to carry a grassroots democratic legitimacy (Moscow Academic 2010), in reality many small business owners do not participate in them. They have been criticized for being a vehicle for successful and ambitious members of the SME community to begin a political career (Moscow Academic 2010, Yakovlev, Zudin and Golikova 2010). Few of the small business owners interviewed in Saratov were members of Russia’s official SMEBAs, although many were members of the Chamber of Commerce and local independent associations. Most respondents indicated that they used these associative mechanisms rarely, if ever. They generally expressed dissatisfaction with the political and

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<sup>67</sup> See Appendix One: Interview Questions for Respondents in Saratov", p. 165.

legal climate for business, and are interested in changing it. They understood the theoretical utility of a BA, but in reality, when an individual business owner was confronted with some arbitrary or corrupt aspect of the system, they almost always would resort to handling the problem themselves.

### *Methodological Alternatives and Challenges*

The interview evidence presents a nuanced perspective on BAs, firm size, and political influence when compared with data obtained via the ubiquitous survey research that dominates the field of Russian state-business relations (Frye 2002, Frye 2003, Frye, Yakovlev and Yasin 2009, Pyle 2009, Slinko, Yakovlev and Zhuravskaya 2002, Slinko, Yakovlev and Zhuravskaya 2005). This body of research tends to focus on more prominent regional SMEs, which may produce results that indicate a higher degree of influence on formal institutions than would come from surveys of the “smallest” small firms. For example, Pyle’s (2009) work finds that a firm’s propensity to confront government predation is positively correlated with membership in a BA. Responses came from managers of regional industrial enterprises—which tend to be at the “larger” end of the SME spectrum—and BA representatives. This complements the work of Frye (2002), who found that membership in a BA is positively correlated with the propensity to lobby and the success of lobbying efforts to change the institutional environment. These findings are based on results from a survey in which the average size of the firm where the respondents worked was 840 employees. Frye, Yakovlev, and Yasin’s (2009) work attempts to find how “everyday firms view the rules of the game in Russia”. They found that firms who reported an intent to reinvest in themselves in the following year—i.e. firms that had attained some degree of profitability and stability—also reported less harassment from government officials and a higher probability of utilizing the court system successfully to obtain an outcome in their favor. The responses on which this work was based came from small firms, but still heavily balanced toward those employing over 50 people, and some up to 500. Slinko, Yakovlev, and Zhuravskaya’s (2002 and 2005) works deliberately sample from larger regional firms in an attempt to assess the effects of firm size on particularistic legislative outcomes for those firms. They found that larger firms were better able to obtain favorable legislation for their operations and that these “captor” firms derived significant financial benefits from their political influence.

However, if we extrapolate that the perspectives from the interview evidence obtained in Saratov for this dissertation, and the interview-based findings of Olimpieva (2009)—i.e. that BAs are not perceived as useful by the smallest of small firms—are in some way

representative of the rest of Russia, we must question the utility of evidence obtained via the aforementioned survey mechanisms. The implication of the interview evidence from Saratov and St. Petersburg (Olimpieva 2009) is that, although BAs may be useful to certain politically-minded or well-established SME owners, most “small” small businesses operate outside the purview of a BA—and under the radar of quantitative survey methodologies.

One of the most acute difficulties in researching the small business community rests in its size. As a large, disparate grouping of businesses of many sizes, ages, and sectors, it becomes difficult to assess the representativeness of the data collected via the interview method. Furthermore, as a lone student researcher working in Russia, it was difficult to be discerning in the selection of interviewees. Often, an interview was set up by a fixer who “knew someone who knew someone” who was running a business. Sometimes this involved an owner, sometimes a manager. Sometimes the business was a micro-enterprise—i.e. with 1 to 15 employees—and others were technically “small enterprises”, employing from 15 to 100 people. This method may have its limitations in terms of representativeness, but this lack of breadth is intended to be counterbalanced by empirical depth. Furthermore, as a complement to the broader levels of analysis in previous chapters, it becomes apparent that the issues widely discussed in national media outlets are in fact those issues discussed by members of Russia's SME community (or those who work with them) in Saratov. From this, a reasonable assumption can be made the issues discussed by interviewees in Saratov are comparable to those that would be discussed by representatives from other regions.

However, a distinct, linear causal mechanism between small business interests and a legislative or political outcome was not apparent from the interview evidence. Frustrated small business owners did not simply gather at the local BA headquarters, discuss their concerns, put them to paper, and then petition their local Duma representative to submit their proposals to the assembly for ratification into law. But there were indications that, even if not unified as a distinct lobbying group, small businesses were able to communicate their concerns to higher levels of the political spectrum. This did occur via the association mechanism, but also via the press and individual casework between an individual business owner and an official (which was usually facilitated by a SMEBA). Small business owners do possess a relatively uniform set of concerns, and political leaders and officials know what they are. Furthermore, there is evidence to suggest that the initiatives the small business community supports do indeed serve a broad collective interest, lending credence to Olson’s idea that encompassing organizations will work in just such an interest when compared with

sector-specific organizations, and to the perspective of Doner and Schneider (2000) and Pyle (2006), that BAs work to improve governmental efficiency and public goods provision.

### **Evidence from Saratov: Pragmatism, Cynicism, and Optimism**

The interview data from Saratov illustrates a number of thematic continuities amongst a diverse range of respondents. Briefly summarized, respondents conveyed varying degrees of pragmatic political concerns, a cynicism toward the current *status quo* and its capacity for change, and optimism for the future that emerged only when prompted to compare the situation today with that of ten years ago. Political democracy as an ideal was not something they saw as a priority. Rather, the pragmatic concerns of economic growth, stability, and corruption were cited much more often than were aspirations for more representative government.

### **General Sentiments**

Many respondents indicated that the problems Russia faced in terms of corruption and a transition to more accountable governance had to do with the country's early development stage, saying in one way or another, "Russia is just getting started" (Economist/Small Business Owner 2012, Small Business Association Executive Director/Small Business Manager 2011, Medical Services Company Vice-Director 2012, Shop Owner 2011). Several respondents said that local politicians had an open-door policy to representatives from small businesses and they had been successful in obtaining aid from them (Small Business Association Representative 2012, Small Business Association Executive Director/Small Business Manager 2011). "Round-table" (*kruglyye stoly*) meetings between officials, businesspeople, SMEBA leaders, academics, journalists, and other experts were ubiquitous and attendance limited only by the space constraints of the venue. Interview respondents universally cited inspection regimes (FL- 294), tax reform, and the issues surrounding preferential purchases of state property (FL-159) and participation in state procurement for SMEs as the most pressing issues facing the small business community. As the previous chapter illustrated, these were in fact the issues receiving the most attention in local media outlets as well. Most respondents were skeptical of the utility of SMEBAs in helping to solve their problems (Focus Group 2012, Shop Owner 2011, Medical Services Company Vice-Director 2012, Government Services Consultant 2012). And although many respondents expressed frustration with the current legal and political climate for starting up and running a business, several agreed to varying degrees that the climate has improved in the past ten years

(Government Services Consultant 2012, Consulting Firm Director 2011, Ad Agency Owner/Economist 2012).

Evidence for the perspective that BAs work to help SMEs adjust to an unfavorable business climate rather than working to improve it emerged from the interviews conducted in Saratov. But smaller, sector-specific associations also played a role in lobbying for specific concessions from the local administration. If a business owner was to act collectively, it appeared more likely to be done in this manner (Government Services Consultant 2012, Medical Services Company Vice-Director 2012, Ad Agency Owner/Economist 2012). Eleven out of twelve members of a focus group of small business owners and managers had never even heard of OPORA or *Delovaya Rossiya*, despite their status as the largest SMEBAs in Russia (Focus Group 2012).

### The Chamber of Commerce

With roots in the late-tsarist and early Soviet era, the Chamber of Commerce is Russia's longest standing commercial association (Torgovo-promyshlennaya palata Rossiyskoy Federatsii n.d.). As Russia's largest multi-sector business group, it represents both a "peak association" and an "encompassing" interest (Olson 1971, Olson 1982, Olson 2000). Most of those interviewed belonged to it. Although independent and respected, several respondents indicated that as such a large organization, the interests of individual owners become subsumed in a diluted pool of myriad interests (Manager of Beauty Salon 2012, Government Services Consultant 2012). Fedotov (2007, 55) describes the Chamber's "inclusivity" as a key *advantage* of the "Eurasian Model" of the Chamber (in which he includes Russia):<sup>68</sup>

Voluntary and multisector membership...helps gauge an aggregate opinion on the entire range of economic issues of the socially active entrepreneurs united in a chamber. Conflicts of interest within the entrepreneur community are resolved by identifying and discussing salient issues with an agreed position communicated to the authorities, which is exactly the approach acceptable for the latter.

Many individual business owners in Saratov saw this as a distinct *disadvantage*, as pursuing their company's interest within a SMEBA involved time and a certain amount of

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<sup>68</sup> Fedotov (2007) contrasts this model with "Anglo-Saxon", "Continental", and "Asian" models of Chambers of Commerce, each of which are distinguished according to factors such as degree of government supervision over a Chamber, whether membership is mandatory, relative delegation of public functions to a Chamber, financing (public or private), and a Chamber's advisory status with the government.

politicking. When asked about the advantages of membership, most said that they saw it initially as a way to voice their concerns to local government. However, they also said that they had not participated actively in the organization and did not see much benefit (Shop Owner 2011, Medical Services Company Vice-Director 2012). One small business owner joined in 2008 in response to what he called the “war on entrepreneurs” happening in Saratov at the time:

We became a member of the Chamber because a few years ago the city administration started a ‘war’ on street trading [i.e. small shops]. At the time I was running a small bakery. Essentially the administration started this war during the 90s when there was little legislation and [their scope of action] was without limits. They [the authorities] would arrive, load any [improperly licensed] equipment and drive off. More than a few entrepreneurs experienced this administrative tyranny. It made people [i.e. entrepreneurs] search for a way to solve this problem...the Chamber provided one such way. Entrepreneurs could meet, have a dialogue...It essentially acted as a buffer between the city administration and small business owners (Shop Owner 2011).<sup>69</sup>

The respondent could not cite a specific instance of the Chamber coming to his company’s aid. The implication of his response was that the city administration’s arbitrary seizure of property was epidemic, and he saw membership in the Chamber as a means to dissuade officials from targeting his business. Later in the interview he expressed a slight cynicism to the utility of the Chamber. There was a sense of helplessness in the response: the Chamber may not be the perfect defender of the small businessman, but it was all he had.

