CONTROL AND ACCESS:

INTRA-ELITE CONFLICT AND FINANCIAL INTEGRATION IN RUSSIA

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ABSTRACT:

This article explores the implications of financial integration for the relationship between economic and political elites in countries with weak property rights institutions, using evidence from Russia. Weak institutions can be both detrimental and beneficial to the interests of economic elites. We argue that a model of financial integration that combines majority control with otherwise unrestricted access for foreign investors allows the economic elites to continue benefiting from weak property rights institutions while obtaining liquidity, investment capital, and increasing the cost of expropriation for the current or future political elites. The article documents how this "control and access" approach was first implemented by the Russian oligarchs during the first decade of transition, and later embraced by the new economic elite that arose around Vladimir Putin. We rely on evidence from three major episodes of property ownership reconfiguration in Russia since 1991. All three displayed the same pattern. In the absence of functioning domestic property rights institutions, short-term political considerations dictated the distribution of control over property to the new owners, who resisted greater financial openness before gaining full control. In each episode, once they obtained majority control, the owners welcomed foreign minority ownership. This account of Russia's history of financial integration favors the "contractarian" approach to the study of non-democratic regimes, which suggests that increased capital mobility associated with financial globalization can reinforce kleptocratic authoritarianism.

KEY WORDS: Property Rights, Financial Openness, Authoritarianism, Russia, Foreign

Investment.

1. Introduction

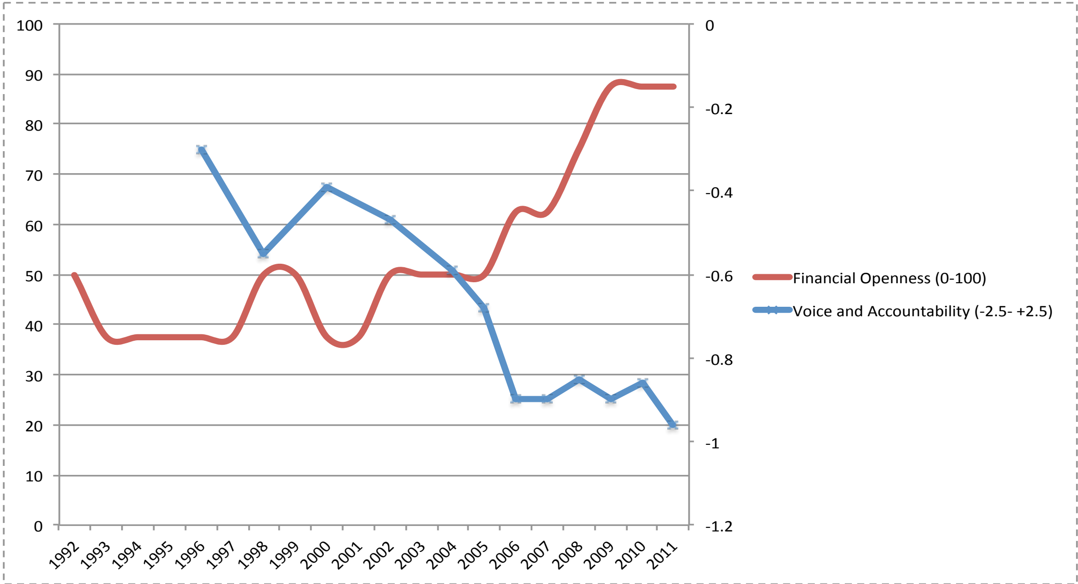
Financial globalization has forcefully spread outside of the rich world over the past three decades. On the eve of the Global Financial Crisis of 2008-09, net private flows to developing countries surpassed $1 trillion, quintupling since 1999. International capital flows slowed down somewhat after 2010, but almost all emerging economies remain significantly more integrated into the global capital markets than ever in the past. Even as the importance of debt declined since the middle of the 2000s, investment flows continue to account for large portions of the international financial positions of emerging market and developing economies.[1] The successful march of financial globalization stands in marked contrast with the record of democratization in recent years. Authoritarian leaders have strengthened their hold on governments in most of post-Soviet Eurasia, in the Middle East and North Africa, part of Asia, and sub-Sharan Africa. In some parts of the world like the Middle East or East Asia, autocrats never loosened their grip on power in any significant way. Longtime observers of democratic politics recently raised concerns that "authoritarianism… has the wind at its back."[2] Even where political repression is less severe than in the past, low-quality governance and weak property rights protections are everyday realities for most people outside of the industrialized democracies. As Francis Fukuyama noted in 2015, most of the world's population still lives in "rent-sharing kleptocracies run for the private benefit of the insiders."[3]

The connection between autocracy, kleptocracy, and financial integration is particularly stark in the case of Russia under Vladimir Putin. Shortly after introducing limits on political competition, exiling or imprisoning several Yeltsin-era oligarchs, and significantly expanding the

[1] IMF 2016; World Bank 2008; Donnan 2017; Lund et al. 2017
[2] Plattner 2015, 9
[3] Fukuyama 2015, 13

state's footprint in the economy in 2003-05, the Russian government removed most restrictions on cross-border capital movements, making it far easier for foreigners to own minority shares in state-owned companies, including the largest state-controlled enterprises. Since these policies were first enacted in 2006, the Kremlin has remained steadfast in its commitment to open financial borders, despite the downturn during the Global Financial Crisis and the increasingly hostile relationship with the West after the annexation of Crimea.[4] What explains the introduction of financial openness policies in Russia in 2006, and not before? What explained the unwavering commitment to financial integration? What can the Russian case show us about the broader relationship between financial globalization and politics of authoritarian kleptocracies?

Figure 1: Democracy and Financial Openness in Russia (1992-2011)



- Financial Openness (left scale) is measured using Quinn, D. et al; and Democracy (right scale) using "Voice and Accountability" metric by Kaufmann et al.

We argue that the internal struggle for control over major assets under the condition of weak property rights institutions fundamentally shaped Russia's pattern of integration into the

[4] Aris 2018; Reuters 2017

global financial system, and, by extension, the relationship between its political and economic elites. The widespread implementation of the "control and access" model, which combines domestic control over the assets with financial accessibility of the shares in the assets on global financial markets, has been a natural consequence of weak property rights institutions and deepening financial globalization during the past 30 years. In Russia the extent of access granted to foreign investors was determined by powerful domestic interests, who used financial openness policies as a mechanism to legitimize their ownership rights, increase the value of their assets, and raise the costs of expropriation for the political elites. Indeed, this model had been widely used by wealthy Russians for well over ten years before it was adopted as official government policy in 2006 to accommodate the new economic elite that rose around Vladimir Putin. The argument implies a disquieting possibility of a symbiotic co-existence between deep financial integration and kleptocratic authoritarianism in Russia and elsewhere.

