Russian Patrimonial Capitalism and the International Financial Crisis

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The international financial crisis brought Russia's run of economic growth to a halt and has given a greater sense of urgency to President Medvedev's calls for modernization. This, however, does not mean that crisis has changed Russia or its political economy. Russia's economic system is a form of patrimonial capitalism, a particular form of patrimonialism created when patrimonial systems reform under the influence of global economic forces. Russian patrimonial capitalism developed in the 1990s and stabilized under Putin. This type of capitalism is hard to change and does not tend to promote economic modernization or diversification. The crisis has so far not fatally wounded this system, and this will make future reform harder to secure.

How much change has the international economic crisis brought about in Russia? Did the crisis lead to a change in the potential for economic reform? Did it, as with crises elsewhere in emerging markets, change the way in which the Russian economy relates to the global economy, and did it do so in a way that reduces the options for Russia's leaders, forcing them to follow new policies?

The answer to these questions seems to be 'yes'. The crisis brought to an end the rapid growth of the Russian economy that followed the 1998 crisis and pushed Russia into recession; any growth over the next few years (except where caused by major spikes in energy prices) is likely to be modest. A change in economic direction would thus appear inevitable and it is not surprising that the crisis has consolidated a change in the way in which economic policy is discussed in Russia. 'Modernization' was on the political agenda before the crisis, but crisis made it a fixture of political discourse. Commonly,
modernization means both the updating of Russia’s industrial infrastructure and the diversification of its budget revenue and export earnings away from a reliance on oil and gas. President Dmitrii Medvedev has repeated endlessly a mantra of ‘we cannot rely on hydrocarbons alone’. Medvedev has also tied energy dependency and crisis together. In his 2009 presidential address to the Federal Assembly, he argued that the crisis hit Russia harder than ‘most countries’ as a direct result of dependency on oil and gas and Russia’s failure to move to a diversified economy exporting a variety of high-value goods. Modernization is thus designed to end Russia’s old relationship with the global economy and the power structures around this and create a new relationship.

Medvedev is right: the crisis did hit Russia very hard and its vulnerability to crisis was in large part a result of its dependency on oil and gas sales to fund its state budget and generate its current-account surplus and national development funds. But intellectual and rhetorical acceptance that Russia has to change is not change in practice. It is an open question whether the crisis fundamentally altered the structure of power in the Russian economy, its political economy, and as a result began the process of institutionalizing new ideas about development that will break the hydrocarbon dependency of the past and forge a new relationship with the global economy.

Russia’s economic prospects, we argue, will not change greatly because the crisis has not yet brought about a fundamental change in the structure of Russia’s political economy. To demonstrate this, we will apply the idea of patrimonial capitalism to Russia. Contrary to the usual ways of describing Russia as a version of state capitalism or corporatism, or some combination, this approach argues that under Putin, Russia achieved a type of stability rather than elaborating a state-led model for development. Thus, the form of Russia’s political economy is the problem and not the solution. This is already recognized by part of the Russian political establishment, hence the calls for modernization.

The patrimonial capitalist system has been in place since the 1990s, but stabilized only in the next decade as it supported itself on high hydrocarbon prices and looked for its development to global capital mixed with national resource wealth. It had achieved a short-term equilibrium, and was possibly on the verge of moving beyond this. The crisis removed that possibility and the response to it was to restore equilibrium and preserve the state’s role as a mediator between the domestic and the global economy.

This may make future reform harder. Sources of investment capital are now much shrunken, thanks to the attrition of reserves and the uncertainties facing global investors as the crisis works its way through the world economy. In these conditions, the political risks of creating a developmental regime and breaking with the patrimonial capitalist system are high since they mean an attack on that system rather than its transmutation through
development in which there are resources both for 'partners' in patrimonialism and for the establishment of new economic sectors that can, in time, replace as sources of political power those resource and other sectors that are the bedrock of patrimonialism.

**Patrimonial Capitalism**

Russia is a 'political capitalist' system and this needs to be conceptualized. The usual approach is to argue that it is a form of state capitalism, but this is an ill-defined concept and one that too readily accepts the logic of Putinism. This logic inflates the break between the Yeltsin and Putin eras and assumes that a growth in power in the Kremlin equates to some changed ability to manage Russia's economy. Naturally, changes took place after Yeltsin, but these were and are reified by analysts into a solution to the problems that Russia faced in integrating with the global economy both by Putin and by the state-capitalist approach. The reformist agenda of the early 1990s, for all its faults, recognized that Russia had to change the way it related to the global economy, and that Russia had to change in order to achieve this goal. Under Putin, economic nationalism, tied to notions of 'sovereign democracy', made out that Russia could dictate the terms of its relations with the global economy, thanks to the power of the state. There is nothing wrong with aspiring to some autonomy from the global economy, but believing that it had been attained in Russia ignored the weaknesses of the Russian economy, particularly its need for investment, the underdevelopment of its financial system and continued relative technological backwardness. In turn, this perpetuated Russia's dependency on energy sales for economic stability and growth. It also underplayed the political problems associated with achieving broader integration into the global economy, both under Yeltsin and subsequently. It conceived of the state as an entity sufficiently powerful to dictate the terms on which engagement would take place. The very fact that Russia was so harmed by the crisis of 2008 onwards shows this not to have been the case. The crisis was not just a crisis of neo-liberalism, as has been widely touted, but a crisis of a 'state capitalist' solution of Russia's problems, too, as Medvedev now recognizes.