One vice-director from a private emergency medical services company, which has been a member of the Chamber of Commerce since the company’s opening in 1999, described the extent of the Chamber’s utility to him:

There are some advantages [of membership in the Chamber]...for example sometimes we can discuss some problems which are not clear for us. Because ... the Chamber of Commerce has its own personal team of lawyers, so we can discuss with them some problems, some laws. And...the Chamber can help us solve some problems, but I don’t remember some practice when we...appealed to Chamber to solve our problems because it’s better to solve them ourselves. Because we are the most interested persons who are most interested in solving of these problems. We can take advice from Chamber, but it’s very seldom. [sic]

This respondent echoed the theoretical utility of the Chamber, but in practice his company chose to solve the problems internally, or with other companies in the same sector. This particular respondent saw more utility in organizing with other members of the same sector to

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<sup>69</sup> Recall similar accounts from chapter two, when officials arbitrarily seized property from small business owners (see " The Inspectocracy: ", p. 73).

discuss means of resolving administrative issues pertaining to their specific interests (see below). Satisfying the encompassing interest of *all* SMEs was not something this respondent saw as a useful effort on the part of his firm.

While the Chamber may be a large and respected business organization with a close relationship with the state, the small business owners interviewed indicated that the only service they valued upon joining was its legal support function, which they apparently used rarely. Yakovlev, Zudin and Golikova (2010, 4) echo this sentiment, noting that Russia-wide, most local Chambers fulfill few functions to “everyday” members aside from providing legal advice. They highlighted the Chamber’s low membership fees, which may explain its high membership rates. The Chamber may help provide more favorable regulatory environments with the “right of legislative initiative” they enjoy in many regions and at the federal level.<sup>70</sup> But in reality most business owners appear to “free ride” on what benefits are provided to them.

That SMEs seem to value this “legal support” function of the Chamber indicates that many are more concerned with solving the particular administrative problems of their particular enterprises as they arise. It lends credence to the idea that Russia’s SMEBAs’ daily activities are more geared toward helping SME owners adjust to an unfavorable business climate rather than changing that business climate systemically. The fact that SMEs seem to rarely use the functions they valued indicates that either they are encountering few administrative obstacles, or are choosing to surmount those obstacles in other ways.

Insofar as the interview evidence pertaining to the utility of the Chamber to SMEs is concerned, SMEs do not appear to be a politically efficacious force for institutional modernization. While it is certainly an institution of protected consultation as it maintains a close relationship with the state, the apparently low participation rates indicate that it may be viewed by SMEs as a rather hollow organization of little value. It also brings up the issue of defining SMEBA strength not just in terms of the length of its membership roster, but in terms of the proportion of its members that actually engage in its organizational activities. The size of its roster may point to a “mobilized” SME community, while the participation rate would likely point toward SMEs’ latency as a collective interest.

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<sup>70</sup> See “Taking the Legislative Initiative”, p. 95.

## The Realities of SMEBA Participation

Several respondents were outright dismissive of participation in Russia's official SMEBAs. Yakovlev, Zudin and Golikova (2010, 2) note that it was "2<sup>nd</sup> tier" SMEBAs—i.e. local organizations with under 100 members—who played the most prominent role in advancing SME interests in the 2000s. When asked why his company was not a member of OPORA or *Delovaya Rossiya*, a director of a consulting firm, which itself worked with companies to handle SMEs' problems with local administrative bodies, said

...in Saratov we have created cooperative associations from below. But OPORA and *Delovaya Rossiya* were created from above... And I don't feel that they represent our interests. For this reason we don't work with them and I don't see where we can work with them... There are problems that interest me that I want to solve. But I don't see [OPORA and *Delovaya Rossiya*] solving them. Even if they publicize certain problems [of the SME community], I don't see how they can solve them (Government Services Consultant 2012).

Although this respondent was dismissive of participation in Russia's peak SMEBAs, in this statement he does allude to the fact that they publicize SME issues. This may have little direct bearing on the activities of his firm, but it does provide evidence for the idea that SME owners can affect how administration performs simply by being informed themselves of their rights.

When prompted to describe their impressions of and experiences with SMEBAs, one member of a focus group said he joined a local SMEBA 5 years before, paid a modest yearly fee, yet the group only met once since his joining (Focus Group 2012). Others did not see the point of joining. They needed to devote time to running their businesses, not petitioning for systemic change when any such effort most likely would not be successful (Manager of Beauty Salon 2012, Medical Services Company Vice-Director 2012, Economist/Small Business Owner 2012). In theory, SMEBAs could be an ideal platform for the development of an independent business interest, which in turn could bode well for the development of a politically active middle class and improved representative governance (Moscow Academic 2010). In practice, many small business owners are too concerned with the workaday concerns of running their business to devote their time to participating in the activities of a BA (Business Journalist 2012, Manager of Beauty Salon 2012, Government Services Consultant 2012).

Several respondents, however, said they participated in "ad hoc" collective action with other businesses from their respective sectors. Their efforts were usually in response to a

specific set of problems concerning their particular sectors. One respondent who ran an advertising agency said that in general, the small business community carries very little influence in local politics, but could influence other aspects of city administration:

We have an advertising agency as a business. In general we can interact with [other agencies]. In many of these circumstances we are not competitors. We have solidarity. If there is some general question that arises in the economy we can discuss solutions together. For example, during the [2008 financial] crisis we had to pay quite high taxes to the city administration. We went [to them] with proposals to increase the amount of time for us to pay these taxes, for example, or to reduce them. The administration agreed to them because we were not just one advertising agency, but a group. When there is that kind of consolidation [of interests] then yes, in this regard we can influence decision-making (Owner/Economist 2012).

This may illustrate a less “encompassing” public good of SME lobbying provided to a parochial interest—i.e. favorable tax payment schemes for local advertising agencies—but it also demonstrates the responsiveness of the city administration to SME petitioning. It illustrates a core tenet of classic Olsonian collective action theory: a small group with a strong interest in providing a public good for their group will find it easier to organize to achieve that end than a larger group. A peak SMEBA may have given some organizational *gravitas* to this effort, but in this particular case it was easier for these advertising agencies to mobilize themselves. But this petitioning does illustrate an aspect of institutional “modernity” in Saratov in that local authorities did not see tax reductions as a decrease in a source of rents for the administration as some have in other circumstances, but rather as a reasonable concession to grassroots interests struggling with the circumstances of the 2008 crisis.<sup>71</sup> Responsiveness to the needs of constituents was put before the needs of the administration.

A medical services company vice-director (2012) discussed the usefulness of meeting with other members of the medical services community in the Saratov region to share experiences and strategies in dealing with administrative barriers and inspectors. One issue facing the medical services industry in Saratov was a law passed in the regional Duma that would not allow private ambulances to carry prescription medications in vehicles without an (expensive) permit. Naturally, this was of great concern to the industry, whose work functions could not be carried out without powerful medications. The vice-director indicated that this was an issue brought up in industry meetings in the region. At the time of the

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<sup>71</sup> Recall from chapter three the widespread stonewalling by city officials to SME requests to purchase municipal properties at preferential rates as stipulated by FL-159 on the grounds that it would deprive city coffers of a key source of income (see "Dialogue", p. 107).

interview, he said that discussions were underway to apply for permission to allow the industry to form a self-regulating organization at the regional level in order to help deal with this and other issues (Medical Services Company Vice-Director 2012).

The propensity for these interests to engage in small-scale, sector-specific collective action indicates that the “encompassing interest” public goods of Russia’s peak SMEBAs are of little immediate value to these business owners. Each respondent participating in these kinds of collective action pointed out that they had immediate concerns with specific regulations. The high-level and drawn out politicking needed to achieve an outcome via a peak SMEBA would not resolve these concerns. This validates the classic Olsonian view that “a group which has members with highly unequal degrees of interest in a collective good, and which wants a collective good that is...extremely valuable in relation to the cost, will be more apt to provide itself with a collective good than other groups with the same number of members” (Olson 1971, 45). In short, only an acute, immediate problem seemed to prompt these business owners into collective action as a means to resolve it.

As far members of the SME community appear to be concerned, campaigning for the long-term goals of administrative reform and modernization are initiatives likely to be pursued by well-established SME owners who have the financial security to turn their attention to political matters. Yakovlev, Zudin and Golikova (2010, 6) find that formal BAs tend to attract active, motivated, and relatively successful businesses. In turn, these BAs tend to work with ambitious, reform-minded local politicians in a *quid pro quo* kind of exchange (ibid, 4). In fact, according to these authors, one widely-raised criticism against some BAs is that those that are the best funded—i.e. those with the wealthiest members—form alliances with local *chinovniki*. They then use their wealth and collective bargaining power to gain unfair administrative advantages (ibid, 3). This indicates a kind of “capture” dynamic emerging as the interest involved gains more wealth and influence, and may explain the prevalence of “raiding” (*reyderstvo*) at the regional level in the past decade (Osipian 2010): as enterprises grow and become more profitable, they also interact more and establish working relationships with officials. A relative lack of institutional constraints means that such relationships may degenerate into collusion between local officials and well-off business interests to combine the advantages of administrative authority with financial backing to seize lucrative competitors’ enterprises. Regarding the interviewees in Saratov, many owned or worked for companies employing under ten people. These were likely struggling firms whose relative lack of financial resources meant that they would have to devote the most

significant part of their workdays to simply maintaining their businesses. Successful, well-established firms do not suffer as acutely from this burden of subsistence. Their leaders have the time and resources to devote to outside activities.

A Moscow academic (2010) and Yakovlev, Zudin and Golikova (2010) stated that in the state-sponsored SMEBAs OPORA and *Delovaya Rossiya*, participation in the higher levels of the organization was often a means to advance personal political aspirations within the power vertical. As such, leaders tend to conform to party lines and not to take an activist stance against entrenched authorities. This Moscow academic went further, arguing that Russia's weakly institutionalized environment incentivized political ladder-climbing, especially within SMEBAs. Associations of large enterprises had already been reined in by Putin's equidistance doctrine, and any political machinations on their part were highly visible. SME leaders, on the other hand, were not so much on the radar. He stated:

...generally speaking, small- and medium-sized business typically is less politically connected and therefore these people should and could prefer a more free economic environment, more competition, and so on and so on. But under Russian conditions, unfortunately...such kind of organization can be even more politically connected and more rent-seeking oriented, comparing to these big BAs...RSPP [*Rossiyskiy soyuz promyshlennikov i predprinimateley*, or RUIE, the Russian Union of Industrialists and Entrepreneurs, one of Russia's most influential BAs representing Russia's largest companies] is much more transparent at the moment from the point of view of business and from the point of view of experts. Because RSPP provided a number of some kind of public goods for many people. But in my opinion it's not the case of OPORA. Generally speaking, small- and medium-sized business should be more democratic...but under the situation of the very imperfect institutional environment, both on the side of market and on the side of state, unfortunately it can also be a quite strong opportunistic incentives for small- and medium-sized enterprises with idea to use such kind of organization like OPORA or *Delovaya Rossiya* to lobby some private interests and to make some kind of political career and to receive some kind of higher social status. [sic]<sup>72</sup>

As with many of the interview respondents, this academic emphasized the gap between the theoretical ideal of having an empowered small business community as a vanguard movement within Russia's nascent civil society to push for better administration, and the realities on the ground in Russia (Local Lawyer and Business Director 2012, Manager of Beauty Salon 2012, Business Journalist 2012). Putin may have subsidized the

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<sup>72</sup> Some of the public goods provided by the RUIE include standardizing accounting practices, transferring many enforcement and punitive functions from the bureaucracy to the courts, reforming the customs system to international standards, and many more (Markus 2007, 286).

greater costs of collective action for the SME community by creating these state-sponsored associations, but by attaching them so strongly to the power vertical, it limited their ability to expand horizontally into civil society and instead created incentives for opportunistic career advancement.