Our argument supports the "elite-competition" account of authoritarian politics, which focuses on the lack of credible property rights protections as a key obstacle to good governance.[5] We show that financial integration has enormous consequences for internal regime dynamics because it resolves the key dilemma for wealthy asset owners: the need to defend their wealth both against the competitors and the state. We present a comprehensive argument that accounts for the choices regarding financial openness, demonstrating that financial openness policies put in place under Putin mirror the script that had been in place since the onset of the economic transition.[6] The article also builds on recent scholarship, which complicates the picture of financial integration in the developing world by making an important distinction between formal capital account openness policies and the actual practice of restricting foreign access by the politically connected

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[5] Ansell and Samuels 2014; D. C. North and Weingast 1989
[6] The article expands on the logics identified in Sharafutdinova and Dawisha 2017; Markus 2017

domestic economic agents, demonstrating some limitations of the use of standardized cross-national indices.[7] Finally, by investigating specific instances of struggle over property ownership we present evidence that somewhat contradicts the predictions of sectoral or ideational models of financial integration.[8]

After presenting the argument in the context of extant research on authoritarianism, property rights, and financial globalization, we demonstrate this logic using evidence from three key instances of property reconfiguration in Russia. We first explore the role of financial access in the conduct of the voucher privatization (1992-1994), which led to Russia's first stock market boom-bust cycle in 1994, driven almost entirely by the inflows of foreign portfolio investment. We then detail the second major battle for asset control in the infamous "loans for shares" scheme, which was followed by the second boom-bust cycle in Russian equities (1996-98). Finally, we use evidence from the third and most recent major episode, which took place in the course of Vladimir Putin's first two presidential terms. Through purchases and outright expropriation, Putin and a close-knit group of insiders were able to achieve state blockholding control over the largest Russian companies, most notably Gazprom and Rosneft. After this process concluded in 2005-06, the Russian government implemented a program of radical decontrol of cross-border capital. Greater access created the largest stock market rally in Russia's history, leading to skyrocketing valuations of the state's newly majority-owned companies and creating a new cadre of economic elites interested in safeguarding recently acquired wealth. All three cases followed the same pattern: a fight for control over the Russian assets took place among domestic elites, with winners determining the extent of foreign access. The article concludes with a brief discussion of the role

[7] Pepinsky 2013; For a review of indices in wide use today, see Quinn, Schindler, and Toyoda 2011; Pond 2018
[8] Pepinsky 2013; Frieden 1991; Chwieroth and Sinclair 2013

of Western financial and legal institutions, which continue to provide services and safe havens to economic elites from countries with weak property rights protections.

2. Analytical Framework

Why do political and economic elites welcome financial integration in some countries and not others, and in some time periods and not others? Political scientists have not yet developed a comprehensive framework for understanding the implications of a single global capital market on political development outside of the rich world.[9] However, increasingly sophisticated theoretical work on the political economy of non-democratic regimes has shed new light on the connection between financial openness and political dynamics in regimes characterized by inadequate democratic and property rights institutions. One avenue of scholarship on authoritarianism and democratization has focused on the conflict between the elites and the masses over taxation. This approach assumes that elites (political leaders and the wealthy asset-holders) share similar views vis-a-vis regime outcomes, which are in diametric opposition to the interests of the poor citizens. Choices of the elites with respect to political outcomes are driven by the anticipated "redistributive threat" associated with different regime types. According to this view, autocracies (conceptualized as regimes where a minority of wealthy elites are "in charge") tax the rich less than do democracies, where the median voter is "in charge." [10] Higher mobility of capital reduces the redistributive threat of democratic governments making the rich elites more open to democracy. This is in part why countries democratize as they get richer. Their economies transition from asset bases that are predominantly specific (agriculture, mining) to bases that are mostly mobile (finance, technology).[11]

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[9] Lane 2009; Milner and Mukherjee 2009b
[10] These works are based on the median voter theorem and the framework developed in Meltzer and Richard 1981 See, ; Boix 2003; Daron Acemoglu and Robinson 6; Bates and Lien 1985
[11] Boix 2003

This long-term process, however, is exogenous to government policy, hence it cannot be directed by the elites in the short term. Insofar as it lowers asset specificity, greater financial integration offers a quicker path to increasing the mobility of assets.[12] John Freeman and Dennis Quinn have argued that legal entry into global financial markets allows the wealthy elites to engage in the "exchange of assets with foreigners who also hold diversified international portfolios."[13] Liberalization of capital controls increases the mobility of otherwise "trapped" assets, and therefore the outcomes of political conflict within autocracies. This, in turn, changes their attitude towards potential democratic rule. In other words, this important innovation endogenizes policies of financial openness into the intra-regime dynamics. Newer work has shown that liberalization of financial markets allows economic elites to lessen the redistributive demands of future democratic governments.[14] According to this line of work the impetus for the capital owners to take their assets abroad stems specifically from their search for lower taxes and not the fear of expropriation by the state.[15] On balance, these studies show that increases in the mobility of assets through financial integration *makes democratization more likely*.

A second avenue of work on political regimes has concentrated on the intra-elite conflict, producing a different set of results about the impact of financial integration and regime outcomes. Instead of concentrating on how the numerical advantages of the poor can allow them to redistribute wealth, the "contractarian" or the "intra-elite conflict" approach focuses on the ability of the political elites to expropriate wealth from one group of wealthy actors to another.[16] In a line of inquiry that dates back to John Locke's *Second Treatise on Civil Government*, scholars have

[12] Freeman and Quinn 2012; Pond 2018; Daron Acemoglu and Robinson 6, 338–43
[13] 2012, 58–62
[14] Pond 2018
[15] D. Acemoglu and Robinson 2006, 341–43; Pond 2018
[16] See Ansell and Samuels 2010; Glaeser, Scheinkman, and Shleifer 2003

singled out institutions that impartially protect property rights as central deterrents against political tyranny.[17] Today, in most of the world, and certainly in almost all authoritarian regimes, corrupt states and weak rule of law are the defining background condition against which politics and policy are made.[18] In such settings, the state is the main threat to the interests of economic elites and rising middle class.[19] For the business tycoons, wealth defense is their main preoccupation, as "…the claim 'all of this is mine' will constantly be confronted with the response 'says who?'"[20] Hence, the economic elites fear expropriation (the imposition of a 100 percent wealth tax) far more than marginal increases on income tax imposed by the median voter in a democracy.