An alternative approach is the concept of patrimonial capitalism. Patrimonial capitalism is produced when patrimonial forms of political and economic organization, where power over the economy is highly personalized and economic exchange is particularistic and involves high degrees of relational capital, are forced to undergo market reform. This reform is often exogenous in source, forced on to a patrimonial or neo-patrimonial system by external lenders or agencies, or because of relative competitive economic failure. The result is different both from traditional patrimonialism, based on pre-modern, highly personalistic legitimating devices as described by Max
Weber, and from neo-patrimonialism, where traditional political structures sit alongside modern bureaucratic structures, but the economy remains relatively closed. In the latter system, the tension is between the traditional appropriation of property as personal wealth and the directive, modernizing power of modern state structures, but the state is not subject to external economic pressure. Patrimonial capitalism is a variant of this system as market logics and global economic competition are added to the mix of traditional personalistic and state-bureaucratic modes of domination. Hence patrimonial capitalism is an 'emergent economic order'; it is a development that has occurred as the relatively autarkic patrimonial states of the past have been put under increasing pressure through processes of economic globalization. Patrimonial capitalism has some of the features of neo-patrimonialism in that it has bureaucratic structures that are 'modern'—that is they are hierarchical and subject to some degree of legal rationality—but cannot achieve the level of economic closure that in the past may have been associated with bureaucratic domination or traditionalism. Connections to global markets and capital put pressure on political and bureaucratic elites to adapt and may also be resources that national actors can draw on. In turn, however, these connections cannot easily develop into more liberal capitalism because of the ways in which the political illiberality and the personal basis of patrimonialism limit the global penetration of markets and market norms.

Patrimonial capitalism as a Weberian ideal type thus stands at one end of the spectrum of 'patrimonialism'. At the other end is traditional patrimonialism, where legitimating power is traditional and personal. Neo-patrimonialism rests in the middle, with tradition blended with state bureaucracy and some idea of a rational—legal, neutral state administration in tension with tradition. Patrimonial capitalism is at the other end, with personalism and state-bound rational legality in tension with one another, and with market rationality imposed from without by global price structures, capital and trade flows. Leaders in such systems can rule through each or a combination of these modes of legitimation. They can rely on the purely personal, traditional clientelist system, or on an appeal to a modernizing bureaucractic impersonalism or to the demands created by global competition, or then can try to combine them in some way, by, say, creating areas of economic activity that are globalized and then using that to fund clientelism, or appealing to bureaucractic modernization as a means to deal with the demands of external economic forces, and using this appeal to strengthen their hand against traditional groups. However, no matter what the style of rule, patrimonial capitalism remains a form of illiberal capitalism, with five main features:

1. formal and informal rules (laws on the one hand, and values and behavioural patterns on the other) are not mutually supportive but work against one
another, with the informal often taking precedence owing to the importance of personal loyalty; formal rules are often used to punish the disloyal;
2. economic power rests in those sectors where elites dominate; these are resistant to outside penetration since in the absence of the rule of law property and contract rights are best secured through personal connections, the development of which is highly costly to ‘outsiders’;
3. transaction costs are high owing to the costs of securing rights within a formal framework that sets out rights, but probably does not protect them;
4. the pace and nature of any reform serves elite interests, and these interests determine what reform can happen;
5. political leadership is not subject to democratic constraint.  

The combination of these features makes it very difficult for a patrimonial capitalist system either to transit to liberal capitalism or to achieve development. Politics mediates between the global economy and the national to constrain the influence of the former. The movement of an economic transition requires either a political break to destroy control over the economy by the patrimonial elite, or an economic break to introduce new actors, from outside or from within, powerful enough to supplant the elite and rewrite the political rules. Patrimonial capitalism blocks these developments because of the power that rests within the elite and because of the costs that would be involved in tackling elite factions. Moving decisively beyond patrimonial capitalism would require either a change of regime, or a decisive move to build up the state as an agent of social and economic transformation, or a major external shock that forced change. Modernization, in other words, has political requirements that are very difficult to achieve, or that need to be imported, and is a threat to stability since it threatens any balance that exists between elite interests within the patrimonial system.

Patrimonial capitalism thus throws up a classic problem of development: the extent to which development can occur depends on the degree to which institutions can be put in place to overcome traditional obstacles – economic, social or political, or some combination thereof – to growth; such institutions are necessary to move resources from what Gerschenkron called ‘old wealth’ to investment, or to facilitate inflows of investment from abroad. At the same time, the stability of patrimonial capitalism depends on the degree to which development and external pressures for change can be contained. Either may undermine a patrimonial regime by threatening flows of resources or by creating new socio-political actors with access to external capital. There are, therefore, inherent tensions within patrimonial capitalism as a form of political economy shaped by interaction with the global economy. Internally there is a tension between regime maintenance, economic development and securing resources to maintain state functions. Externally, the global economy
and structural pressures compete to produce patrimonial capitalism and, at the same time, expose its weaknesses to put the issue of modernization on the political agenda. The domestic interests of elite factions and of rulers constrain demands for modernization, or try to structure them in a way that is politically not contentious, and seek to isolate and control the disciplining effects of the global economy. Some action for economic development is generally possible: states may have some residual power to shift resources from consumption to investment. However, this does not guarantee either prolonged development — that is, flows of resources to investment over time — or intensive development — that is, development that is supported not only by the transfer of resources from consumption to investment but also by growth generated by cost efficiency, raised labour productivity, and the production of goods of higher value that can support diversified (from primary and simple manufactures) export-led growth. Achieving development that is prolonged, intensive (or both) requires overcoming any arrangements put in place in the past to contain political divisions, generally as well as specifically over development. Where there has been political division in general, or where development has been politicized to shore up policy preferences in other areas, the co-option of actors from a wider society to stabilize power will broaden the base of the regime and equalize the claims of consumption and investment. This makes development through the state harder, since the tendency is towards creating equilibrium through policies of economic inclusion that predate the growth of sustainable and advanced industrial economy and of rational–legal administrative structures. In these circumstances, political and redistributive equilibria become substitutes for growth, and relations with the global economy are managed so that their promotion of change is controlled.\footnote{16}