The question as to whether this creates a situation that perpetuates the *Status Quo* or *Emergent* model of business-state interaction remains an open one. An argument can be made that having SME owners in high-level positions may be beneficial for advancing the SME interest in administrative modernization. On the other hand, it could drive many to utilize their newfound power for personal advantages. The Moscow academic above noted that Russia was a society of “strong actors and weak institutions”, by which he meant that few institutional constraints exist to check the self-serving behavior of powerful individuals. Such an environment incentivizes corruption in the form of kickbacks, *reyderstvo*, and other forms of capture and elite exchange. An extensive review of parliamentarians’ backgrounds and history of SME policy support would be necessary to understand the ramifications of former SME owners becoming active in the political arena. As it stands, the evidence presented in the preceding pages indicates that SMEBAs themselves can become part of the perpetuation of the *Status Quo* as individual SMEBA leaders gain power and influence.

### **The Changing Business Climate for SMEs**

The owner of the local advertising agency, who also studied as an economist, stated that in comparison with 10 years ago, the small business community did have more influence in government, although it was still marginal. According to her, the legal system was much more trustworthy. Every small business owner (she knew, presumably) had their own lawyer, and was fairly confident that the legal system would work fairly for them should an issue come to arbitration (Ad Agency Owner/Economist 2012). This was echoed by several other respondents (Manager of Beauty Salon 2012, Business Journalist 2012, Editor 2012).<sup>73</sup> She said in 2008 local authorities became much more responsive to its concerns in the wake of the financial crisis, which was crippling for the region. A local business journalist echoed this statement (Business Journalist 2012). She described the reform of Russia’s cash register law as a prime example of the SME community successfully lobbying for a law to ease the

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<sup>73</sup> This reflects Russia-wide sentiments as well. Comparing the results of the 2011 and 2008 Business Environment and Economic Performance Surveys (BEEPS) of Russian firms, the World Bank found that in 2008, only 35% of respondents indicated that the court system did not represent a significant obstacle to doing business. In 2011, 77% of respondents did not see courts as a key problem affecting their businesses (World Bank 2013, 4).

burden of doing business, which became much more acute during the crisis.<sup>74</sup> Although conforming to the former version of the law may seem like a small expense (about \$300 per year), this represented a significant cost for the smallest business owners. According to another respondent, his brother's family of four, living in a village outside of Saratov, subsisted on about 6,000 rubles (~US \$185) per month (Medical Services Company Vice-Director 2012).<sup>75</sup> These are the region's consumers, so naturally the revenue of most locally-owned business is commensurate with the community it serves. Our journalist juxtaposed the reform of the law with the realities of surviving in Russia during the crisis for the majority of small business owners:

...conforming to the mandatory purchase of a cash register box was quite a large expense [for small business owners]. If we take the smallest businesses which represent the majority [of all enterprises], they [are run] by people who simply want to work. Their fate is tied to the decisions of our...high leadership. They are [former] engineers, chemists, physicists, technicians... [After the USSR's collapse] they were without work. So they started businesses. In general they are the most enterprising...Their goal is simply to feed their families and perhaps five or six relatives. That's it! Most of them do not explicitly aim to grow their companies to become large, but rather just want to live at the average level. They do not have [grand] ambitions. They just want to feed themselves and their families. That's it. If you take the laws regarding small businesses, and analyze them all you will see that they don't actually defend them [but rather regulate and constrain]...Russia only understood the need to protect small businesses in 2009, when it was realized that Russia wasn't a fortress of stability, and that the talk of a crisis was more than just talk. It actually affected actors outside the financial sphere. And then authorities became concerned that there were not enough safeguards to protect business. They were scared that people would lose the ability to feed themselves and their families, would become hungry and go out to the square [to protest]. Because Russians go out to the square when they open the refrigerator and it's empty. And [during the crisis], they weren't just empty for a week, but for two, sometimes three months. Only when they've eaten everything they have will they go out to the square and bang on their empty cooking pots, and make an attempt to sweep away power.

She further stated that aside from reforming the cash register law, in the past five or six years there were no systemic reforms that involved the direct lobbying efforts of the SME community. Most low-level initiatives were taken by groups representing a specific business sector, and they did not involve a SMEBA.

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<sup>74</sup> This reform initiative was described in chapter three. See "The "Black Box" Campaign", p. 96).

<sup>75</sup> The average monthly income in Saratovskaya *oblast'* in 2011 was 13,097 rubles, which comes to about US \$430 at the average 2011 dollar-ruble exchange rate of 30.626 (Russian State Statistics Service 2012b, US Internal Revenue Service 2014)

Our medical services company vice-director (2012) cited constantly changing laws and regulations as the most significant obstacle to his business. This corroborates findings from the World Bank-EBRD Business Environment and Enterprise Survey (BEEPS), which found that a major concern of firms in Russia is the unpredictability of the regulatory environment (Desai 2008). For example, in the private medical services industry, new regulations have recently been introduced in Saratov that require a certain system of ventilation in their facilities. Building the new system would incur a significant cost on this small medical services company, which employed about 45 people. They would have to knock down walls, and buy and install expensive new equipment. The vice-director described the reason behind his reluctance to conform to new regulations:

Our legislature, our laws...are changing always. And it's too hard to [conform to] them and sometimes...there is a situation when, for example, our parliament has published a law. We have read it, we read it and made all to have our deal in connection with this law [i.e. we have done everything we were supposed to do to conform to this law]. So...in two years, [there is a] new law and we understand that we have to change all the things we have done for [for the previous one]. [sic]

The implication from the interview was that it is simply cheaper just to pay a bribe to an inspector than to try to adapt his business to conform to the new regulations. The respondent indicated that his was the preferred solution for his company and many others working in Saratov.

### **Perspectives on Inspection Reform**

This constantly changing legal environment provides rich ground for inspectors to extort bribes from small firms. The region's Deputy Prime Minister, Pavel Bol'shedanov, emphasized the centrality of Russia's inspection regime to business development, noting that the region's political leaders "demand transparency at all levels of government in their relationship with business, from the municipal to the federal inspection and supervisory authorities" (Levenets 2012, para. 8). The local business journalist described a situation in Saratov and across Russia in which the legal system was so convoluted and full of loopholes that inspectors could enter a business and cite ostensible infractions at will (Business Journalist 2012). One manager at a beauty salon described how she routinely challenges inspectors who come to her premises. She jokingly attributed her extensive experience with inspectors to her business being located next to the headquarters of the main city inspection authorities. According to her, she has learned how to beat them at their own game, demanding they produce the requisite identity documents and warrants for their inspections,

much to their consternation. Most often they cannot. Many in fact are imposters posing as inspectors from some sub-ministerial department, which is a common scam (Delovaya Rossiya 2007, Prokuratora Saratovskoi Oblasti 2009).<sup>76</sup> She recounted her experience:

We're located next to the administrative buildings, so we're inspected a lot. It must be that an inspector thinks, 'I need to inspect a beauty salon today. Look! There's one nearby!' In eight years we've been inspected by every possible inspection agency working in Saratov...every one there could be... [But] we've become smarter. I know now what inspections there should be: once every three years. No more. I learned the regulations regarding inspections. If someone comes and says, 'I'm from the tax service,' I tell him, 'Then show me your documents.' He'll say, 'Hold on I've left them in the car.' [After a bit] I'll look out and no one's there! The man was just 'off-duty' [or not an inspector at all, and just trying to extort bribes]. This happens all the time, very often. If someone says, 'Show me the documents for your property,' I reply, 'Who are you?' 'I am from the Department of Housing of the Regional and City Administration.' I then say, 'OK. Show me your documents. Tell me your name: surname, patronymic, given...I will call [your office]. Show me the warrant for this inspection. If you're here to demand something of me, then show me all the documents which give you the right to do so and which show who you are.' There's a huge amount of these people, so many. Last year two guys came to our premises six times. I kept track! They actually did work for the Department of Housing. I had already been going to the administration headquarters once a week to ask why they were sending [these guys] so often. One was brought along to warn me [about my obstinate behavior]. The whole time he was shouting, cursing. But I kept a strong face and said, '...Show me your documents! This is my work...Show me your documents! I'll call the salon director, we'll have a meeting...' But they didn't show their documents! They couldn't deal with us!

This respondent's resistance to officials' demands demonstrates how "activist free riders" may be crucial—if difficult to quantify—factors in encouraging administrative modernization in Russia. She is unlikely to be the only business owner in Russia acting this way. Evidence from the previous chapter indicated that many other business owners did not fear inspectors and were willing to challenge them, either on the spot or in courts.<sup>77</sup> This respondent was not a member of a peak SMEBA, but cited regulations that were meant to constrain inspectors' behavior. This is knowledge that has been widely publicized by Russia's peak SMEBAs, and had "trickled down" to the level of this individual business owner. The aggregate effect of business owners resisting officials in this way may make them think twice about citing a firm for anything less than an unambiguous violation of code. In short, it encourages officials' to

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<sup>76</sup> These are the charlatans who exploit the right in Russia to form independent "consumer protection" organizations as described in chapter two (see "SME Rights versus Consumer Rights", p.76).

<sup>77</sup> See "Empowerment", p. 105.

behave in a more professional, standardized manner characteristic of “modern” administrative systems.

