UNIVERSITÄT POTSDAM

WIRTSCHAFTS- UND SOZIALWISSENSCHAFTLICHE FAKULTÄT

VOLKSWIRTSCHAFTLICHE DISKUSSIONSBEITRÄGE

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DO INSTITUTIONS MATTER?
An Analysis of the Russian Competition Policy in the Period of Transformation

Diskussionsbeitrag Nr. 88

Potsdam 2006

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XI. AISPE Conference
Padua, 15. - 17. June 2006

Potsdam 2006

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1 Introduction

As the process of transformation in Russia began at the end of 1989, there were no concrete theories about what have to be done to accomplish the transformation process successfully with a free market economy established. The paper discusses what transformation theory changes were occurred in the passed 15 years of transformation process and the recent theory developments. Three strategies were applied consecutively by leading economists. The first ordoliberal approach was based on a gradual creation of framework of free market economy. The second, based on the neoclassical theory, proposed a radical change process involving the immediate destruction of old institutions and a rapid conversion to free market arrangements. In particular, the ordoliberal approach propounded already in 1989 reforms with emphasize on gradual setting of framework of the free market economy. The result was a collapse of producing structures and declining of the social product. As consequence, in the earlier 1990s most leading economists in their advisory capacities assumed that a speedy change of the system from a centrally managed economy to a free market economy would be possible and better. Therefore, they tried to speed up the introduction of appropriate accountable institutions of the free market economy, like legal and financial systems, private property etc. Once again the method showed not to be the right and the institutions proposed, partly, didn't and still don't work properly. On a deeper analysis it's evident that both of the transformation approaches focus on the static institutional result and answer the question which institutions need to be implemented. However, the more important issue is how institutions have to be designed and established that they can fulfil their aims. Responding the question, why the new institutions do not work, the third approach has been developed lately. This model, which nowadays seems to be the most promising, refers institutional economics approach with a focus on the way of implementation as well as on quality of institutions measured by their effectiveness and/or efficiency. On this basis the paper analyses the competition policy in Russia as an example of a new free market institution. After a long transformation period the effectiveness of Russian competition policy is still low: the old producing structures sustained despite the privatisation; markets are mostly signed by high concentration and abuse of dominant market position; the existing competition law and the law enforcement procedure are ineffective and can hardly provide a long-term positive effect. Drawing upon existing theories of institutional economics, the paper analyses how new institutions could be successfully established and which factors are responsible for effectiveness and efficiency of new institutions.

2 Institutions and the Institutional Change

2.1 Institutions and Theoretical Concepts in Economics

At the starting point should be clarified what we assume to be an institution. In a broad sense, institutions are sets of rules that reduce uncertainty restricting and canalising behaviour of economic and social actors. It can be distinguished between formal and informal institutions. Formal or codified institutions involve organisations, law, and economic agents themselves and are generally defined as the law sphere, with constitutions, regulations and policies. Formal rules are directly connected to the political-economic structure such as governance, property rights, and judiciary system. Thus, the legal system bears responsibility for the reinforcing of the formal institutions. Besides, there are informal or not-codified institutions such as behavioural rules, social norms, conventions, moral values, religious beliefs, traditions and other behavioural norms that have passed the test of the historical evolution and that determine the individual's behaviour as well as organisations in pursuit of their aims. This last type of intuitions represents cultural heritage of a community, and results from the dynamic evolution of the society. Furthermore, these rules are self-reinforcing through mechanisms such as imitations, traditions and other form of teaching. Fears to be not accepted in a community or even be excluded from it facilitate the self-reinforcing process.[1]

The institutions, formal and informal, are not exogenously defined and unchangeable. They have a social nature so they change, slowly but continuously. People change itself in the run of the time, according to also institutions. As mentioned above, they aim the reducing of uncertainty by planning and conducting economic activities. A frequent or a fast change of institutional rules causes instability and uncertainty by economic (and political) actors, so that they need to show a grade of stability and persistence. A certain resistance against changes is, therefore, characteristically for institutions. Notwithstanding, they change in the run of time and adapt themselves to the new economic data.