Politicians and wealthy asset-holders share some interests, but their relationship is also characterized by persistent distrust and even occasional enmity.[21] In kleptocratic authoritarian regimes, the economic elites have an easier time obtaining favors and undue influence among the political class.[22] At the same time, they are always focused on "the political challenges of defending concentrated wealth."[23] Under poorly functioning property rights institutions, the economic elites struggle to both protect their wealth against expropriation and maintain the channels of rent-seeking.[24] Financial integration, however, offers a potential solution to the problem of wealth defense. The idea that changes in the mobility of capital increase the bargaining power of economic elites vis-à-vis the politicians is perhaps as old as modern capitalism. Concerns about the threat of expropriation and violence by the government against asset holders prompted

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[17] C. D. North 1981; Levi 1981
[18] Fukuyama 2015, 13
[19] Ansell and Samuels 2014, 2
[20] Winters 2011, 20
[21] Albertus and Gay 2017; Ansell and Samuels 2010; S. Guriev and Sonin 2009
[22] I use the term "kleptocratic" to underline the lack of property rights protections. Most authoritarian regimes are kleptocratic to some extent, although there are a few exceptions of rules-based, or "constitutional" authoritarianism. See, Popova 2017
[23] Winters 2011, 39
[24] S. Guriev and Sonin 2009; Sonin 2003; Daron Acemoglu 2003

Charles Montesquieu's famous observation about the impact of the invention of the bill of exchange for the ability of commercial traders to escape violence by having "invisible wealth that can be sent anywhere, and leave no trace anywhere."[25] Similarly, the modern technological innovations like the globally integrated stock markets allow the wealthy to address the problem of "asset specificity," which otherwise make them vulnerable to state predation.

Contractarian analyses of financial integration in non-democracies have emphasized the dual nature of financial globalization for autocrats. More capital mobility leads to the expansion of the total amount of wealth that can be expropriated, while also strengthening potential regime opponents, specifically the rising economic classes, who tend to hold predominantly non-specific assets.[26] For example, although Ansell and Samuels derive ambiguous results concerning capital mobility, they do suggest that insofar as it makes expropriation more costly for the elites, "intra-elite conflict may actually be minimized."[27] Imperfect local property rights protections combined with access to safe foreign assets can benefit the elites in equilibrium and lower the impetus for political reform.[28] Recent accounts focusing on Russia and China have conjectured that greater financial integration has made it easier for the regime to count on the loyalty of the wealthy economic agents, who have become adept at using foreign courts and financial infrastructure, thus dampening their interest in challenging the political status quo.[29] In other words, according to this perspective, greater financial openness can moderate the intra-elite conflict in non-democracies, thus *lowering the chances of institutional reform and strengthening authoritarianism*.

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[25] Quoted in Bibby 2016, 85
[26] Dadasov, Harms, and Lorz 2013, 19
[27] Ansell and Samuels 2014, 94, 136–39 One of the reasons for their relatively uncertain conclusions is their claims that good measures of capital mobility are elusive.
[28] Braguinsky and Myerson 2007
[29] Sharafutdinova and Dawisha 2017; Markus 2017; Hess 2016

Our analysis of the relationship between financial integration and the intra-elite conflict in Russia since 1991 lends support for this hypothesis. We show that a model of financial integration which combines majority control with otherwise unrestricted access for foreign investors allows the economic elites to continue benefiting from weak property rights while obtaining liquidity, investment capital, and a measure of protection against expropriation by the current or future political elites. The evidence from Russia shows that greater financial integration actually makes kleptocratic authoritarianism more durable by making the position of the economic elites more secure without forcing them to give up domestic rent-seeking opportunities. Indeed, the irony of the modern Russia is that its system of authoritarian kleptocracy requires deep financial integration.

3. Conceptual and Methodological Preliminaries

We emphasize an aspect of financial openness we call "financial access," which aims to capture the extent to which ownership rights in domestic assets are *accessible* for purchase by foreign investors. Financial access determines "the ability to sell any asset for other assets or cash at will."[30] Specifically, our focus is on both legal-formal and informal elements of access that determine the "availability of the country's equities to foreigners."[31] While the quantitative studies of financial openness must amalgamate uniform indicators from various political environments, our approach goes beyond a sole focus on fiat government policy.[32] Informal political practices often drive the choices of formal institutional solutions, which allows us to understand the granular micro-politics behind these choices. A strict focus on formal rules and legal practices overlooks important aspects of the way business is actually conducted in countries like Russia where

[30] Pistor 2013, 316
[31] Edison and Warnock 2003, 82
[32] See for example: Freeman and Quinn 2012

informality is prevalent. Contextual and informal factors play a central role in shaping choices of actors, leading them to prefer some strategies, institutions and governance solutions over others.[33]

This is not to understate the importance of official rules and formal institutions, which play an equally significant role, especially in the arena of finance. Indeed, all financial systems at their core are constituted by legal rules.[34] Foreign investors have a fundamental interest in the establishment of formal regulations that can safeguard their ownership rights as much as possible. Weakness of property rights protections that drives the domestic economic elites towards financial integration also frightens foreign investors. In order to engage in commercial exchange, they demand capital account regulations and legal arrangements that allow on-demand cross-border asset exchange with relatively low transaction costs.[35]

This is why in this paper we focus on the stock market transactions and channels of portfolio investment (PI). PI is different from foreign direct investment (FDI), precisely because it is not "associated with ownership and control."[36] Foreign portfolio investors are able to acquire speculative short-term positions, which nevertheless constitute exchange of assets between politically connected local agents with undiversified portfolios and globally diversified investors without local political influence. Stock markets lower the costs of exchange so long as they operate under legal frameworks that govern mutually acceptable understandings among the trading

[33] McCarthy and Puffer 2013; Gourevitch and Shinn 2005, xiv Another important concern in the Russian case is that some of the quantitative data for the early years of transition is absent or is of questionable quality.
[34] Pistor 2013, 321. Notably, the informality of property rights governance in Russia is mirrored in the use of strict formal legal rules and institutions outside of Russia.
[35] Peter Henry defines capital account liberalization as a "decision by a country's government to move from a closed capital account regime, where capital may not move freely in and out of the country, to an open capital account system in which capital can enter and leave at will." Henry 2007, 887; It is usually measured based on restrictions collected in the International Monetary Fund's Annual Reports on Exchange Arrangements and Exchange Restrictions and other sources. For an overview, see Quinn, Schindler, and Toyoda 2011; Similar argument concerning a more "comprehensive" account of financial openness can be found in Pond 2018, 109
[36] Aizenman, Jinjarak, and Park 2013, 373

parties.[37] Transnational financial intermediaries like global investment banks, clearing houses, and custodial firms make it possible for asset holders to trade shares across borders. Thus, the establishment of close ties to the global equity markets serves as a partial but effective solution the rule of law problem. This explains why over the years, removal of restrictions on capital movements, listings on foreign exchanges, and the institutional maturation of the Russian stock market resulted in much higher accessibility of Russian assets, without commensurate improvements in the domestic rule of law.

The article is based on in-depth qualitative analysis of the formal and informal practices that have shaped the patters of Russian financial integration. Although we report only some of the data, our work has been informed by insights from over 50 interviews with policymakers, representatives of the banking sector, and academics conducted between 2011 and 2017, along with thousands of press accounts published in Russian and English spanning three decades. The focus on multiple cases within a larger single case allows us to produce "covariational" analysis and to "control" for several confounding socioeconomic variables (e.g., weak economic institutions, industry type, structure of the economy).[38] The focus on Russia is justified by the fact that is has been at the vanguard of globalized kleptocracies, countries that are deeply integrated into the global financial system, yet where state power is not constrained, politics and business are intimately linked, and the quality of economic institutions is poor. Although the Russian case certainly has some idiosyncratic peculiarities, it is "typical" of the broader population of globalized kleptocracies allowing us to explore the causal mechanisms that represent a broader population.[39] It is our hope that the logic outlined here will be tested in a broader set of cases in the future.

