
A Regional Analysis of Transactional Strategies of Russian Enterprises

Kathryn Hendley, Peter Murrell and Randi Ryterman*

This article inquires into the attitude of Russian enterprises toward law and legal institutions within the context of conflict resolution. The authors examine the regional variation in how Russian enterprises do business with one another, focusing on specific strategies used to resolve conflict. Contrary to popular belief, the Russian business world is not exactly a "Wild East" where the enforcement of commercial obligations must be done through dubious means. Litigation and the use of the law are seen as options, thus indicating a certain level of legitimacy conferred on the legal sphere. At the same time, however, enterprises seem to favour informal avenues of conflict resolution.

The present analysis is grounded in a survey of industrial enterprises in six Russian cities. The authors compare the use and the effectiveness of various strategies across regions, including relational contracting, self-enforcement, enterprise networks, private enforcers, administrative agencies, and courts. The differences are evaluated to determine whether regions emerge as a significant causal factor. While the data show variation, it is less than expected. With the exception of Moscow and to a certain extent Barnaul, few patterns emerge despite the variation among the regions in the use of strategies by the surveyed enterprises.

The authors' research shows little support for the use of private force in contractual relations. The authors call for a re-evaluation of the popular view that economic reform has been thwarted by the absence of viable mechanisms for enforcing contracts and other property rights.

Cet article s'intéresse à l'attitude des entreprises russes face au droit et aux institutions judiciaires dans le contexte de résolution de conflit. Les auteurs examinent la variation régionale dans la manière dont les entreprises russes font affaire entre elles, en se concentrant sur les stratégies particulières employées pour résoudre tout conflit. Contrairement à ce que l'on croit, le monde des affaires russe n'est pas un monde où l'exécution d'obligations commerciales doit être faite par des moyens douteux. Le litige et le recours au droit sont perçus comme étant des options, indiquant ainsi qu'un certain niveau de légitimité a été conféré à la sphère juridique. Cependant, en même temps, les entreprises semblent préférer des voies informelles de résolution de conflit.

L'analyse est fondée sur une étude d'entreprises industrielles dans six villes russes. Les auteurs comparent l'emploi et l'efficacité de diverses stratégies à travers les régions, incluant les relations contractuelles, l'auto-exécution, les réseaux d'entreprises, les agents privés d'exécution, les agences administratives et les tribunaux. Les différences furent évaluées pour déterminer si les régions constituent un facteur de causalité important. Les données montrent une variation, mais celle-ci est moins marquée que prévu. Avec l'exception de Moscou et jusqu'à un certain point Barnaul, peu de modèles émergent, malgré la variation régionale dans l'emploi de stratégies.

La recherche des auteurs démontre qu'il existe peu d'appui pour l'emploi d'une force privée dans les relations contractuelles et les auteurs prônent une réévaluation de la perception populaire dictant que l'absence de réforme économique est due à l'absence de mécanismes viables pour exécuter les contrats et autres droits de propriété.

* Kathryn Hendley is Associate Professor of Law and Political Science at the University of Wisconsin-Madison; Peter Murrell is Professor of Economics at the University of Maryland; and Randy Ryterman is an Economist at the World Bank. Thanks are due to Alla V. Mozgovaya of the Institute of Sociology of the Russian Academy of Sciences, who coordinated the survey throughout Russia, and to James H. Anderson, Liba Brent, and Berta Heybey for research assistance. We gratefully acknowledge the support of the National Science Foundation, the National Council for Eurasian and East European Research, the World Bank, and the United States Agency for International Development under Cooperative Agreement No. DHR-0015-A-00-0031-00 to the Center on Institutional Reform and the Informal Sector (IRIS). The findings, interpretations, and conclusions expressed in this article are entirely those of the authors. They do not necessarily represent the views of the World Bank, its Executive Directors, or the countries they represent.

© McGill Law Journal 1999

Revue de droit de McGill 1999

To be cited as: (1999) 44 McGill L.J. 433

Mode de référence : (1999) 44 R.D. McGill 433

Introduction**I. The Spectrum of Strategies****II. The Use of Strategies by Russian Enterprises: Regional Variations***A. Relational Contracting**B. Self-Enforcement**C. Third-Party Enforcement**D. Private Enforcement**E. Administrative Levers of the State**F. Shadow of the Law**G. Litigation***Conclusion****Questionnaire Boxes****Tables of Figures****References**

Introduction

Do Russian enterprises do business differently in different parts of the country? More specifically, to what extent do the strategies adopted by Russian enterprises to deal with their trading partners vary regionally? To take it one step further, can different attitudes toward law and legal institutions among regions be discerned? Specialists generally agree that Russia should not be viewed as a single polity or economy. Regional variation has been documented in a variety of settings, such as prices,¹ the behaviour of elites,² the pace of economic reform,³ the effectiveness of policy implementation⁴ and of government more generally.⁵ Much of this research focuses on the behaviour of government and takes either elite opinion⁶ or pre-existing economic structure⁷ as key explanatory variables. In this article, we take a different approach by concentrating on enterprise behaviour. We lay out the regional differences for a series of transactional strategies, and suggest possible explanations.

The stability and predictability that enterprises desire in their business relations can arise from a variety of sources. Law may or may not be germane. When the parties have a long history of mutually beneficial trading, they may be satisfied to rely simply on the integrity of their trading partners. In such cases, the fear of reputational sanctions may be more potent than any legal remedy. Law plays a more meaningful role when the parties are not acquainted with one another or when they have good reason to distrust one another. Under these circumstances, law facilitates transactions

¹ D. Berkowitz & D.N. DeJong, "Russia's Internal Border" (1998) [unpublished, archived at the University of Wisconsin-Madison with Professor K. Hendley].

² J.W. Hahn, "Reforming Post-Soviet Russia: The Attitudes of Local Politicians" in T.H. Friedgut & J.W. Hahn, eds., *Local Power and Post-Soviet Politics* (Armonk, N.Y.: M.E. Sharpe, 1994) 208; and J.F. Young, "Institutions, Elites, and Local Politics in Russia: The Case of Omsk" in Friedgut & Hahn, *ibid.*, 138.

³ O. Grigor'ev, M. Malyutin & A. Neshchadin, "Regional Alternative Approaches to Economic Reform" in K. Segbers & S. De Spiegeleire, eds., *Post-Soviet Puzzles: Mapping the Political Economy of the Former Soviet Union*, vol. 2 (Baden-Baden: Nomos, 1995) 85.

⁴ A. Kovalevskii, "Regional Peculiarities of Privatization in Russia" in Segbers & De Spiegeleire, *ibid.*, 221; D. Slider, "Regional Aspects of Privatization in Russia" in P.J. Stavrakis, J. DeBardeleben & L. Black (with the assistance of J. Koehn), eds., *Beyond the Monolith: The Emergence of Regionalism in Post-Soviet Russia* (Washington: The Woodrow Wilson Center Press, 1997) 105; and P. Hanson, "Regions, Local Power and Economic Change in Russia" in A. Smith, ed., *Challenges for Russian Economic Reform* (Washington: The Brookings Institution, 1995) 21.

⁵ K. Stoner-Weiss, *Local Heroes: The Political Economy of Russian Regional Governance* (Princeton: Princeton University Press, 1997).

⁶ *Ibid.*; and Hahn, *supra* note 2.

⁷ B. Van Selm, "Economic Performance in Russia's Regions" (1998) 50 *Europe-Asia Stud.* 603; N. Markova, "Russia's Regions: The Results of Four Years of Economic Reforms" (1996) 39:6 *Probs. Econ. Transition* 6; V. Bezrukov, "Basic Problems of Development of the Economic Reform in Regions of the Russian Federation" (1996) 39:6 *Probs. Econ. Transition* 26; and Grigor'ev, Malyutin & Neshchadin, *supra* note 3.

by providing a set of rules that can serve as a starting point for bargaining and default provisions if neither side is able to prevail in the negotiations. Of course, the capacity of law to serve this function arguably depends on its own legitimacy within society. If law is routinely flouted and judicial decisions languish unenforced, then law's ability to act as a common language in business transactions may be severely undermined. When law's authority is in question and business partners do not trust one another, they may turn to third parties to enforce their agreements. These outsiders may take on many forms, from people who hold sway due to others' respect for them to people who demand obedience at gunpoint. Law may also be marginalized in various types of authoritarian regimes, including state socialism. Non-democratic societies rarely allow any significant autonomy to law.⁸ Instead, law is moulded to the desires of those holding power. Business people, often by ingratiating themselves with the political elite, recognize that legal niceties will not ensure contractual enforcement.

In most countries, enterprises employ a combination of these strategies, depending on the circumstances. Even in the United States, which has a well-deserved reputation for being highly legalistic, enterprises eschew law whenever possible in favour of more informal mechanisms. While most transactions are memorialized in the form of written contracts, the parties' behaviour is mediated not by the language of the contract, but by the informal norms that emerge out of the underlying relationship.⁹ Law formally enters the fray in the guise of litigation only when all other options have been exhausted. A clear recognition of the peripheral role of law even in a country where law and legal institutions are generally well-respected is important at the outset so that our expectations are appropriately modest when considering Russia.

Thanks to its past—during which trading relationships were enforced through the planning system—and its present-day efforts to make the transition to a market-based system, Russia represents a highly unusual case. The popular press—both in Russia and the West—has created an image of the “Wild East”, where stable business relations are virtually impossible. The scholarly literature mostly follows this line, arguing that Russia lacks the necessary legal structure to enforce contracts or uphold property rights,¹⁰ and that enterprises routinely rely on private enforcers in order to ensure stability in their business relations.¹¹ To date, however, very little empirical work has

⁸ P. Nonet & P. Selznick, *Law and Society in Transition: Toward Responsive Law* (New York: Harper & Row, 1978) at 14-16, 29-33, 54-60.

⁹ S. Macaulay, “Non-Contractual Relations in Business: A Preliminary Study” (1963) 28 *Am. Sociological Rev.* 55.

¹⁰ E.P. Hoffmann, “The Dynamics of State-Society Relations in Post-Soviet Russia” in H. Eckstein *et al.*, *Can Democracy Take Root in Post-Soviet Russia? Explorations in State-Society Relations* (Lanham, Md.: Rowman & Littlefield, 1998) 69 at 99, 146; A. Aslund, *How Russia Became a Market Economy* (Washington: The Brookings Institution, 1995) at 5-7, 138, 211; and M. McFaul, “Why Russia's Politics Matter” (1995) 74 *Foreign Affairs* 87.

¹¹ See *e.g.* P.D. DiPaola, “The Criminal Time Bomb: An Examination of the Effect of the Russian Mafia on the Newly Independent States of the Former Soviet Union” (1996) 4 *Indiana J. Global Leg. Stud.* 145; J. Leitzel, C. Gaddy & M. Alexeev, “Mafiosi and Matroski: Organized Crime and Rus-

been done on this issue. Most scholars have relied almost entirely on anecdotal evidence or on what they thought were logical inferences.

Our research represents one of the first systematic efforts to study how Russian enterprises interact with one another. We draw on the results of a survey of 328 Russian industrial enterprises conducted between May and August of 1997. In each enterprise, Russian surveyors administered different survey instruments to four top managers: the general director and the heads of the sales, purchasing (supply), and legal departments.¹² The sample included enterprises from six *oblasts* (regions)—Moscow, Novosibirsk, Ekaterinburg, Saratov, Voronezh, and Barnaul—with each *oblast* represented roughly equally. The enterprises were concentrated among ten industrial sectors.¹³ Their sizes range from 30 to 17,000 employees, with a median of 300 and a mean of 980. Most of the enterprises were established during the Soviet era, and about three-fourths (77%) are privatized. In virtually all of those that are privatized, some stock was in the hands of insiders, and nearly a third were entirely owned by insiders. Outsiders (non-employees of the enterprise) held some stock in 60% of the enterprises.