Institutional change can follow as a consequence of the social evolution or occur by strategic decisions of policymakers. The first way is a more natural one, though not applicable by radical changes such as economic transformation. In this case institutional change needs to be imposed by political decision. The crucial question is what result of such change could be expected. In this point the theoretical approaches differ very strongly due to different conception of institution's role they are based on. Most important are to be presented here.

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[1] Tridico (2004), pp. 4-6.

Neoclassical approach

In the basic paradigm of the *Neoclassical theory* no allocation mechanism different from market exists. The only institution admitted is the market, which determines the prices. Informal institutions such as equity, norms and behaviours are not subject of consideration because they do not influence allocation regarding to the concept. Besides, the institutions are exogenously given; they built only the framework for market activities and are not considered in the economic analysis. In the *Neoclassical theory* with perfect information the allocation is price-guided; and as framework only institutions significant to market activity such as institution of property rights and financial institutions need to be set up. Generally said, no other institutions are useful instead they inhibit the economic performance. Thus, the *Neoclassical theory* proposes by economic transformation a radical change (Big-Bang)[2] through a fast establishing of indicated set of rules and counts on the market forces in the further developing of the market economy.

Ordoliberal approach[3]

Ordoliberalism in its broad conception underlines the necessity of basic principles to implement an economic order.[4] Institutions and their establishing build the main core of this approach. The requirements of *the Ordoliberal* concerning the planning of institutions are high. First of all, they demand the rule of law and the precept of conformity to the institutional framework. It means, all relevant institutions in the economy must satisfy this precept. Secondly, they consider not only the isolated laws, but also the interaction of these elements in the system of laws. This system needs to be governed by a set of principles[5], which all together should take care of a human order. These principles must guarantee the workability of the whole set of rules. On the one hand, the principles must respond the characteristics of the processes in the market and in the political-administrative machine. On the other hand, they have to reflect what we understand by a humane society.[6]

In practice, politicians will pursue an economic policy forming an integrated whole, which can be done as a gradual process. Establishing of new institutions must be examined by

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2 Sachs (1993), S. 236.

3 Here I refer to Eucken, Böhm and Miksch.

4 The deeper overview of the Ordoliberal approach, see Goldschmidt/Berndt (2003), p. 12.

5 Eucken defined in his "Principals of Economic Policy" two groups of principles: structuring and regulating principles, see Eucken (1990); Grossekettler on the basis of the same book distinguishes four groups of principles: structuring principles, regulating principles, "potential additional principles" and the principles of the state itself, see Grossekettler (1994), pp. 17-18.

6 Grossekettler (1994), pp. 14-15.

conformity with the whole framework and with the sets of principles. In *the Ordoliberal view*, competition is the primary regulative principle, because only an environment of competition allows economic actors optimally unfold their creativity and helps to coordinate it in voluntary decisions. Accordingly, every markets form can be established must be safeguarded by the market order of functioning competition. The policy should include the protection of competition, since it suffers from a tendency to self-destruction.[7]

Old Institutional Economics (OIE) [8]

The core of *Old Institutional Economics* builds a concept of economic behaviour, which shapes and explains institutions. The representatives of this school reject the concept of methodological individualism as well as the concept of a rational behaviour, which is directed towards maximisation of individual utility. Therefore, *OIE* emphasises the role of habits, behavioural and social rules as the basis of human action. According to *OIE's* concept, the institutions represent a set of rules that allows the enterprises and the consumers respectively "satisfy" and not "maximise" their own return and utility. Moreover, the institutions are not necessarily created to be socially and economically efficient, but to serve and to preserve the interests of some social groups and to create new rules. Therefore, as long as institutions are committed to their original aims, they are considered to be effective.[9]

In accordance with *Old institutionalism*, imitation and emulation of behaviours lead to the emergence or reinforcement of institutions. On its part, an institution standardises behaviours and helps to transmit rules to new social actors. Institutions, in that way, summarise individual actions to a collective action. These collective actions are regulated and controlled by laws, social customs, organisations and individual behaviour in terms of bargaining, negotiating, transacting, etc. Therefore, collective action determines directly and indirectly all economic relations of individuals.[10]

To conclude, the representatives of the *Old Institutional School* are convinced that most of what people do is governed by institutions of their society. And for them it means that culture defines the permissible and the forbidden, defines right and wrong, the admirable and its opposite, gives content to these definitions with rules for behaviour and so provides

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7 Miksch (1937), p. 9.
8 Here I refer to Veblen, Commons and more recently to Hodgson.
9 Tridico (2004), p. 4.
10 Chamberlain (1963), p. 75.

opportunities as well as limits.[11] A strategic change of institutions in a short term cannot succeed according to this conception. New formal institutions, which are not supported by existing informal institutions, would not be accepted, and finally do not correspond with their original aims.