[37] Alchian and Demsetz 1973, 26
[38] Gerring 2004, 342–43, 352
[39] Gerring 2004, 342–43, 352

4. "Control and Access" as a Solution to the Oligarchs' Dilemma

Our evaluation of the relationship between financial integration and the internal struggle for property control concentrates on the calculus and actions of the Russian economic elites vis-à-vis other oligarchs and the political leadership.[40] The "oligarchs" are the wealthy economic agents who rely on political influence to both acquire and defend their wealth.[41] In transition economies like Russia, most of oligarchic wealth traces its origins to state property, so the relationship with the political elites has been at the center of the oligarchs' strategies of wealth accumulation and defense for the last quarter-century.

Their continued association with the state poses a dilemma for the oligarchs. On the one hand, they benefit from the informal nature of their political connections. The ability to resolve conflict through informal means creates rent-seeking opportunities that would otherwise be unavailable under a working rule of law system. This, in part, is why economic transitions can result in a "partial-equilibria" outcomes whereby the oligarchs, having enriched themselves though initial reforms preserve their rent-seeking opportunities by lobbying against the introduction of new reforms. Meanwhile, the oligarchs are able to deter new market entrants in part by constructing large-scale private solutions to defend their property rights, making them even less interested in supporting public property rights institutions.[42]

On the other hand, because relationships with politicians are always informal and contingent, defending the wealth acquired through rent-seeking becomes a continuous, costly preoccupation. In the early days of transition when the state was extremely weak, the Russian oligarchs relied on various private means of wealth defense against other oligarchs, up to and including funding

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[40] Similar to other writings on the Russian economy, I use the term "oligarch" or "tycoon" as a value-neutral term, see S. Guriev and Sonin 2009; Sergei Guriev and Rachinsky 2005

[41] See, Winters 2011, 9

[42] Sonin 2003; Glaeser, Scheinkman, and Shleifer 2003; Braguinsky and Myerson 2007; Hellman 1998

private security armies.[43] Ultimately, the distribution of control over the assets was determined by political considerations outside of the formal political process, reducing the legitimacy of the privatization process among the broader public.[44] Absence of minority shareholder protections led to the widespread adoption of the majority-blockholding model of corporate ownership, with most major enterprises controlled by a single individual or family. Majority blockholding (ownership of at least 50 percent plus one share of the asset) allowed the owners to both exercise better control over management and preclude all combinations of minority shareholders from taking away control.[45]

Blockholding control serves as an effective tool of wealth defense against other oligarchs, but it offers few protections against state expropriation. It does not resolve the main problem with owning Russian assets: the fact that they are physically located in Russia. Even an oligarch with significant "relational capital" vis-à-vis the current political elites, cannot be sure he can retain the same level of influence in the future.[46] Although most of them acquired their wealth by thriving in the chaos of the transition, the continued absence of property rights protections has been a major problem for the oligarchs. Yet, most of them were able to hold on to their wealth and rent-seeking opportunities, despite the fact that almost all oligarchic wealth remained country-specific and "visible" to an unconstrained state.

As we demonstrate, they succeeded despite these obstacles by deftly manipulating the rules of financial access. Once the economic elites controlled the assets outright, they welcomed policy changes that enabled greater access, which allowed them to acquire safe and liquid foreign assets in jurisdictions with credible property rights protections in exchange for granting access to small

[43] Volkov 2002
[44] Denisova et al. 2009
[45] Gourevitch and Shinn 2005, 16–18, 59–60; Gugler, Ivanova, and Zechner 2014
[46] Sonin 2003, 716

ownership stakes in their local holdings. Granting access to the holders of tradable assets located outside the juridical control of the Russian state, rather than to the domestic competitors not only maintains an oligarch's position in the intra-elite struggle, but it also constrains the government. Financial integration has not been an iron-clad protection, but the presence of foreign minority shareholders imposes an additional cost on state expropriation. Thus, control and access script offered a way for the Russian economic elites to successfully walk a tightrope: obtaining a measure of property rights protections outside the country, while maintaining rent-seeking opportunities inside of it.

5. Evidence from Russia

5.1 Episode 1: Insider Privatization (1992-1994)

From the start of the economic transition, Boris Yeltsin and a cadre of liberal reformers saw privatization of state-owned assets as the crucial step in the process of transition from communism. Their main political opponents were the managers of the enterprises, who made up the most influential political constituency in the country. Although the reformers preferred to sell state property to outsiders (both foreign and domestic), just a few months after the start of the reforms, Yeltsin was forced to amend the details of the program, bowing to the pressure from the Soviet-era managers of enterprises who demanded an option for the insiders (managers and workers) to acquire the majority of the shares in the enterprises.[47] The decision to privilege these actors ushered in an era of "kleptocratic managerism," during which industry insiders were able to translate their *de facto* control over the enterprises and the workers into real shares in those firms.[48] Politics and property control became intertwined right at the onset of the transition with the most

[47] Blasi, Kroumova, and Kruse 1997; Cook and Gimpelson 1995
[48] Shogren 2017; "If the Communist Party Was the backbone of the system, the enterprise-centered social and economic life was its essence." Cook and Gimpelson 1995, 466; Gourevitch and Shinn 2005, 58–62; 192

politically powerful acquiring most property. By the end of this first phase of privatization, managers and workers together controlled majority stakes in 65 percent of all Russian firms, while outsiders had majority control in only 8 percent of companies.[49]

Yeltsin agreed to the privatization by insiders because it fit their political goals of speeding up market transition. This is one of the reasons why privatization initially went faster in Russia than in Central and Eastern Europe with two-thirds of state enterprises being privatized between 1992 and 1995.[50] But this large-scale transfer of state property into private hands occurred in the absence of a firmly established legal framework for corporate governance, disclosure requirements, minority shareholder protections, and even basic rules of custodianship. As a result, the workers, technically the principal beneficiaries of privatization, could not fully exercise their ownership rights.[51] Given the rapidly declining standards of living and broader political uncertainty, many workers sold their stakes at meager prices to outsiders or managers. Meanwhile, in the absence of a single majority owner, the managers often engaged in outright asset-stripping.[52]

Although the pro-market members of the government favored greater financial openness from the start, the cabinet delayed financial integration under pressure from insider-directors. [53] In the course of 1992-1994, the directors opposed all foreign participation, in large part because they did not want additional competition for the workers' shares or foreign oversight over their activities.[54] Although some adventurous foreign investors bought shares on secondary markets, foreign entities were technically prohibited from participating directly in the voucher auctions.[55]