The obstacles to launching development in a patrimonial capitalist system are therefore great, and the incentives to backtrack from development are numerous. Where this happens, the state does not develop either the autonomy or the capacity to force development. The problems that this can cause may be recurrent. They might be evaded for a time so that growth ensues; but unless this leads to a change in the state’s general capacity — and specifically in its ability to create incentives for economic actors to generate higher labour productivity, invest in high-value production and so forth, or means of imposing discipline if they fail to do so — these problems are likely to re-surface.

There is, in other words, a high degree of path dependency that fixes patrimonial capitalism in place. However, that fix depends on the tying of elites to the system. If there are not enough resources available to fix patrimonialism in place, then efforts at co-option will fail. Alternatively, there may be such resources for a time, but if they disappear or are reduced, then the patrimonial system is open to pressure to change, again from — potentially — both internal sources such as dissatisfied client groups and external sources including
funding bodies. Reform might, of course, be avoided: an undemocratic government can ride the storm by relying on coercion and squeezing the general population to maintain payments to client groups. The outcomes of these policies are potentially costly, however, since they further discourage investment (out of fear of appropriation, for example, or lack of domestic demand for local products because of wider economic inequality), or raise the costs of investment further (since personal and particularistic relations that need to be decoded to see if investment is a good risk become more opaque). The danger here is that the patrimonial system reaches a crisis point: the amount needed to maintain patrimony plus the amount needed to maintain basic state functions is greater than the amount that can be appropriated by a patrimonial regime domestically and borrowed internationally. The source of these problems can arise internally or externally. The form of crisis and its outcomes are immaterial; the important point is that, if such a situation arises, a patrimonial capitalist system becomes inherently unstable, rather than turning into a stable political economy able to reproduce itself economically and politically.

**Russia as a Case of Patrimonial Capitalism**

Russia is an obvious fit with the five features of patrimonial capitalism listed above: Russia has had difficulties making formal rules stick; its main economic sectors, oil and metals, have been dominated by ‘oligarchs’ and by members of the political elite; the costs of doing business are high for outsiders (hence the comparatively low rates of foreign investment) and uncertain for insiders (hence the flight of capital); reform has been slow and there is weak political accountability. But this fit does not tell us how far Russia’s patrimonial system is capable of resisting crisis and pressure for further reform. To gauge this, we need to look at the origins of patrimonial capitalism, since these will go some way to explaining its resilience: they show how embedded it is. A greater sense of its resilience can be acquired by looking at the resources that can be commanded through the patrimonial system and the demands upon those resources. What these together show is that, after the difficulties it experienced at birth in the 1990s, Russian patrimonial capitalism achieved a stability in the past decade as an equilibrium was reached, thanks to the revenues from hydrocarbons, and as the political battles to control, these were resolved in favour of the Russian political authorities. However, this equilibrium was fragile, as the crisis showed, and its preservation, and that of the state’s role, was the aim of the anti-crisis measures launched in 2008–9.

The roots of Russia’s patrimonial capitalism lie in its peculiar mixture of traditionalism, modern bureaucratic structures and globalized economy. Russia had a particularly patrimonial form of communism, where personalism
and clientelism significantly and simultaneously undercut and supported the
formal bureaucratic hierarchies of the party-state. The collapse of the
Soviet system left the tasks before a modern state bureaucracy unchanged —
the provision of security both domestically and internationally, welfare and
social management — but empowered networks of personalism and clientelism,
which expanded to try to secure property and economic advantage as a
control over the Soviet economy declined. There was thus an imperative
at the start of Russian independence to re-create state bureaucratic power
and structures, and develop anew formal rules governing social management
and economic relations, but these were at odds with informal structures.
Furthermore, there was an impetus to build formal political institutions and
establish impersonal rules as part of the development of Russian democracy,
which again was at odds with personalism. To these were added the externally
generated economic model of capitalism to which Russia was forced to
accommodate itself owing to its economic collapse and the lack of any credi-
able alternatives. Russia’s economic transition was in large part designed
externally and much of the intention of, and struggle over, reform was con-
cerned with the problem of aligning Russian and global price structures so
that Russian industry was subject to the discipline of the global market and
its commercializing pressures.