New Institutional Economics (NIE)[12]

The *New Institutional Economics* tries to put together the previous theoretical findings, though is undoubtedly based on the neoclassical theory. Some of representatives like *Liebecap* claim that "the new institutional economics retains its general attachment to *Neoclassical economics* with its emphasis on individual maximization and marginal analysis, but with attention to transaction costs, information problems, and bounded rationality"[13]. Another like *North* provide an alternative definition of institutions – they are considered as "…the rules of the game in a society, or more formally, are the humanly devised constraints that shape human interaction"[14]. Here, institutions help to reduce uncertainty in economic relations and remedy market failures. *North*, in his theoretical approach, is close to the *Old institutionalism* as he states that institutions should not be necessarily efficient – "[i]nstitutions are not necessarily or even usually created to be socially efficient; rather they, or at least the formal rules, are created to serve the interests of those with bargaining power to devise new rules"[15]. Furthermore, *North* highlights the vital role of power clusters and lobbies upon the institutional agreements. He introduces the concept of transaction costs and considers efficient the institutions that minimise the transaction costs. To him, the most important role of institutions is that of reducing the uncertainty in order to determine a steady framework of social relations.

Building a bridge between the *Old* and the *New Institutional Economics North* states that imperfect information, bounded rationality and different types of market asymmetries cause a rise in transaction costs. The mean of institutions in this imperfect economic world is to reduce uncertainty and give more stability to economic relations. Transaction costs can make up a big part of the total cost of production and derivers from exchanging, protecting and enforcing property rights as well as acquiring information. As in the *Neoclassical theory*

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[11] Neale (1988), pp. 227-256.
[12] Here I refer to Liebecap, North and Stark.
[13] Libecap (1998).
[14] North (1990), p. 3.
[15] North (1990), p. 16.

institutions can be set up in a short period of time, however, the extent of transaction costs would determine institution's efficiency.

As in introduction mentioned, the first two approaches had a little success in introducing of the new institutions during the transformation process, especially to Russia. The pure existence of new institutional rules does not assure their functioning, which can be valuated in terms of effectiveness and efficiency of the institution. In consequence, the theoretical findings of *the New and the Old Institutional Economics* can be used to define the determinants of institutional effectiveness and efficiency. However, before these will be explained, some additional characteristics of institutional change resulting of the last two theoretical approaches such as path dependence and a possible inconsistence of institutional development need to be presented.

2.2 Path Dependence

The concept of the path dependence in the institutional economics implies that initial coincidences can determine an evolutionary path in developing of institutions. Caused by the self-reinforcing characteristics of this process, the taken path cannot be left again so easily. Cultural heritage of society and existing habits and traditions strongly influence the decision making. Specific events in the past provide that certain institutions become chosen. However, that path doesn't need to be the best. If one of several alternatives asserts itself, the solution can be efficient or inefficient. The development can lead also to suboptimal results.

The conception of path dependence means that a historic institutional heritage restricts the variety of possibilities by institutional innovations. Institutional alterations admittedly are not determined in advance but also do not happen by pure chance.[16] Positive feedbacks such as profits, which result from the prosecution of the chosen way by individuals, increase continually, and the costs of the way abandoning such as learning and adapting costs, possibly exceed the benefits caused by a path-change.[17]

[16] Leipold (2000), p. 11.
[17] Polster (2001), pp. 21-23.

The conception of path dependence favours a gradual institutional change because the influence of historic institutional heritage is not avoidable. The question is, however, how strong its impact on institutional innovations is.