An analysis of these data for Russia as a whole indicates that Russian enterprises also use a variety of strategies for maximizing stability in their business relations.¹⁴ Russian enterprises exhibit a strong preference for working with long-term partners, suggesting that trust plays an important role in ensuring stability. This is hardly surprising given the chaotic nature of the contemporary Russian marketplace, and the difficulty of assessing the credibility of potential trading partners. The ever-deepening debt crisis also contributes to this tendency, since credit is more likely to be extended if there is a shared history. Equally interesting is that, contrary to the common wisdom, Russian enterprises do not reject the use of law and legal institutions out of hand. This is not to say that legalistic strategies are preferred, but merely that they are considered. Moreover, we found little evidence of enterprises resorting to private law enforcement, and little evidence that they held out any hope of the State assisting them with their financial problems.

In this article, we examine regional variations in the use of these strategies. As a general rule, the basic findings track those for Russia. With the exception of private

sian Reform" (1995) 13 *Brookings Rev.* 26; and L. Shelley, "Post-Soviet Organized Crime and the Rule of Law" (1995) 28 *John Marshall L. Rev.* 827.

¹² When the enterprise did not have one of these departments, the person who carried out the relevant duties in the enterprise responded to that questionnaire.

¹³ The industrial sectors are (number of enterprises in parentheses): food processing (67); textiles, clothing, and leather (60); fabricated metal (34); electronics (34); chemicals and petroleum (33); machinery and transport equipment (23); construction (18); wood products (8); paper and printing (5); and other (46).

¹⁴ K. Hendley, P. Murrell & R. Ryterman, "Law, Relationships, and Private Enforcement: Transactional Strategies of Russian Enterprises" (1998) [unpublished, archived at the University of Wisconsin-Madison with Professor K. Hendley] [hereinafter "Law, Relationships, and Private Enforcement"].

enforcement, which the regions uniformly shunned, we found considerable variation among the regions in the use of strategies by the surveyed enterprises. Yet we find no overarching patterns. For example, the behaviour of enterprises in the so-called “Red Belt” does not emerge as consistently different from those outside this area.¹⁵ Each strategy seems to have its own logic, and different factors impact on the propensity for its use.

In this article, we focus on seven general categories of strategies that enterprise managers might use when their trading partners fail to live up to their obligations, selecting the mechanisms that emerged as most typical in each category. We begin by describing each in general terms, laying out the incentives for its use. We then engage in a comparative analysis of the actual use of these strategies by enterprises in each of the six *oblasts* surveyed. This analysis also addresses the perceived effectiveness of each strategy.

I. The Spectrum of Strategies

Enterprises make a series of choices in every business transaction. Underlying these choices are assumptions about the reliability of their trading partners and the legitimacy of state-sponsored legal institutions. One or the other of these concerns may dominate, depending on the specifics of the transaction. If, for example, two enterprises have been trading with one another for decades, then they may have developed deep bonds of trust that override any nagging fears of non-payment or other types of contractual non-performance. In such cases, as Macaulay argues,¹⁶ the contract is largely superfluous. If defaults occur, enterprises tend to find informal remedies that bypass the formal legal system. Yet if defaults become routine, indicating that the informal remedies have not had the desired disciplining effect, the bonds of trust will begin to fray, and enterprises will increasingly look for external help. Such assistance can take many forms, such as asking respected figures within the business or government community to use their influence to convince the trading partner to rethink its behaviour. Sometimes threats to file a lawsuit or to resort to less savoury methods of enforcing contracts are used, and sometimes enterprises follow through on these threats.

We see these options as existing along a continuum. The continuum does not represent any absolute natural order. It can be constructed along different axes, depending on which factors are considered most important. For this reason, we do not view the continuum as reflecting stages that enterprises go through in any logical, predetermined progression. In fact, we recognize that an enterprise may employ several of

¹⁵ Berkowitz & DeJong, *supra* note 1 at 2, define the “Red Belt” as including regions that voted in favour of the Communist Party during the 1996 presidential elections. Four of the surveyed regions fall within the Red Belt: Novosibirsk, Saratov, Voronezh, and Barnaul. The remaining two—Moscow and Ekaterinburg—are outside the Red Belt.

¹⁶ *Supra* note 9.

these strategies in its effort to resolve a single problem (or may limit itself to only one). The choice of strategies depends on a broad array of factors, only some of which are within the control of the parties.

The continuum which we have constructed can be conceptualized as being driven by trust in one's trading partner versus reliance on law. At one end is the sort of relational contracting described above, in which outsiders play no significant role. At the other end is litigation, in which the parties have been unable to reach a negotiated solution themselves and have turned their dispute over to the courts. Their willingness to resort to the formal legal system results not just from their frustration with their trading partner, but also from a basic belief in the legitimacy of this institution. The placement of different options along the continuum is determined by the level of reliance on outsiders for enforcement, and the identity of those outsiders, *i.e.*, their source of authority. The options range from complete reliance on one another, to reliance on non-state actors, to reliance on state-sponsored institutions. We highlight seven basic types of strategies, and present them in their natural order along this particular version of the continuum. The description is generic. We particularize the strategies to Russia in the next section of the article.

Relational Contracting. This outcome assumes that enterprises trust one another to fulfil their contractual obligations. This trust may evolve gradually over long periods of time or may be forced on the parties through a kind of corporate shotgun marriage. If problems arise, they tend to be resolved through informal negotiations between the trading partners, without involving outsiders or resorting to the courts. The implicit threat that underlies such negotiations is that the relationship will be terminated if some compromise cannot be reached. The non-performing enterprise is presumably sufficiently interested in maintaining the tie that it will modify its behaviour accordingly.

Self-Enforcement. A small step away from relational contracting are arrangements based on self-enforcing remedies. These are mechanisms that are built into the contractual framework with the goal of providing both parties with an incentive to perform. Examples of these mechanisms include letters of credit, barter, and prepayment. Thus, the relationship continues to be one of mutual dependence. In cases of non-performance, the basic relationship between the enterprises may or may not survive, depending on their desires. Like relational contracting, the frame of reference is generally limited to the two contracting parties, though the parties may assume the normal functioning of financial institutions. Neither state institutions nor private actors are affirmatively called upon for assistance.

Third-Party Enforcement. As an enterprise becomes frustrated with the conduct of its trading partner, it may turn to outsiders for help. The most benign form of this behaviour is an appeal to individuals or associations that are perceived to have some influence over the trading partner. This represents a step away from self-reliance, but does not yet presume state involvement or the use of extra-legal remedies of self-help. Examples of this include informing bankers or members of business associations about the poor performance. The assumption is that the trading partner will be concerned about its business reputation and, fearing ostracism, will alter its behaviour.

Private Enforcement. When an enterprise experiences high levels of default among its trading partners, and neither negotiations, self-enforcement, nor third-party enforcement yield the desired results, more concrete action may be required, such as resorting to private methods of contractual enforcement. Such behaviour assumes a lack of trust in both the trading partner and in the capacity of the legal system to provide acceptable relief. This strategy is typically one that is multi-layered, often beginning with implicit threats, and sometimes culminating in the use of violence. While violence is not an essential element, intimidation is.

Administrative Levers of the State. Moving from private to state actors, the first step may be to ask government officials to talk to the trading partner in an effort to convince them to fulfil their contractual obligations. Even in market economies, governments have many levers of influence over enterprises and, depending on the circumstances, may be willing to use them. Presumably, the non-performing enterprise will change its behaviour rather than risk the ire of the State, even if this displeasure is expressed in a circuitous manner.

Shadow of the Law. When relations between trading partners are characterized by a low level of trust, confiscatory remedies are often included in contracts to protect the parties in case of default. Examples of these are collateral arrangements or penalty clauses. These differ from the self-enforcement remedies described above in that they usually require court action to be implemented. Thus, as relations unravel, correspondence begins to include threats to initiate lawsuits and to enforce these confiscatory contractual terms. Settlement occurs because it is cheaper than litigation, not because of any sense of duty to long-term business partners.

Litigation. At the opposite end of the continuum from relational contracting is litigation. Filing a lawsuit typically indicates a breakdown in the relationship between the trading partners. They would not appeal to court, given that litigation inevitably consumes time and money, if settlement could be reached through negotiation. Litigation is also costly in relationship terms. Harsh words are exchanged, and the trading relationship is sometimes irretrievably severed. Submitting a dispute to the courts implies an acceptance of the legitimacy of the institution, and a willingness to abide by its decision. Problems arise when such attitudes are not shared by the defendant, and it refuses to obey the court's decision.

II. The Use of Strategies by Russian Enterprises: Regional Variations

How are these strategies used by Russian enterprises? How does the use vary among different regions? In this section, we focus on specific strategies, comparing their use as well as the perceptions of effectiveness across the six regions surveyed.

The data are drawn primarily from responses to two composite questions that were posed to the procurement director and the sales director.¹⁷ These two questions were intended to complement one another, with one addressing how the enterprise as purchaser dealt with problem suppliers (Box 1), and the other addressing how the enterprise as seller dealt with recalcitrant customers (Box 2). The two questions are not identical. In order to maximize the data gathered, keeping in mind our respondents' limited patience, we altered the starting assumptions slightly, and we adapted the list of responses. In the question for the procurement director (Box 1), we asked whether each strategy had been used "in helping your enterprise to prevent and/or resolve problems arising in relationships with suppliers" during the past two years. By contrast, we asked the sales director whether the enterprise had "used or threatened to use" each listed strategy in dealing with "customers that did not honour their agreement with your enterprise" (Box 2). Both sets of questions asked the respondent to evaluate the effectiveness of the method in altering the behaviour of the trading partner.

We have elsewhere reported the aggregate responses to these questions.¹⁸ Space limitations make it impossible for us to include the results for each permutation of these strategies on a regional basis. Consequently, we have identified one or two examples that are most representative of how Russian enterprises use each strategy.

A. Relational Contracting

We were interested in knowing whether the surveyed enterprises found non-legalistic tactics to be helpful when difficulties arose. We asked purchasing directors whether their enterprise had used formally arranged business meetings between lower-level officials to prevent or resolve problems with suppliers during the preceding two years. We went on to ask them to evaluate the effectiveness of this method. This method fits squarely within the relational contracting approach.¹⁹ It focuses on the precise level at which most contracts are actually negotiated in Russian enterprises. Few agreements to purchase inputs attract the attention of the general director. Instead, their terms are dickered over by mid-level managers, and their relationship plays a critical role in determining the overall success of the trading partnership.

Table 1 reports the results for this question. The second column sets forth the percentage of enterprises using this strategy in each region. The third column summarizes the enterprises' evaluation of the effectiveness of the strategy by presenting the mean scores of the 0 to 10 scale, including only the responses of the enterprises that actually used this strategy. The final column combines the information on the extent

¹⁷ See Boxes 1 and 2, below, for the English-language text of these questions. There is a small change in format from the versions actually used in the field so that the reader is not confused with the instructions given to the surveyors.

¹⁸ See "Law, Relationships, and Private Enforcement", *supra* note 14.

¹⁹ See generally O.E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, 1985); and Macaulay, *supra* note 9.

of use and effectiveness. Assuming that the effectiveness of this strategy is 0 for those enterprises that failed to use it, one can calculate a mean effectiveness score across all enterprises. These mean scores appear in the fourth column.