The political economy that developed over the Yeltsin years was thus
shaped by Soviet legacies, which were patrimonial, by external economic
pressure, and by the maintenance of formal bureaucratic institutions in
order both to fulfil state functions and to build democracy. The form of patri-
monial capitalism that emerged was highly unstable. Yeltsin swung between,
on the one hand, responding to and justifying reform in terms of the demands
of the global economy and calling for the bureaucratic impersonalism of the
state to be developed to respond to these demands, and, on the other hand,
using the global economy and the state as resources to shore up his personal
rule. Hence the economy was opened up first through the liberalization of
trade and later through the opening of government debt markets to foreigners;
privatization and commercialization policies based on cuts to subsidies were
supposed to increase the power of the state through developing its fiscal
control. But these developments were all compromised. Trade concessions,
created for political reasons, undermined trade liberalization and commercial-
ization; foreign investment in the debt market was used to transfer resources
to oligarch-controlled banks; and privatization and commercialization were
opportunistically undermined by insiders and re-created to sustain informal
networks of power. Reform, as a result, swung between failure and hesitant
restarts. The latter were prompted by the state’s continuing fiscal crisis, on
the one hand, and the demands of international financial institutions and
lenders, on the other, which forced efforts at reform that then ran up against
the rocky shores of regime maintenance as Yeltsin struggled to hold on to office and authority. Consequently, the economy was not held in a stable equilibrium, neither was it able to create the conditions for growth. Equilibrium was created, undermined, re-created and undermined again. This cycle was driven by the contest for control over resources between the state (whether for purposes of development or for patronage) and economic and other elites (the so-called oligarchs and regional leaders in particular). The contest was unresolved because of the political chaos, the large number of actors making claims on resources, and the undersupply of resources to be distributed. The global economy and its structures were a resource called on and used by different actors so that reform continued, at least symbolically, through the presence of reformers in the government. This made it easier for external agencies and government to provide some financial aid, but the effects of aid were limited, supporting the Yeltsin regime rather than promoting growth.

Putin’s Achievement: The Stabilization of Patrimonial Capitalism

This situation changed towards the end of the Yeltsin era and under Putin, and created both political and economic conditions for the relative stabilization of Russia’s patrimonial capitalism. Part of this stabilization was then protected during the global economic crisis, instead of the crisis bringing about the end of the Russian version of patrimonial capitalism. The stabilization was based first on controlling the number of actors who could make claims on resources, or on the extent of their claims, or both. Second, it was based on a growth in the amount of resources that could be shared out, so that conflict could be scaled down and did not upset political stability. Stabilization was thus contingent upon a number of political and economic factors coming together, rather than upon deep-seated change under Putin.

Politically the story of the stabilization is well known. Putin’s selection and election as Yeltsin’s successor did not involve the same negotiation over support that had marked Yeltsin’s 1996 re-election and his earlier fight for survival against parliament (1993). Once Putin had won the presidency in 2000, he used his mandate to re-create central political authority, at first by taming the ‘oligarchs’ (by the making, for example, of Vladimir Gusinskii and Boris Berezovskii) and then by expanding the parameters of ‘managed democracy’. This re-creation of political authority was a continuing process that used Putin’s personal popularity, opportunities such as those presented by the Chechen conflict, manipulation of electoral rules, and so forth, to limit as far as possible the claims that could be made on Putin and the state. Economically, the growth of Russia’s economy explains stabilization to a certain degree: there was more to share so less to fight over, especially
since the political costs of fighting might be higher if it displeased the Kremlin. But the stabilization was wider and more inclusive as it produced equilibrium through economic inclusion and social pacification. This equilibrium weakened efforts to promote growth in areas where Russia might have a comparative advantage in high-value goods, or to force the development of greater economic efficiency. After the crisis of 1998, growth was initially driven by the devaluation of the rouble; subsequently much of the growth that occurred was due to the boom in hydrocarbon prices, but this did not lead to the diversification of the economy or to its modernization. Much of the investment in the early 2000s was in the energy sector, with growth in output in other sectors coming from under-utilized capacity brought back online after the slump of the 1990s. Foreign direct investment remained comparatively low and Russia's competitiveness did not improve either generally or in comparison with other emerging market economies. Growth was thus spectacular, but its base, as the OECD has noted, rested more on 'temporary factors' than on deep-seated structural change; the government's role was limited, based on restraint in spending rather than on the promotion of development. In other words, the Russian government did not cause growth: it just stopped the economy from overheating. The institutional bases of development remained weak, in particular the development of the Russian financial system, where the state began to squeeze out private banks but did not resolve the problem of the availability of credit to Russian business. Foreign investment was frequently not foreign but came from tax havens to which Russian money had been directed in order to avoid taxes. The foreign investment and borrowing that did occur to compensate for the weakness of domestic lending went to the large enterprises in export sectors (mostly energy and metals), or was spent not on modernization, but on asset acquisition and mergers, frequently overseas. Russia's economic success did not, therefore, mimic that of China, where domestic savings and foreign capital combined to restructure and diversify the economy continuously and have added high-value production. Instead, and in essence, Putin stabilized the economy inherited from Yeltsin and bent the political relations that it had contained in order to serve this stability. There were several dimensions to this new stability.

First, it was based on incomplete reform. Economic reform was often compromised by the poverty of public administration and because of political risk. The monetization of welfare benefits is a case in point: poor public administration meant that much of the reform could not be implemented, and certain key provisions of the policy were delayed after protest and as regional governments were unable to administer the policy. Building up power within the Kremlin did not translate into the development of the state as an engine for economic management and change. Putin's achievement was in a narrow
political field of regime consolidation rather than in the larger field of state building. There was, of course, some spill-over between the processes of regime consolidation and state building, since success in consolidating power in the Kremlin unified decision-making to a certain extent and gave Putin a higher degree of autonomy than Yeltsin had possessed. But this is not the same thing as developing state capacity.