2.3 Inconsistence of Institutional Development

There is another important characteristic which has to be taken into consideration. The institutional development involves two processes, which strongly interplay: the change of formal and informal institutions can occur simultaneously, consecutively or divergent. From the view of path dependence a slow, gradual institutional development is advantageous, because it takes into account the inner dynamics of an institutional change. The attempts to establish new formal institutions rapidly or to transfer them from another jurisdiction and to implement in owns country disclose the risk that the development of formal and informal institutions diverges too strongly, because the informal institutions are not yet prepared for such a change. This inconsistence in the institutional development leads to problems of the acceptance and, thus, of the enforcement of the new formal rules.[18] With a rise of inconsistence grow also transaction costs (i.e. costs of information, learning, enforcement and not at least costs of control).

Through the inconsistence of formal and informal institutions the institutional change becomes slowed down in its development. Discrepancies between the quick realization of new formal rules and a gradual path-dependent development of informal rules such as traditions and norms of conduct create conflicts between these institutions. Thereby, the result of a rapid or an extreme institutional change becomes hardly predictable.

Taking in consideration these characteristics of institutions, determinants of effectiveness and efficiency of institutional development can be defined.

2.4 Determinants of Effectiveness

On the constitutional level the effectiveness of institutions is determined by the relationship between de-facto rules (the rules in fact applied in a community) and de-jure rules (the rules included in the written right law or also codified rules). If the de-facto occurring decision-

[18] Streit/Mummert (1996), p. 12.

making processes correspond to the de-jure rules, an institution is effective.[19] No state can impose the formal law against the will of the citizens for a long (except country ruled by a dictator and at very high costs). The law enforcement is based to some content on informal institutions such as social norms, individual values, private rules and traditions. Therefore, the effectiveness of institutions depends on the consistence of formal and informal institutions. [20] All in all, the new implemented institutions are not automatically effective and their adjustment succeeds only under particular conditions.

Particularly important for the success of institutional adjustment and, thereby, for a higher effectiveness of institutions the three following components:

1) Legitimation by social actors

The demand for institutions is important for the legitimacy of those institutions. The social actors must be convinced by the necessity of the new formal set of rules.[21] Generally said, at the constitutional moment (the formation of the constitution) shall exist a social consensus about the necessary institutions.

2) Familiarity with new rules in the society

The familiarity with the new implemented rules could be expected in cases, if a country in its recent history was already confronted with institutions of the same legal family or with a similar set of rules. Here, the so-called "cultural border" could play a central role.[22] Some of researches confirm that the effectiveness of the newly enforced institutions in a country is higher, if it was once in its history familiar with basic principles of such institutions. In such case, the social actors can better understand the means of the rules and, therefore, to make better use of them. Here, the formal rule of law is supported by informal institutions.[23]

3) Adjustment of formal and informal institutions

The inconsistence of institutional development can theoretically be removed by the adjustment or adaptation of the new formal rules to the informal institutions. One conceivable possibility could be an "informed choice" between different models of institutional change. These models are the result of the comparative studies that take into account all the cultural and the historical features of the relevant country, with other word, considering its informal

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19 Voigt (1999), p. 8, und Berkowitz/Pistor/Richard (2003), p. 166.
20 Voigt (1999), pp. 15-22.
21 Adamovich (2004), pp. 270-271.
22 Pistor/Raiser/Gelfer (2000), pp. 336, 346.
23 Berkowitz/Pistor/Richard (2003), p. 175.

institutions.[24] Such an adjustment is at least theoretically possible, since formal institutions in contrast to informal could be changed relatively easily. Moreover, the adaptation success would be presumably higher if, all in all, more relevant actors and especially more domestic specialists (in relation to foreigners) would participate in the process of the institution establishing because they naturally know the best the informal institutions of their own country.

Furthermore, also the adjustment of informal institutions to formal might be conceivable. In such case, the adaptation would possibly take longer because informal institutions cannot be changed overnight by political decision. However, the dynamics of institutional change would increase as social actors recognise or experience the long lasting advantages of the new formal institutions as, for example, increasing national and international competitiveness of domestic enterprises respective improvements of quality or of product's cost-benefit relation for consumers.