The bottom row of Table 1 requires some additional explanation. In order to examine whether the differences between the regions are statistically significant, we analyzed the underlying data with crude statistical tests. The first column of this table serves as an example. Each enterprise has a "score" on the use of relational contracting, which in this case is a dichotomous variable indicating use or non-use of the method. This score was the dependent variable in a regression, where this variable was related to the following independent variables: size of the enterprise, age of the enterprise, state ownership, presence of a legal department in the enterprise, and dummy variables for regions. A standard F-statistic was used to test whether the addition of the dummy variables for the regions added any explanatory power to the regression, over and above that provided by the other variables. We examined whether this F-test is significant at the 5% level and placed the results in the last row of Table 1.²⁰

If the word "significant" appears in this last row of Table 1, this means that regional effects appear to be explaining patterns in the data. These regional effects cannot be due to variations between regions in the standard characteristics of the enterprises in our sample—such as age, size, ownership, and the presence of a legal department—since measures of these characteristics have been included in the regressions. Therefore, a natural interpretation of the significance is that it reflects some property of the regions themselves that has an effect on how the enterprises conduct their relationships.

Table 1 clearly shows the popularity of the strategy of relational contracting among Russian enterprises. In all regions, well over half of the surveyed enterprises had used these sorts of meetings between lower-level managers to deal with problems with suppliers during the past two years. Just as interesting are the uniformly high grades on effectiveness among enterprises who used this strategy. All regions have mean scores above seven, on a 0 to 10 scale. The differences among regions are minor, and can be attributed to specific features of the enterprise.

Widespread use of this relational contracting strategy is not terribly surprising. Almost anywhere, management can be expected to begin the problem-solving process in a low-key fashion. A meeting between the concerned managers allows for an assessment of the seriousness of the problem and whether it can be resolved quickly and inexpensively. As we will see below, many of the other methods give rise to costs for the enterprise that it may prefer to avoid, such as the cost and expense associated with litigation or private enforcement, or even the potential damage to its own reputation when it begins to speak ill of its trading partners.

²⁰ Note that this calculation has been carried out for all of the strategies, and is presented in the bottom row of all the tables.

The extreme popularity of this strategy tends to confirm certain characteristics of the Russian economy. It suggests that Russian enterprises want to deal with people they know—at least well enough to set up meetings. This, in turn, indicates the presence of some modicum of trust. In the current climate of uncertainty, this is to be expected. In the absence of any reliable credit-rating service, enterprises find it difficult to assess the business integrity of new trading partners. This same lack of information limits their ability to learn of alternative suppliers. The combination of these factors, plus the widespread knowledge that failure to pay contractual debts has reached epidemic proportions throughout Russia, no doubt encourages enterprises to continue dealing with the trading partners they have come to know. In principle, there is nothing wrong with this sort of loyalty. However, it does limit an enterprise's flexibility and undercuts its right to pick its own suppliers and customers, a right finally won with the end of the state-planning system.

Notwithstanding the overwhelming endorsement of this method, sharp differences exist in the level of use among the regions. With only 60% of surveyed enterprises reporting use, Saratov is the outlier. By contrast, more than 70% of enterprises in the other regions used it and, in two regions (Barnaul and Voronezh), well over 80% used it. Our analysis indicates that these variations are attributable not to differences in the underlying characteristics of the enterprises, but to differences among the regions. Our data do not allow for definitive conclusions as to why Saratov emerges as unique. We can suggest a few possible reasons. It may be that Saratov managers have weaker personal connections with their suppliers. Logically, this might result from a preponderance of new suppliers. Yet our data indicate that, like all of the regions surveyed, the Saratov enterprises have experienced about a 50% turnover in suppliers. It may be that the Saratov procurement managers have been slower than their counterparts in other regions to find some common ground with their suppliers. On the other hand, perhaps Saratov managers regard other strategies as more helpful. It is certainly intriguing that Saratov enterprises emerge as among the most likely to initiate litigation against recalcitrant customers.²¹ This may indicate a higher level of trust in the efficacy of formal legal institutions than in personal connections.

B. Self-Enforcement

The unpredictability that has characterized the Russian economy over the past decade has caused some enterprise managers to seek stability in the confines of specific contractual relationships. In this section of the article, we examine two ways in which Russian enterprises seek to protect themselves: prepayment and barter. The impetus for both mechanisms is the same, namely the increasing difficulty of obtaining payment for goods.

Prepayment is an innovation of the post-Soviet era. Under the planned economy, payment was less important since all enterprises were state-owned and bankruptcy

²¹ See Table 8, below.

was not possible. The end of state socialism, with its guarantee of perpetual life to industrial enterprises, was followed in short order by a crisis of non-payment of inter-enterprise debt.²² One practical solution was to require payment before goods would be shipped. While this appears straightforward, it became a new source of delay in the post-Soviet production cycle since the banks were ill-equipped to manage the process.²³

The composite questions did not cover prepayment. Consequently, our analysis of prepayment is drawn from a series of questions posed to the procurement director and the sales director relating to a particular purchasing and sales transaction, respectively, of their choice. Among these questions was a detailed inquiry about the terms of payment. We gave the managers a variety of choices, among which were full and partial prepayment.²⁴ We also asked them to compare the percentage of the price which they had been contractually obligated to prepay, and the percentage they actually paid. Table 2 sets forth the results for both transactions. Columns 2 through 4 summarize the responses given by the procurement directors, while columns 5 through 7 detail the responses given by the sales directors.

A cursory glance shows the importance of this coping mechanism in both sales and purchase transactions. In this regard, the results from the questions to the procurement director are most revealing since enterprises are disclosing their own behaviour (rather than the terms they imposed on their trading partners). We see that, across the board, more than 35% of enterprises agreed to terms requiring full prepayment. The use of partial prepayment is considerably higher, ranging from a low of 65% in Voronezh to a high of 85% in Ekaterinburg.²⁵ Given that prepayment has become an accepted feature of doing business in Russia, it is not surprising that partial prepayment emerges as more common than full prepayment. The burden on the purchaser (in this case, the respondent enterprise) is lower and therefore more desirable. Moreover, interviews reveal that demands for prepayment tend to decrease in percentage terms as the parties become more comfortable with one another.

²² See B.W. Ickes & R. Ryterman, "The Inter-Enterprise Arrears Crisis in Russia" (1992) 8 *Post-Soviet Affairs* 331; and B.W. Ickes & R. Ryterman, "Roadblock to Economic Reform: Inter-Enterprise Debt and the Transition to Markets" (1993) 9 *Post-Soviet Affairs* 231.

²³ Prepayment might also be seen as a Russian variant on letters of credit, which are commonly used in international transactions to ensure payment. International transactions raise uncertainties that are somewhat similar to those found in the Russian case, since the trading partners may not know one another personally and may be unable to assess trustworthiness. The key difference between Russian prepayment and letters of credit lies in the role of banks. When a letter of credit is accepted by a seller, goods are shipped before payment is received. Payment is guaranteed by the bank that issues the letter of credit upon the presentation of certain key documents. By contrast, the Russian practice is that the seller is not required to ship goods until payment is received in its bank account. This obviously slows down the transaction, whereas letters of credit tend to speed up transactions.

²⁴ Among the other choices for payment terms is penalties, which we analyze in Part II.F, below. See columns 2 and 3 of Table 7, below.

²⁵ Note that the variations among regions for both full and partial prepayment are the result of differences in the basic properties of the surveyed enterprises.

The results of the questions posed to the sales directors indicate an even higher propensity to rely on prepayment. With the exception of Barnaul, all of the regions report a higher percentage of sales transactions in which full prepayment was contractually mandatory than was reported in procurement contracts. We might suspect a tendency on the part of sales directors to inflate their ability to force these rather onerous terms on their customers. Yet the differences do not bear out these suspicions. While the difference is more than 15% in Saratov, it is less than 3% in Novosibirsk, Ekaterinburg, and Voronezh, suggesting that puffery is not an issue. As with the purchasing transaction, significantly more sales transactions involve partial prepayment than full prepayment. This is to be expected for the same reasons set forth above.

The bottom row of Table 2 indicates that regional differences are at the root of the variation among regions in full and partial prepayment in sales transactions. This time, Barnaul emerges as the outlier, with low demands for full and partial prepayment. Given that prepayments are processed through the banking system, we can reasonably surmise that regions with lower numbers of enterprises relying on this strategy have relatively weaker banks. For example, the number of days required to process payments is much higher in Barnaul than in any of the other regions. More specifically, we can infer that bank transfers are processed more slowly in these regions than elsewhere and, consequently, enterprise management has learned that prepayment does not provide a solution, but merely adds to the woes of non-payment. By contrast, it follows that regions where enterprises use prepayment more actively—*i.e.*, Moscow, Novosibirsk, and Saratov—have banks that are able to process payments efficiently. The survey data provide some support for these inferences. Payments are processed most quickly in Moscow, and most slowly in Barnaul.²⁶

Another strategy used by Russian enterprises that fits within the self-enforcement category is barter. Unlike prepayment, barter was also part of the planned economy, though certainly hidden in the shadows. Somewhat ironically, Russia's economic transition has had the unexpected effect of increasing the incidence and importance of barter. As the budget constraints have hardened, enterprises have struggled for their very survival. Deprived of liquid assets and desperate to avoid bankruptcy, barter has become their lifeline. Yet barter has become more than just a tactic employed by enterprises drowning in debt; it has grown to become a normal part of Russian business life. Even thriving enterprises barter, motivated in large part by the perception that they can avoid tax liability on in-kind transactions.

As with prepayment, our analysis of barter is based on several questions that are not part of the composite questions set forth in Boxes 1 and 2. We asked the general director to estimate the percentage of enterprise output "sold" via barter in 1992 and

²⁶ We asked procurement directors how many days elapsed between the time they ordered their bank to pay a typical supplier and that supplier's receipt of the payment. The mean number of days for each region is set forth parenthetically. The first number is for intra-*oblast* transactions, and the second number is for inter-*oblast* transactions: Moscow (3.58 / 8.4); Novosibirsk (4.66 / 10.1); Ekaterinburg (4.85 / 8.67); Saratov (4.87 / 11.1); Voronezh (5.73 / 10.87); and Barnaul (8.3 / 14.48).

1997. The counterpoint is provided by a question posed to the procurement director, in which we asked for an estimate of the percentage of production inputs obtained via barter in 1992 and 1997. The results are set forth in Table 3. Not surprisingly, the table convincingly demonstrates the explosion of barter over this five-year period. With the exception of Moscow (which is discussed below), the incidence of barter in all the regions multiplied many times over. Barnaul, which reported a six-fold increase with regard to both sales and procurement transactions, is the most extreme. It follows that this region, which has comparatively less prepayment, would compensate by bartering more actively.