This can be seen in Figure 1, which records changes in Russia’s World Bank Governance indicators, here aggregated into two measures, one for democratic governance, and one for economic and public governance. The World Bank scores governance on a scale from −2.5 to +2.5, with a higher positive score indicating better governance.

The initial move from Yeltsin to Putin led to improvements in both measures, as some of the grosser personal and family abuses of power ended. However, the move to consolidate regime, marked by the falling score for democratic governance, did not produce a corresponding development of the state’s capacity, which would have produced a higher economic and public governance score: initially the latter indicator rose as the former fell, but this did not last and gradually the two began to converge. What this tells us is that in effect Putin built up the regime’s strength so as to achieve negative power: he was better able to stop things from being done than to do them. The things that were ‘stopped’ were in particular the demands placed on the government under Yeltsin by economic interests. Putin was able to control these, partly because the hydrocarbon boom meant that there were sources of abundant rent apart from the state, and partly because the consolidation of the regime meant that he could fend off calls for increased spending. Unlike Yeltsin, Putin did not have to barter for

**FIGURE 1**

DEMOCRATIC AND ECONOMIC AND PUBLIC GOVERNANCE IN RUSSIA, 1996–2008

support. Thus, there was fiscal prudence under Putin, which had some positive effects: it helped to control inflation to a certain degree and to deaden ‘Dutch disease’ effects that might have been expected, given the large current account surplus generated by high oil prices. However, this did not amount to the transformation of Russia by the state as an institutional ensemble with the capacity to get things done. The state was as much as a barrier to development as its facilitator. Low state capacity complicated such things as foreign investment. Actions against Yukos and the experiences of Shell and BP supported patrimonial capitalism by weakening property rights and raising the costs of entry into the Russian economy. Both Putin and Medvedev recognized this when they began to talk about modernization before the financial crisis took hold, and as Putin tried to move from regime consolidation and negative, blocking power, to a more positive use of power through national development projects and corporations in 2007.

Second, there was a continued lag in the adjustment of domestic energy prices to international market prices, so that the subsides to industry remained in place. This perpetuated a key plank of what had been the ‘virtual economy’ under Yeltsin, transferring value from the energy sectors to the rest of the economy, and in particular to the highly energy-inefficient industrial economy. Under Yeltsin, this had led to demonetization, the non-payment of taxes and wages, or their payment in kind. These were now paid in money, thanks in part to tax reform, and also because of the remonetization caused by the 1998 crisis and the greater wealth created by the energy booms. The first boom that funded subsidies was the merciless exploitation of rents by their private owners in 2000–4. The export value of oil, gas and metals nearly doubled in dollar terms between 1998 and 2002. This was due partly to increased prices and partly to increased export volumes, as economic actors cashed in on assets acquired under Yeltsin. In 2000, oil exports were 171.5 per cent of what they had been in 1999; this level of output was maintained in 2001 and then expanded again in 2002. Six major private oil firms accounted for nearly all of these additional exports since state-owned firms barely expanded production. This expansion of oil exports accounted for about a quarter of Russia’s growth in 2001–4. Russia had a kind of resource windfall, therefore, even before the better-known spike in energy prices between 2005 and 2008. Both booms provided means to transfer value from the energy sectors to the rest of the economy so that it continued to be a hybrid, between the ‘normal’ market and the virtual economy. This hybridity was a function of the degree to which the Russian economy remained outside global economic structures under the tutelage of the Russian state and Putin’s regime.

Third, and on the back of these energy booms, there was the central bank intervention in currency markets to try to protect Russian industry from imports and maintain competitiveness. The Russian Central Bank intervened
heavily in the foreign exchange market to slow the appreciation of the rouble. Appreciation was still significant and fast, so the bank was constantly chasing a moving and costly target. However, the bank could deal with this thanks to the massive revenues earned from oil and gas sales. This massive intervention helped maintain some industrial competitiveness by leaving the rouble undervalued by about 10–20 per cent (depending on the methodology used to calculate value). This was, in effect, another subsidy to Russian producers - another transfer of value from energy sectors made through the state - but it was only partially successful since increases in the volume of imports grew at a greater rate than domestic production so that there was, excluding oil and gas, a growing trade deficit. In many ways, Putin was getting the worst of both worlds, using the central bank to subsidize domestic-orientated industry from oil revenues but still seeing its uncompetitive nature as imports grew using oil money and as this money funded the growth of non-tradable sectors in construction and services. As the international financial crisis hit Russia, labour and capital productivity were only 26 per cent that of the USA in the sectors analysed on one report.33