2.5 Efficiency of New Institutions

Depending on how strong the inconsistence between formal and informal institutions appears, beside the effectiveness also the efficiency of the new institutions can be influenced. The efficiency of institutions is explained by the North's concept of transaction costs. Institutional efficiency is high if the costs of realization, enforcement and control of institutions are minimized. If de facto-rules correspond to de jure-rules, an institution is assumed to be effective. However, if the inconsistence between formal and informal rules is present, it would cause high transaction costs. These manifest themselves in such activities as lobby-work, formation of power-clusters, increasing corruption, waste of time and financial expenditures to reduce uncertainty. The bigger the discrepancies in the institutional development, the higher are transaction costs and their influence on the economic development.

The first reason for high transaction costs is explained by the *theory of public-choice*. Every development of new rules in a community always would be influenced by the old rules of conduct and by the social groups profiting of them. Thus, it is almost inevitably that through the change underprivileged and therefore this change rejecting groups would try to protect

[24] Berkowitz/Pistor/Richard (2003), p. 180.

their interests through formation of the lobby-groups and the rent-seeking behaviour.[25] The different norms (the old ones and the new ones) will not only coexist but also compete with each other.[26] If it would succeed to bring in agreement the development processes of formal and informal institutions, the norm disconformities might be reduced and thereby the enforcement process of new rules facilitated.

The second reason for high transaction costs is explained by increasing uncertainty that accompanies every process of institutional change. By strong discrepancies between old and new rules uncertainty as well as the costs to reduce it would expanding.[27] In countries, where the change of formal institutions occurs in a better agreement with the development of informal institutions, transaction costs are lower and the acceptance of changes through the individuals is higher.[28] Thereby, also the economic performance is positively influenced. Would be such an agreement by political/economic means easily attainable, institutional change like transformation might proceed in different countries much more similarly and possibly faster. However, the biggest problem is that informal institutions are politically hardly moldable. "Informal constraints, unlike formal rules cannot be changed overnight".[29] In case of strong discrepancies between formal and informal institutions, policymakers cannot influence informal (in contrast to formal) rules directly or change them immediately.[30]

At this point the necessary theoretical concepts to analyse the competition policy are presented. In the following chapters, first, the competition policy is introduced as a very important market economy institution. Second, its introduction in Russia is examined on the basis of the previous theoretical discussion. At the end of the paper the Russian experience in establishing of competition policy and problems fields are identified, which can be used as suggestions for further reforms.

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[25] The change rejecting individuals are rather willing to pay more in order to maintain the old framework. They could build a representative lobby or a political party to secure advantages of their particular positions.
[26] Streit/Mummert (1996), pp. 14-18.
[27] North (1990), p. 30.
[28] Streit/Mummert (1996), p. 6.
[29] North (1992), p. 12.
[30] North (1990), p. 7.

3 What is "Competition Policy"?

"Competition policy" is an essential institution established in order to protect and promote economic activity. Moreover, it determines the place of the state in the economic life through defining of the activities the state will be involved in and which will be left to private sector. The private actors always try to reduce or even to eliminate the pressure and the forces to act permanently, which are caused by competitive surroundings. Therefore, competition and thus the whole economic system are jeopardized by "the constructional error of market economy" (Böhm). The state establishes the competition law to protect competition from restraints and to avoid that strong economic power can be misused against competitors. To further goals of competition policy could be counted: the delivering of goods and services to domestic consumers at the cheapest sustainable prices; the encouraging of innovation and technological development; the increasing of productivity and the engaging of participation in trade and competition on international markets. A prime scope is to protect markets from obstruction and to expand opportunities for small and medium sized enterprises. In order to fulfil these tasks some of political measures appeared to be successful, such as prohibition the formation of cartels or administrative reducing of barriers to entry existing markets.[31] However, the aims of competition policy are not confined to the economic. They also affect social objectives, including equity, the welfare of consumers and the enhancement of the quality of life of all.