However, this respondent’s story also illustrates the problems with reforming Russia’s inspection law. FL- 294 limits the amount of *planned* inspections authorities are allowed to carry out in a given year. Yet the reviews of its efficacy are mixed, based on the interview evidence. Several respondents indicated that it was the unplanned inspections—which inspection authorities have a right to conduct on slight pretense—that were the main problem. However, others indicated that the publication of inspections on the internet was useful, and that arbitrary harassment by the police and inspectors was a thing of the past. Our business journalist detailed some of the problems:

...one law, it was Medvedev’s law [FL-294], was to limit the amount of these inspections, those official inspections carried out under the local public prosecutor’s authorities, such as inspections by Rospotrebnadzor...and [once passed], small business was able to breathe a little easier. But just a little. Because in Russia anyone can circumvent a law if he needs to. If [an inspector] wants to conduct an inspection, he’ll [find a way]. Nothing has really changed for anyone because it’s the unofficial inspections [that are the problem]. We have a very tangled policing structure. That is, we have police for society-at-large, administrative police... There’s many, many different levels. And they all have the right to drop in [to a business] if they’re [the type of person] who likes to find faults. They have the right to say, ‘I just dropped by [to say hello] in an ‘unofficial’ capacity, [to ‘have a look around’]’. The signal is sent that ‘I am going to inspect you’. Our businesspeople aren’t [perfect] and they always have something to hide, and they know perfectly well that this guy has come for a bribe. It’s natural that they give them... These big, official, state-sanctioned inspections... must be forewarned. There needs to be a list of the agencies and when they are planning to come. It has to be made public in advance. They are limited to one visit every three years... But I’ll repeat, it’s the unofficial inspections that are the biggest problem... (Business Journalist 2012)

In contrast, one owner of a small chain of clothing shops, and who had been running a small business in Russia since the early 1990s, saw things quite differently:

Nowadays everything is very well-ordered in Saratov. We [small business owners] have a list of scheduled inspections of Rospotrebnadzor. They communicate with us as to when there will be an inspection. We can find out online, and if you don’t have access to the internet, you can just make a phone call... Everything’s well-ordered. I can say that in our city the authorities are very open. It’s not like before. Police, fire inspectors came all the time. Now, [they don’t]. If they come to conduct an inspection, everything is relaxed and [polite]. And I know well that in [my stores] the supervisory authorities [e.g.] Rospotrebnadzor, the fire inspectors, and worker safety inspectors, don’t come anymore. And neither do the police. Before, police came a lot. Now [they don’t] (Owner of Clothing Shop Chain 2012).

Clearly then, there are two different perspectives on the efficacy of inspection reform. Some businesses may be targeted more than others. The contrast may provide on-the ground validation of the research of Frye, Yakovlev and Yasin (2009), who found that investor firms were less likely to report harassment from officials. The owner of the clothing shop owned three premises. She obtained them via the preferential privatization program for small businesses (FL-159). She became a private entrepreneur as soon as it became legal in the early 1990s, and has seen her businesses through some incredibly turbulent times. Contrast her with our young salon manager, whose shop opened in 2004. The shop was successful enough to open another branch, but with the onset of the 2008 financial crisis, it was forced to shut down. Her company has had to downsize in the past few years. The impression from the first woman was that she was something of a “force of nature” in Saratov’s business world, which the young student who set up the interview confirmed. She had worked with local administration and bureaucracy for years. Our salon manager had a less positive relationship with local administrative organs, but perhaps time and grit will help her reach a more productive understanding with officials

### **The Long View: Generational Evolution of Private Sector-State Relations**

A generational perspective may explain the contrast between these two business owners. Evolving Russian attitudes toward authority and social activism came up as a consistent theme across interviews. Several respondents commented on Russians’ aversion to resolving conflicts via the legal system (Small Business Association Representative 2012, Owner of Clothing Shop Chain 2012, Manager of Beauty Salon 2012). They also commented on their aversion to grassroots organization and solving problems collectively (Government Services Consultant 2012, Manager of Beauty Salon 2012). However, several respondents attributed significance to the differences between older generations brought up in Soviet times and young people today who have little or no memory of them. They expressed a degree of cautious optimism toward the future because of Russia’s youth, who have become accustomed to a more open society than previous generations (Owner of Clothing Shop Chain 2012, Small Business Association Representative 2012). They use the internet to voice complaints against government and police. They are used to having access to consumer goods, and buying from private retailers. Furthermore, they are much less deferential to authority. Another respondent, the leader of the Saratov branch of a national small business association, implied that turnover in government from the older Soviet-born generations to the younger is key to understanding where Russia is going and how far it has come:

...the youth today are very different. Today the system of higher education is completely different [than in Soviet times]. I taught in the 1980s. And now it's a completely different thing. You must realize that [we are progressing in leaps and bounds]. Because of this young people are already much more progressive when it comes to a lot of questions. Let's take questions of rights. If we talk about Soviet times, we had rights, but it wasn't an important subject. Economics also was not an important subject. Everyone just accepted the policies that came from the top. Now it's quite a different story: in all higher education courses there is legal training, economics training...and we're seeing very different people [pass through our university system]...And fortunately now they have a path to the Duma... (Small Business Association Representative 2012).

This particular respondent was from the same generation as the owner of the chain of clothing stores quoted above, who also provided some historical perspective on how the youth are determining the prospects for Russia's future:

[In Soviet times], people were very scared to bring anything to court. They had a subconscious fear of arbitration via the state. You know about the repression of the 1930s and following years...everyone knew that it was impossible to assert your rights in court. It took a long time to build [this institutionalized fear], and people were scared of the courts. Now the situation is changing. Young people are using the internet. It's bad and good. [They] don't respect the principle of the law. Yet on the other hand, they aren't scared. They're a completely different generation (Owner of Clothing Shop Chain 2012).

It bears mentioning that the owner of the chain of clothing shops just quoted not only had more than two decades of experience navigating the treacherous waters of the Russian business world in the immediate aftermath of the USSR's collapse, but also studied as a lawyer and is well-versed in business law. Perhaps respect for age and reputation played a role in the apparent lack of harassment from the authorities. The manager of the hair salon mentioned above provides a contrast to the image presented by the owner of the clothing store chain. She is young—under 35—and indicated a less than deferential respect for the authorities. She educated herself on the laws pertaining to small business and inspections. Yet she was still confronted by them.

In general, the respondents advocated a long-term, gradualist policy of economic growth and development over political liberalization. The young medical services company vice director (2012)—who previously worked for the liberal Yabloko party—provided a succinct and representative summation of many respondents' pragmatic attitudes toward development:

Officially we have democracy, but everyone understands that he can [only] feel...free...if he has money. Democracy depends on money. If I have money, I can

travel anywhere, I can buy...everything that I want. I can visit the theater. I can visit some concerts, and organize my holidays as I want, and do as I want. For example, I like snowboarding. But I have bought [a snowboard only] this year because it's too expensive. And I have the right to do snowboarding. But if I don't have money, if I don't have time, then I can't afford it. In other questions it's the same. For example if I have democracy but I don't have money, what will I do with this democracy? I can speak about it, but what can I do? I can stay at home and watch my TV. Not more.  
[sic]

Other respondents echoed this sentiment in one way or another, essentially stating that solving the problems of corruption was more important than implementing democratic reforms (Owner of Clothing Shop Chain 2012, Small Business Association Executive Director/Small Business Manager 2011, Government Services Consultant 2012).

Many respondents explicitly stated that time was a key factor in Saratov's and Russia's economic development, and that there had not been enough of it to build a healthy relationship between small companies and government. Some examples of how this was put:

Small businesses don't influence much, but their influence only just began (Small Business Association Executive Director/Small Business Manager 2011).

Small business influence is growing, but there's much more work to do (Director of Consulting Firm 2011).

Small businesses' problems may be a result of [remaining] Soviet attitudes to business. We just need more time, maybe another 30-45 years (Shop Owner 2011).

It's really just the beginning. Small business owners are just starting to build up their own capital bases (Economist/Small Business Owner 2012).

Our history has just begun. We've only had 20 years. Before that it was a completely different country. I was born in the USSR and now I live in Russia. We cannot change our situation totally [within such a time frame]. We have to wait for change because it's not so quick and easy (Medical Services Company Vice-Director 2012).

Indeed, the generation born after the collapse of the USSR is just reaching political and social maturity. They have grown up with relatively free access to diverse sources of news and information. While the older generation of Russian business pioneers quoted above spearheaded initial efforts to establish a private, independent business community, it is the current Millennial generation that will consolidate the legal and political framework for business development. Their expectations, as noted above, of government, of living standards, and of information contrast with those held by their parents and grandparents. Although many young people may desire a cushy job with government or large state-run conglomerate, the state will be able to provide only a small fraction of them with jobs (Local

Economist/Small Business Owner 2012). This will likely necessitate movement into the private sector in a dynamic similar to the highly-trained workers and technicians of the former Soviet Union having to do the same to subsist during the difficult times of the 1990s (ibid).

## Conclusion

The evidence from the interviews conducted in Saratov and Moscow with SME representatives and experts illustrates the tension between the *Emergent* and *Status Quo* models of evolving SME-state interactions presented at the outset of this dissertation. This “micro” analysis indicates that many features of the *Status Quo* model remain, despite efforts from the highest levels to rein them in. This comes as no surprise given Russia’s reputation for epidemic graft, administrative corruption, and bureaucratic headaches. Respondents indicated frustrations with a regulatory environment that is constantly changing. This in turn provides a rich ground for inspectors to exploit SMEs who often lack the time and resources to maintain up-to-date legal knowledge. Russia’s peak SMEBAs offer legal services to their members as key selective incentives to join, yet many respondents indicated that such measures were of little practical use to them. A general cynicism toward what these peak SMEBAs could offer the respondents’ firms was evident from the interview data.

However, there were indications that features of the *Emergent* model were becoming apparent even at this micro level of analysis. These positive developments for members of the SME community may in fact be obfuscated by a predilection for cynicism among business owners toward Russia’s political and economic character that remains as a remnant of Russia’s long-standing reputation for corruption and maladministration. When pressed, many respondents indicated that legal, administrative, and business climates had in fact improved considerably in the last decade, despite the many difficulties that remain. The reaction to this question appeared to provoke a mild epiphany among many respondents. Furthermore, several respondents indicated a willingness to challenge inspectors, to bring cases to adjudication, and to approach the local administration for concessions for their industry-specific needs. Each apparent trend demonstrates an administrative structure at this local level that is more transparent, professional, and responsive to local SME concerns than could be discerned from analyses focusing on stories of nefarious intrigues amongst Russia’s *siloviki*, regional oligarchs, and other well-connected political cronies.

It is difficult to place the evidence obtained through these interviews into a neat theoretical “box”. Many of the tenets of Olsonian collective action theory appear validated: SMEs as a “latent” group face difficulties in organizing to achieve broad reforms, which is a product of the individual weakness of group members and the lack of incentives to act for the collective good of such a diverse interest grouping. Many of the respondents did not participate in the formal campaigns of Russia’s peak SMEBAs, and were in fact “free riders” on what collective goods were provided. This appeared most prominently in the “trickle down” effect of peak SMEBAs’ campaigns to increase SMEs owners’ “legal literacy”. Several respondents demonstrated a sophisticated knowledge of Russia’s new inspection laws and their rights under them, a knowledge that is very much a public good provided as a result of the efforts of Russia’s peak SMEBAs. Classic Olsonian collective action theory would not hold a place for these “free riders” in producing an “encompassing public goods” outcome for the SME constituency..

However, the aggregate effects of what have herein been dubbed “activist free riders” widely asserting their rights under Russia’s new SME support regime may carry more significant—if difficult to quantify—institutional effects than any piece of legislation or other tangible form of public good outcome lobbied for by an organized interest group. Identifying a causal mechanism between these small business owners and aggregate institutional effects may be an impossible task. Empirical data gathered from a small sampling of interviewees may be called into question on the grounds of representativeness. Hopefully such concerns are in some way addressed by the evidence provided in previous chapters, derived as it is from a broader analysis of SME attitudes and experiences in other regions of Russia. Indeed, many of the issues that came up in those analyses were in fact those issues brought up by the respondents in Saratov. Yet many of the effects of SME collective action on administrative modernization may be subtly apparent only in the realms of behavioral changes and normative understandings between low-level state and private sector actors. But however subtle those changes may be, and however much they may be smothered by stories of corruption and graft, they are there. And they are new.