Finally, global economic growth, the revenues generated by the record global energy prices and the availability of cheap credit in the USA and Europe meant that it was cheap for Russia’s major businesses to borrow in foreign currency: on average the rouble cost of dollar loans was 1 per cent between 2003 and mid-2007. There was, therefore, a flurry of borrowing by Russia’s major firms such as the aluminium concern Rusal, and by many state-owned firms including the oil company Rosneft (which borrowed to finance its purchase of Yukos) and Gazprom, the gas giant (which borrowed to finance its development of the Sakhalin projects lost by BP). This was partly to generate investment revenue for development in Russia in the absence of a developed domestic banking sector, partly to fund purchases outside Russia as firms bought both upstream and downstream, and developed as global players in areas such as metals and energy. The scale of this borrowing can be seen in Figure 2, which shows the precipitous rise in such borrowing outside of the financial sector in Russia. This suited the Russian government, since it created investment, and suited the firms involved, since it spread their assets and sometimes their ownership beyond Russia, thus freeing them from some of the risk to economic actors inherent in a patrimonial capitalist system. The very low rates at which borrowing took place represented a subsidy from energy production to the borrowers, and this generated Russia’s credit rating, inflated Russian growth rates, and made Russia an attractive emerging market to foreign investors. External borrowing reached $307bn in June 2008 outside the financial sector, with that sector borrowing about $200bn in June 2008 – all told some 40 per cent of gross domestic product (GDP).35
The Fragility of Putin’s Achievement: Russian Patrimonial Capitalism and Crisis

What Putin achieved was thus a better-funded and more stable form of the economic system than what had emerged under Yeltsin. This economic system was still not integrated into the global economy, since vast parts of it were outside global chains of production and financing, although it was exposed to it owing to energy dependency and private borrowing. Cumulatively, this meant that the growing economic power of the government, based first on Putin’s taming of the ‘oligarchs’ and then on the development of the system of ‘managed democracy’, was protecting consumption and existing economic practices rather than transforming them. Rising state revenues, derived directly from energy taxes and indirectly from taxes on imports, meant that Putin was able to stabilize his regime and carry on the fundamental business of the state with ease not available to Yeltsin. There was some greater latitude in dealing with outside pressure, following the paying down of foreign debts. But these were not solutions to Russia’s larger problems of development, and ran the risk of damaging the Russian economy outside the hydrocarbon sector. The boom of revenue from energy sales threatened to raise the rouble’s value and undercut the competitiveness (already low on quality and technological standards) of many Russian goods, in other words, to expose it to the ‘Dutch disease’. This would erode many of the gains made in expanding output since the crisis of 1998. Moreover, Russia could not expect energy prices or rents to remain high. Even ignoring price fluctuations, the high rates of resource exploitation by private firms and relatively low levels of investment meant that future levels of production – and hence revenue – were uncertain. Low investment in energy sectors in comparison
with levels of profit meant that high levels of exploitation of energy could not continue; low investment in the rest of the economy meant that the future fiscal base of the government was not growing. Political control was also not a guarantee of future revenue if certain state prerogatives, such as control over the infrastructure of energy exports, in particular pipelines, was challenged. Such a challenge would cut the revenues both for regime maintenance and for state formation and economic development.

Securing the longer-term political stability of the Putin regime thus led towards a greater political involvement in the economy to secure sources of rent, to reduce their availability to other actors, and to have them at the state’s disposal if it needed them for patronage, for funding basic functions, and possibly for development. The stabilization of Russia’s patrimonial capitalism thus took on an increasingly economic dimension as the role of the state in the economy grew. This stabilization of patrimonial capitalism did not look as though it would pose a major threat to Russia since the expansion of foreign reserves and the creation of a stabilization fund based on the huge energy earnings appeared to ensure that the state could maintain expenditure in the event of a shortfall in revenues caused by a decline in the price of energy. Indeed, such was the build-up of reserves that by late 2007 Putin appeared able to maintain the state’s functions and expand its role in development without endangering support for the regime that might be expected if reform imposed costs on economic interests. Thus, the time thus seemed right for the state to move to a more active role in the economy, as outlined by Putin when in early 2008 he introduced a development plan to take Russia to 2020. Problems remained about how to the plan was to work and the capacity of the Russian economy to absorb investment effectively. Plans announced in early 2008 for an investment fund would, some experts contended, have favoured existing industrial structures and given regional authorities access to off-budget funds for local projects. The development plan, in other words, looked like a means of transferring resources to the existing economic structure so that it replicated itself and continued to provide support to the regime. But some such problems were inevitable, given the general difficulty that all resource-rich economies have in absorbing investment resources without waste. If the end result had been that some of the national corporations and projects planned by Putin had succeeded, then the waste might have been worth the risk: Putin and subsequently Medvedev would have managed the difficult task of simultaneously managing and transforming patrimonial capitalism.

The crisis of 2008 means that we can never know whether Putin’s plans would have come to fruition. It is probable that they would not have, or at least not have done so simply. Even before the crisis, it was doubtful that Russia could have funded the growth that it planned and at the same time
RUSSIAN PATRIMONIAL CAPITALISM

maintained the equilibrium that it had achieved under Putin. As matters turned out, the crisis forced a retrenchment. It hit Russia from three angles: first, there was spill-over from the international financial crisis; second, global energy prices fell; and third, confidence in Russia fell owing to the war with Georgia, which led to capital flight and tightened lending to Russia. Together these lowered Russia’s growth, hit its budget, and raised the costs of its state and private firms’ borrowing. In many ways, the governmental response was in line with the responses made by governments elsewhere to the crisis in 2008–9: it increased its spending in order to try to alleviate the crisis and provide credit in the economy. It was helped in this by its reserve funds built up from oil wealth, so that it was not pushed quite as far into deficit as would otherwise have been the case, given the falling of tax revenues as energy prices fell. The form that this relief took reflected the peculiarities of Russia’s economy, however, and worked to support the equilibrium that Putin had achieved rather than to break with it.