Table 3 also shows a striking similarity in the propensity to barter across the two types of transactions. For example, in 1997 the difference between the percentage of output "sold" through barter and the percentage of inputs obtained through barter is consistently less than five. One logical explanation for this similarity is that output is being bartered for inputs. Enterprise interviews indicate that such direct exchanges are not the norm. Instead, "sellers" in barter transactions are more likely to obtain goods that they have to resell (either directly or through intermediaries) or use to offset debts to their suppliers or workers.²⁷ To acquire inputs through bartering, "sellers" have to organize byzantine multi-sided transactions (*tsepochnki*) that often require five or more trades before obtaining something of value. Huge amounts of time and energy go into arranging these deals. Even so, if enterprises are bartering to escape taxes, as is usually argued, then it still seems odd that the level of "sales" via barter is not much greater than the acquisition of inputs. After all, enterprises need not pay tax on purchases, yet the level of bartered "purchases" are virtually identical to the level of bartered "sales." The amenability of procurement directors to going along with their suppliers' desire to barter to escape taxes as a goodwill gesture is undercut by the 15% to 20% surcharge that is typically placed on bartered goods to account for the higher transaction costs. Perhaps enterprises are bartering more out of desperation than out of a desire to avoid taxes. These two factors may be so intertwined as to be indistinguishable. Enterprises across all the regions agreed that a substantial decrease in tax rates is the factor most likely to cause a decline in the level of barter.²⁸

The bottom row of Table 3 indicates that the regional variations in barter for 1997 cannot be explained by enterprise characteristics. The factors that are likely to have a meaningful impact on barter are the strength of the regional economy and of the basic

²⁷ For example, producers of automobile parts receive "liquid" goods, such as cars or trucks, in "payment" for supplying the large automobile assembly plants. Sometimes these cars can be "resold" to obtain the raw materials necessary to produce parts. This is becoming more difficult as creditors grow less willing to absorb the costs of reselling these goods. As a result, enterprises in the position of these parts producers have begun to work more closely with intermediaries, who sell the cars or trucks on their behalf.

²⁸ Enterprises were asked to evaluate the potential effect on levels of barter of: (i) decline in interest rates; (ii) increase in enforceability of *arbitrazh* court decisions; (iii) increase in competition; and (iv) decline in tax rates. All of the surveyed regions agreed that a decline in tax rates would be most likely to decrease the propensity to barter.

financial institutions. Where the regional economy is relatively healthy, enterprises are more likely to have some liquidity, thereby allowing them to produce and sell their goods without resorting to barter. Among the regions included in our survey, Moscow stands out. At 14% to 15%, the incidence of barter reported by the Moscow enterprises is less than half that of the next lowest *oblast* (Voronezh), and is one-third or less of the remaining regions. This conclusion holds for both sales and purchases.

That Moscow has significantly lower levels of barter is hardly shocking. During the years of the economic transition, Moscow has grown increasingly unique. Its economy, as well as its financial institutions, are stronger than those of the other regions. For example, debts owed to tax authorities, unpaid wages, and supplier arrears are less of a problem for the Moscow enterprises surveyed than for enterprises in other regions. This suggests a lower level of desperation in Moscow than elsewhere. Enterprises need not barter in order to survive; the availability of short-term bank credits provide them with options. As a result, Moscow enterprises seem to be bartering only when it is advantageous to them, perhaps for tax gains or to placate trading partners that insist on this form of exchange.

C. Third-Party Enforcement

When problems arise between trading partners and they are unable or unwilling to work them out between themselves, one option is to turn to a third party. Sometimes this results from one side growing fed up with the other side's constant failure to live up to its contractual obligations. In other cases, it may simply reflect a lack of trust in, or knowledge of the other side. For the purposes of this analysis, the reasons are moot. We are interested in whether Russian enterprises turn to enterprises that are not involved in the transaction to help them sort out problems. This is, of course, a relatively common phenomenon in many market economies. It may take on a variety of forms, from an informal word-of-mouth sanction to formal sanctions imposed by business associations.²⁹ The common thread is the potential for reputational harm that may be suffered by the enterprise that has allegedly misbehaved.

Our analysis is based on two questions drawn from the composite questions posed to the procurement and sales directors that are set forth in Boxes 1 and 2. While both questions addressed the appeal of third-party enforcement as a strategy, the tone and substance of each question is sufficiently different to warrant separate discussion of the results.

The question put to the sales director asked whether, when dealing with a recalcitrant customer, the enterprise had ever told or threatened to tell other enterprises about the customer's behaviour. Column 5 of Table 4 sets forth the percentage of enterprises

²⁹ Business associations do not appear to play this role in Russia. In the two composite questions set forth in Boxes 1 and 2, we asked whether the enterprises had ever turned to business associations for assistance in dealing with their suppliers or customers. Only thirteen of the 328 procurement managers surveyed reported having tried this strategy, while only nine sales managers used this method.

that have used this method during the past two years. It demonstrates the widespread use of this strategy. The percentages range from a low of 40 in Moscow to a high of 54.55 in Ekaterinburg. We also asked the sales directors to evaluate the effectiveness of this method in getting their problem customers to abide by their agreements. The enthusiasm for this method is considerably more muted than for the meetings between low-level managers presented in Table 1, or even for intervention by other enterprises, which is discussed below. The variations among regions in terms of use and effectiveness is attributable to enterprise characteristics such as age, ownership status, size, and presence of a legal department.

Although the propensity to tell or threaten to tell other enterprises about poor performance combined with indifference toward the usefulness of the strategy may seem incongruous, it does make sense. This sort of action—whether limited to a mere threat or taken further—imposes few costs on the wronged enterprise. Under the worst scenario, the target of criticism may take offence and refuse to do business with the initiator of the story. In all likelihood, the initiator will have given up on the target anyway, resulting in no real harm. Thus, the initiator may regard it as worth a try.

The more troubling question is why is this strategy, aimed at imposing reputational damage, not more effective in the Russian context? The answer lies in the difficulty in obtaining information and the amorphous nature of Russian business culture. As we have previously noted, reliable sources of information are few and far between. Although faxes and the Internet have dramatically increased the quantity of information, its quality remains highly suspect. More importantly, Russian business people seem unconcerned about building or maintaining a reputation for fair dealing or following through on their contractual duties. Contractual defaults are so commonplace in Russia³⁹ that customers may have no fear of ostracism if news of their poor behaviour is spread around.

The question posed to the procurement director was framed quite differently. We asked whether the respondent enterprise had ever asked third-party enterprises to intervene on their behalf to prevent and/or resolve problems with a supplier. This question clearly presumed greater activism on the part of both the respondent and the third-party enterprise. Not surprisingly, we find that a significantly lower number of enterprises use this strategy. Column 2 of Table 4 reports the results. Four of our six regions exhibit a striking similarity, with 14% to 15% resorting to this strategy. The relatively few enterprises that pursue this tactic find it very productive. The mean scores for effectiveness, set forth in column 3 of Table 4, are consistently higher than those for the more popular strategy of simply telling other enterprises (column 6 of Table 4). This suggests that a higher threshold of frustration or anger must be reached before an enterprise that believes it has been wronged by a supplier will appeal for help to an unrelated enterprise, but that when this step has been taken, it often yields the desired result. Ironically, it seems that the original trading relationship is more

³⁹ See K. Hendley, "Temporal and Regional Patterns of Commercial Litigation in Post-Soviet Russia" (1998) 39:7 *Post-Soviet Geography & Econ.* 379 [hereinafter "Temporal and Regional Patterns"].

likely to be preserved through this method than through the seemingly less invasive tactic of gossip.

D. Private Enforcement

The popular media would have us believe that the “mafia” is a central actor in the resolution of Russian business disputes.³¹ A number of Western specialists agree.³² Typically, this is presented as the only reasonable option in the face of institutional gaps or the incapacity of existing institutions to cope.³³ Our data contradict this common wisdom. As a part of the composite question posed to the procurement directors (see Box 1), we asked whether they had used private enforcement firms to resolve problems with suppliers. The results, set forth in Table 5, speak for themselves. An extraordinarily small number of enterprises reported using this strategy. Indeed, only nine of our 328 surveyed enterprises employed this strategy. This includes three enterprises in Moscow and Barnaul, and one enterprise in Novosibirsk, Ekaterinburg, and Voronezh. No use was reported in Saratov. Those enterprises in Barnaul and Ekaterinburg that used the private enforcement strategy found it incredibly effective. But the numbers are so small that these scores represent little more than anecdotal evidence.

These findings are buttressed by the answers to two questions addressing how often the enterprise depended on internal or external security services to facilitate the collection of debts and the safe delivery of its output. The general directors were asked to estimate their use of one of these services on a 0 to 10 scale, with higher scores indicating greater frequency. The mean responses for the use of internal security services ranged from 1.1 in Moscow to 2.8 in Saratov. Along similar lines, the mean responses for the use of external security services ranged from 1 in Moscow to 2.4 in Barnaul. This strongly suggests that these security services, which may well exist in many Russian enterprises, are not being used to resolve contractual disputes.

At the same time, the surveyed enterprises are not unaware that private enforcement may have certain benefits for them. We asked the general directors to compare the effectiveness of private enforcement with the courts in resolving disputes along several parameters.³⁴ As a general matter, the results indicate that the general directors recognize that judgments of private enforcers are speedier and more likely to be enforced. These conclusions would seem to be obvious, yet the respondents were guarded in their enthusiasm, perhaps indicating a wariness of the slippery slope of private enforcement. Although none of the regions showed an absolute preference for

³¹ See S. Handelman, *Comrade Criminal: Russia's New Mafiya* (New Haven: Yale University Press, 1995) at 20-22 for a discussion of the difficulties of defining “mafia” in the Russian context.

³² See *supra* note 11.

³³ We address this claim in our discussion of the strategy of litigation in Part II.G., below.

³⁴ Our question clarified that we were interested in a comparison between private enforcers and the *arbitrazh* courts. This follows since we were asking about methods for resolving contractual disputes between enterprises. The *arbitrazh* courts have exclusive jurisdiction over such disputes.

private enforcement, Ekaterinburg and Moscow were, respectively, at the high and low ends of the scale.³⁵

E. Administrative Levers of the State

Another option for an enterprise that has grown frustrated with its trading partner is to look to the State for assistance. During the Soviet era, industrial enterprises turned to the State as a matter of course. As Joseph S. Berliner documents, the first instinct of Soviet managers was to turn to their industrial ministry for assistance.³⁶ Ministerial officials were often able to convince suppliers to provide needed inputs and thereby resolve the problem. Their persuasiveness, of course, stemmed from their role as gatekeepers for state investment (both in production and in the social sphere). As such, they were able to offer compelling incentives to suppliers who were initially uncooperative. Alternatively, Soviet managers might go to the local Communist Party organization and, if the supplier was nearby, the Partkom officials could also have a powerful effect on its behaviour.³⁷

These Soviet levers of influence either no longer exist or no longer operate in the same way.³⁸ Enterprises are, for the most part, privatized. Even if state-owned, they are no longer part of some vast state bureaucracy that can be manipulated at the center. Instead, enterprises are now responsible for their own destiny, which has both positive and negative consequences for management. On the negative side, managers now have to resolve their own problems. They can no longer assume that the ministries (or the State in some form) will bail them out. Yet this should not be taken to mean that the State has become irrelevant to enterprises in post-Soviet Russia. Even in long-standing market economies such as the United States or Germany, the State plays an important role in the economy.³⁹ The nature of this role varies across countries. The

³⁵ The general directors were asked to use a 0 to 10 scale. A score of 0 indicated an absolute preference for private enforcement, whereas a score of 10 indicated an absolute preference for the courts. The regional means for enforcement ranged from a low of 3.2 in Moscow to a high of 6.2 in Ekaterinburg. By contrast, the regional means for enforcement ranged from a low of 4 in Moscow to a high of 5.7 in Ekaterinburg, but the mean scores are more closely clustered together. The differences among regions may be more a reflection of the general directors' attitude toward the courts than their opinion of private enforcement.

³⁶ J.S. Berliner, *Factory and Manager in the USSR* (Cambridge: Harvard University Press, 1957) at 248-63.

