

Neoliberalism and the Law in Post Communist Transition

The evolving role of law in
Russia's transition to capitalism

Ioannis Glinavos



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This work examines ideas about the role of law and legal reform in the creation of market economies, focusing on the process of post communist transition in Russia. Processes of transition in Russia were guided by a set of very specific neoliberal ideas about the nature of markets and capitalism, about the role of law and the primacy of the economic over the legal and political. These ideas, however, have come under fire as a result of the Russian experience of transition and the serious problems encountered by reforms. This led to a revision of the original neoliberal ideas, not least concerning the role of law and its relationship to the economic and the political. The result has been the emergence of a much more complex body of ideas about the role law plays in economic transformation.

This book aims to close a gap in the literature on post communist transition by offering a theoretical interpretation of Russia's experience that makes transition reform models comparable to development reform models. Focusing on the role of law and the relationship of economic priorities to law reform, this work offers a critical evaluation of currently dominant theories of economic and legal reform put to use in varied transition and development scenarios. In looking at the ideas that directed and animated reform in Russia, an enquiry is thus made into the wider relationship between democracy, regulation and the market in contemporary capitalism.

Neoliberalism and the Law in Post Communist Transition will equip scholars and students of development studies, law, political economy and international economics with a critical guide to transition focused on the often neglected legal aspect of the reforms.

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This book is dedicated to my children.

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Preface

This book examines ideas about the role of law and legal reform in the creation of market economies, focusing on the process of post communist transition in Russia. Neoliberalism has been a particularly potent source of ideas that determined responses to the challenge of reforming post communist countries. Processes of transition in Russia were guided by a set of very specific ideas about the nature and ‘naturalness’ of markets and market capitalism, about the role of law in this process and the primacy of the economic over the legal and political. These ideas, however, have since come under fire as a result of the Russian experience of transition and the serious problems encountered by the original reforms. This has led to a revision of the original neoliberal ideas, not least concerning the role of law and its relationship to the economic and the political. The result has been the emergence of a much more complex body of ideas about the role of law in economic transformation. This lends the study of Russia wider significance in assessing the interaction of legal, economic and political aspects of development and shows that the use of law in creating a minimalist market framework and the neoliberal insistence on a limited state not only jeopardise legal development but also the sustainability of a democratic political system. The effort to overcome the limitations of the neoliberal model not only shows that a much greater role for law and regulation exists in modern capitalism, but also that the theoretical assumptions of neoliberalism as to self-governing and self-generating economic processes are deeply flawed. In looking at the ideas that directed and animated reform in Russia, an enquiry is thus made into the wider relationship between democracy, regulation and the market in modern capitalism.

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Introduction

Post communist reforms

This work examines the first two decades of post communist reforms in Russia and, in particular, the ideas that underlay and animated the reform process. It argues that the process of reform in Russia, which was intended to bring about a swift transition to capitalism, was inspired by a particular set of neoliberal ideas about the nature of markets and market capitalism, about the proper roles of law and state, and about the relationship between the economic, the legal and the political. The book suggests that despite their increasingly evident flaws, these ideas – which formed the foundation of the so-called ‘Washington Consensus’ – not only continue significantly to influence academic understandings of market economies and economic development but continue to shape the policies and thinking of many international agencies and governments. The book therefore seeks to use the Russian experience as a vehicle for exploring the neoliberal mindset and the consequences of its application to the transition from communism. To this end, it traces the intellectual history of neoliberal reform in Russia, mapping both the ideas underlying the initial reforms and the revisions to those ideas that took place in response to the difficulties into which the original reform ran, revisions that are reflected in the emergence of a so-called ‘Post Washington Consensus’. In doing this, the book seeks among other things to cast light on the complexities of the relationships between the economic, the legal and the political in a capitalist society, complexities which, as the Russian example vividly illustrates, are often understated or overlooked by neoliberal modes of thought.

In its initial stages, the post communist reform effort in Russia was driven by a strikingly simple set of ideas about economic life, markets, and the role of law and state. These ideas were underlain by a fierce economic determinism in which the legal and political spheres were firmly subordinated to the economic. The reformers believed that the economic processes of ‘the market’ and market capitalism were consonant with human nature and that a transition to capitalism in Russia would, therefore, be fairly straightforward and easy to effect. In essence, all that was required was for the state radically to be shrunk and for the ‘natural’ forces of ‘the market’ to be allowed to weave their economic and organisational magic. This demanded little more than the creation of private property and