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[49] Blasi, Kroumova, and Kruse 1997, 58; Kokh 1998
[50] Passell 1993; Goldman 2003, 28
[51] Puffer and McCarthy 2011
[52] Blasi, Kroumova, and Kruse 1997, 152; Appel 1997, 1439
[53] Izvestiya 1993
[54] Cook and Gimpelson 1995, 469; Lewis 1994
[55] Kozitsyn et al. 2000 These legal prohibitions did not stop some companies from selling significant stakes to foreigners. For example, in 2000 it was revealed that 15 percent of the vouchers in the Russian Unified Power System Company were illegally sold to non-resident investors ; *Bloomberg.Com* 2001

Overstating the dangers of foreign ownership also helped the directors retain the loyalty of the workers, who were concerned about restructuring and layoffs. The amendments to the privatization program made in July 1992 not only gave the insiders the right to acquire majority stakes using enterprise funds, but also allowed them to review and disqualify outside investors.[56]

Upon the completion of the voucher phase of privatization in mid-1994, security of the property rights in the privatized assets became the new owners' chief source of concern. Up to this point, the insider-managers had thrived in the circumstances of uncertainty and regulatory chaos. After the voucher phase was completed, they began to share the views of the less influential market participants who had understood government actions as "state racketeering, plain and simple" for some time.[57] Between 1993 and 1994, the government finally introduced a basic legal framework for nonresident investors.[58] With the fight over initial privatization settled and the basic rules of foreign access established, Russia experienced its first stock market boom. Although estimates vary widely, between several hundred million and $2 billion in portfolio investment entered the country during the first nine months of 1994.[59] By the end of 1994, British trading houses began offering Russian mutual funds to investors who were interested in dipping their toes in the volatile but enticing Russian market.[60] It was at this time that foreign portfolio investment first emerged as a crucial tool by which Russian owners were able to access foreign currency and to create an additional barrier against theft by other economic agents. The portfolio channel made it possible for the domestic asset owners to exchanges ownership rights in immobile assets located in Russia for liquid capital that mostly settled in offshore jurisdictions.

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[56] While foreigners technically could not participate in the original auctions, they were allowed to purchase shares in the companies on the secondary markets. Most famous among them was Boris Jordan, who acquired millions of vouchers on semi-formal voucher exchanges. Cook and Gimpelson 1995, 468; Stevenson 1993; Gustafson 1999, 61
[57] Maksimov 1994; Borodulin 1995a
[58] Kahn and O'Brien 1998
[59] Savvateyeva 1994; Uchitelle 1994; Stevenson 1994; Gustafson 1999, 62
[60] Lewis 1994

Establishing a pattern that would repeat itself several times in the coming two decades, the first "bull market" ended in a spectacular bust. The ruble crisis and obtuse government regulations put the final nail in the coffin of the first equities market boom in late 1994.[61] By January 1995, foreign investment dwindled to a mere $20 million, and by some accounts the market "ceased to exist" by 1995.[62] At this time, all privatized assets were being valued at only $7 billion – the equivalent of the total market capitalization of the Kmart Corporation.[63] Yet this initial experiment with financial openness demonstrated the full power of granting foreign access to domestic securities. Foreign investors were the dominant buyers of Russian equities during the bull market, accounting for over 90 percent of transactions.[64] The insider managers, in particular, became quick converts to capitalism once they saw the benefits of open financial borders. A Western hedge fund manager diagnosed the situation precisely, when he told the *Wall Street Journal* that eventually "people will figure out that you can get much richer by selling stock than by stealing directly from the company."[65] Although tepidly at first, the emerging Russian business elites began to appreciate the benefits of selling stock to foreign investors.[66]

5.2 Episode 2: "Loans for Shares" (1995-1996)

As the presidential elections of 1996 approached, the macroeconomic conditions in Russia continued to worsen. With an approval rating of only 12 percent in mid-1995, Yeltsin's prospects for re-election looked less than promising.[67] Since the start of the reforms, economic output had declined by 40 percent.[68] In 1993 and 1994, only 40 percent of workers were paid on time.[69] Prices

[61] Borodulin 1995a
[62] Gustafson 1999, 61
[63] Stevenson 1994
[64] Savvateyeva 1994; McKay 1997b; Gustafson 1999, 64; Stevenson 1994
[65] quoted in Browning 1995
[66] For an illustration of this based on the fight over the Timan-Pechora oil field, see Narzikulov 1995
[67] FOM 1995
[68] World Bank 1995, 1
[69] VCIOM study cited in World Bank 1995

increased by a factor of ten in 1993, quadrupled in 1994 and doubled again in 1995.[70] Meanwhile, several key oligarchs, including both the Soviet-era managers and the new "upstarts" hailing from the burgeoning banking industry, amassed significant financial and media resources. Despite its deep fiscal problems, the government on its part had retained stakes of between 38 and 45 percent in many major extractive industries, especially in the oil sector.[71] The election became an opportunity for the oligarchs to acquire control of these enterprises in exchange for cash.[72] The infamous "loans-for-shares" scheme allowed the government to receive loans from individual investors, using stakes in key companies as collateral. By structuring the loans-for-shares auctions in a way that scheduled ownership transfers only took place after the election, Yeltsin's team assured political loyalty and support from the oligarchs.[73] Because many of them already held significant stakes in these enterprises, the auctions allowed the oligarchs to become majority blockholders, removing the possibility of having to contend with other shareholders, including the state. Auctioned shares were valued at about $1.5-1.9 billion, or 8-10 percent of the total market capitalization in late 1995 and early 1996.[74] After Yeltsin's miraculous re-election, he appointed several of the oligarchs as members of his government allowing them to personally supervise the completion of the scheme.[75]

Throughout this process, an agreement among the oligarchs explicitly barred foreign investors from competing for the shares.[76] One early summary of the loans-for-shares agreement called it a "strategic offensive by major Russian financial structures in their struggle with foreign

[70] Passell 1995
[71] Victor 2008, 47.
[72] Borodulin 1995b
[73] Appel 1997, 1443
[74] Treisman 2010, 209 Companies included were Lukoil, Surgutneftegaz, Yukos, Sidanko, Sibneft, Norilsk Nickel, Mechel, Novolipetsk Steel Works, and several other smaller entities.
[75] Paddock 1998
[76] Hoffman 2002, 313

investors for Russian property."[77] Along with promising to "operate openly," the oligarchs argued that the scheme would allow for a creation of "a civilized securities market" in Russia, a market which in their view was otherwise moving abroad through mechanisms, such as the American and Global Depositary receipts.[78] So vocal was the oligarchs' opposition to foreign participation that they even made unusual allies with conservatives in the Duma, for whom "the only thing worse than selling off strategic enterprises to the bankers would be selling them off to foreigners."[79] In the end, the oligarchs were even allowed to be both the auctioneers and bidders, assuring that they could gain exclusive control of the assets ahead of anyone else.[80]

