Legitimacy and Trust in the Forest Policies of Russian Regions

Project Summary

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1. **Summary of the purpose of the project**

This project has the following purpose:

1. To critically assess the claim that the central problem with the transformation of the Russian forest sector to make it more efficient lies in the institutional set-up guiding (or restraining) actors’ behavior.

2. To identify and explain which changes are most urgently needed in the institutional set-up governing the regional Russian forest sector in order to improve the sector’s performance, to make it economically more efficient while simultaneously ensuring sustainability.

3. To identify and discuss some critical institutional factors that are insufficiently explored in theories of transition purporting to explain the transformation of the Russian economy from a command economy to a market economy.

4. To study on-going processes of institutional change in the regional Russian forest sector with the purpose of identifying how efficient policies can be developed and how obstacles for efficient policy formulation processes can be eliminated. (By efficient policies is meant policies that have found a ranking of the most pertinent problems to be solved and that suggests efficient and implementable solutions to these problems.)

2. **Background**

With Perestroika and, especially, with the collapse of the Soviet Union in 1991, life in Russia – normal habits and ways of conducting business – suddenly and drastically changed. Market economic features (like market set prices) started to emerge. However, the change was not smooth and uniform. It proceeded unevenly in time as well as in space. Since what happened to price formation, even if it was not a simultaneous and uniform change all over Russia, affected the basic functioning of the economy – producers started to react on “real” income-cost relations – its impact was profound and immediately noticeable. The “driving force” in the economy was no longer the plan but rather the potential of making profits. The subsequent privatization only added further momentum to this fundamental transformation process.¹

However, it soon became evident that such a profound system change is no fast and easy process. A multitude of basic characteristics of the old system had to be radically changed or discarded altogether. In the decade following the disintegration of the Soviet Union quite a lot has indeed happened. Radical reform measures have been heavily subsidized by the western world, notably led by the United States. But it is equally clear that much of the highly raised expectations of those directly or indirectly promoting and supporting these changes have not yet been met. Still, a large number of the Russian business firms operate under rules that have little or nothing to do with conditions prevailing in a “normal” market environment.² The question is why.

¹ A huge literature has appeared, esp. during the last five years, dealing with the Russian privatization. There is no argument about the fact that the privatization has been comprehensive. Most companies have, in fact, been privatized. What is frequently questioned, however, is the “quality” of the privatization (many companies were only privatized “in name”) and the change in ownership did not always produce the effects intended by the political circles engineering the reforms. While the goal of the reform was to create an efficient corporate governance, there is little evidence indicating a success in this respect. Recently, an increasing critique has also focused on the frequent irregularities of the privatization process, resulting in transfers of property to “insiders” at very low prices thus drastically reducing the expected income from the sales for the previous owner (the State). (Cf. for instance, Cox, 1997; Boycko et al., 1995; Wedel, 1998; Kokh, 1998; Solnick, 1998; Ellman, 1999; Hedlund, 2001; Perevalov et al., 2000; Moers, 2000.)

² A convincing explanation of the way so many Russian firms, which would be bankrupt under normal market conditions, manage to stay alive and continue to operate is to be found in the theory of the Russian “virtual economy” advanced and elaborated by Clifford Gaddy and Barry Ickes based on the results of a Russian state committee (see e.g. Gaddy & Ickes, 1998a, 1998b, 1999a, 1999b, 2002; Gaddy et al., 2000). The whole western
If it is true that institutional development is “path dependent” it immediately begs the question of the relation between institutional development and social development in general. Are institutional changes determined (or influenced) by the social development or is it the other way around? Or is there an interdependence? What is the role of institutions in social change?3

The Russian society of today offers an interesting “laboratory” for this kind of study. Here, social changes are currently more dramatic and they happen at a much faster pace than in most other parts of the industrialized world (and especially compared to Europe). Whatever the causes of this social change may be, it is evident that institutions play a role, either in the sense that they are affected by the changes or in the sense that they influence them.

3. Results of the previous IIASA study of Russian forest sector institutions

Since the late 1980s, a large study of the sustainable future of the forest resources of Russia has been conducted by a group of researchers at the International Institute for Applied Systems Analysis (IIASA) under the leadership of Prof. Sten Nilsson.4 Between April 1997 and the end of 2001, the study “Institutions and the Emergence of Markets – Transition in the Russian Forest Sector” was part of IIASA’s Forestry Project. The “institutional framework study” looked at the institutional embedding of the forest sector in eight Russian regions (Murmansk, Arkhangelsk, Karelia, Moscow, Tomsk, Krasnoyarsk, Irkutsk, and Khabarovsk). Apart from the case studies a number of features of the institutional changes in the Russian forest sector were also discussed in the study.