## CHAPTER FIVE: CONCLUDING ARGUMENTS

This dissertation has set out to explain the relationship between SME collective action and the nature and quality of public goods provision for SMEs in Putin's Russia. The different levels of analysis presented in the previous chapters—the national, the regional, and the municipal—suggest that SMEs do in fact have strong incentives to pursue institutional modernization as a collective good. With the state subsidizing many of the costs of collective action through co-opting SMEs into organization via Russia's peak SMEBAs, there have been many notable achievements in the creation of new, formal legal frameworks governing business-state ties and in the implementation of those frameworks at the local level.

However, achieving widespread reform of Russia's administrative apparatus toward that of a "modern" Weberian system of protected consultation is an enormous task. SMEs' role in it appears to be constrained by significant obstacles to collective action, which is especially apparent as analysis is scaled down to more local levels. Evidence obtained from respondents in Saratov indicated that mechanisms connecting low-level SME activity with higher level SMEBA lobbying and administrative modernization were only present in a very limited sense. Many of the respondents did not participate in SMEBAs, were unconcerned with pursuing systemic reforms for all SMEs, and perpetuated the *Status Quo* model of business-state ties in Russia by continuing to give bribes.

SMEs as a collective interest have herein been evaluated as a "mobilized latent group". This is a group large enough to preclude individual efforts to push for collective goods in the group's interest, but that has been mobilized into action by an external force with the provision of selective incentives to participate (Olson 1971, 51). The state has empowered Russia's peak SMEBAs to provide selective incentives to participate to their members. Such incentives include access to the policymaking process, legal support functions, and individual-level casework for members confronted with administrative difficulties. These "umbrella" organizations incorporate and cooperate with smaller, local SMEBAs to achieve their objectives. This is part of a larger effort of the central state to enlist local allies in support of its anti-corruption campaign, which is a key aspect of its long-term economic modernization program.

A tension exists between what this dissertation has termed a *Status Quo* model of SME-state ties—characterized by a “grabbing hand” mode of interaction—and an *Emergent* model, which shows elements of an increasingly “modern” set of understandings between public officials and small business owners. While higher-level actors can benefit from lucrative “capture” or “elite exchange” modes of interaction, *de novo* SMEs tend to suffer under the *Status Quo* model. Their modest resources and lack of political connections means that they are often the subjects of officials’ illicit rent-seeking. Up until the early 2000s, they had few options in terms of political leverage or legal recourse against this behavior. Now, with such a large emphasis placed on SME growth as an aspect of Russia’s modernization strategy, and a powerful, pro-market statist sitting as president, the *Emergent* model appears to be gaining ground. Whether this model will replace the *Status Quo* in the coming decades remains an open question. While sincere efforts to reform Russia’s administration toward a more modern system have achieved results, the *Status Quo* model still appears to be the dominant influence on SME-state ties in Russia.

### Causal Mechanisms behind SMEs’ Effects on Institutional Modernity

The evidence presented in this dissertation suggests that SMEs’ desire for impartial, professional institutions of protected consultation has coupled with a high-level agenda to pursue administrative reforms as part of Russia’s long-term economic development strategy. As SMEs are individually weak, they *must* act collectively to achieve political outcomes. This means that they must bargain and reach consensus with their peers as to which objectives to pursue. These objectives tend to be geared toward resolution of the common problems of the broad SME constituency, rather than toward achieving advantages for a narrow coalition of interests. For most SMEs in post-Soviet Russia, the most significant of these problems was the “grabbing hand” of the state, represented most often by the ubiquitous inspection regimes who exploited their authority to extort bribes from powerless small firms. The encompassing collective good of inspection reform was in high demand. SMEs’ need to reform this system became the basis for the central thesis of this dissertation: SMEs will push for “modernizing” reforms such as a professional bureaucracy and uncorrupt administration as an *intrinsic* manifestation of SMEs’ necessity to collectively act as an encompassing interest to achieve political outcomes under the conditions of transition. In the absence of alternatives for achieving firm-specific advantage, this form of encompassing interest business lobbying is geared toward producing a fair and impartial administrative

system, as this was the most immediately relevant collective good to Russia's *de novo* SMEs. It was therefore one of the few political objectives that could be agreed upon by the myriad firms and sectors representing the SME community in Russia.

The idea of institutional "modernity" has been used in this dissertation to encapsulate the dependent variable of encompassing collective goods provision in its broadest sense. The encompassing collective goods of SME empowerment that emerge either from above, in the form of state co-opted SME collective action mechanisms, or from below, in the form of grassroots SME interest channeling and lobbying, tend to reinforce movement toward institutional "modernity" as conceived in this dissertation; that is they encourage better governance and greater protected consultation. This is broadly in line with Olsonian conceptions of encompassing interests—represented as they tend to be by peak associations—in that they typically pursue objectives that serve very broad constituencies (Olson 1982, 48). SME collective action can thus be seen as part of a push for encompassing public goods for society-at-large, as many can benefit from increased protected consultation, which has a key form in more professional, efficient, and accountable administration.

However, this is very much a process "in progress". Other forces as remnants of the *Status Quo* model are in tension with those comprising the *Emergent* model. Russia is still rife with official corruption and cronyism. As the empirical evidence indicated, Russia's SMEBAs themselves may be involved in perpetuating these tendencies. Questions remain as to whether SMEBAs will advance the push for administrative modernity, and thus validate more positive views on the socio-political and economic impact of business associations offered by Maxfield and Schneider (1997), Doner and Schneider (2000), and Pyle (2006). These scholars found that, in the absence of modern administrative institutions, BAs can work to provide public goods that institutionally "modern" states normally would, such as uncorrupt administration and impartial, standardized property rights and contract enforcement. Yet, as the evidence indicated, SMEBAs can offer opportunities for successful SME owners to pursue political ambitions, enter informal networks that perpetuate the *Status Quo* (*sistema*), and in the aggregate may create administrative and business climates hostile to new entrants to the market, and thus to greater economic growth, prosperity, and (potentially) modernization (Moscow Academic 2010, Yakovlev, Zudin and Golikova 2010).

## Evaluating the Hypotheses

Initially, this dissertation was guided by a view that SMEs were natural "democratizers", in that their interest in protecting their property rights via SMEBA mechanisms would lead to greater civic engagement and a propensity to advocate for democratic procedures as a means to "level the playing field" against their larger, better-connected large-enterprise counterparts. This initial theoretical framework evolved into one that viewed SME influence in Russia less as an exercise in democratization and more in terms of the kinds of public goods SMEs would produce under the conditions of Russia's transition. A large body of "large n" statistical studies pointed to a relationship between private businesses, business associations, and "modernizing" institutional effects. They are summarized below:

- Frye (2003) found that owners of *de novo* private firms in Russia were significantly more likely to support market-oriented political parties and express attitudinal support for democratic practices
- Duvanova (2007) found that increased measures of low-level bureaucratic corruption in Russia's regions encouraged the formation of business associations as a means to combat predatory state behavior
- Pyle (2009) found that a firm's willingness to confront government predation and lobby for institutional reform was positively correlated with membership in a BA, which was based on a survey comprised mostly of SMEs
- Frye, Yakovlev, and Yasin (2009) found that firms that were more likely to re-invest in themselves—i.e. relatively successful, well-established private enterprises—were more likely to report productive, cooperative relationships with officials to overcome the weak institutional environment
- O'Neal (2012) found positive, statistically significant associations between SME strength in Russia's regions—measured in terms of SMEs per 1,000 of the labor force—and higher democracy scores in Petrov's (2004) index of democracy for Russia's regions

The goal of this dissertation has been to identify a potential causal mechanism and theoretical explanation for such results. The explanation proposed has been that the particular issues SMEs face regarding the "grabbing hand" bureaucracy and the collective action

problems confronting them as a large group of individually weak actors has driven their desire for an impartial, “modern” bureaucracy. This is synergistic with the economic development agenda of Russia’s dominant power vertical. Put bluntly, the administrative apparatus is caught between grassroots and high-level interests in achieving institutional modernization.

The overarching model proposed at the introduction of this dissertation juxtaposed a *Status Quo* model of SME influence on public goods outcomes with an *Emergent* model. The *Status Quo* is typified by SME-state interaction in the 1990s. At this time, the *context of transition* was the main variable conditioning this relationship. A low level of legal development, a weakened central state, a high degree of regional autonomy, and scarce capital were the factors underlying the "Wild East" image of Russia in the immediate aftermath of the USSR's collapse. Private sector actors vied for competitive advantage in the absence of legal norms, resulting in pervasive mafia rackets and Russia's "violent entrepreneurs" (Volkov 2002). The central state under Yeltsin was concerned primarily with ensuring its financial solvency. This necessitated high-level negotiations with Russia's oligarchs who controlled most of the country's strategic assets. The regions were left largely to fend for themselves as they could not well rely on Moscow to provide them with financial support or political guidance. These factors contributed to the phenomenon of "segmented regionalism" as a result of Russia's "neo-feudalization", which are Sakwa’s terms to describe this regional autonomization taking place in Russia at the time (Sakwa 2008, 255, Sakwa 1999, 194)

This post-Soviet *context of transition* multiplied the already significant risks of starting a business, in addition to the collective action costs of organizing to lobby for political reforms. However, the 1998 ruble devaluation induced Russia's consumers to purchase domestic products while at the same time demonstrating the value of a home-grown private sector as a source of economic stability and grassroots prosperity. The ascendance of Vladimir Putin to the presidency in 2000 would come to signify a strong-handed reassertion of state authority over Russia's polity and economy. He ascribed a high significance to the growth and development of Russia's SMEs as a key element of Russia's economic modernization agenda, which may be explained in terms of Olson's conceptualization of the "encompassing interest of the autocrat" (Olson 2000, 13). Central to achieving this objective was curtailing the rampant, low-level corruption that stifled Russia's grassroots economic growth. In the early 2000s, Russia may have had a powerful president sitting at the top, but it

still suffered from a lack of state capacity to induce its administrative agents at lower levels in the regions and municipalities to conform to the spirit of this modernization agenda (Markus 2007). Empowering the SME community with the creation of state co-opted peak SMEBAs tied to the new "power vertical" was an effort to enlist these private sector actors as allies in the fight against the growth-stifling bureaucracy who preyed on these powerless small firms.