Whereas, much effort in liberal capitalist economies was concentrated on replacing (or stabilizing) the banks as lenders, Russian policy supported, stabilized and preserved the politically sensitive areas of the economy, and reduced their exposure to foreign influences. Initially this focused on alleviating pressure on elements of the Russian economy that had made use of cheap credit in the USA and Europe and borrowed heavily in foreign currency. This credit was no longer cheap, as falling oil prices and the fallout of the Georgian war put pressure on the rouble and threatened to raise the costs of debt repayment. As Figure 2 revealed, that debt had grown dramatically and in particular had been built up by Russian firms, rather than banks — indeed, by major firms. As the rouble began to slide with falling energy prices, and as foreign capital fled Russia or simply dried up, the costs of repaying loans rose and the possibility of rolling them over decreased. The state stepped in to relieve the pressure on these firms. It did so, first, by delaying the devaluation of the rouble so as to slow the rate at which the cost of loan repayments grew. This was little more than a wait-and-see policy, created by a belief that the fall in energy prices would be short-lived and that the negative economic affects of the Georgian war would dissipate, and by a misplaced confidence that had led Medvedev, Putin and the government to see crisis initially as an American problem.

This head-in-the-sand position could not last, however, as it soon began to drain the state’s reserves too rapidly, threatening the state’s ability to mediate between the domestic and the global economy and threatening its management of the patrimonial capitalist system. A variety of anti-crisis measures were, therefore, introduced throughout 2008 and into 2009. Again, the chief focus of this was to relieve the pressure on the major firms — some state-owned — that had foreign loans. Generally speaking, therefore, companies at the apex
of the economy benefited most from the anti-crisis measures, and the relationship of the internationalized sectors of the Russian economy to the global economy was maintained. The government essentially took over their debts, directly and indirectly, by providing government credit guarantees and interest rate subsidies, stalling tax payments, and setting preferential export and import tariffs. The chief beneficiaries of these policies were energy firms, metals producers and other rent-generating firms, and those whose closure would have the greatest social impact because of the dominance of local economies (one-company towns). This minimized the damage to the elites and to those areas of the country where the economic downturn would have sparked protest, while keeping the government at the centre of the economic game. The cost fell both on households, as devaluation eventually decreased real wages, and on firms that lacked access to the government’s largesse. Some of these briefly reverts to the practices of barter and non-monetary exchange that had kept them ‘solvent’ in the 1990s.

The anti-crisis measures that were adopted thus supported elite interests rather than fostering the diversification of the economy through the protection of small and medium enterprises. In general, these smaller firms generally benefited only partially and at second hand from the anti-crisis measures. So, when the crisis began to abate at the end of 2009, recovery was not based on any change in economic activity but was led, once more, by the oil sector and driven by the stabilization of the oil price over the last months of 2009. The prospects of any change from this reliance on oil were also probably reduced by the anti-crisis measures. Although the anti-crisis measures staved off the collapse of Russia’s banks, they were nevertheless weakened, and their borrowing power — and hence their ability to channel money into the wider economy — was reduced. The large firms bailed out by the government have been able to roll their debts over and extend their credit, thanks to the support of the government, but Russian banks were unable to do so. As a result, lending to firms by Russian banks was small in the aftermath of the crisis, and the banks’ position was weakened and made more dependent on the state.

Conclusion

The crisis did not mark a break with the past: in the words of one group of Russian analysts, ‘the opportunities that the crisis offered for modernization were wasted’. Russia was cushioned by its wealth and saved by a stabilization of oil prices that kept them within the range ($60–70 a barrel) at which its budget was forecast to break even. In the end, the anti-crisis measures amounted to another transfer of social wealth generated by the energy boom to the apex of the economy, with little appreciable gain in
terms of dealing with the problems that had exposed Russia to the crisis in the first place. The reliance on oil was deep. The total budget deficit caused by the crisis and the measures adopted to deal with it was modest, about 6.4 per cent of GDP, but the non-oil deficit was more than twice this as a percentage of GDP and far in excess of estimates of what would be sustainable from oil revenues over the longer term. The transformative affects of this spending, however, were weak because of its concentration on minimizing the exposure of large firms; many of the anti-crisis measures have been described as ineffective, and were introduced only after the crisis had passed. As one Russian analyst has put it, the ‘government continues the game as before . . . There is no guarantee that the allocated money will be used to develop advanced technologies and expand production, rather than to cover losses or new currency and financial speculation’.48