Institution of competition policy also has certain social functions. First of all, competition law is established to build and sustain public confidence in institutions, and so, as rule of law, can help underpin the stability of democracies. And this is the key to an effective market economy. Secondly, a sound competition policy can provide the basis for economic development and enhances country's living standards, which leads to social development. Thus, the chance of economic growth lies in private sector activity rather than in the largely-failed government-led commercial initiatives of the past. Besides that, competition policy prevents formation of a strong economic power which can negatively affect political processes. Beside, when the institutions designed to promote competition policy are weak, corruption erupts and can flourish. For all these reasons, "a well-thought out "competition policy" in its totality can give substance to a country's vision of what it wants be", as Transparency International brings it to the point.[32]

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[31] Böhm (1958), pp. 167-203.
[32] Transparency International (2000), p. 260.

Due to the complexity of social processes, the establishment of competition policy is an uneasy task. Only in Europe and the United States has there been extensive experience in using law and policies to protect competition. However, the development of competition policy as an institution took them a long period of time.[33] Today the necessity of competition policy is recognised in many parts of the world. The main question is whether this institution can be successfully copied or transplanted from experienced countries. In the post-socialist states much will depend on how decision-makers perceive and access competition policy. To develop an economy based on market and polities based on political freedom, for example, one of the main tasks is to structure the relationship between law and economic conduct, and competition law is at the heart of this relationship.[34]

As all East- and Middle European transformation countries also Russia introduced the competition policy as important step on the way to market economy. Since the transformation process began in 1989 different strategies were applied. How successful they were is a subject to following analysis.

4 The Competition Policy in Russia as an Institution

4.1 Establishment of the Competition Policy as an Institution

The competition law has been already introduced to Russia in the first years of transformation following the conception of the competition law of the western market economies. However, the Russian competition law was not copied from one western country but different traditions in competition policy became integrated into the Russian legislation.[35] On the administrative side 1991 was established the competition authority in form of a ministry for Antimonopoly politics (MAP). The status of "ministry" determined advantages and disadvantages. On the one hand, it should place the political signal that the highest priority was granted to the competition policy. In the practical realization, however, strong political dependence was founded, because the competition authority had to coordinate all decisions with the other ministries and could be sanctioned of them. This often led to conflicts with the sector-specific ministries due to the strong divergence of interests. The legal action against central and

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[33] In United States the competition law was established by the Sherman Act of 1890 and Clayton Act of 1914, in Germany by the GWB of 1958.
[34] Gerber (2003), p. 2.
[35] OECD (2004), pp. 19-43.

regional state authorities became with it impossible.[36] Nevertheless, the strengthening of the competition policy belonged to the most important political tasks in the first years of transformation. This changed rapidly after the replacement of the gradual transformation-strategy by the Big-Bang.[37]

Due to the social tensions 1994 came the decision to abandon the steady development of the new framework. From that time emphasis was put on fast privatisation and reformation of the state structures. Later the major political task became the overcoming of finance crisis. Protection and advocacy of competition moved into political background. This quickly manifested itself in a sinking reputation of the competition authority. Its financial and personal sources shrank (especially during the finance crisis of 1998) while at the same time its task catalogue became even more extensive. Instead to concentrate mainly on advocacy and protection of competition, competition authority was overloaded with different task. It had to deal with structural and institutional problems and to solve them as well as to develop general market conduct rules. Moreover, the legal action against undesirable activities of market participants belonged to its tasks. Relatively fast changes in the structure of the authority as well as in its tasks, regular alterations of the antimonopoly legislation regarding the scope of tasks and duties impeded the development of legal standards and limited sources to carry out the most important tasks of the competition policy.[38]

4.2 Market Structure and Competition Policy

In the early nineties, the country's market structure was determined by gigantic conglomerates descending from the Soviet time, which represented geographical and sector-specific monopolies. Such structures eased the planning and control tasks of the central administrative state that possessed also the owner-rights on production capital. The later applied Big-Bang strategy was mainly directed towards privatisation process with the primary task to break the old ownership structures and to implement the system of property-rights. In this reform process, however, no attention was paid to the creation of a more efficient internal and external control for enterprises as well as to an incentives development for companies restructuring.

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[36] OECD (2004), pp. 43-44.

[37] Big-Bang is a radical program, which aims to exchange the most important economic elements in the shortest time.

[38] OECD (2004), p. 8.