Many analyses of business-state ties in Russia are premised on some variation of "capture" theory (Frye 2002, Frye, Yakovlev and Yasin 2009, Slinko, Yakovlev and Zhuravskaya 2005, Slinko, Yakovlev and Zhuravskaya 2002, A. A. Yakovlev 2006, A. Yakovlev 2009). In Russia's early post-Soviet period, this typically involved powerful oligarchic business interests who controlled much of Russia's financial assets "buying" state offices to ensure that legislation and regulations would provide particularistic administrative advantages to their firms (Hellman, Kaufmann and Jones 2000). With the ascendance of Vladimir Putin to the presidency, the model of state capture by business gave way to business capture by the state as strategic industries were effectively nationalized and local political authorities were able to use their newfound influence to gain a stake in regional industries (A. Yakovlev 2009, A. Yakovlev 2006). "Exchange" models also pervade these types of analysis, in which officials and private sector actors make mutually beneficial arrangements to receive kickbacks (*otkaty*) from lucrative contracts and to ensure continued political support for close political authorities (Frye 2002).

However, these models of business-state interaction which have been so widely applied to Russian cases do not apply to smaller, *de novo* private firms who lack long-standing political connections (Frye, Yakovlev and Yasin 2009, A. Yakovlev 2009). They lack the resources to "capture" state offices, and are too small to be the target of systematic seizure by state authorities. Low-level officials have been able to exploit Russia's loophole-ridden and constantly changing legal code to extort bribes from these firms, who are understandably unwilling to challenge a bureaucratic infraction in a court system that has historically been an appendage of anti-market, totalitarian state.

### ***The National-Level Perspective: Empirical Review and Theoretical Significance***

Examining SME-state interactions at the national level of analysis tends to present an idealized picture of the relationship between SME influence and public goods outcomes. Russia's peak SMEBAs have campaigned for a number of high-level initiatives, such as

inspection and tax reform, and campaigning for SMEs access to “preferential privatization” and state procurement programs. Their leaders feature prominently in the media discourse on SME issues. Putin and his high-level lieutenants meet regularly with representatives from these SMEBAs to discuss further initiatives to support Russia’s SMEs. Billions of rubles are directed each year toward SME support programs.<sup>78</sup> At this level of analysis, the relationship between Russia’s organized SMEBA community and public goods outcomes for SMEs appears relatively direct, straightforward, and transparent. SMEBAs amalgamate the concerns of their constituents, translate those concerns to a policy initiative, then campaign to achieve a political outcome in a manner similar to lobbying campaigns in many countries.

The 1998 financial crisis was central to galvanizing the disorganized SME sector into effective mechanisms of collective action. It demonstrated the structural weaknesses of Russia’s economy and the necessity of diversified economic growth. These conditions gave Russia’s still nascent SMEBA community a more prominent voice in discussions with political authorities. Compare the outcomes from Russia’s 1<sup>st</sup> Congress of SMEs in 1996 with those of the 2<sup>nd</sup> in 1999. The 1<sup>st</sup> was organized as part of a political decree of President Yeltsin, held in the Kremlin, and attended by prominent political figures such as Mr. Yeltsin and then Moscow mayor Yuri Luzhkov as well as about 4,000 delegates. Few tangible results were produced. The much smaller and seemingly less significant 2<sup>nd</sup> Congress took place in October 1999, with the effects of the previous year’s crisis still fresh. With only about 1,000 attendees and much fewer prominent political delegates, this 2<sup>nd</sup> Congress was able to achieve a number of significant political outcomes as discussed in chapter two. This included beginning the campaign to reform Russia’s inspection laws.

Enter President Putin in 2000. A central element of the new president’s agenda was a strong-handed reassertion of the state into Russia’s economy. Pro-market statism would come to define the development strategy of Russia’s economic modernization program. Key to this modernization was reforming Russia’s predatory bureaucracy, whose “grabbing hand” stifled grassroots economic growth. This presented a challenge to the new president: how to induce Russia’s administrative agents to participate in the reformation of the system from which they derived so much illicit benefit. President Putin found a natural ally in the fight against bureaucratic corruption in the SME community. Long-suffering from the “grabbing hand” of

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<sup>78</sup> See footnote 7, page 21.

the state, they were inherently anti-bureaucratic and desired bureaucratic reforms, especially as they pertained to Russia's inspection regime.

### Theoretical Significance

Two features of Russia's SMEs derived from Olsonian collective action theory help to explain the success and limits of SME mobilization to achieve institutional modernization as a public good outcome in contemporary Russia. First, as such a large and diverse group, SMEs, when organized as a collective interest, tend toward the formation of "encompassing interest organizations". However, organizing SMEs as a salient collective interest requires strong outside co-optation. A small shop owner in Irkutsk has no incentive to pursue a collective good outcome that would benefit a medium-sized manufacturer in Sochi. They do not share an immediately apparent collective interest. Thus the emergence of SMEs as a coherent collective interest represents something of an artificial creation.

Empirical manifestations of Olson's conceptualizations can be seen in the formation and empowerment of Russia's peak SMEBAs. According to Olson (1982, 50), a "peak" association is a "national confederation of business" that tends to pursue policies that are in the encompassing interest of its broad constituency. He notes that these organizations may lack strong cohesive bonds between members, which preclude significant influence on public policy (*ibid*). However, the conditions of Russia's transition to a market economy and the emergence of an assertive central state influence the balance of strengths of these peak associations. The pervasive "grabbing hand" of the state at the local level drives SMEs to share a common interest. The small shop owner in Irkutsk and the manufacturer in Sochi are both likely to have been the victim of officials' rent-seeking. And although SMEs face higher costs to collectively act to resolve this common problem, those costs have been subsidized by a central state that is actively pursuing an economic modernization agenda. The creation of Russia's peak SMEBAs was an attempt to co-opt SMEs into organization. Their natural aversion to Russia's rent-seeking bureaucracy meant that they could become a grassroots ally in the effort to build the administrative apparatus of a "modern" economy.

It is important to note that this national-level analysis illustrates the very "public face" of the emerging relationship between SMEs and the state in Russia. It tends to validate the overarching thesis of this dissertation, that SMEs will naturally pursue institutions of good governance under the conditions of Russia's transition and when collective action costs are

subsidized by the state. The necessity of collective action to achieve political outcomes results in a transparent process of bargaining, interest amalgamation and channeling through Russia's newly empowered peak SMEBAs. Channeling the interests of this grassroots constituency into high-level legislation represents an aspect of democratic policymaking in the interest of providing the public good of modern administration to SMEs as an encompassing collective interest.

At this level of analysis, SMEs appear very much as a “mobilized latent group”. Access to SMEBA channels of policymaking and legal support functions are the “selective incentives” offered exclusively to SMEBA members to participate in these organizations. However, as the examination drills down into more local levels of analysis, it becomes apparent that these selective incentives are not valued by a wide variety of “everyday” SMEs. Many do not have the time to devote to the politicking necessary to achieve systemic public goods outcomes for all SMEs. They free-ride on what outcomes are achieved. They are more concerned with the everyday maintenance and solvency of their enterprises. As the analysis is scaled down, the institutional outcomes of SME mobilization become less clear. The “latent” aspect of Olson's conceptualization appears to take more precedence than the “mobilized”.

### ***The Regional Level: Empirical Review and Theoretical Significance***

Examining SME-state interactions at a more local level exposes the difficulties SMEs face in achieving tangible political outcomes in the milieu of a systemically corrupt political economy. Frustrations with the administrative system are widely voiced, with much SME discourse focused on bureaucratic abuse and administrative barriers. Yet the forums in which this discourse is taking place are significant public goods outcomes in themselves. SMEs, often via their SMEBA representatives, engage in dialogue with administrative authorities to voice their dissatisfaction and to cite specific instances of administrative abuse. This informs higher-level political authorities who are more closely tied to the SME support initiatives of the power vertical. They can then leverage that authority against those who perpetuate Russia's corrupt *status quo*.

Local lobbying initiatives represent a formalized, institutionally “modern” aspect of this dialogue. In the regions surveyed in chapter three, local branches of national SMEBAs have been given the “right of legislative initiative”, meaning they are able to propose legislation in local Dumas. The “black box” campaign to eliminate cash register transaction

tracking devices for the smallest small firms represents one tangible success of an SME lobbying initiative that began at the grassroots level. The campaign to prevent a rise in the Unified Social Tax may have failed, but it brought thousands of SMEs into the political process to voice their opposition. Each of these initiatives demonstrates the bargaining and consensus-building necessary to building a collectively cohesive SME lobbying campaign. And, like anywhere, politics is not always "neat". The bargaining process demands widespread discourse via media outlets and SMEBA intermediaries. It involves bringing the many SME "free-riders" to the table to sign a petition or describe their circumstances in order to help build a case for or against an initiative. Such efforts demonstrate how SMEs and SMEBAs are helping to expand protected consultation institutions in Russia. In this sense they demonstrate how SMEs are drivers in the push toward institutional "modernity" as conceived in this dissertation.

These protected consultation institutions have empowered SME owners in their legal battles with administrations, and provide an oversight mechanism with which SMEs can check the activities of officials. In addition to the right of legislative initiative, SMEBAs have also been empowered to oversee the drafting of legislation pertaining to SME issues. They have signed cooperation agreements with local police and inspection agencies which provide for SMEBA representatives to be present during inspections. These achievements illustrate the renegotiation of relationships between the state and private sector taking place in Russia at more local levels as the country transitions from the administrative structure of a command economy to that of a market-oriented legalistic state.

This process is not linear or deterministic. These representations of the *Emergent* model of business-state interaction are often in tension with those of the *Status Quo* model. The net "winner" between these two models has yet to be determined. These emergent institutions of protected consultation illustrate the "by product" manifestations of state co-opted SME mobilization. They encourage public discourse among a broad range of the SME constituency. This requires a transparent process of negotiation and bargaining. These collective actors, supported as they are by the powerful central state, can now engender increased accountability from political officials through these mechanisms of protected consultation. In this sense, these "by product" institutions of SME mobilization represent key empirical manifestations of the overall theoretical assertion made in this dissertation; that is that SMEs as state-subsidized collective actors under the conditions of Russia's transition to a market economy will naturally push for institutional "modernity".

## Theoretical Significance

Moving down into this more local level of analysis begins to reveal some of the nuances underlying the outcomes of state co-opted SME mobilization in Russia. Their weakness as a “latent” group becomes more apparent as SME owners voice their frustrations with local administrative barriers and abuses. Despite high-level legal reforms, many local administrations are reluctant to enforce Russia’s new legal codes of SME support. For example, giving SMEs access to state-owned property at preferential purchase rates (FL-159) deprives local coffers of a direct source of rents. Widespread stonewalling from officials in implementing this program was apparent from the evidence presented in chapter three. Inspections are often utilized not just by an individual official looking to extort rents, but often as part of a more systematic effort by well-placed authorities to remove unconnected SME owners from their places of business in favor of financially-endowed cronies. The widespread practice of *reyderstvo*—a uniquely Russian form of hostile takeovers using fraud and political connections—is a main feature of the state’s “grabbing hand” and a continuing source of frustration and harassment for SMEs.

