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A rise of state activism in a competitive industry: The case of Russian retail trade law of 2009

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ABSTRACT

The paper is aimed at exploring the Russian state return to the highly competitive industry of retail trade by adopting restrictive industry-specific legislation in 2009. We reveal a new precedent model of governance using the liberal rhetoric of the competition protection to justify intervention in interfirm contractual relations. We use survey data collected from 843 retailers and suppliers in 2013 to demonstrate that the new legislation had not achieved the proclaimed goals. The paper concludes that instead of market facilitation, the new state activism leads to the further suppression of business and the subversion of antimonopoly policy.

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1. Introduction

After having a weakening and incapable state in the 1990s, the Russian government in the 2000s activated its intervention into the economy. Initially, it intervened into “strategic industries” (banking, fuel and energy, high-tech, and defence) perceived as critical for national safety and economic integrity. Then, by the end of 2000s, the state unexpectedly became involved in the active regulation of a “peripheral industry” of retail trade that had previously been ignored by policy makers. A restrictive trade law aimed at “repairing” the retailer-supplier relationships was adopted in 2009.

More importantly, a new model of governance was introduced with regard to retail trade. This model is not easily conceptualised in the frame of well-established concepts of liberalism, corporatism, or statism (Schmidt, 2002; Levy, 2006; Weiss, 2010). Neither this intervention could be fully described as the “invisible hand,” “grabbing hand,” or “helping hand” governance models (Shleifer and Vishny, 1998). A new governance model became a mixture of diverse elements rather than representing one ideal type. Unlike a traditional industrial policy pursued by the federal ministries in order to protect the particularistic interests of their own industries, this new governance model was carried out under universalistic liberal slogans of antimonopoly policy and competition protection. At the same time, it was implemented through the direct intervention into retailer-supplier contractual relationships. Intervention was aimed at restoring the market power balance and offered a helping hand to the discriminated suppliers and small suppliers in particular.

In stark contrast to a similar international experience (FTC, 2003; Klein and Wright, 2007), in Russia, neither social, nor economic analysis was presented before the adoption of legislative changes to justify state intervention. Even more importantly however is that little work was done on the regulatory impact assessment of the enactment of the new trade law. A standardised survey of 512 managers of retail and supply companies has been conducted by the end of 2010 to examine changes in retailer-supplier relationships, but it could reveal only short-term outcomes of the new law enforcement (Radaev, 2011). Subsequent empirical evidence with regard to market arrangements was confined to an Ernst & Young survey of 31 companies in the food industry (Ernst and Young, 2011). More generally, very little research has been conducted on trade

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liberalisation policies in the post-Communist countries (Frye and Mansfield, 2003). With regard to the new reverse movement back to state regulation in the Russian domestic trade, which will be explored in this paper, scholarly literature is scarce. Daugavet (2011), Dzagurova and Avdasheva (2010), Novikov and Paneyakh, 2014, and Radaev (2011) made important exceptions. However, the governance model has not been properly specified in these studies.

The paper is aimed at answering the following questions: What were the reasons for the sudden return of the state to the highly competitive industry of retail trade? What type of governance model was used for this state intervention? Which intended and unintended outcomes were produced? What broader lessons could be drawn from this industry-specific case?

We explore relationships between two types of market actors in the consumer markets. On the one side, we address retailers presented by the chain store companies in which all the stores belong to the same owner (franchises are not widely spread in retail trade of consumer goods in Russia at present). On the other side, we address suppliers including both producers and distributors of consumer goods who deliver their products to the chain store companies.

In the remainder of this paper, we reveal the character and main reasons for state intervention and put it in a broader theoretical context presented in existing literature. We formulate our research hypotheses and describe the sources of data. Then we present our findings on the effects of the trade law on the retailer-supplier contractual relationships and the level of regulatory pressures. Some generalizations are made with regard to the new model of governance associated with business capture and subversion of antimonopoly policy. Finally, we draw conclusions and reflect upon most recent changes, which influence should be further explored in future studies.

2. Background of the state intervention

Retail trade was known as a significantly liberalised sector in the Russian economy since 1992, when Russian Federation President Boris Yeltsin signed the decree “On Freedom of Trade” that allowed trading activity to be conducted by any legal entity or person without special licensing. Price liberalisation, which eliminated price control, was accompanied by the mass privatisation of trading outlets. The latter were sold out or given away to the working collectives of the shops. Within the two years of 1992–1993, 60% of trading outlets were privatised. By the end of the 1990s, non-state retail activity accounted for 96% of sales in Russia and 99% of sales in Moscow (Radaev, 2005). Privatisation deprived the government of direct control over trading firms. Hard budget constraints were imposed on them, with no state subsidies, governmental orders or low-interest credits from the state-run banks.

All things considered, the retail trade largely resembled a competitive market ideal at that time. Private initiatives became crucial for the industry. A large percentage of privatised shops were small and possessed a negligible market share. The leading firms followed an exit strategy of keeping a distance from the state (Yakovlev, 2006). Federal state policy regarding the retail sector was virtually absent. After the mid-1990s, there were several attempts to develop a strategy for the domestic trade development, but the leading policy makers ignored these efforts during the first 15 years of post-communist transformation.

Of course, this did not mean that trading companies escaped administrative control. At the shop-floor level, local trade inspectors, fire and sanitary surveillance bodies, tax authorities and security agencies made numerous planned and spontaneous visits to trading outlets to enforce multiple and detailed regulations that no one was able to fully satisfy. Thus, the liberal model of governance was combined with some elements of a “grabbing hand” model. Local inspectors collected formal fines and, even more successfully, extorted informal bribes from the trading firms.¹ However, the Russian state was more incapable than “grabbing” because it largely failed to enforce laws and extract tax revenues (Brown et al., 2009). In addition, business practices gradually moved away from the disorganised predatory state that characterised the beginning of the 1990s (Shleifer and Vishny, 1998: 239). On the one side, market actors successfully adapted to extortion and used small bribes to pay off the public inspectors. On the other side, the number of spontaneous inspections decreased over time (Bessonova et al., 2010).

At the end of 2006, domestic trade suddenly attracted serious attention from the higher political layers. First, the new federal law “On Retail Markets and Changes to the Russian Federation Labour Code” passed with striking speed because of a direct order from Russian President Vladimir Putin. The law prescribed reducing the share of foreign citizens in the open-air markets to 40% of sellers and aimed to reach the zero level in one year. The retail trade of alcohol and medicine was prohibited for immigrants. The law was passed using populist slogans to defend the interests of small domestic producers amid a dominance of migrant traders in the open-air markets. However, the major focus of these legislative undertakings was a restrictive migration policy rather than the regulation of trade per se.

Second, and much more importantly, a need for a general federal law on the state regulation of trade was claimed at the end of 2006. Chain store companies were criticised for discriminatory practices and particularly for additional payments required from their suppliers. These payments included marketing fees paid by the suppliers *ex ante* to see their goods on the store shelves and to change the assortment of goods, volume fees (retro-bonuses) paid by the suppliers *ex post* for the increase in sales of their goods above an expected level, and payments covering the retailers' losses from product damage and shoplifting (Radaev, 2013).

¹ Frye and Shleifer (1997) provided a useful comparison of Polish and Russian relevant business experiences.

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