1998 DIW (the German Institute of Economics settled in Berlin) pointed out in one of its studies that the targets of the privatisation process were the directing investments to the real sector, the broadening of tax base as well as the maintenance and creation of workplaces. The crucial precondition for reaching these targets had to be the implementation of efficient internal control structures for the complete or partial privatised enterprises.[39] This important point was, though, neglected as well as the creation of external control structures. As consequence, the ownership of the most of the big enterprises only changed from state to new oligarchs. The last, however, are mainly interested in general improvements for the business conditions rather than in competition strengthening.[40]

In 1997 some attempts to change the situation and to boost competition were undertaken. To sharpen the control of monopolistic activities, a new legal foundation in the competition law was introduced. The practical realisation was, though, not efficient and did not have any impact on the existing inefficient price regulation, on the opening of market access and on the controlling of corporate governance. In the financial crisis of 1998 price limits and political control over monopolies were discussed and implemented. These measures brought immediately some economical relaxation, but did not contribute to the strengthening of the competition structure on the long term.[41]

At the end of the nineties a new program of supporting and assistance for small and middle sized enterprises has been introduced. Those companies, according to the program, should boost competition and create new workplaces. However, no concrete measures were mentioned regarding how the assistance might be put in place and no changes to insufficient framework were planned.[42] It could be supposed that the lack of institutional knowledge as well as the absence of political interest in changing the economic structure of the country is the reason for this development.[43]

Since 2003 an extensive reform of the competition policy has been preparing, with some steps implemented in the last years. In 2005 the status of the Antimonopoly Authority was changed from ministry to a “Federative Antimonopoly Service” (FAS - Federal’naja Antimonopol’naja Slushba). Now, the new institution is independent and legitimated to investigate in cases of

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39 DIW (1998), p. 37.
40 Guriev/Rachinsky (2005), p. 145.
41 DIW (1998), p. 38.
42 DIW (1998).
43 OECD (2004) and EBRD (2004).

competition law violations by administrative bodies. This should signal, at least formally, the independence of competition authority from politics. The tasks shall be focused more on protection and advocacy of competition. Furthermore, a new competition law amendment is planned for the end of 2006.[44]

4.3 Measures of Competition Policy

The competition legislation in Russia is very similar to the basic European Communities' conception of how to combat restraints of competition. Three areas are particularly essential to protect competition activities: cartel legislation, prohibition of abuse of economic power position and merger control. In addition, the antimonopoly legislation also contains special regulations that are characteristically Russian.

4.3.1 Prohibition of Competition Restrictive Agreements or Concerted Actions

The Article 6 of the "Law on Competition" regulates the handling of restrictive agreements. The law distinguishes between horizontal and vertical agreements. The current version of the Law specifically prohibits (Article 6.1) horizontal agreements concerning prices or any element of price policy (make-ups, discounts), market division, restriction of market access, elimination of participants from the market or boycott.[45] Previously, finding any of these violations required a combined market share on the part of the violators of at least 35% of the relevant market. The latest amendment eliminated the previously existing exception for the violators with a combined market share less than 35% of the relevant market and also made them per se violations by removing the possibility for approval by the competition authority on the basis of positive effects.[46] Other types of horizontal agreements are prohibited if they prevent, restrict or eliminate competition (or may do so) and infringe upon the interests of other economic subjects (Article 6.2). Like the per se violations defined in Article 6.1, the other possible types of horizontal agreements are no longer subject to the collective 35% market share test. Horizontal agreements are particularly intensive controlled because they can be more easily identified and impair strongly competition. Furthermore, the disposition of restrictive agreements is in Russia, historically conditioned, particularly high.[47]

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[44] FAS (2006).
[45] FAS (2005a), Art. 6.1 of the "Law on Competition".
[46] OECD (2004), p. 22.
[47] Butyrkin (2004), p. 45.