³⁷ See e.g. J.F. Hough, *The Soviet Prefects: The Local Party Organs in Industrial Decision-Making* (Cambridge: Harvard University Press, 1969) at 214 where Hough cites a *Pravda* article on the practice of local Party organs of "beating out of the suppliers the equipment, materials, etc., which the enterprises have been allocated."

³⁸ For example, only one of the 328 surveyed enterprises reported that they had asked a political party to intervene with a supplier to help them.

³⁹ J. Zysman, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change* (Ithaca: Cornell University Press, 1983).

State may limit itself to establishing the basic "rules of the game" or, alternatively, it may intervene to protect certain essential industries.⁴⁰ These are political choices.

The role of the State in the economy of post-Soviet Russia remains unclear,⁴¹ as is the relative power of federal, regional, and local state institutions.⁴² Both our enterprise interviews and the survey data suggest that enterprise managers are far more concerned about their relationships with local and regional governmental officials than with federal governmental officials. To that end, general directors report that their senior managers meet more frequently with local or regional officials than with officials of the federal government.⁴³ Consequently, our analysis is focused on the responses by the procurement and sales directors to our questions about local and regional government,⁴⁴ which are contained within the composite questions set forth in Boxes 1 and 2.

We asked procurement directors whether they had asked local or regional officials to intervene to sort out a problem with a supplier. This is a particularly revealing question, since it asks about a method that was commonplace during the Soviet period. The responses, reported in column 2 of Table 6, confirm the drastic decline in the popularity of this method. Although 20% of surveyed enterprises in Barnaul and Saratov had used this strategy over the past two years, in the other regions considerably fewer enterprises had turned to the local or regional government for assistance. Even more telling are the evaluations of the effectiveness of this method. These mean scores reflect the procurement directors' view of the ability of governmental officials to force suppliers to live up to their agreements.⁴⁵ The scores are lower across the board than those for relational contracting or third-party enforcement. However, the variations suggest that procurement directors in Barnaul have much more confidence in the ability and willingness of officialdom to intervene on their behalf than do managers in other regions. Particularly intriguing is the dismal showing of Moscow, where the local government under Mayor Luzhkov has a reputation as interventionist. Along

⁴⁰ See P. Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton: Princeton University Press, 1995); and P. Evans, D. Rueschemeyer & T. Skocpol, eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985).

⁴¹ What was clear was that none of the surveyed enterprises expected help from the government, in any form, in the case of financial difficulties. We asked general directors to evaluate (on a 0 to 10 scale) the likelihood of receiving assistance from the government if they were forced to lay off workers. The means for all regions were less than 1.

⁴² See G.M. Easter, "Redefining Centre-Regional Relations in the Russian Federation: Sverdlovsk Oblast" (1997) 49 *Europe-Asia Stud.* 617; and J. Hughes, "Regionalism in Russia: The Rise and Fall of Siberian Agreement" (1994) 46 *Europe-Asia Stud.* 1133.

⁴³ Across the regions, general directors report that meetings between senior managers and federal officials occur once or twice a year, whereas meetings with local or regional officials typically occur on at least a monthly basis.

⁴⁴ The Russian-language version of the composite questions makes it clear that we are drawing a distinction between the federal government on one hand, and the local and *oblast* governments on the other.

⁴⁵ See column 3 of Table 6, below.

similar lines, the Saratov *oblast* government under Ayatskov is also well-known for its close relations with industry.⁴⁶ Yet the mean score of 0.8 on a 10 point scale indicates that Saratov procurement directors regard appeals to the Ayatskov government as useless.

Turning to the question posed to the sales directors, we find somewhat anomalous results. We asked these managers whether they had reported or threatened to report their trading partners to local or regional government officials when these partners did not fulfil their contractual obligations. This question presumes less activism on the part of the government. The assumption is that enterprises want to stay in the good graces of the government, and so might alter their behaviour if the respondent enterprise threatened to disclose their poor performance. With the exception of Barnaul, we find that few enterprises have embraced this strategy.⁴⁷ The contrast is striking. 30% of the Barnaul enterprises reported using this method. This is consistent with the reputation of elites from this region for relying heavily on state subsidies.⁴⁸ On the other hand, less than 10% of the enterprises in any of the other regions have used it. Enterprises that resorted to this strategy generally found it helpful.⁴⁹ The evaluations of the effectiveness tend to be higher than for the preceding question. The comparison of the mean scores for effectiveness for the two questions is particularly intriguing. Some regions, such as Barnaul and Ekaterinburg, exhibit consistency. Others are remarkably different. For example, the Moscow and Saratov enterprises that used this tactic found it much more effective in changing the behaviour of their trading partners than direct intervention. These results fit more closely with the reputation of these regional and local governments for working with industry.

F. Shadow of the Law

As enterprises grow more wary of one another—whether as a result of repeated defaults in payment or as a result of a deterioration in macro-economic indicators—they may seek cover through various types of confiscatory remedies. We categorize these as existing within the shadow of the law because they are contractual remedies that assume non-performance and often require the specter of judicial action in order to be operationalized.⁵⁰ We see this strategy as being on the very brink of litigation. Examples of this strategy, such as penalties or collateral arrangements, are more legalistic than the methods previously considered.

⁴⁶ K. Hendley, "Struggling to Survive: A Case Study of Adjustment at a Russian Enterprise" (1998) 50 *Europe-Asia Stud.* 91.

⁴⁷ See column 5 of Table 6, below.

⁴⁸ P. Kirkow, *Russia's Provinces: Authoritarian Transformation Versus Local Autonomy?* (New York: St. Martin's Press, 1998).

⁴⁹ See column 6 of Table 6, below.

⁵⁰ See generally R.H. Mnookin & L. Kornhauser, "Bargaining in the Shadow of the Law: The Case of Divorce" (1979) 88 *Yale L.J.* 950.

Our analysis of this strategy focuses on the use of penalties. Like most countries with a civil law legal tradition, Russian contract law allows for punitive remedies when one party fails to live up to its obligations. This represents a continuity with Soviet law. During the Soviet period, penalties were mostly assessed for late delivery or poor quality. The amounts were minuscule. Their purpose was less to punish the wrongdoer in terms of money than to send a signal to the ministry that something was wrong. Penalties have taken on a very different function in post-Soviet Russia. As inter-enterprise arrears mounted, penalties became a mechanism for encouraging contractual discipline. Penalties against delinquent purchasers were authorized by both presidential decree⁵¹ and statutory law.⁵² However, these penalties are not imposed automatically, but must be affirmatively asserted and claimed by the disgruntled seller.⁵³ Technically, no court order is required to compel payment of penalties, but in actual practice, penalties are one of the threats usually associated with litigation and few purchasers pay them voluntarily.

In order to assess the use of penalties, we return to the questions relating to specific transactions that were posed to the procurement and sales directors. In the set of questions about the payment terms associated with these transactions, we asked whether penalty clauses had been included in the contracts.⁵⁴ We also rely on several questions to the general director in which we asked whether the enterprise had used penalties to obtain payment from delinquent customers over the past two years and whether he was aware of other enterprises using this method. The responses are set forth in Table 7.

As a rule, sellers control the terms of the transactions,⁵⁵ and so the responses of the sales directors presented in column 3 are highly revealing about the intentions of

⁵¹ In mid-1992, President Yeltsin issued a decree authorizing sellers to assess penalties of 0.5% per day of the amount owed against delinquent purchasers with regard to contracts for goods: *Postanovlenie Prezidiuma Verkhovnogo Soveta Rossiiskoi Federatsii i Pravitel'stva R.F. "O neotlozhnykh merakh po uluchsheniui raschetov v narodnom khozyaistve i povyshenii otvetstvennosti predpriyatii za ikh finansovoe sostoyanie"* (25 May 1992) *Vedomosti S"ezda narodnykh deputatov i Verkhovnogo Soveta R.S.F.S.R.*, No. 23.

⁵² Art. 331 of the *Civil Code of the Russian Federation* (Part 1 was enacted in 1994; *Sobranie zakonodatelstva R.F.* (1994) No. 32, item 3301; and Part 2 was enacted in 1995; *Sobranie zakonodatelstva R.F.* (1996) No. 5, item 410 [hereinafter C.C.R.F.]; for the English-language translation, see P.B. Maggs & A.N. Zhiltsov, eds., *The Civil Code of the Russian Federation*, trans. P.B. Maggs & A.N. Zhiltsov (Armonk, N.Y., M.E. Sharpe, 1997)) provides for the enforceability of penalty clauses included in written contracts. Art. 395 C.C.R.F. allows sellers to seek interest for the period during which payment has been delayed. *Arbitrazh* courts differ on whether this interest should be construed as punitive or compensatory damages: see e.g. Part 1 of the C.C.R.F.

⁵³ See generally K. Hendley, "Growing Pains: Balancing Justice & Efficiency in the Russian Economic Courts" (1998) 12 *Temple Int'l and Comp. L.J.* 302 [hereinafter "Growing Pains"].

⁵⁴ This is the same series of questions where we asked about prepayment: see Part II.B., above.

⁵⁵ K. Hendley, P. Murrell & R. Ryterman, "Do 'Repeat Players' Behave Differently in Russia? An Evaluation of Contractual and Litigation Behavior of Russian Enterprises" *L. & Soc. Rev.* [forthcoming in 1999] [hereinafter "Do 'Repeat Players' Behave Differently"].

the respondents. The proportion of surveyed enterprises that included penalty clauses ranged from about one half to two-thirds. At the very least, these findings confirm the widespread use of this strategy. This is reinforced by the responses of the general director as to whether the enterprise had used penalties as a method of collecting overdue payments. In four of the regions, more than 70% of surveyed enterprises reported use of this strategy. In the remaining two regions, Moscow and Voronezh, 53% of enterprises used penalties as a mechanism for collecting debts. How can this discrepancy be explained? Perhaps it is a measure of the regional business culture and the prevailing level of contractual discipline. Over the past two years, Voronezh has had comparatively fewer non-payment cases in the *arbitrazh* court than the national average.⁵⁶ Alternatively, it may be a measure of the health of the regional economy. Moscow enterprises may resort to penalties less often because they have less need to do so. Overall economic indicators are more positive in Moscow and, consequently, these general directors may be less desperate.

We do not assume that the inclusion of a penalty clause or the claim by the general director that the enterprise used penalties to compel payment of contractual obligations necessarily means that penalties were actually collected. Given that the seller has full discretion over whether or not to ask for penalties, this operates as a potent threat. The seller can later appear magnanimous when it foregoes penalties as negotiations draw to a close. This supposition is confirmed by the results of two additional sets of questions. We asked both the procurement and sales directors to estimate what percentage of their contracts include a penalty clause. We then asked in what percentage of contracts in which payment was overdue were penalties actually paid. In the case of the procurement director, this would mean that the respondent enterprise paid the penalties, whereas in the case of the sales director, this would mean that the respondent enterprise collected the penalties. The responses to these questions draw a remarkable contrast. On the one hand, the responses to the questions about inclusion of penalty clauses confirms the popularity of this strategy.⁵⁷ On the other hand, when we asked about what actually happens when payment is late, we found that enterprises rarely collect or pay penalties. On the national level, more than half of all sales contracts include penalty clauses, but in only 8% of sales contracts involving late payment are penalties collected. Regional variation is present, with the percentage of sales contracts in which penalties were collected ranging from three in Moscow to eleven in Barnaul.⁵⁸ The same stark difference is apparent with regard to purchase

⁵⁶ Over the two years of 1996 and 1997, non-payment cases as a percentage of the total number of civil cases decided was 38.25% in Voronezh, as compared to a national average of 50.8%. See "Temporal and Regional Patterns", *supra* note 30.