Meanwhile, between 1995 and 1996, a team of government officials, key market players, and foreign advisors created a centralized, functioning stock market exchange, called the Russian Trading System (RTS).[81] Proper valuation and sale of the considerable state-owned assets was the key motivating factors behind this effort.[82] Given the poor state of fiscal health of the Russian state, the inability to attract investment from domestic sources, the lack of long-term foreign investment and the upcoming presidential election, the main argument in favor of the development of the stock market was that it would make it possible to attract foreign investment to the second "money-based" phase of privatization.[83] At one point, government officials announced in the press that 92 percent of all investment in industry and half of the funds to cover the budget deficit would "depend directly on the degree of liquidity of the securities market."[84]

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[77] *Kommersant-Daily* 1995
[78] *Kommersant-Daily* 1995
[79] Johnson 1997, 352–53
[80] Hoffman 2002, 314
[81] Lomskaya 2015; Frye 1997
[82] Lomskaya 2015
[83] Koltsov 1994; Andrews 1997
[84] Lantsman 1994

The state had a great deal at stake in the creation of the stock market, given that it would be the primary seller of securities.[85] The stock market was one of the very rare examples of institution-building by the Russian state that actually resulted in improvements in contract compliance.[86] At the same time, a few Russian enterprises were able to list American Depositary Receipts, while Western investment banks created mechanisms for foreign investors to acquire shares in Russia-listed companies.[87] The team in charge of the creation of the stock market was in open opposition to the "loans for shares" agreement, but there was little they could do to stop it.[88] The oligarchs directly argued that the "gold reserve" of assets should be sold to strategic investors, and "not portfolio-type investors."[89]

In addition to the informal rules that precluded foreign participation, some legal decisions that would have attracted foreign investors were delayed until after the completion of the loans-for-shares scheme. Russia signed on to Article 8 of the IMF's Articles of Agreement, which removed some currency restrictions and made the ruble partially convertible only in the spring of 1996, well after the scheme went to effect. Given the absence of reliable minority shareholder protections, this development gave nonresident investors an additional measure of confidence that they could repatriate their earnings, naturally making the bonds and equities markets more attractive.[90] The fact that the ADRs of six Russian companies became available for purchase in New York in early 1996 also made the Russian assets more accessible, contributing to the rise in valuations. Just in time for re-election, the oligarchs, having secured control over the assets in the loans-for-shares schemes, changed their stance concerning foreign investors and developed an

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[85] Bekker 1995a
[86] Frye 1997
[87] Blasi, Kroumova, and Kruse 1997, 163; Stevenson 1995
[88] Frye 1997, 380
[89] Bekker 1995b
[90] Kuznetsov

acute interest in this more mature stock market which allowed for easier contracting with foreigners.[91] The "first control, then access" sequence repeated itself for the second time.

Yeltsin's re-election and the news that the Russian economy began recovery in 1997, sent the stock market to all-time highs.[92] From only 13 traded stocks, the platform grew to include listings of hundreds of companies.[93] The market returned well over 100 percent in dollar terms in both 1996 and 1997, outperforming all other equity markets in the world.[94] Reports that the five-year long economic recession was finally over sent the market soaring 58 percent in a single week in July of 1997, when total market valuation of the 200 most traded stocks reached $100 billion.[95] Foreign investors were eager participants in this second bull market, at one point owning one-third of total market capitalization and accounting for the majority of transactions.[96] Nonresident investment firms and Western-Russian partnerships accounted for more than half of trading turnover, while foreign portfolio investment increased from $8.9 billion in 1996 to $45.6 billion in 1997.[97]

Once again, the boom market was short-lived, ending in a spectacular bust in August of 1998. The result wasn't a mere market sell-off, but a government default, and "a watershed in the new Russia's history of capitalism" that ultimately created the conditions for Vladimir Putin to take the reins of the Russian state.[98] More immeditaly, it led to the closing of the capital account, including restrictions on outflows, capital investments by foreigners and new requirements for

[91] Hoffman 2002, 308
[92] Blasi, Kroumova, and Kruse 1997, 161
[93] Lomskaya 2015
[94] Kiewiet and Myagkov 1998, 26
[95] McKay 1997b; Frye 1997, 373
[96] Even if foreign investors owned much of the traded stock, it is important to keep in mind that only a tiny portion of all outstanding stock was floated on the market.
[97] McKay 1997a; Gustafson 1999, 64
[98] Nesvetailova 2007, 105–6

foreign exchange repatriation.[99] After the crisis of 1998, liquidity on the Russian stock markets declined, with only 60 companies being traded regularly, as opposed to over 200 before the crisis. The oligarchs who argued so fervently against portfolio investment now fully embraced financial integration. Of those 60 stocks, 57 had American Depositary Receipts available in New York.[100] In fact, by this point most trading in Russian securities was done offshore. Between 1996 and 2005, 17 Russian companies went through initial public offerings, compared to only 9 IPOs on Russian markets. The total valuation of foreign IPOs ($5.7 billion) was nine times larger than the Russia-based offerings, which totaled only $650 million.[101] The lesson of the experimentation with financial globalization in the 1990s was undeniable: integration into the global financial system made it possible for the oligarchs to safeguard and legitimatize their wealth, without having to give up the benefits of ill-functioning property rights institutions in Russia.

5.3 Episode 3: The State is Back in Business (2000-2006)

After the crisis, Russian big business consolidated into even fewer hands. When the "dust" of buyouts, mergers and acquisitions settled, just a handful of oligarchs came to dominate the Russian economy, and in particular the energy sector. For example, by the end of the 1990s, the state's share in total oil production declined to around 10-15 percent.[102] Meanwhile, just four private companies were responsible for two-thirds of production and 57 percent of exports.[103] In 2002, just eight conglomerates owned 85 percent of the largest 64 privatized companies.[104] Financial heft translated into political influence. Only two oligarchs were included in the list of

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[99] Starobin 2001; Kiriyenko and Dubinin 1998
[100] Puffer and McCarthy 2003, 401-02
[101] Smyslov 2008, 20
[102] Hashim 2010, 266; Victor 2008, 48
[103] Locatelli 2006, 1077
[104] cited in McCarthy and Puffer 2003, 412

the 100 most influential Russians in 1996, but by 2000 ten of them were on the list with three in the top 10.[105]

With Vladimir Putin in power, the oligarchs discovered that informal political influence, even when significant, is fundamentally contingent. In contrast to the previous two episodes, when the state was in ill fiscal health, this time around with higher energy exports revenue and more competent leadership, the balance of power shifted drastically in the favor of the state. In the first five years in office, Putin was able to secure a pro-Kremlin parliamentary majority and complete authority over the appointment of regional governors, reducing the avenues for informal influence by the oligarchs.[106] Several prominent Yeltsin-era tycoons were exiled, and their media assets were acquired by the state. Putin was intent on fulfilling a promise he made early in his presidency: that the business elites who wished to influence politics would "cease to exist as a class."[107]