In his study of business organization in contemporary Russia, Pyle (2009, 5) notes that when state actors make property rights insecure, then businesses’ motivation for organizing falls in line with broad social objectives. The common outrage at government predation is one that transcends sector- or firm-specific differences, especially among *de novo* private firms who do not enjoy long-standing political connections that many more established firms tend to. The “grabbing hand” of the state, very much a product of Russia’s *context of transition*, drives the emergence of a common business interest among smaller, newer firms. These firms suffer the most from this “grabbing hand”, and with a collective action organization such as one of Russia’s peak SMEBAs their only legal recourse to defend against it, we can see how such a tendency becomes a mechanism for producing campaigns for institutional “modernity” as a public good outcome for the SME community. On the other hand, we can also see how extra-legal means to deal with predatory state actors—i.e. giving bribes—can perpetuate the *status quo*.

Beyond relatively straightforward public goods outcomes, such as a piece of legislation supporting the SME community, are these “by product” institutions that emerge as a result of state co-opted SME mobilization. SMEs’ need to engage in collective action with the broad range of business interests that comprise the SME community means that forums

must be provided to accommodate them. This regional level of analysis demonstrates that although SME efforts to encourage more professional, non-corrupt, “modern” administration continue to be frustrated in many areas, *the forums of interaction themselves are key public goods outcomes that will likely provide a more enduring mechanism for institutional modernization in Russia than any piece of legislation.* They allow SME representatives to engage in dialogue with political authorities, to oversee many areas of administrative activity most prone to corruption, and provide a vital mechanism in building a horizontally integrated civil society that has been so difficult to achieve in modern Russia.<sup>79</sup> Furthermore, the form these kinds of institutions inherently take draw strength from transparent, public discourse in the media and thus encourages accountability on the part of authorities who now have incentives to interact with them as part of Russia’s overall modernization program. In this sense we can see a form of democratic decision-making and public oversight in Russia that runs counter to prevailing views of a country on a slide toward greater authoritarianism.

### ***The Municipal Level: Empirical Review and Theoretical Significance***

A municipal level of analysis built on interviews with SME owners and business experts in Saratov and Moscow reveals many of the "on the ground" realities of the SME-state ties in Russia. At this level, the *Status Quo* model seems to prevail in relations between the two. Signs of the *Emergent* model apparent at higher levels of analysis become difficult to see, as many business owners express cynicism toward institutional change and the utility of participation in Russia's peak SMEBAs. A mechanism linking higher-level efforts to change the *status quo* with these grassroots actors was not apparent. SMEs appear much more "latent" than they do "mobilized". Harassment from officials still appears common and bribes still seem pervasive. Many of those SME owners interviewed had never even *heard of* OPORA or *Delovaya Rossiya*; those who had ascribed little utility to joining. Firms appeared to act collectively only in response to specific problems to their local industries that could be handled by specific administrative authorities. Many only seemed to resort to more established SMEBAs when a particular administrative issue was making life difficult for their individual firms. In short, many SMEs seemed more concerned with the quotidian affairs of

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<sup>79</sup> “Civil society” as such can link groups and actors “vertically” and “horizontally”. A civil society “vertical” integrates lower-level social and economic actors with higher levels of power, while a civil society “horizontal” is about associations between and within communities operating at roughly the same level of the politico-economic power stratum (Olimpieva 2009, 218, Pyle 2011, 17, Pyle and Solanko 2013, 24).

running their business than devoting the resources to lobbying for systemic changes to the administrative climate.

However, there were signs that this "selfish" concern was combining with the grander normative institutional evolution of SME-state ties being advanced at higher levels under the framework of Russia's economic modernization agenda. Most respondents expressed a negative attitude toward the local administrative climate, but when pressed to compare it with that of ten years ago, *all* admitted that it had improved considerably. Administrative barriers and harassment may have been significant issues, but now there were mechanisms in which SME owners could work to address them, even if they chose not to use them. Several expressed that working within established juridical and administrative structures was common, even if action was taken to solve a firm-specific problem. Some indicated that inspections were much more "well-ordered" than in previous years and that visits had decreased considerably. This appeared to be the case Russia-wide, as visits from inspectors were reported to have been reduced as well (World Bank 2013). If we extrapolate this increasing sense of empowerment among SME owners to the rest of Russia, which the regional level of analysis indicates is not unreasonable, a part of the causal mechanism behind this may be the aggregate effects of SME owners' increased willingness to assert their rights in the face of administrative harassment.

### Theoretical Significance

Despite continuing problems, this level of analysis illustrates a grassroots aspect of normative institutional change in Russia. It is certainly not a linear, deterministic march toward institutional "modernity", but it demonstrates the rationale behind the central assertion in this dissertation, that SMEs' have a fundamental desire for more fair and impartial administration. And this is in distinct contrast to many prevailing perspectives on business-state ties in Russia as based solely on backroom dealings, cronyism, and "capture" dynamics.

However, while there is some evidence to indicate an increasing sense of empowerment among SME owners in the face of bureaucratic corruption and a more positive relationship with local administrative authorities, a mechanism linking these grassroots SMEs to the higher level push for administrative modernization was not apparent. Russia's main SMEBAs had a presence in each region analyzed (in addition to a number of local SMEBAs), but those interviewed indicated that they were not aware of these organizations or did not

participate in them. Little evidence of SMEBA impact at this level emerged. Many of those interviewed did indicate a sense of their legal rights in the face of corrupt inspections, but it was unclear as to whether this sense was a direct result of SMEBA campaigns.

Mobilizing a latent group is a difficult task according to Olson (1971, 132). It requires the provision of attractive selective incentives to participants, which often can only be provided by a powerful outside force such as the state. The explicit selective incentives offered by Russia's peak SMEBAs have been touted as increased access to the policymaking process and various legal support functions (Yakovlev, Zudin and Golikova 2010). As shown in chapter three, regional branches of peak SMEBAs have been given the "right of legislative initiative" and the right to provide consultation and input in the drafting of legislation pertaining to SME issues. This appears to be an attractive incentive only to relatively established, well-off SMEs with ambitions to enter the realm of politics (ibid, 6). This municipal level analysis showed that of those very small SMEs who did join a SMEBA—most often the Chamber of Commerce—did so because of the ostensible legal support it could offer members. This is a reactive rationale behind membership. This contrasts with the selective incentive of access to policymaking which will likely be more valued by well-established smaller firms who have the resources to be more proactive in the political arena. It provides additional evidence for Olimpieva's (2009) finding that SMEBAs most often act to help SMEs adapt to a changing business environment rather than working to shape the environment itself.

The *Status Quo* model of business-state ties is a powerful barrier to the advance toward institutional "modernity" as conceived in this dissertation. It rewards the corrupt behavior of officials, and offers few enforcement mechanisms to provide consequences for such behavior. Several respondents indicated that giving bribes was still the preferred method of dealing with the corrupt officialdom. Russia's still-developing legal code perpetuates a sense of "policy uncertainty" on the part of many firms. Unscrupulous inspectors are able to exploit both SMEs' lack of legal knowledge and the inevitable loopholes created under such conditions to extract rents (Desai 2008, 97).

However, the *Emergent* model appears to be gaining some ground. Nuanced as it may be, the interview data contains evidence of an increasingly empowered SME community and a local administration that is more responsive and accountable to the needs of this grassroots constituency. Much of this was demonstrated on an individual basis. Individual small

business owners resorted to a SMEBA only when they were confronted with a specific administrative issue. And these issues appeared to be resolved regularly, with SMEBA representatives acting as intermediaries between political authorities and SME owners. An individual small business owner demonstrated resistance to the demands of officials rather than acquiesce to their demands for bribes. Small group SME collective action appeared to be fairly normal and a relatively productive means of interacting with the local administration. If we extrapolate the aggregate effects of these dynamics to the rest of Russia, and assume that they will continue to grow in significance as the forces behind the economic modernization agenda further entrench themselves, Russia's SME community may have the potential to become a significant factor behind the grassroots implementation and acceptance of the norms of "modernity" that are key to the success of high-level legislative reforms.

### **Discussion: Significance of Findings in Theories of Business-State Ties**

With SMEs representing more than 90% of Russia's economic entities and contributing ever more to Russian GDP (RCSME 2013), additional frameworks for understanding state-business ties evolving beyond the immediate chaos of the post-communist transition need to be developed. O'Neal (2012, 40) argues "the fact that small firms [in Russia] are typically new is important to understanding why they would be a source of innovation or change in pre-existing patterns of interaction with state structures". As SMEs grow in size and influence, will they continue to push for "institutional modernity" or will they become enveloped in a more powerful *Status Quo* model that encourages corruption and firm-specific administrative advantages? As an individual small firm grows, will it maintain this propensity for engaging in the pursuit of encompassing public goods, which in the aggregate may drive further administrative modernization?

These are questions to guide future research. The tension between the *Status Quo* model and the *Emergent* model of SME-state interactions will likely remain unresolved for years. As SMEs grow larger, they may exhibit a tendency to perpetuate the *status quo* as they become better connected and more financially endowed. On the other hand, SMEs will likely continue to challenge government officials, demand greater accountability, and otherwise pursue their interests in SMEBA forums. This may be a vital aspect of building a horizontally integrated civil society that encourages the proliferation of modern institutions of protected consultation, especially at local levels.

Haggard, Maxfield and Schneider (1997, 20) in their broad survey of theories and trends in business-state interactions around the world, find that most institutionally “modern” bureaucracies emerged under the aegis of authoritarian government. They argue that such bureaucracies are the most significant factors in reining in corruption. However, these bureaucracies are rare in the developing world, and business associations and encompassing firms can fulfill a similar function in reducing the likelihood that business-state ties will slip into corruption and rent-seeking (ibid, 5). Missing between these general truths is the causal mechanism by which “modern” institutional arrangements emerge from the general milieu of myriad private sector associations and enterprises. This dissertation has attempted to add one piece to the explanatory puzzle, arguing for an aggregate effect of SMEs on the provision of encompassing public goods under Russia’s circumstances of transition. The encompassing public goods outcomes have been cast in various forms. In chapter two, they were represented as legislation pertaining to inspection reform that was intended as a high-level attempt to rein in the predatory bureaucracy that hindered grassroots economic growth. In chapter three, the public goods outcomes of SME lobbying were not so “neat”. They were viewed in terms of the “by product” institutions of protected consultation that emerged as a result of Russia’s SME support regime under the framework of the president’s modernization agenda. They have been central to encouraging accountability on the part of public officials through transparent interactions between private sector and state actors. In chapter four, SMEs’ “latency” was most prominent as it became apparent that many business owners did not participate in SMEBAs, and therefore were not part of the formal interest aggregation, channeling, and dialogue with government that theoretically would help to modernize Russia’s administrative apparatus. In Olsonian terms, they were “free riders”, enjoying what benefits there were from campaigns to provide public goods to the SME community while not paying the costs of provision. However, this free-riding may not necessarily preclude the pursuit of institutional modernization as conceived in this thesis. Several of those interviewed demonstrated an increasing sense of “legal literacy” that empowered them in their interactions with officials. In the aggregate, this grassroots resistance to corrupt officials may be one of the most powerful forces for institutional modernization in Russia in the coming decades.