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private property rights, the facilitation of market mechanisms (contract laws), the reduction of regulatory fetters to free exchange and the elimination of political involvement in economic decision making. Both law and the state were to be firmly subordinated to the economic processes of the market and were to play strictly limited roles in economic affairs. The constraints on state power required by neoliberal theory also meant, amongst other things, that limits had to be placed on the scope of democracy, especially on the capacity of democratic politics to determine economic policy. Correspondingly, the initial legal reforms focused on defining and protecting private property rights and facilitating market exchange. In a dramatic withdrawal from economic and social life, state regulation, so pervasive during communism, was reduced to instituting and maintaining what were seen as the prerequisites of a capitalist economy. For the reformers, however, the limited role to be ascribed to law and state regulation during the transition process in Russia was not merely a particular and specific response to the challenges of post communism but the basis for successful economic development worldwide, a model for the optimal organisation of all market economies. The ‘truths’ of neoliberalism, with its underlying economic determinism, were not confined to particular locations, cultures or historical periods. On the contrary, as products of a trans-historical economic logic, they extended to all times and places. It is hardly surprising, therefore, that the policy trajectory of post soviet states in general and of Russia in particular shares many characteristics with other developing countries.

In the mid 1990s, however, the Russian economy nearly disintegrated and the neoliberal ideas that had become the ruling economic orthodoxy of the late twentieth century (the Washington Consensus) began to be questioned. There was a shift in policy priorities towards the promotion of so-called market supporting institutions and the rule of law, a shift that contained the seeds of a radical revision of the core assumptions of neoliberalism about human nature and the operation of market economies. While the revisions in Russian neoliberalism did not yet signify an abandonment of the sacred tenets of the reform project, they seemed to entail a growing recognition that markets and market capitalism are based on a much more complex relationship between economics, politics and the law than originally suspected. The shift from the Washington to a Post Washington Consensus and the realisation that markets are in need of considerable legal, political and institutional support has inevitably led to revisions of the ideas held by reformers about the nature of capitalism and the role of law and the state in free markets. In providing an intellectual history of the Russian reform process, this book seeks to explore the intellectual history of current, neoliberal-inspired ideas about development and the role law has to play in effecting transition and in promoting development.

Chapter summary

The book is divided in three parts. Part I traces the ideas held by the Russian neoliberal reformers and their advisers about the role of law in the creation of a

market economy (Chapter 1 – Markets and law) and their understanding of the nature and functioning of the economy under soviet communism (Chapter 2 – The command economy). Part II analyses the model of ‘instant capitalism’ that animated the reform process (Chapter 3 – Instant capitalism), its evolution and the criticisms levelled at it (Chapter 4 – Responses to instant capitalism). Part III examines the promotion in the period after 1998 of so-called ‘institutional’ and ‘rule of law’ reforms (Chapter 5 – Second stage reforms) and the emergence of a so-called ‘Post Washington Consensus’ (Chapter 6 – Neoliberalism revisited).

In Part I it is argued that the post soviet reform project in Russia was rooted in a belief in the existence of a trans-historical, market based economic rationality, in the naturalness of market exchange and the ability of markets to self regulate, in the central importance of private property rights and in the need for the state to play a limited role in economic affairs. At the beginning of the reform process, it is argued, the advisers to the Russian government were convinced that the existing command economy was wholly contrary to economic rationality and that a successful transition to capitalism therefore demanded a complete and rapid break with the communist past. They were also convinced that law and state had an important but strictly limited role to play in the creation and maintenance of a market economy.

Chapter 1 explores how those advising the Russian reformers saw capitalism as a reflection of natural human tendencies. It maps the emergence and ultimate dominance of neoliberal ideas through the move from ‘embedded liberalism’ to neoliberalism, and examines the neoliberal belief that ‘the market’ is a reflection of human nature and the neoliberal claim that, left unimpaired, ‘natural’ economic forces will shape social structures. It also explores the neoliberal belief that the most fundamental laws governing human affairs are those deriving from the market imperative of ‘efficiency’ and the conviction that, as a consequence, the state needs to keep out of economic affairs. Against this backdrop, it analyses the neoliberal claim that the essential and principal role of the law in a market capitalist economy is to facilitate market exchange by constituting and maintaining property rights and the laws of contract.

In this context an analysis is made of the distinctive contributions of Hayek and of the Law and Economics movement to the formulation of the reformers’ ideas. In the early stages of transition, the reformers argued, law had to be used to liberate the economy from state control and to establish the prerequisites of a market economy as determined by neoliberal theory. One of the most important beliefs held by the reformers was that law could and should be essentially apolitical. It was, it is argued, the widespread acceptance of neoliberal ideas as an expression of ‘economic rationality’ and the concomitant belief that economic policy is (and should be) in essence a scientific matter that gave momentum to the drive for so-called ‘depoliticisation’ in Russia. As a result, reform came to be seen not as entailing the substitution of one ideology by another (communism by capitalism) but as the final rationalisation of Russian economic and social life.

Chapter 2 continues the examination of the theoretical bases of the reform effort by looking at the reformers’ understanding of the ills of communism.