The study was conducted by Prof. Lars Carlsson, Prof. Nils-Gustav Lundgren (Luleå University of Technology), Mr. Mats-Olov Olsson (Umeå University) and Dr. Soili Nysten-Haarala (Lapland University, Rovaniem)5 with the support of a number of collaborators in the respective Russian regions that were part of the study. Several Ph.D. students were also engaged in the study while participating in the IIASA Young Scientists Summer Program.

The results of the institutional framework study was continuously published in the institute’s interim report series and in international scientific journals (cf. attached complete List of Publications from the project). A summary of the main findings of the study was published in an article called “The Russian Detour – Real Transition in a Virtual Economy?” in the September 2001 issue of the British journal Europe-Asia Studies.

The study of the institutional embedding of the Russian forest sector was based on the so-called Institutional Analysis and Development (IAD) framework developed by Prof. Elinor Ostrom and her collaborators at Bloomington University, Indiana, USA, during many years of institutional studies of the management of common pool resources, incl. water and forests.6 As illustrated in Figure 1 the IAD framework tells you to focus on an “action arena” (in our case the forest sector, the chain of wood reform support effort (mainly the “shock therapy” approach sometimes labeled the “Washington Consensus”) has been severely criticized, notably by the former head of the World Bank economics division and Nobel Laureate Joseph Stieglitz (1999). Recent articles also discuss the obstacles in the way of a successful restructuring of the Russian economy (see e.g. Dyker, 2000; Polonsky & Aivazian, 2000; Hedlund, 2001.)

3 There is rapidly growing literature on institutions and path dependence. For a recent discussion of the consequences of path dependence and institutional change in Putin’s Russia, see Hedlund, 2000.

4 More about the IIASA Forestry Project can be found on the project’s web pages at URL: http://www.iiasa.ac.at/Research/FOR/

5 Lars Carlsson worked full time in the project between Sept. 1997 and June 1998. After that he continued working at IIASA on a part time basis (50%) until the end of 2000. Nils-Gustav Lundgren spent a total of about three months working for the project during various visits to IIASA in 1997–2000. Mats-Olov Olsson worked full time for the project at IIASA between April 1997 and June 2000. From July 2000 and until the end of 2001 he continued his work at IIASA on a part-time (50%) basis. Dr. Soili Nysten-Haarla worked full time at IIASA between Jan. and Aug. 2000 focusing on legal aspects on the transition in the Russian forest sector. Between Sept. and Dec. 2000 she was affiliated with the project on a part time basis.

6 The results of this research has been published in a large number of books and articles, see for instance Ostrom et al., 1994, Ostrom, 1996.
deliveries from the forest to the final user), but also to look at the “environment” of this action arena, such as “attributes of the physical world” (primarily characteristics of the resource, in our case the forests and what determines the growth of forests), the “attributes of community”, and the “rules-in-use” (institutions) governing the behavior of the actors in the action arena. The interaction that takes place between actors in the action arena is conditioned by the quality of the environment (the “boxes” to the left in the figure) and it emerges to the analyst as “patterns of interaction”. This interaction pattern produces certain “outcomes” in the system (in the case of the Russian forest sector such outcomes may be various wood products and the benefits users have of these products). An “evaluation” of these outcomes will tell you whether or not the actions that led to a certain pattern of interaction are adequate or not, depending on to what extent the outcome is considered satisfactory.

Figure 1. The Institutional Analysis and Development (IAD) framework for institutional analysis (Source: Ostrom et al., 1994:37).

In the IIASA study of institutions in the Russian regional forest sector data on the conditions restricting the behavior of the actors in the system (the boxes to the left in Figure 1) were collected with the help of Russian local study coordinators. The data consisted of public statistical information, existing forest sector plans and reports, etc. Actors’ behavior on the action arena was captured through interviews with representatives of some 25–35 forest sector enterprises in each one of the eight regions in the study. (The same interview format was also used for a parallel survey study of 24 forest enterprises in northern Sweden.) The data obtained in this way was then analyzed. Observing the actual behavior of forest firms and noting the opinions of their managers allowed a comparison with a number of “base-line” criteria characterizing the “normal” situation in a market economy. This way it was possible to assess to what extent the firms in the eight regions that were studied behaved in a manner that is typical in a market economy environment. An overview of the evaluation criteria and the observed behavior of the Russian forest firms in our sample is shown in Table 1.