The central thesis of this dissertation has not been that SMEs will necessarily *produce* the encompassing public good of institutional modernity, but rather that SMEs will *desire* such an outcome under the specific conditions of Russia’s transition, and are also more likely

to attain them under those conditions. A key condition of that transition has been the emergence powerful central state supportive of the SME cause as part of a development strategy to bring Russia out from the debilitating circumstances of transition. Institutional modernity has been cast in terms of the encompassing public goods of good governance, “protected consultation”, and more transparent and service-oriented administration. But as the evidence gathered for this dissertation demonstrates, although SMEs may desire these types of outcomes, they are not always produced; progress toward them is by no means upwardly linear or deterministic. The *Status Quo* model of business-state ties remains powerful, and may continue to hinder administrative modernization that is central to the emergent model hypothesized to exist in this dissertation.

### Determinants of Successful SME Mobilization

A number of factors condition the success and limits of SME mobilization in Russia. First, the bureaucratic apparatus remains a key hindrance to the grassroots economic growth central to Russia’s modernization agenda. The hundreds of thousands of new firms that have entered the system have had to contend with constant bureaucratic rent-seeking and administrative barriers. Older, larger, more established firms tend to enjoy more “productive” collaborative relationships with political officials. Although stories of such relationships between Russia’s flamboyant oligarchs, Machiavellian *siloviki*, and a shrewd former KGB officer-cum-president make for good press, they are far from representative of the vast majority of interactions going on between state and private sector actors throughout Russia. The “grabbing hand” of the state—represented in this dissertation under the framework of the *Status Quo* model of SME-state interactions—is coming under increasing pressure to conform to a kind of Hippocratic management ethos of “first, do no harm” to those being administered, and, in many cases, to provide a “helping hand” interaction mechanism to once powerless SMEs. The ubiquity of the “grabbing hand” in Russia has driven the emergence of a common SME business interest that transcends the kind of particularistic, sector-specific interest that is seen in longer-established polities with well-developed, predictable legal and administrative systems.

However, the amalgamation of the SME interest around systemic reform of Russia’s corrupt administration creates a distinct problem that can be explained in terms of a basic tenet of Olsonian collective action theory. Put simply, larger groups are harder to organize than smaller groups to achieve a public good for the group (Olson 1982, 31). Haggard,

Maxfield and Schneider (1997, 44) note that “the lower the economies of scale in a sector, the simpler the technology required, and the lower the capital required for entry, the lower the capacity for collective action”. A group as large as Russia’s SME community, represented by millions of firms scattered across the country, will remain “latent” because no individual member has the resources or incentive to act on behalf of the whole. According to Olson (1971, 143), the efficacy of business lobbying groups stem from the fact that business tends to organize along individually small, sector-specific units; business as a whole is not an interest group. Only when acted upon by an outside force will such a group mobilize for collective action. As noted by Haggard, Maxfield and Schneider (1997, 45), “when small businesses are able to organize for collective action, we often find the visible hand of state actors and political entrepreneurs”.

## Conclusion

In the late 1990s, Sakwa noted how the key challenge for the Russian state was how “to stimulate an indigenous society-powered modernization process responsive to domestic consumer needs and functionally integrated into the global economy” (1996, 196). Empowering Russia's SME community is one aspect of facing up to this challenge. Ironically, under the authoritarian regime of Vladimir Putin, SMEs may actually be *more* represented than they otherwise would have been under less controlled circumstances. Compare the 20<sup>th</sup> century examples of SME collective action in the democratic United States with that of authoritarian Mexico under the *Partido Revolucionario Institucional* (PRI). In the pluralistic United States, SMEs struggled to gain traction as an organized political lobby, devoting resources to building membership rosters to compete with the myriad other organizations looking to do the same (Bean 1996, Bean 2001, Young 2008, Young 2010). Many of them *actively sought* state recognition in an attempt to be the US' "official" SMEBA (ibidem). In Mexico, the PRI co-opted SMEs into organizing into a state-sponsored SMEBA, CANACINTRA. Although the policy platforms they had to pursue had to be politically "accommodationist" so as not to upset their authoritarian benefactors, they were able at least to articulate their economic interests through a regularized channel of interaction with the ruling elite (Shadlen 2004). When Mexico democratized in the 1990s and the PRI lost its grip on power, CANACINTRA disbanded. SMEBAs proliferated. This led to a similar, competitive pluralistic environment as that of the US. This actually *decreased* SMEs' ability to advance their interest via state channels, leading to what Shadlen (2004) terms a "democratization without representation" effect.

However, the circumstances of Russia's transition are unique. Few historical parallels exist to illustrate the dynamics at play as a society undergoes a revolutionary transition from a homegrown, totalitarian command economy to a market-oriented, legalistic state. No one can say how long the process is "supposed" to take, nor its end form. The totality of the Communist party's control over market relationships and civil society was unprecedented. This is the context in which the renegotiation of relationships between the state and grassroots, private sector actors is taking place. It is a context that appears largely forgotten by many Russia-watchers, but one that still conditions how these actors interact.

The collapse of this system led to the economic chaos of the 1990s, which is shorthand for the *context of transition* variable presented at the outset of this dissertation; it accounts for the strong-handed reassertion of state authority by President Putin. This drove the emergence of Russia's power vertical and created conditions for establishing a common cause for SME interests. Weak state control over its administrative agents, coupled with their rampant, low-level rent-seeking, created a synergy of interests in administrative modernization as an aspect of overall economic development from the highest and lowest levels of the politico-economic hierarchy.

The nature of SME collective action meant that a transparent, inclusive process of bargaining and public campaigns would be necessary for them to lobby for reform of Russia's "grabbing hand" administrative apparatus. By subsidizing SMEs' increased costs of collective action as a latent group, and drawing them into the political process, the state in effect empowered grassroots actors to participate in a complex of open, democratic forums for interest aggregation and channeling. Such forums encouraged the search for and formulation of common causes among a diversity of sectors and interest. In the context of the post-Soviet transition to a market-oriented economy, the most salient and immediately relevant such cause was found in the curbing of low, level, epidemic, and unchecked rent-seeking on the part of officials. This served the interests of both grassroots economic actors who remain a cornerstone of Russia's economic modernization agenda, and of an increasingly powerful central state determined to fulfill that agenda. These factors illustrate the causal forces underlying the core thesis of this dissertation, that SMEs will pursue institutional modernity under the circumstances of Russia's transition. Whether that modernity gains ground in the face of a powerful, lucrative, and rampant system of corruption is a question that remains open.

## Appendix One: Interview Questions for Respondents in Saratov

### *Questions for Journalists*

1. How have conditions for small businesses changed in recent years?
  - a. How would you characterize the level of influence small businesses have in the local political system compared with previous years?
  - b. Can you name a specific law that has changed conditions for small businesses?
    - i. Who or which groups were the sources of this law?
2. What are the most important concerns of small business owners?
  - a. In your view, do business associations help to address them?
3. What kinds of leverage to businesses associations possess to influence the political authorities?
  - a. What motivates a political authority to support an initiative of a business association or the small business community?
4. How does being a business owner influence one's perception of politics and administration? Is there an influence?
  - a. Do owners of small businesses feel solidarity with each other?
5. Does the small business community have the potential to help in the fight against corruption and improve the business climate?
6. How do you view the prospects for small businesses in terms of growth and political influence in the next ten to twenty years?

### *Questions for Small Business Owners*

1. How long have you owned/run your business?
2. How many employees do you have?
3. Are you a member of a business association?
4. What are the most important concerns of small business owners?
5. How have conditions for small businesses changed in recent years?
  - a. How would you characterize the level of influence small businesses have in the local political system compared with previous years?
  - b. Can you name a specific law that has changed conditions for small businesses?
6. If you could change anything in the local administrative system to help your business, what would it be?
7. How does being a business owner influence one's perception of politics and administration? Is there an influence?
  - a. Do owners of small businesses feel solidarity with each other?
8. What motivates a political authority to support an initiative of a business association or the small business community?
9. Does the small business community have the potential to help in the fight against corruption and improve the business climate?
10. How do you view the prospects for small businesses in terms of growth and political influence in the next ten to twenty years?

### *Questions for Small Business Owners who are Members of Business Associations*

1. How long have you been a member of the association?
2. Why is your business a member?
  - a. What advantages do you receive from membership?
3. How have conditions for your business changed as a result of the association's activities?
4. What kinds of leverage to businesses associations possess to influence the political authorities?
5. In your view, is the association able to resolve the problems of small businesses?

### *Questions for Representatives of SMEBAs*

1. How long have you worked in this association?
2. How many members do you have?
3. What are the benefits of membership in your association?
4. What are the most important concerns of small business owners?
  - a. In your view, do business associations help to address them?
5. What kinds of leverage to businesses associations possess to influence the political authorities?
6. Can you speak of a specific initiative to improve the business climate for which your association lobbied?
  - a. Why was this initiative successful or unsuccessful?
  - b. Where did the idea for the initiative come from?
7. Can you speak of a specific instance in which your association successfully defended a member in the courts?
8. What motivates a political authority to support an initiative of a business association or the small business community?
9. How would you characterize the level of influence small businesses have in the local political system compared with previous years?
10. Does the small business community have the potential to help in the fight against corruption and improve the business climate?
11. How do you view the prospects for small businesses in terms of growth and political influence in the next ten to twenty years?

## Appendix Two: List of Interview Respondents

1. London Academic (14 October 2010)
2. Moscow Academic (9 November 2010)
3. Moscow Academic (11 November 2010)
4. Moscow Academic (11 November 2010)
5. Moscow Academic (16 November 2010)
6. Owner of Clothing Shop Chain/President of Local Branch of National SMEBA (23 May 2011)
7. Consulting Firm Director (23 May 2011)
8. Shop Owner (24 May 2011)
9. Editor of Local Business Journal (27 March 2012)
10. Ad Agency Owner/Economist (11 April 2012)
11. Government Services Consultant (11 April 2012)
12. Focus Group, "Small Business Influence in Russia's Regions". Saratov: Povolzhskaya Akademiya Gosudarstvennoi Sluzhbi, (13 April 2012)
13. Medical Services Company Vice-Director (17 April 2012)
14. Business Journalist (18 April 2012)
15. Local Economist/Small Business Owner (18 April 2012)
16. Manager of Beauty Salon (18 April 2012)
17. Small Business Association Representative (19 April 2012)
18. Two local lawyers (21 April 2012)
19. Local Lawyer and Business Director (21 April 2012)
20. Owner of Clothing Shop Chain (26 April 2012)

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