The signal from the state was clear, as deputy prosecutor-general Vladimir Kolesnikov indelicately put it: "Let those who are not yet in jail think hard about what they are doing."[108] The message had the intended effect, as the response of the oligarchs proved to be muted. Most among the tycoons understood that it is "impossible to fight the state."[109] Putin also stopped short of outright war on the business elites. With overwhelming majorities of Russians supporting full or partial revision of privatization, Putin could have turned to "pitchfork politics," but instead chose a more pragmatic route of accommodation.[110] He tried to re-assure big business that there would not be "a return to the past."[111] The government also introduced several business-friendly policies, like a flat 13 percent income tax and reduction in corporate, payroll, and value added taxes, in

[105] Quoted in Kryshtanovskaya and White 2005, 298
[106] Gaddy and Ickes 2005
[107] Quoted in Kryshtanovskaya and White 2005, 295
[108] Goldman 2004, 42
[109] This is a quote from Vladimir Yevtushenkov in 2000, see York and Freeland 2000
[110] Goldman 2004
[111] Arvedlund and Tavernise 2003

addition to liberal land reform, deregulation in electricity generation industry and measures for investor protection.[112] The oligarchs who stayed out of politics also did exceptionally well financially. In 2003 there were 17 billionaires in Russia, compared to zero in 2000.[113]

The tycoons did not take this peace for granted, taking additional steps to safeguard their skyrocketing wealth by doubling down on the "access" facet of the "control and access" model by expanding their activities to foreign markets.[114] By 2003 Russian business groups were almost universally registered as investment partnerships offshore.[115] However, the government refused to return to the pre-1998 levels of financial access that would entice foreign investors back to Russia-listed assets. The oligarchs began lobbying for deregulation of cross-border financial flows as early as 2002. The Russian Union of Industrialists and Entrepreneurs demanded that the government institute equal treatment of non-residents in Russia, and even suggested that it was willing to contest the cross-border capital flows restrictions in the Supreme Court.[116] By 2003, some pro-market government announced plans for future capital account deregulation, including letting nonresidents freely trade ruble-denominated securities within Russia.[117] But despite these early pronouncements, the Kremlin did not institute full financial openness until after the state acquired majority ownership of key domestic assets, in particular in the energy-exporting industry.

Between 2001 and 2005, Putin completely redrew the demarcations of control over the most valuable assets in the economy. When he moved into the Kremlin, the Russian economy was largely privatized. Privately held firms took up 8 of the 10 top spots on the list of the companies with the largest capitalization. By 2008, only five of the top 10 companies were privately owned,

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[112] Bekaert and Harvey 2002
[113] Arvedlund and Tavernise 2003
[114] Arvedlund and Tavernise 2003; Arvedlund 2004a; Financial Times 2006; Ignatova 2003
[115] Sergei Guriev and Rachinsky 2005, 134
[116] Netreba 2002
[117] Mytarev 2003

and the three largest by capitalization – that is, Gazprom, Rosneft, and Sberbank – were all majority-owned by the state. In 2004, SOEs accounted for 31.4 percent of the capitalization of the top-200 Russian companies. By 2008, the number increased to 47.5 percent.[118] In a 2006 survey, the OECD reported 29 major state takeovers in industries ranging from natural resource extraction to media.[119] Another study accounted for 107 acquisitions that resulted in the government acquiring at least a 25 percent stake, with 64 of these resulting in a complete takeover during this period.[120] While the renationalization campaign was initially advertised as a matter of national security and an effort to preserve "natural treasures" in the hand of the state, the nationalizations were not limited to extractive industries, extending also to manufacturing, shipping, banking and other industries.[121]

By this point, blockholding was a nearly universal form of corporate ownership in Russia. Data collected by the World Bank in the early 2000s, show that most of the oligarchs owned majority and supermajority stakes in their assets.[122] A later study identified a pattern whereby "large individual shareholders substitute for missing good country governance" to a far greater extent in Russia than anywhere else in Central and Eastern Europe.[123] In 2006, in Russia 32 percent of companies were controlled by families or individuals, industrial companies owned 8 percent,

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[118] Sprenger 2010
[119] cited in Chernykh 2011, 1238
[120] Sprenger 2012, 8
[121] As Vernikov notes, most of this control is not direct, but rather channeled through other state-owned corporations that owned public capital. Renationalization of the Russian banking system over the past decade, makes it more similar to China or Vietnam, than to other East European economies. "After 20 years of experimenting with private financial intermediation, Russia appears to be backtracking towards a state-run credit system" (p. 20). Vernikov 2009, 9
[122] Sergei Guriev and Rachinsky 2005, 134
[123] Gugler, Ivanova, and Zechner 2014

while 57 percent were controlled by the state. There were zero large firms with widely held ownership in Russia.[124]

The history of trading restrictions on Gazprom stock is illustrative of the importance that Putin's regime placed on "control" as a condition of greater "access." Yeltsin-era legislation created a "ring fence" separating trading in Gazprom shares on foreign and domestic markets. Foreigners could not own more than 20 percent of the stock, and only through American Depositary Receipts (ADRs), which traded at a premium relative to the domestically traded shares.[125] These restrictions created a "gray" market for Gazprom's shares, which its management "not only tolerated… but practically encouraged," as a way to illegally siphon revenues to offshore safe havens.[126] After Putin appointed his allies Dmitry Medvedev and Alexey Miller to head Gazprom, the most obvious solution to the problem was to remove the "ring fence," and to grant full access to foreign investors interested in owning shares in Gazprom. However, the government officials openly refused to consider this policy change until the state become the majority owner in the company, which it did by 2005.[127] As one newspaper columnist put it, the Russian government "…will be willing to consolidate the Russian and foreign markets in Gazprom stock only after it becomes Gazprom's majority shareholder...."[128] In other words, the "first control, then access" logic was at the center again. By denying access to other bidders, the government was making sure that the stock price was artificially deflated and that no other combination of minority shareholders could acquire control of the most valuable Russian company.

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[124] Gugler, Ivanova, and Zechner 2014; There are examples of minority blockholding, which continues to produce damaging conequences for these companies, see Foy 2018
[125] The 20 percent figure fluctuated, but never exceeded 25 percent. Victor 2008, 35–37
[126] Arvedlund 2004b
[127] Arvedlund 2004b
[128] Grivach 2002

On July 1, 2006, the evening news broadcast of the state-owned Channel One announced that "all restrictions on movement of capital are removed." [129] The Central Bank of Russia stopped requiring exporters to sell dollar-denominated proceeds of foreign sales. Residents and nonresidents were no longer required to reserve a portion of the cross-border capital transfers with the CBR. The authorities removed controls on the foreign borrowing activities of Russian companies. Residents were allowed purchase securities abroad and non-residents could invest in Russian domestic securities without restrictions. Foreign and offshore investors could begin opening ruble bank accounts. There were no more restrictions on investments in the Russian bond market.[130] Years after the policy went into effect, policymakers, representatives of the banking sector, and other experts interviewed for this project identified these reforms as a watershed moment in the modern economic history of Russia.[131] Foreign investors received an unprecedented level of access to many of the key Russian assets. After the state became the majority blockholder of Gazprom, the government did away with its long-standing "ring fence" policy that maintained separate markets for foreign-traded and domestic shares of its stock. In 2006, despite the protestations of some prominent Western financiers and politicians, Rosneft successfully launched an IPO on the London Stock Exchange in 2006, successfully raising over $10 billion.[132] As of 2006, for the first time in nearly a century, capital faced no restrictions as it moved freely across Russian borders.