The analyses of the situation in the various regions were rounded off with a number of conclusions about the situation and recommendations on how to achieve changes that would make the forest sector function in a more market efficient way. Not unexpectedly, it was found that a large number of functional deficiencies among the forest enterprises were dependent on problems at various levels in society. Some problems typically belong to the constitutional level (e.g., ambiguities concerning property rights, contradictions between the constitution and the forest code, etc.), some problems must be handled on the collective choice level (e.g., taxation reforms, improved bankruptcy legislation,

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7 The case study reports (cf. IR-98-084, IR-99-010, IR-99-021, IR-99-068, IR-99-069, IR-99-070, IR-99-071, IR-00-017, IR-00-028 in the appended List of Publications) all contain chapters in which the results of this analysis are discussed.

8 These results are discussed in more detail in Carlsson, Lundgren and Olsson (2001, see appended reprint).
policy programs should be elaborated, entrepreneurship should be encouraged, education and training of personnel should be organized, etc.), while others could be attacked and solved by the actors in the forest sector themselves (these are problems at the operational choice level, such as improved product development, enterprise management should focus on economics rather than engineering, the education of the workforce should be improved, good market behavior rewarded, etc.).

<table>
<thead>
<tr>
<th>Evaluation criteria</th>
<th>Criteria vs. reality in the Russian forest sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constitutional rules are acknowledged and transparent.</td>
<td>Some examples to illustrate malfunctions:</td>
</tr>
<tr>
<td>The structure of property rights is settled and well defined (i.e., private actors can acquire property or get the right to utilize property for their own benefit).</td>
<td>- Many companies are only privatized in name and ownership has often remained unclear.</td>
</tr>
<tr>
<td>Rules and regulations from official authorities are regarded as legitimate and apply equally to similar actors.</td>
<td>- Effective bankruptcy and arbitrage procedures are lacking.</td>
</tr>
<tr>
<td>The market decides prices of property and goods, and costs should reflect the real costs.</td>
<td>- Worthless company shares are traded for tax deficits and other public dues.</td>
</tr>
<tr>
<td>Decision-making regarding collective choice and operational rules is decentralized.</td>
<td>- A significant increase of non-market transactions, such as bartering.</td>
</tr>
<tr>
<td>Private investors can realize the returns on their investments.</td>
<td>- Even though rules are enacted to prevent devastation of forest lands, authorities lack the means to monitor and implement them.</td>
</tr>
<tr>
<td>Rules are enacted to prevent the devastation of natural resources.</td>
<td>- Pricing of timber is a farce.</td>
</tr>
<tr>
<td>Legitimate authorities take measures against violation of rules.</td>
<td>- Property rights are ill-defined, rules collide.</td>
</tr>
<tr>
<td></td>
<td>- Investment is insignificant.</td>
</tr>
</tbody>
</table>

**Table 1: Evaluation criteria and actual behavior of Russian forest enterprises**

After the phase of investigation described above the IIASA research team conducted a series of “policy exercises” in four of the eight Russian case study regions. The purpose of these exercises was to bring back the results of the IIASA study and to initiate a discussion among the regional forest sector stakeholders on ways to improve regional forest policies.9

### 4. Notes on goals and methodology

Since we can identify the most important features that differ between the post-Soviet system and a “normal” market economy, what we, ideally, would like to construct here is a theory of the various stages that Russia has been going through in the chain of events leading from the old social system (the Soviet command economy) to the new one (a market oriented economy). The ambition is to understand the basic reasons for the actual transition development in the Russian forest sector.

A hypothesis coming out of the previous IIASA project is that the key to understanding the Russian transitional performance is to be found in the resource allocation and asset redistribution systems.10

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9 The policy exercises are currently being reported in the IIASA Interim Report series. To date one report (on the exercise in Tomsk Oblast’) has appeared (cf. Olsson, 2001). A second report (on the exercises in Murmansk, Arkhangelsk, and Karelia) is under preparation.

10 The importance of redistributinal issues in the Russian transition has recently been emphasized by several western analysts. See for instance Schröder, 1999; Ellman, 2000; Hedlund, 2001; Holmes, 2001.
Issues related to property rights

A central focus in this project will be on the distribution and redistribution of property rights in the forest sector. In our context, “property rights” do not primarily refer to ownership. It has rather to do with various types and degrees of access to the forest resources. Forests in Russia are state owned but the use of the forest resources is open to anyone, private citizens as well as (public and private) enterprises. The rights of forest use that actors can lawfully acquire may, however, vary. The variation takes the form of different “degrees” of access. The principal differences in access is illustrated in Table 1:

Table 1: The varying rights of different resource claimants

<table>
<thead>
<tr>
<th>Access</th>
<th>Owners</th>
<th>Proprietor</th>
<th>Claimant</th>
<th>Authorized user</th>
<th>Authorized entrant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Withdrawal</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Management</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exclusion</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Alienation</td>
<td></td>
<td></td>
<td>X</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Ostrom, 1996

An important issue in the project will be to trace the redistribution of property rights in the Russian forest sector. The development in the sector during the last 10–12 years has been intimately related to changes in property rights (changes in access to the forest resources). The impression from the previous IIASA study is that non-market behavior still to a large extent prevails in the sector. This might (at least partly) be explained by the character of the changes in property rights.