⁵⁷ The percentages of sales contracts reported to include penalty clauses are: 54% in Moscow; 54% in Novosibirsk; 65% in Ekaterinburg; 44% in Saratov; 50% in Voronezh; and 50% in Barnaul. The percentages of purchase contracts reported to include penalty clauses are: 31% in Moscow; 55% in Novosibirsk; 44% in Ekaterinburg; 33% in Saratov; 50% in Voronezh; and 39% in Barnaul.

⁵⁸ The results for the other regions are: 10% in Novosibirsk; 10% in Ekaterinburg; 4% in Saratov; and 6% in Voronezh.

contracts. The national level data indicate that penalty clauses are included in 40% of all purchase contracts, yet penalties are paid by customers in only 8% of contracts involving overdue payments. Regional level responses vary, with the percentage of purchase contracts in which penalties were paid ranging from five in Moscow to thirteen in Barnaul.⁵⁹

We asked the general directors why penalties are not used more. The responses are remarkably consistent across the regions. They point to a fear of damaging the relationship with the delinquent customer as well as to the inadequacy of laws and institutions (both legal and financial) needed to implement the strategy. They are unconcerned that local or regional authorities might have a negative attitude toward using penalties.

Without exception, fewer enterprises in all regions admit to the inclusion of a penalty clause in purchasing agreements. The terms of these agreements are likely to be controlled by the seller rather than by our respondents.⁶⁰ As a result, the surveyed procurement directors may have viewed this admission as an indicator of weakness. Even assuming that these numbers are a bit soft, they still reflect widespread use of penalties.

G. Litigation

When all else fails, a disgruntled enterprise can always file a lawsuit. We proceed from the assumption that this is a last resort rather than a knee jerk reaction, though we recognize that threats to file lawsuits may come earlier.⁶¹ Indeed, these threats may even be part of a negotiating strategy. Both parties' desire to avoid the costs associated with litigation acts as an inducement to compromise.

Going to court is a meaningful threat and a feasible strategy for dealing with customers only if the courts are perceived as an institution capable of resolving disputes and enforcing their judgments. Assessing the legitimacy of judicial institutions is always a tricky matter.⁶² Under Russian law, disputes between industrial enterprises are within the exclusive jurisdiction of the *arbitrazh* courts.⁶³ These courts are an institutional successor to the Soviet-era state *arbitrazh*.⁶⁴ A number of Western observ-

⁵⁹ The results for the other regions are: 8% in Novosibirsk; 10% in Ekaterinburg; 8% in Saratov; and 7% in Voronezh.

⁶⁰ See "Do 'Repeat Players' Behave Differently", *supra* note 55.

⁶¹ See W.L.F. Felstiner, R.L. Abel & A. Sarat, "The Emergence and Transformation of Disputes: Naming, Blaming, Claiming ..." (1980-81) 15 L. & Soc. Rev. 631; and Macaulay, *supra* note 9.

⁶² See M. Shapiro, *Courts: A Comparative and Political Analysis* (Chicago: University of Chicago Press, 1981).

⁶³ See generally K. Hendley, "Remaking an Institution: The Transition in Russia from State *Arbitrazh* to *Arbitrazh* Courts" (1998) 46 Am. J. of Comp. L. 93 [hereinafter "Remaking an Institution"]; and K. Pistor, "Supply and Demand for Contract Enforcement in Russia: Courts, Arbitration, and Private Enforcement" (1996) 22 Rev. of Central & East Eur. L. 55.

⁶⁴ S. Pomorski, "State *Arbitrazh* in the U.S.S.R." (1977) 9 Rutgers-Camden L.J. 61.

ers have dismissed the *arbitrazh* courts as incapable of handling the sorts of disputes that are likely to arise during the transition to a market economy.⁶⁵ Yet their arguments, which center on claims of prohibitive filing fees and long delays, do not stand up to a detailed assessment of the evidence.⁶⁶ Over the past few years, more than 95% of contractual disputes filed in the *arbitrazh* courts have been resolved within the two-month deadline established by law.⁶⁷ Comparatively speaking, this is a record that most countries (including the United States) cannot match. The difficulty with petitioners being turned away from the *arbitrazh* courts because they could not pay the initial filing fee has been ameliorated by a practice of allowing cash-poor enterprises to petition to have the filing fee paid by the loser at the conclusion of the case.⁶⁸ This is not to say that *arbitrazh* courts are problem-free. They are justly criticized for a poor record on implementation. When the lawyers for our surveyed enterprises were asked to evaluate possible obstacles to using the *arbitrazh* courts, they consistently cited difficulties in enforcing decisions as the most serious of these.⁶⁹ Institutional reforms designed to facilitate the enforcement of decisions were introduced in mid-1997.⁷⁰

The best evidence of the viability of commercial litigation in post-Soviet Russia as a transactional strategy is the high percentage of enterprises that report using, or threatening to use, the *arbitrazh* courts over the past two years.⁷¹ We base our analysis on the composite question posed to the sales director⁷² because it presents the situation of seeking payment from customers, which is the most common scenario according to *arbitrazh* court statistics.⁷³ Table 8 presents the percentage of enterprises in each re-

⁶⁵ See B. Black & R. Kraakman, "A Self-Enforcing Model of Corporate Law" (1996) 109 Harv. L. Rev. 1911; J.R. Hay, A. Shleifer & R.W. Vishny, "Toward a Theory of Legal Reform" (1996) 40 Eur. Econ. Rev. 559; and N.F. O'Donnell & K.Y. Ratnikov, "Dispute Resolution in the Commercial Law Tribunals of the Russian Federation: Law and Practice" (1977) 22 North Carolina J. of Int'l L. & Com. Reg. 795.

⁶⁶ "Temporal and Regional Patterns", *supra* note 30.

⁶⁷ *Ibid.*

⁶⁸ *Ibid.*; and "Growing Pains", *supra* note 53.

⁶⁹ Among the other obstacles listed were cost, time delays, procedural complexity, expense of outside counsel, bias among judges, incompetence of judges, and lack of confidentiality. Respondents from all regions ranked cost and delay as the second and third most serious obstacle to using the *arbitrazh* courts.

⁷⁰ M. Vasil'eva, "Nel'z'ya zhit' po zakonam dzhunglei" (1996) 7 Chelovek i zakon 54.

⁷¹ We presume that threats to initiate lawsuits are *bona fide* and that if the customer fails to respond, the respondent would file the claim.

⁷² See Box 2, below.

⁷³ See "Temporal and Regional Patterns", *supra* note 30. By contrast, lawsuits filed against suppliers are less common. Given the widespread use of prepayment, when lawsuits arise they often involve situations where the customer has paid for goods which were not thereafter delivered. Also militating in favor of fewer lawsuits is the reluctance of enterprises to take actions that might undermine their relationship with long-term suppliers (see Macaulay, *supra* note 9). As this would suggest, the reported use of litigation by procurement directors (see (H) in Box 1, below) is considerably lower. The percentages of enterprises that admitted to filing lawsuits against suppliers are as follows: 24% in

gion that have filed or threatened to file lawsuits. More than half of all surveyed enterprises reported using this strategy. The percentages range from a low of 56 in Novosibirsk to a high of 69 in Ekaterinburg. The variations are attributable to enterprise characteristics. In all likelihood, they stem from the size and/or the presence of a legal department, both of which are legacies from the Soviet era.⁷⁴

The evaluations of the effectiveness of this method are undoubtedly linked to the respondents' opinion of the *arbitrazh* court in their region.⁷⁵ Thus, the mean scores set forth in the third column of Table 8 represent a crude measure of the trust placed in each court, at least by these enterprises. Saratov and Ekaterinburg received the highest scores. It is perhaps not accidental that the *arbitrazh* courts of these two regions have a well-deserved reputation for handling cases efficiently and fairly. The chairpeople (*predsedately*) of these courts are experienced managers, as their consistently low rates of delayed cases confirm.⁷⁶ For example, the average annual percentage of cases that were not decided within the two-month statutory deadline over the three-year period from 1995 to 1997 was 0.8 in Saratov and 1.6 in Ekaterinburg, compared with 8.8 in Barnaul and 5 in Moscow.⁷⁷ These latter two regions received the lowest scores for effectiveness.

The comparatively low scores awarded by the Moscow sales managers is a bit puzzling. The Moscow City *arbitrazh* court is universally recognized as highly competent. In fact, many non-Moscow enterprises include a clause in their form contracts granting jurisdiction to the Moscow City *arbitrazh* court. By virtue of being located in the financial center of Russia, its judges regularly confront more complicated commercial matters than do other *arbitrazh* judges, and they have learned how to deal with these cases. It is also the largest and most well-funded of all the trial-level *arbitrazh* courts. Given all of this, the consensus of the Moscow enterprises that litigation is not a terribly effective strategy is surprising. Perhaps it reflects a dissatisfaction with the outcomes of the cases in which they participated.

Moscow; 33% in Novosibirsk; 20% in Ekaterinburg; 16% in Saratov; 25% in Voronezh; and 34% in Barnaul.

⁷⁴ See "Do 'Repeat Players' Behave Differently", *supra* note 55.

⁷⁵ Russian *arbitrazh* courts are organized on a regional basis. The strong preference of enterprises to litigate in their local court is indicated by their tendency to include clauses in their form contracts ceding jurisdiction to this court. Absent such a clause, the *arbitrazh* court closest to the defendant exercises jurisdiction.

⁷⁶ The Saratov chairman is male. His Ekaterinburg counterpart is female. Both are carryovers from the days of state *arbitrazh*. Multiple interviews with them between 1993 and 1997 indicate that they are well-versed in the new procedures and committed to making their courts run smoothly. These chairpersons carry the title of "judge" but, in contrast to chief judges of common law courts, they rarely hear cases. They are primarily occupied with managerial tasks, such as assigning cases. See generally "Remaking an Institution", *supra* note 63.

⁷⁷ "Temporal and Regional Patterns", *supra* note 30.

Conclusion

The evidence presented above contributes to filling a gap in our knowledge of how Russian enterprises interact with one another. It builds on previous work that looked at survey results for Russia as a whole,⁷⁸ but adds a critical nuance by focusing on regional variation in transactional strategies. Differences among regions in enterprise behaviour is present for all of the tactics examined, both in terms of basic use and perceived effectiveness. Even more importantly, many of these differences are the result of regional effects (as opposed to characteristics of the surveyed enterprises, such as size, age, ownership, and access to legal expertise). At this point, however, we have only begun the process of developing the causal explanations for the behaviour described. Based on our knowledge of the politics and the institutional landscape of the surveyed regions, we have suggested possible reasons for the observed variations. We recognize these as mere starting points for more detailed analyses in order to determine precisely why enterprises in particular regions embrace or eschew each strategy.

The existing literature on Russia's regions tends to evaluate and group them on broader criteria, such as support for economic reform or democracy, or effectiveness of government.⁷⁹ It might seem that, on the basis of relative levels of use of various strategies, we could also surmise that enterprises in certain regions are more positively disposed toward markets and/or law. But this approach only confuses matters in our case. The transactional strategies we have identified cannot be neatly divided into pro- and anti-market. Nor is it always obvious whether their use is indicative of a receptivity or antipathy toward law. Much depends on context. For example, when an enterprise relies on relational contracting tactics rather than filing a lawsuit, it may be seen as an effort to resolve a potential dispute with a minimum of fuss, thereby minimizing transaction costs.⁸⁰ Alternatively, the same situation may be seen as reflecting an unwillingness to deal with unknown trading partners, which may have the effect of limiting market development.⁸¹

The absence of clear and consistent regional patterns in the results is yet another reason why efforts to categorize the surveyed regions are futile. In other words, even if it could be established that certain sorts of behaviour are indicative of pro- or anti-market attitudes, the results are too scattered. Indeed, if we were to rank the regions as to their propensity to use each strategy, we would find that each list looked different. There is not even any consistency as to which regions have similar results. Thus, in contrast to what Berkowitz and DeJong found for price policy,⁸² our findings do not

⁷⁸ "Law, Relationships, and Private Enforcement", *supra* note 14.