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According to the reformers, the structure of property rights under communism, based around state ownership, failed to create incentives for wealth creation, resulting in low growth. The solution to the inefficiencies of the command economy, as they saw it, lay in the creation of clearly defined private property rights and of rights to exchange them. This chapter examines the main characteristics of the command economy and the revisions it went through, and explores the differences between the official proclamations of legal entitlements and the actual structure of rights over state property. One of the main problems with the reformers' approach, it is argued, was that it assumed the command economy to be more or less devoid of private rights prior to the beginning of the reform process, when in reality the soviet economy was characterised by a complex tangle of legal and quasi-legal individual rights over state property and state enterprises. In short, the actual structure of rights was often not accurately reflected in official policies and laws. Instead of recognising the existence and importance of these actual entitlements, however, the reformers chose to ignore them, dealing with them haphazardly and incompetently. In this context, Chapter 2 also explores the difficulties involved in translating Russian property norms into western concepts of entitlements.

Part II traces the first stage of post communist reforms utilising the concept of 'instant capitalism', before setting out the various responses to their perceived failures. Chapter 3 examines what the implementation of the core ideas of neo-liberalism meant in practice and seeks to analyse how the failings of the reforms began to erode the reformers' original assumptions. It introduces the concept of 'instant capitalism' to characterise the methodology of reform that dominated policy in 1990s Russia. The reformers, it is argued, operated with a belief in the possibility of instantly creating capitalism, believing that rapid transformation through 'shock' methods would be sufficient to create a sustainable free market economy. The idea of instant capitalism, it is argued, was part of an international environment dominated by the so-called 'Washington Consensus'. This chapter therefore explores the influence that the neoliberal ideas lying at the heart of the Washington Consensus had on the internal reform initiatives in Russia, focusing in particular on 'shock therapy' and rapid privatisation. How Russia came to embrace the edicts of the Washington Consensus is explained through a presentation of the alternative programmes for reform that were mooted but rejected in the final days of the Soviet Union. Privatisation, it is argued, became, on the one hand, an economic project that sought to create the legal basis for market exchange; and, on the other hand, a political project that sought to build a political constituency in favour of capitalism.

One of the core ideas behind instant capitalism, it is suggested, was the belief that law could be used rapidly to create a market economy that would in turn shape the social and political spheres. The model of reform applied during Russia's original reforms thus sought to use law as a tool of social transformation while keeping the regulatory role of the state to a minimum. This resulted in the top down imposition of reforms and the downgrading of the need for a political transition to democracy. In the early stages of the reform process, the role

ascribed to law was very much in accordance with the theories outlined in Chapter 1, involving the establishment of perceived prerequisites of 'the market' and the separation and 'immunisation' of economic affairs from political control. Indeed, in certain important respects, it is suggested, the debate between gradual and rapid reform was a debate about the role of law in the process of economic transformation. This discussion is brought in sharp focus by a brief analysis of the contemporary Chinese reform effort, seen by many as representing the 'other' path to post communist transition. The chapter concludes that the assessment as to how much law was (and is) required to create and support a market is central to the other choices made during transition. The idea of instant capitalism, it is argued, was fatally flawed: the choice of a rapid reform programme was mistaken. The result has been a partial revision of the instant capitalism model, which has found expression in the demand for so-called 'institutional' and 'rule of law' reforms.

Chapter 4 examines how the reformers' ideas about the legal and other prerequisites of a market capitalist economy changed over time and traces how their understandings (implicit and explicit) of the relationship between the economic and the legal and political have also undergone significant modifications. The apparent failure of the original reform programme to achieve the establishment of a self-sustaining free market was met, it is argued, with various responses, ranging from dogged defences of the idea of instant capitalism to a complete rejection of the idea and assumptions of rapid reform. Three main responses to the failures of the first stage of reform are examined. The first strongly defended shock therapy and the neoliberal models upon which it was based; the second partially revised the idea of instant capitalism by introducing the notion of market supporting institutions and the rule of law; the third completely rejected the idea of instant capitalism. In this context, the fundamental assumptions of the neoliberal reformers regarding the natural and self-regulating capacities of markets are critically examined. With the help of neoliberal advisers, it is argued, Russian policy makers implemented in the early 1990s a half-digested textbook version of capitalism that in certain rather curious respects mirrored their former Marxist ideological training.

This chapter also seeks to analyse the three main responses to the results of the early reform effort by examining the alleged need for 'shock therapy' in the light of the administrative collapse it caused. In this context, the debate between the advocates of rapid and gradual reform is revisited. A brief reassessment of the role of law is attempted in light of the claim that the desire to create instant capitalism did not allow for the necessary development of state capacity or for the development of the institutions needed to support the operation of free markets. The reforms to property rights that were implemented, it is argued, were widely seen as lacking legitimacy: the new property forms lacked social support. At this point, it is suggested, critics of the Russian reform effort began to realise that as the existing reforms were not accepted as legitimate, future reforms were likely to be reversed if democratic control was allowed, explaining the withering of Russian democracy after 2000. This critique forms the basis of

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the discussion of contemporary reforms, which allegedly provide the missing elements to a successful transition to capitalism.