Market players clearly understood that consolidation of assets under state ownership was a precursor to greater accessibility of its shares to foreign investors.[133] Foreign investors reacted

[129] Pervyj Kanal 2006
[130] Buckley 2006
[131] Several interviewees (Nos. 3, 4, 9 and 10) identified the reforms as a watershed moment.
[132] Misamore 2014; Misamore 2006; Kennedy 2006; Macalister and Treanor 2006
[133] Ostrovsky and Davies 2005

enthusiastically to the introduction of new access rules, investing especially heavily in the shares of the government-owned energy giants. There is little doubt that the stock market highs registered in late 2006 were reached because the non-resident investors drove up the prices. One analyst even lamented the lack of supply: "there isn't enough paper in the market for big international investors, like hedge funds and global investment banks."[134] Overall, between 2004 and 2007 the Russian stock market increased nearly 8-fold.[135] Between September 1, 2005 and September 1, 2006, capitalization of Gazprom increased by three-fold and that of Rosneft by 23-fold.[136] The pattern of investment flows remained consistent with the previous record: the portfolio channel continued to play an outsized role, compared to economies of similar profile. Even as late as 2004-05, portfolio inflows remained low (on the order of $1 billion), but following the policy chances of 2006, it shot up to $14.3 billion.[137]

During this third stock market boom, foreign investment accounted for 75 percent of equity and 44 percent of all financial capital in Russia.[138] Of course, what exactly constituted "foreign capital" in Russia remained a curious question, given the offshore registrations of most major investment groups. According to Global Financial Integrity at least half of incoming foreign capital in Russia was "round-tripped" through offshore jurisdictions.[139] Most of the increase in portfolio investment originated in Cyprus and Virgin Islands (accounting for almost half of the jump in portfolio investment), suggesting its likely Russian origins. In terms of total invested capital, Cyprus and Luxemburg accounted for almost 40 percent on incoming inflows. As one analyst put it, the goal of these activities was mostly about "restructuring of privatized properties" though

[134] Munter 2005
[135] Kim 2013
[136] Poussenkova 2007
[137] Navoy 2007, 40
[138] quoted in Sutela 2013, 583
[139] Kar and Freitas 2013

purchasing of newly emitted equity, conversion from one type of security into another, annulment of emissions, mergers and acquisitions.[140] Just as it happened in two previous episodes, the boom phase was invariably interrupted by a bust, only this time it had little to do with policy mistakes made inside Russia. Furthermore, unlike previous episodes, the crisis did not lead to a political crisis and another episode of fight over asset control. Despite the Global Financial Crisis (2008-09) and the imposition of Western sanctions in 2014 the Kremlin remained committed to financial openness, with the Moscow Exchange joining the two biggest international clearing houses and offering Sponsored Market Access between 2012 and 2017, making it even easier for foreigners to settle transactions without having to step foot on Russian soil. [141]

6. Conclusion

With Putin's allies and friends from the security services firmly at the helm of the majority-state controlled enterprises, Kremlin adopted the "control and access" model as official government policy. The "private" oligarchs, who preferred that the policy be introduced earlier, welcomed its adoption nevertheless. It helped that the number of Russian billionaires increased from 17 to 95 between 2003 and 2011.[142] Foreign investors mostly shrugged off Kremlin's expropriations and the protestations of several prominent Russian and Western voices who pleaded with them to "not sell out Russian liberties."[143] Western business leaders appreciated more stability in the Kremlin.[144] In fact, foreign investment into Russia's gas and oil industry accelerated. Describing this perspective, Rawi Abdelal wrote in the *Harvard Business Review*: "[t]here's no longer any doubt about who is in charge or what the state wants. There is money to be made in

[140] Smyslov 2008, 22
[141] Aris 2018
[142] "The World's Billionaires" 2017
[143] Kasparov 2006; Macalister and Treanor 2006
[144] Kalashnikov 2003

Russia, as long as companies play by [Putin's] rules…"[145] In other words, foreigners were granted access, just so long as Putin remained in control.

Writing in 2009 Helen Milner and Bumba Mukherjee lamented the lack theoretical work on the connection between democratization and economic globalization (specifically, capital account liberalization), calling for further research on this subject. In particular, they pointed out the paucity of explanations for the connection between regime outcomes and economic liberalization.[146] In the intervening decade, scholars have made significant advances in the study of political economy of democratization and its connection with economic globalization. Yet, the core of Milner's and Mukherjee's complaint rings true today, especially given the emergence of a new trend in regime politics: the slowing down of the democratization progress combined with continued embrace of globalization by autocratic regimes.

In this article, we have showed that a focus on intra-elite dynamics in countries with weak institutions offers a revealing window into the consequences of financial globalization. The Russian case clearly demonstrates that "the tension between autocracy and property… is far greater than any threat to property under democracy."[147] Financial integration helps alleviate some of this tension. In fact, Russia's entire post-Soviet history of contestation over property rights is inseparable from the process of financial integration. Greater connectivity between the Russian economy and global financial markets has been central in enabling and strengthening the kleptocratic system and limiting the possibility for the emergence of functioning property rights institutions. Russian economic elites instead of challenging the state chose to rely on greater

[145] Abdelal 2010, 128
[146] Milner and Mukherjee 2009a
[147] Ansell and Samuels 2014, 2

financial integration as a safeguard against expropriation while preserving rent-seeking opportunities in the domestic economy.

Finally, the entrenchment of kleptocratic authoritarianism in combination with increased financial integration in Russia offers a disquieting possibility that financial integration can make the current regime more durable. Furthermore, given the evidence that property rights institutions become more corrupted as societies become more unequal, it is reasonable to question whether the benefits of globalization outweigh the costs of outsourcing of growth-promoting institutions.[148] For now, financial openness allows the Russian oligarchs to prefer kleptocracy to democracy even in the face of new Western sanctions.[149] If economic elites elsewhere continue to make similar choices, the globalization project may become increasingly unpalatable the billions of people living in kleptocratic regimes. The system that combines globalization for the rich with authoritarianism for the poor cannot be sustained indefinitely.

[148] Glaeser, Scheinkman, and Shleifer 2003
[149] Aris 2018

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