⁷⁹ Berkowitz & DeJong, *supra* note 1; Stoner-Weiss, *supra* note 5; Grigor'ev, Malyutin & Neshchadin, *supra* note 3; Hahn, *supra* note 2.

⁸⁰ See Williamson, *supra* note 19; and Macaulay, *supra* note 9.

⁸¹ D.C. North, *Institutions, Institutional Change, and Economic Performance* (Cambridge: Cambridge University Press, 1990) at 119-22.

⁸² *Supra* note 1.

reflect any behavioural bright line between regions in the Red Belt and others.⁸³ Indeed, enterprises in the Red Belt regions do not act similarly with respect to any of the strategies studied.

Although we cannot discern the existence of overarching patterns, two regions do emerge as distinct. These are Moscow and Barnaul. The importance of financial institutions provides at least part of the explanation. For example, in Barnaul where banks have proven incapable of processing payments in a timely fashion and bank credits for enterprises are illusory, enterprises barter extensively and look to the government and others to help them out of difficulties. By contrast, in Moscow where banks function fairly effectively, enterprises can rely on arm's length tactics, such as prepayment.

Finally, the evidence tends to undermine a few long-held assumptions. It demonstrates that Russian enterprises generally reject the use of private force to enforce contractual obligations, and that enterprises regularly use legal institutions and pursue legalistic remedies. The argument that economic reform has been thwarted by the absence of viable mechanisms for enforcing contracts and other property rights deserves to be re-evaluated.

⁸³ *Supra* note 15.

Questionnaire Boxes

BOX 1: QUESTION POSED TO THE PURCHASING DEPARTMENT

| During the past two years, how important were the following methods in helping your enterprise to prevent and/or resolve problems arising in relationships with suppliers? First, please tell us whether you used the method. If the method was used, then please evaluate its effectiveness on a scale from 0 to 10. A "0" means either that the method was not used at all or that it was not effective and a "10" means that the method was very effective. | | |
|--|---|--|
| Method | 1 = Yes, this method was used during the past two years. 2 = No, this method was not used during the past two years. | On a scale from 0 to 10, how effective was the method during the past two years? |
| Formal business meetings between lower-level officials of the trading partners. (A) | | |
| Formal business meetings between the general directors of the trading partners. | | |
| Informal meetings between counterparts in the two enterprises, for example, in a restaurant, banya, recreational facility, or civic organization. | | |
| Intervention by other enterprises. (B) | | |
| Intervention by officials of a business association or a financial-industrial group. | | |
| Use of private enforcement firms (security firms, collection agencies, mafia, etc.). (D) | | |
| Intervention by banks. | | |
| Intervention by representatives of political parties or movements. | | |
| Intervention by officials of the local government. (E) | | |
| Intervention by officials of the federal government | | |
| Use of <i>arbitrazh</i> courts. (H) | | |
| Use of <i>treteiskie</i> courts. (Note: <i>Treteiskie</i> courts are private tribunals that arbitrate business disputes at the request of the parties.) | | |

BOX 2: QUESTION POSED TO THE SALES DEPARTMENT

| Listed below are some possible methods of dealing with customers that did not honour their agreements with your enterprise. First, please tell us whether your enterprise has used or threatened to use this method during the past two years. Then, please tell us how effective either the threat of using these methods or their actual use has been in getting them to honour their agreements. Convey your views by choosing a point on a scale from 0 to 10. A "0" means either that the method was not used at all or that it was not effective and a "10" means that the method was very effective. | | |
|---|--|---|
| Method | 1 = Yes, our enterprise used or threatened to use this method during the past two years. 2 = No, our enterprise did not use or threaten to use this method during the past two years. | On a scale from 0 to 10, how effective is this method for getting other firms to honor their agreements with you? |
| Telling other enterprises about the behaviour of an enterprise that did not honour its agreement. (C) | | |
| Forcing the enterprise to pay a financial penalty. | | |
| Stopping trade with the enterprise. | | |
| Filing a complaint against the enterprise with an anti-monopoly committee. | | |
| Sending <i>pretenzia</i> or other notices suggesting a possible court action. | | |
| Filing a claim in <i>arbitrazh</i> court. (G) | | |
| Reporting the enterprise to a local government organ. (F) | | |
| Reporting the enterprise to a federal government organ. | | |
| Reporting the enterprise to a business association or a financial-industrial group. | | |
| Reporting the enterprise to social, religious, or civic organizations. | | |

Tables of Figures

TABLE 1: RELATIONAL CONTRACTING

The use and effectiveness of formal business meetings between lower-level officials of the trading partners in helping the enterprise to prevent and/or resolve problems arising in relationships with suppliers (see (A) in Box 1).

| Regions | Percentage of enterprises using method | Average scale score for those using method | Average scale score across all enterprises (assuming score = 0 if not used) |
|--|--|--|---|
| Moscow | 70.91 | 7.1 | 5.04 |
| Novosibirsk | 75.93 | 7.39 | 5.51 |
| Ekaterinburg | 79.63 | 7.72 | 6.04 |
| Saratov | 60 | 7.12 | 4.27 |
| Voronezh | 83.64 | 7.87 | 6.58 |
| Barnaul | 88.68 | 7.66 | 6.79 |
| Results of an F-test showing whether regional effects are significant or not | Significant | Insignificant | Significant |

TABLE 2: SELF-ENFORCEMENT—PREPAYMENT

| Regions | Re: specific purchasing transaction | | | Re: specific sales transaction | | |
|--|-------------------------------------|------------------------|---|--------------------------------|------------------------|---|
| | Full prepayment (%) | Partial prepayment (%) | Difference: contractual & actual prepayment (%) | Full prepayment (%) | Partial prepayment (%) | Difference: contractual & actual prepayment (%) |
| | (2) | (3) | (4) | (5) | (6) | (7) |
| Moscow | 40 | 70.91 | 6.41 | 52.73 | 83.64 | 7.8 |
| Novosibirsk | 45.45 | 80 | 13.48 | 48.15 | 90.74 | 6.53 |
| Ekaterinburg | 38.18 | 85.45 | 10.36 | 40.74 | 75.93 | 16.73 |
| Saratov | 49.09 | 80 | 5 | 67.27 | 85.45 | 7.33 |
| Voronezh | 36.36 | 65.45 | 5.7 | 38.89 | 55.56 | 7.36 |
| Barnaul | 38 | 68 | 6.25 | 18.37 | 48.98 | 7.94 |
| Results of an F-test showing whether regional effects are significant or not | Insignificant | Insignificant | Insignificant | Significant | Significant | Insignificant |

TABLE 3: SELF-ENFORCEMENT—BARTER

| Regions | Percentage of output sold through barter | | Percentage of inputs obtained through barter | |
|--|--|-------------|--|-------------|
| | 1992 | 1997 | 1992 | 1997 |
| Moscow | 11.06 | 15.49 | 6.02 | 14.05 |
| Novosibirsk | 7.89 | 47.91 | 13.54 | 50.72 |
| Ekaterinburg | 10.06 | 46.47 | 9.14 | 41.46 |
| Saratov | 6.35 | 49.09 | 14.1 | 44.47 |
| Voronezh | 8.13 | 35.13 | 10.71 | 38.75 |
| Barnaul | 9.48 | 63.92 | 9.69 | 63.39 |
| Results of an F-test showing whether regional effects are significant or not | Insignificant | Significant | Insignificant | Significant |

TABLE 4: THIRD-PARTY ENFORCEMENT

Question to Procurement Director: The use and effectiveness of intervention by other enterprises in helping the enterprise to prevent and/or resolve problems arising in relationships with suppliers (see (B) in Box 1).

Question to Sales Director: Telling or threatening to tell other enterprises about the behaviour of an enterprise that did not honour its agreement, and the effectiveness of this method in changing that enterprise's behaviour (see (C) in Box 2).

| Regions | Question to Procurement Director | | | Question to Sales Director | | |
|--|--|--|---|--|--|---|
| | Percentage of enterprises using method | Average scale score for those using method | Average scale score across all enterprises (assuming score = 0 if not used) | Percentage of enterprises using method | Average scale score for those using method | Average scale score across all enterprises (assuming score = 0 if not used) |
| | (2) | (3) | (4) | (5) | (6) | (7) |
| Moscow | 14.56 | 5.13 | 5.04 | 40 | 3.57 | 1.36 |
| Novosibirsk | 14.81 | 5.88 | 5.51 | 45.45 | 4.13 | 1.8 |
| Ekateriuburg | 14.81 | 7.72 | 6.04 | 54.55 | 4.93 | 2.69 |
| Saratov | 7.27 | 7.12 | 4.27 | 45.45 | 5.12 | 2.33 |
| Voronezb | 14.55 | 7.87 | 6.58 | 47.27 | 4.58 | 2.16 |
| Barnaul | 26.42 | 7.66 | 6.79 | 52.83 | 3.93 | 2 |
| Results of an F-test showing whether regional effects are significant or not | Insignificant | Insignificant | Significant | Insignificant | Insignificant | Insignificant |

TABLE 5: PRIVATE ENFORCEMENT

The use and effectiveness of private enforcement firms (security firms, collection agencies, mafia, etc.) in helping the enterprise to prevent and/or resolve problems arising in relationships with suppliers (see (D) in Box 1).

| Regions | Enterprises using method | | Average scale score for those using method | Average scale score across all enterprises (assuming score = 0 if not used) |
|--|--------------------------|---------------|--|---|
| | % | Actual number | | |
| Moscow | 5.45 | 3 | 5 | 0.27 |
| Novosibirsk | 1.85 | 1 | 2 | 0.04 |
| Ekaterinburg | 1.85 | 1 | 10 | 0.18 |
| Saratov | 0 | 0 | — | — |
| Voronezh | 1.82 | 1 | 0 | 0 |
| Barnaul | 5.66 | 3 | 9.67 | 0.55 |
| Results of an F-test showing whether regional effects are significant or not | Insignificant | | No test performed because of small numbers of enterprises using method | Insignificant |

TABLE 6: ADMINISTRATIVE LEVERS OF THE STATE

Question to Procurement Director: The use and effectiveness of intervention by local government officials in helping the enterprise to prevent and/or resolve problems arising in relationships with suppliers (see (E) in Box 1).

Question to Sales Director: Reporting or threatening to report the failure of a trading partner to live up to its contractual obligation to a local government organ, and the effectiveness of this method in changing that trading partner's behaviour (see (F) in Box 2).

| Regions | Question to Procurement Director | | | Question to Sales Director | | |
|--|---|---|--|---|---|--|
| | Percentage of enterprises using method (2) | Average scale score for those using method (3) | Average scale score across all enterprises (assuming score = 0 if not used) (4) | Percentage of enterprises using method (5) | Average scale score for those using method (6) | Average scale score across all enterprises (assuming score = 0 if not used) (7) |
| Moscow | 12.73 | 1 | 0.11 | 7.27 | 5.25 | 0.38 |
| Novosibirsk | 14.55 | 2.88 | 0.42 | 9.26 | 5.2 | 0.47 |
| Ekaterinburg | 5.45 | 3.33 | 0.18 | 5.56 | 4.33 | 0.24 |
| Saratov | 20 | 0.8 | 0.15 | 7.27 | 4.5 | 0.33 |
| Voronezh | 10.91 | 1.83 | 0.2 | 3.64 | 2.5 | 0.09 |
| Barnaul | 20.75 | 4.27 | 0.89 | 30.19 | 4.19 | 1.26 |
| Results of an F-test showing whether regional effects are significant or not | Insignificant | Significant | Significant | Significant | Insignificant | Significant |

TABLE 7: SHADOW OF THE LAW—PENALTIES

Column (2): Percentage of enterprises that included a clause subjecting them to penalties in case of late payment in their specific purchasing agreement. (Question posed to procurement director.)