Part III discusses the effects of the gradual revision of the neoliberal ideas that underlay the initial reform programme, focusing on the increasing emphasis placed on the promotion of institutional and rule of law reforms. These reforms, widely known as the 'second generation reforms', entailed a re-evaluation of the importance of law in the transition process, as the need for the state to establish and maintain market supporting institutions was gradually recognised. This part of the book examines the extent to which second generation reforms constitute a rejection of the logic of instant capitalism and an abandonment of some of the core neoliberal ideas and assumptions that shaped the early stages of the process of transition. It starts by examining the reforms promoted in Russia after 1998 and continues by drawing some general conclusions about the nature of an emerging 'Post Washington Consensus'.

Chapter 5 argues that the second generation reforms have thus far proved to be an ineffectual response to the failings of instant capitalism. It traces the substance of the proposals to promote institutions and strengthen the rule of law, and examines whether they mark a new and different project or form part of the same exercise to establish the fundamentals of a liberal democracy in Russia. In this context, a detailed examination is made of what is meant by rule of law and institutional reforms. Chapter 5 argues that despite a wealth of literature on the significance of promoting the rule of law and on how to do so, second generation reforms have in reality involved little more than increased legal formalism and calls for the reform of judicial administration. While, therefore, the majority of commentators argue that the future of the reform process depends on the capacity of institutional reforms to further the market reform effort, it is argued in this chapter that the reformers' understanding of what institutional reform entails is flawed and, therefore, unlikely to succeed. Crucially, one finds similarities between modern rule of law promotion and previous legal modernisation projects such as the failed Law and Development Movement, which promoted legal reforms in developing countries in the 1960s. The main failing of the current reform efforts, it is argued, lies not in its acceptance of and emphasis on the need for more law but in its continued insistence on a minimal, apolitical state. The chapter concludes that second generation reforms are underlain by the same basic assumptions of shock therapy; that they continue to be motivated by the ideas that gave birth to instant capitalism.

Building upon this, Chapter 6 begins by re-examining the main characteristics of the neoliberal ideas that formed the core of Russian reforms. It outlines the neoliberal mindset by revisiting the need for depoliticisation, summarising neoliberal perceptions as to the sources for legitimacy of market institutions and by restating the aims of second generation reforms. On the basis of this presentation, the chapter proceeds to deconstruct the thesis for institutional and rule of law reforms by showing how the continued insistence on a limited state undermines the effort to erect effective market supporting institutions. This is achieved through highlighting the difference between the neoliberal project of transition

and the promotion of development (economic and political) beyond transition in Russia. A discussion takes place on the limitations of an 'economic' interpretation of historical development, on the difference between transition and development, and on the role of the state in these processes. The chapter concludes by evaluating the future of the Russian reform process under a Post Washington Consensus and examines the extent to which the current promotion of 'independent' institutions – of market regulation without the state – is likely to block political and institutional progress.

Chapter 6 argues that the need to contain state competence, which is central to the model of instant capitalism, is a continuing requirement of neoliberal doctrine and suggests that this is the reason for the perpetuation of legitimacy problems for post communist legal norms. The insistence on the separation of economics and politics and on the maintenance of a reform methodology that continues to see the reforms associated with instant capitalism as a sufficient basis for development has serious consequences: post communist transition along neoliberal lines cannot be a simultaneous process of economic and political transformation. It is argued that in such an environment, the use of law to, in effect, 'ring-fence' the economic domain reduces the scope for political action and ultimately threatens democracy. Neoliberalism in other words, instead of creating an apolitical state, creates a political state of the wrong kind. This is a captured, corrupt, illegitimate and opaque state, disengaged from democratic control. In this context, consideration is made of the importance of the Russian experience for other states in a transition to markets and democracy (such as China and other developing countries) where liberalising reforms on the neoliberal model have been pressed. It is argued that the emergence of a so-called 'Post Washington Consensus' does not mark a complete break with the original 'Washington Consensus'. It is also suggested that the consequences of the 'credit crunch' and the recession that started in 2008 on a global scale, do not threaten the neoliberal bases of economic policy established in the 1980s and 1990s, but are limited to yet a further revision of rhetoric, consistent with this 'Post Washington Consensus'. It seems, the book concludes, that so-called market friendly reforms are set to continue to pose a threat to development beyond transition in Russia and elsewhere, not least by blocking the avenues for public involvement in economic decision making.

Part I

Setting the scene