In the short term, therefore, the crisis only dinted the stability of the patrimonial capitalist system. But the longer term may be different. The crisis has called into doubt patrimonial capitalism as an inclusive economic form, capable of generating resources for distribution beyond elite groups. This promise of Putinism was always fragile, given the huge wealth disparities in Russia inherited from the 1990s, but it was plausible when oil revenues helped to increase incomes in the past decade. The crisis has also deflated the financial cushion that before 2008 had been available to support the patrimonial capitalist system as modernization was carried out. This has largely disappeared owing to the state’s resistance to devaluation of the rouble and its takeover of the foreign debts of major firms. This means that resources to manage the inherent instability of the patrimonial capitalist system – resources that Russia temporarily had in the early years of this century – have to be found within the system, since they cannot be replaced easily by foreign lending, given the continuing problems of the euro zone, the weakness of much of Western recovery, and the fact that other emerging markets are more attractive than Russia’s. Some effort is obviously being made to find these resources: proposed cuts to Russia’s civil service and talk of public sector modernization are aimed both at making efficiency gains in public administration and at giving more room for manoeuvre in state spending. However, such savings are likely to be relatively modest compared with the spending put in place during the crisis and funded by oil. They will not provide the room to manoeuvre that which existed before the crisis or the wherewithal to fund modernization while accommodating the inefficiencies of the patrimonial capitalist system. As Medvedev noted in his 2009 ‘state of the nation’ address, the crisis has made ‘it harder to resolve [developmental] problems’.49 The crisis has thus left Russia more exposed to the dangers inherent in the patrimonial capitalist model; it is less able to deal with the demands placed on it for resource redistribution and for the maintenance of
state functions and to cope with the demands of being a part of the global economy. Consequently, in the longer term, the great international crisis of 2008 onwards may be for Russia the precursor to the crisis of its own economic model, and such a crisis would be much more dramatic and politically unsettling.

NOTES

1. See Justin Robertson (ed.), Power and Politics after Financial Crises: Rethinking Foreign Opportunism in Emerging Markets (Basingstoke: Palgrave, 2008), for a general discussion of how crises in emerging markets have changed the way that they relate to the global economy and the balance of power in these markets.


6. See, for example, Medvedev's call for changes to Russia's 'development paradigm' made to United Russia on 28 May 2010, or the call of the Institute for Contemporary Development (widely recognized as Medvedev's think-tank and sounding-board) for political change to take place alongside economic modernization. Medvedev's comments are at <http://eng.kremlin.ru/text/themes/2010/05/282033_226327.shtml>, accessed 29 May 2010; Institute for Contemporary Development, Rossiya XXI veka: obraz zhelaemogo zavitra [XXI-century Russia: the shape of a desirable tomorrow] (Moscow: Ekon-Inform, 2010).

7. On Russia and political capitalism see Philip Hanson and Elizabeth Teague, 'Russian Political Capitalism and its Environment', in David Lane and Martin Myant (eds.), Varieties of Capitalism in Post-Communist Countries (Basingstoke: Palgrave, 2007), pp.149–64.


11. For reviews of these issues, see Jean-François Médard, 'The Underdeveloped State in Tropical Africa: Political Clientelism or Neo-patrimonialism?', in Christopher Clapham (ed.), Private Patronage and Public Power (London: Pinter, 1982), pp.162–92; Gero Erdmann and Ulf Engel, Neopatrimonialism Revisited: Beyond a Catch-All Concept (Hamburg: GIGA Working Papers, 2006). My thanks to Paul Chaisty and Patrick Köllner for passing on these two references.


13. One further benefit of using patrimonial capitalism is that it enables us to talk about Russia as patrimonial but at the same time not simply lump it together in an undifferentiated mass with other post-Soviet polities that are more dictatorial and economically less open, but that have also been labelled patrimonial. This deals with one complaint about labelling Russia patrimonial: it is not Uzbekistan or Kazakhstan. Of course it is: Uzbekistan would be further along the spectrum of patrimonialism, somewhere between traditional patrimonialism and neo-patrimonialism, with a tendency towards the former; Kazakhstan would be between traditional patrimonialism and neo-patrimonialism with a tendency towards the latter.

14. These are adapted from Schlumberger's longer list of ten features: see Schlumberger, 'Structural Reform, Economic Order, and Development'.


16. For more on this as a general problem, see David Waldner, State Building and Late Development (Ithaca, NY: Cornell University Press, 1999), esp. pp.50–1.

17. A patrimonial capitalist system is thus vulnerable to the instability that is normal for any limited access order, that is to the instability that can affect any political system that rests on a coalition held together by rent distribution: see D.C. North, J.J. Wallis and B.R. Weingast, Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History (Cambridge: Cambridge University Press, 2007).


24. For example, Cyprus has consistently been a major source of foreign direct investment in Russia.


26. The democratic governance score here is a composite of the scores for Voice and Accountability, and Political Stability. The public and economic governance score is a composite of the scores for Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption.


RUSSIAN PATRIMONIAL CAPITALISM


40. See, for example, the discussion of the ‘Long-term fiscal sustainability of the Russian Federation’ in the World Bank’s Russian Economic Report, No.16 (2008), pp.17–20, published just as the international crisis was about to hit Russia.

41. For a description of how crisis hit Russia, see Krizisnaya ekonomika sovremennoi Rossii [The crisis economy of contemporary Russia] (Moscow: Institut ekonomiki perekhodnogo perioda, 2010), esp. pp.10–19.

42. See the list of beneficiaries in Gosudarstvenni universitet – Vysshaya shkola ekonomiki (GU–VES), Mezhdosmosstvenni analyticsheskii tsentr (MATs) [State University – Higher School of Economics, Interdepartmental Analytical Centre], ‘Otsenka antikrizisnykh mer po podderzhke real’nogo sektora Rossiiskoi ekonomiki’ [Assessment of anti-crisis measures for support of the real sector of the Russian economy], Voprosy ekonomiki, No.5 (2009), pp.44–6.


47. See, for example, the assessment in Gosudarstvenni universitet – Vysshaya shkola ekonomiki, ‘Otsenka antikrizisnykh mer’.