Property rights should be stable and transparent. The only stable property right in the Russian forest sector is the ownership right (and even here there is some uncertainty concerning the division of ownership between the federal level and the “subjects of the federation”). As for the other access rights listed in the above table claims are much more insecure and uncertain. It could be expected, then, that the redistribution of these rights of access to the forest resources causes much frustration among actors in the Russian forest sector. The basic issue is that of legitimacy, i.e., to ensure that the decisions or the control of that redistribution is accepted by all actors in the system.

The complex privatization process in the Russian forest sector and a large number of institutions (“rules-in-use”) constraining the behavior of the actors in the sector (like the rules governing sales, inheritance, taxation, price setting, transfers, education and training, business agreements, buying and selling practices, etc.) all exert an influence on the current property rights in the Russian forest sector. The empirical data compiled in the IIASA institutional framework study can be used to illustrate the changes that have taken place in these institutions. The data also allows some comparisons with the Swedish situation.

Issues related to institutional change

It is important to understand the structure and functioning of currently existing “rules-in-use”, but the most important issues concern the “mechanism” through which “rules-in-use” actually change.

One way of approaching the issue of institutional change would be to further explore the empirical implications of the hypotheses proposed by Paolo Ramazzotti (1998 and 1999) about the hierarchical arrangement of institutions and the importance of learning for explaining institutional change.

According to Ramazzotti (1998:7) there are certain institutions that dominate others:

A dominant institution (or a dominant institutional setup) may now be defined as one which is both persistent over time and extensive over economic space.11 It is the one most likely to affect a

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11 Here Ramazzotti adds in a footnote: “Dominance may be determined in absolute terms or relative to a specific subset of institutions or institutional setups.”
great deal of other institutions and related setups. This occurs in two ways. First, the order parameters generated subsume or exclude those of other institutions; thus, for any given field of action, the institution is highly ranked in terms of its order hierarchy. Second, the institution acts upon many fields of action, i.e. it is highly ranked in terms of a structural hierarchy.

Thus, it would be a task in the project to try to identify the dominant institutional setups governing actors’ behavior in the Russian forest sector. In a very general perspective the ideas outlined above would make us look for such institutional setups among the rules governing the distribution and redistribution of forest property rights.

Ramazzotti’s classification suggests that we should expect a certain type of institutions to be prevalent in Russia, viz., those that he labels “spontaneous voluntary institutions” (Ramazzotti, 1998:15):

Spontaneous voluntary institutions presumably prevail in economies where the division of labor is not highly developed. The other two kinds of institutions [Ramazzotti labels them constrained voluntary institutions and coercive institutions] appear to be more significant in modern economies. This suggests, however, that change does not have a subjective dimension only and that the nature of power must be assessed.

Ramazzotti’s rich theoretical framework will be of help in structuring our investigation of the factors determining institutional change in the Russian forest sector. With its focus on hierarchies of rules and knowledge-based power it should be well suited for a study of the specific social order that currently prevails in Russia.

We will also use Douglass C. North’s notion of the kind of institutions that play a decisive role for economic performance. North (1997) has indicated four “variables” that he sees as determining the “costliness of transacting in exchange.” It will be a task in the project to assess how these variables appear in the context of the Russian forest sector. According to North (1997:2–3) the variables that are decisive are:

1. the cost of measuring the valuable attributes of the goods and services or the performance of agents in exchange;
2. the size of the market;
3. rule enforcement; and
4. ideological attitudes and perceptions.

The situation in Sweden and Canada will be used to establish a frame of reference necessary to allow a comparative assessment of the evolving Russian situation.

To summarize, the attempted achievement in the project is (a) to understand the stages in the on-going transition in the Russian forest sector, and (b) to identify crucial steps that are necessary to change the institutions governing the Russian forest sector so that they become more conducive to an efficient and sustainable development.

The main outcome of the project will be a monograph to be published by an international publishing house. To bring the findings of the project to the attention of the stakeholders in the regional Russian forest sector seminars will be arranged in (some of) the regions where the previous case studies were conducted. The results of the project should also be valuable for actors in the forest sector of other countries, who want to develop commercial relations with Russian forest companies.

References


North, Douglass C. (1997). The Contribution of the New Institutional Economics to an Understanding of the Transition Problem. UNU/WIDER Annual Lectures 1, Friday 7 March 1997. (Downloaded from the UNU/WIDER web site at URL: http://www.wider.unu.edu/publications/.)