Column (3): Percentage of enterprises that included a clause allowing them to impose penalties on customers who did not pay in a timely fashion in their specific sales agreement. (Question posed to sales director.)

Column (4): Percentage of enterprises that endeavoured to collect penalties from customers with overdue payments. (Question posed to general director.)

Column (5): The percentage of general directors who believe that other enterprises have used penalties to collect overdue payment from customer.

| Regions | Penalty clause in purchase agreement (%) | Penalty clause in sales agree- ment (%) | Use of penalties to collect over- due payments (%) | Use of penalties by other enter- prises to collect overdue pay- ments (%) |
|--|--|---|---|---|
| | (2) | (3) | (4) | (5) |
| Moscow | 44 | 51 | 53 | 56 |
| Novosibirsk | 56 | 67 | 71 | 58 |
| Ekaterinburg | 24 | 47 | 71 | 65 |
| Saratov | 38 | 49 | 71 | 67 |
| Voronezh | 43 | 56 | 53 | 65 |
| Barnaul | 43 | 62 | 75 | 70 |
| Results of an F- test showing whether regional effects are significant or not | Significant | Insignificant | Significant | Insignificant |

TABLE 8: LITIGATION

Filing a lawsuit in *arbitrazh* court or threatening to do so as a mechanism for encouraging non-paying customers to honour their agreements, and the effectiveness of this method (see (G) in Box 2).

| Regions | Percentage of enterprises using method | Average scale score for those using method | Average scale score across all enterprises (assuming score = 0 if not used) |
|--|--|--|---|
| Moscow | 58.18 | 3.57 | 1.36 |
| Novosibirsk | 56.36 | 4.13 | 1.8 |
| Ekaterinburg | 69.09 | 4.93 | 2.69 |
| Saratov | 61.82 | 5.12 | 2.33 |
| Voronezh | 60 | 4.58 | 2.16 |
| Barnaul | 60.38 | 3.93 | 2 |
| Results of an F-test showing whether regional effects are significant or not | Insignificant | Significant | Significant |

References

Legislation

Civil Code of the Russian Federation, Part 1: *Sobranie zakonodatelstva R.F.* (1994) No. 32, item 3301; Part 2: *Sobranie zakonodatelstva R.F.* (1996) No. 5, item 410.

Postanovlenie Prezidiuma Verkhovnogo Soveta Rossiiskoi Federatsii i Pravitel'stva R.F. "O neotlozhnykh merakh po uluchsheniiu raschetov v narodnom khozyaistve i povyshenii otvetstvennosti predpriyatii za ikh finansovoe sostoyanie" (25 May 1992) *Vedomosti S"ezda narodnykh deputatov i Verkhovnogo Soveta R.S.F.S.R.*, No. 23.

Articles

Berkowitz, D. & DeJong, D.N., "Russia's Internal Border" (1998) [unpublished, archived at the University of Wisconsin-Madison with Professor K. Hendley].

Bezrukov, V., "Basic Problems of Development of the Economic Reform in Regions of the Russian Federation" (1996) 39:6 *Probs. Econ. Transition* 26.

Black, B. & Kraakman, R., "A Self-Enforcing Model of Corporate Law" (1996) 109 *Harv. L. Rev.* 1911.

DiPaola, P.D., "The Criminal Time Bomb: An Examination of the Effect of the Russian Mafiya on the Newly Independent States of the Former Soviet Union" (1996) 4 *Indiana J. Global Leg. Stud.* 145.

Easter, G.M., "Redefining Centre-Regional Relations in the Russian Federation: Sverdlovsk Oblast" (1997) 49 *Europe-Asia Stud.* 617.

Felstiner, W.L.F., Abel, R.L. & Sarat, A., "The Emergence and Transformation of Disputes: Naming, Blaming, Claiming ..." (1980-81) 15 *L. & Soc. Rev.* 631.

Grigor'ev, O., Malyutin, M. & Neshchadin, A., "Regional Alternative Approaches to Economic Reform" in K. Segbers & S. De Spiegeleire, eds., *Post-Soviet Puzzles: Mapping the Political Economy of the Former Soviet Union*, vol. 2 (Baden-Baden: Nomos, 1995) 85.

Hahn, J.W., "Reforming Post-Soviet Russia: The Attitudes of Local Politicians" in T.H. Friedgut & J.W. Hahn, eds., *Local Power and Post-Soviet Politics* (Armonk, N.Y.: M.E. Sharpe, 1994) 208.

Hanson, P., "Regions, Local Power and Economic Change in Russia" in A. Smith, ed., *Challenges for Russian Economic Reform* (Washington: The Brookings Institution, 1995) 21.

Hay, J.R., Shleifer, A. & Vishny, R.W., "Toward a Theory of Legal Reform" (1996) 40 *Eur. Econ. Rev.* 559.

Hendley, K., "Growing Pains: Balancing Justice & Efficiency in the Russian Economic Courts" (1998) 12 *Temple Int'l and Comp. L.J.* 302.

Hendley, K., "Remaking an Institution: The Transition in Russia from State *Arbitrazh* to *Arbitrazh* Courts" (1998) 46 Am. J. of Comp. L. 93.

Hendley, K., "Struggling to Survive: A Case Study of Adjustment at a Russian Enterprise" (1998) 50 Europe-Asia Stud. 91.

Hendley, K., "Temporal and Regional Patterns of Commercial Litigation in Post-Soviet Russia" (1998) 39:7 Post-Soviet Geography & Econ. 379.

Hendley, K., Murrell, P. & Ryterman, R., "Do 'Repeat Players' Behave Differently in Russia? An Evaluation of Contractual and Litigation Behavior of Russian Enterprises" L. & Soc. Rev. [forthcoming in 1999].

Hendley, K., Murrell, P. & Ryterman, R., "Law, Relationships, and Private Enforcement: Transactional Strategies of Russian Enterprises" (1998) [unpublished, archived at the University of Wisconsin-Madison with Professor K. Hendley].

Hoffmann, E.P., "The Dynamics of State-Society Relations in Post-Soviet Russia" in H. Eckstein *et al.*, *Can Democracy Take Root in Post-Soviet Russia? Explorations in State-Society Relations* (Lanham, Md.: Rowman & Littlefield, 1998) 69.

Hughes, J., "Regionalism in Russia: The Rise and Fall of Siberian Agreement" (1994) 46 Europe-Asia Stud. 1133.

Ickes, B.W. & Ryterman, R., "The Inter-Enterprise Arrears Crisis in Russia" (1992) 8 Post-Soviet Affairs 331.

Ickes, B.W. & Ryterman, R., "Roadblock to Economic Reform: Inter-Enterprise Debt and the Transition to Markets" (1993) 9 Post-Soviet Affairs 231.

Kovalevskii, A., "Regional Peculiarities of Privatization in Russia" in K. Segbers & S. De Spiegeleire, eds., *Post-Soviet Puzzles: Mapping the Political Economy of the Former Soviet Union*, vol. 2 (Baden-Baden: Nomos, 1995) 221.

Leitzel, J., Gaddy, C., & Alexeev, M., "Mafiosi and Matrioshki: Organized Crime and Russian Reform" (1995) 13 Brookings Rev. 26.

Macaulay, S., "Non-Contractual Relations in Business: A Preliminary Study" (1963) 28 Am. Sociological Rev. 55.

Markova, N., "Russia's Regions: The Results of Four Years of Economic Reforms" (1996) 39:6 Probs. Econ. Transition 6.

McFaul, M., "Why Russia's Politics Matter" (1995) 74 Foreign Affairs 87.

Mnookin, R.H. & Kornhauser, L., "Bargaining in the Shadow of the Law: The Case of Divorce" (1979) 88 Yale L.J. 950.

O'Donnell, N.F. & Ratnikov, K.Y., "Dispute Resolution in the Commercial Law Tribunals of the Russian Federation: Law and Practice" (1977) 22 North Carolina J. of Int'l L. & Com. Reg. 795.

Pistor, K., "Supply and Demand for Contract Enforcement in Russia: Courts, Arbitration, and Private Enforcement" (1996) 22 Rev. of Central & East Eur. L. 55.

- Pomorski, S., "State Arbitrazh in the U.S.S.R." (1977) 9 Rutgers-Camden L.J. 61.
- Shelley, L., "Post-Soviet Organized Crime and the Rule of Law" (1995) 28 John Marshall L. Rev. 827.
- Slider, D., "Regional Aspects of Privatization in Russia" in P.J. Stavrakis, J. DeBardeleben & L. Black (with the assistance of J. Koehn), eds., *Beyond the Monolith: The Emergence of Regionalism in Post-Soviet Russia* (Washington: The Woodrow Wilson Center Press, 1997) 105.
- Van Selm, B., "Economic Performance in Russia's Regions" (1998) 50 Europe-Asia Stud. 603.
- Vasil'eva, M., "Nel'z'ya zhit' po zakonam dzhunglei" (1996) 7 Chelovek i zakon 54.
- Young, J.F., "Institutions, Elites, and Local Politics in Russia: The Case of Omsk" in T.H. Friedgut & J.W. Hahn, eds., *Local Power and Post-Soviet Politics* (Armonk, N.Y.: M.E. Sharpe, 1994) 138.

Books

- Aslund, A., *How Russia Became a Market Economy* (Washington: The Brookings Institution, 1995).
- Berliner, J.S., *Factory and Manager in the USSR* (Cambridge: Harvard University Press, 1957).
- Evans, P., *Embedded Autonomy: States and Industrial Transformation* (Princeton: Princeton University Press, 1995).
- Evans, P., Rueschemeyer, D. & Skocpol, T., eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985).
- Handelman, S., *Comrade Criminal: Russia's New Mafiya* (New Haven: Yale University Press, 1995).
- Hough, J.F., *The Soviet Prefects: The Local Party Organs in Industrial Decision-Making* (Cambridge: Harvard University Press, 1969).
- Kirkow, P., *Russia's Provinces: Authoritarian Transformation Versus Local Autonomy?* (New York: St. Martin's Press, 1998).
- Maggs, P.B. & Zhiltsov, A.N., eds., *The Civil Code of the Russian Federation*, trans. P.B. Maggs & A.N. Zhiltsov (Armonk, N.Y., M.E. Sharpe, 1997).
- Nonet, P. & Selznick, P., *Law and Society in Transition: Toward Responsive Law* (New York: Harper & Row, 1978).
- North, D.C., *Institutions, Institutional Change, and Economic Performance* (Cambridge: Cambridge University Press, 1990).
- Shapiro, M., *Courts: A Comparative and Political Analysis* (Chicago: University of Chicago Press, 1981).

Stoner-Weiss, K., *Local Heroes: The Political Economy of Russian Regional Governance* (Princeton: Princeton University Press, 1997).

Williamson, O.E., *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, 1985).

Zysman, J., *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change* (Ithaca: Cornell University Press, 1983).