Vertical agreements are prohibited "between economic subjects not competing on the corresponding market, receiving and supplying goods"[48] if such agreements prevent, restrict or eliminate competition (Article 6.3). The provision is not valid, however, for "economic subjects with a collective share of the market for a specific good of less than 35%."[49] Experts criticise, however, the fact that "it is not at all clear how this restriction is to be applied to vertical agreements since the participants in a vertical agreement may not have a "collective share" in any market at all"[50]. The problem arising from this language is that "it may be possible to interpret the provision to require that at least one of the participants in the vertical agreement have a share of more than 35% in a market affected by agreement (although this would not be a "collective share"), which might limit enforcement to situations in which the agreement is somewhat more likely to have a restrictive effect"[51].

Article 6.4 of the "Law on Competition" contains exception cases. First of all no block exemptions are provided in the law and it does not envision a process for the creation of such exemptions. However, in exceptional circumstances, the competition authority is authorised to allow specific horizontal or vertical agreements (except for horizontal cartel agreements listed in Article 6.1) if it is shown that "their positive effects outweigh their negative effects, or if the specific type of agreement is provided for by federal law"[52]. Such specific agreements relate particularly to the socioeconomic area. To these effects belong, for example, the increase of competitiveness of the Russian exports on the world markets and the support of the technical and scientific progress (industry-political aspects).[53]

4.3.2 Abuse of Dominance

In accordance with the Article 5 of the "Law on Competition" dominance is defined as an exclusive position of an economic subject that gives the ability to exert decisive influence on the conditions of circulation of the relevant goods or to obstruct access of others to the market. Therefore enterprises with a share of the market equal to 65% or greater will be found to be dominant unless the enterprise proves the contrary,[54] while those with a share of 35% or

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48 FAS (2005a), Art. 6.3 of the "Law on Competition".
49 FAS (2005a), Art. 6.3 of the "Law on Competition".
50 OECD (2004), p. 23.
51 OECD (2004), p. 23.
52 FAS (2005a), Art. 6.4 of the "Law on Competition".
53 Dillenz (1999), p. 78.
54 FAS (2005a), Art. 5 of the "Law on Competition".

less may not be found to be dominant under any circumstances.[55] Between the two percentages, firms may be found to be dominant if the competition authority can prove this fact based on all of the evidence.[56]

Important is to remark here that not a mere dominant position according to the law is sufficient for the identifying of abuse, but the abusive activities to competition. In Article 5.1 abuse of dominance is defined as "actions (inaction) of an economic entity (group of entities) occupying a dominant position, which result or can result in prevention, restriction or elimination of competition and (or) infringement of the interests of other persons"[57]. Both acts and failures to act are specifically covered. A list of abusive practices includes: "withdrawal of goods from the market to create a deficit and/or raise prices; imposition of abusive terms of contract or terms not related to the subject of the contract on contracting partners; tying; creation of discriminatory conditions for access to the market or for sales and purchases for specific contracting partners; creation of barriers to entry or exit; violation of legally imposed pricing restrictions; establishment of monopolistically high or low prices; reduction or cessation of production of a good that is in demand and that can be produced without incurring losses; and boycott."[58] As in case of restrictive agreements the law, however, permits the FAS to recognise specific actions as acceptable if the firm proves that the positive effects of those actions exceed the negative consequences for the market.

According to statistics, the most frequent practice of abuse in Russia is the imposing by contract agreement the most unfavourably conditions, which partly are not subject to actual contract (41 percent of all registered cases), followed by the violation of legal imposed agreements on the price regulations (14%) as well as by obstruction of market access through creation of economic obstacles (7%).[59] More than a half of all infringements from the abuse of dominance is caused through the natural monopolies or regulated utilities.[60] Many of the remaining cases also concern allegedly dominant enterprises with a market share at or well above the 65%, which results in a presumption of dominance. These cases tend to rely on the legal presumption because there is rarely any qualitative analysis of the market power of the respondent. In majority of such cases the FAS focuses on the question of whether the behaviour was abusive and not on the dominance determination. Staff members indicates that

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55 Tkatsch (2005), p. 21.
56 OECD (2004), p. 27.
57 FAS (2005a), Art. 5.1 of the "Law on Competition".
58 FAS (2005a), Art. 5.1 of the "Law on Competition".
59 Artemjew/Golomolsin (2004), p. 100.
60 OECD (2004), p. 19.

"a lack of resources to conduct research, poor official information sources and restrictive time frames all make it difficult for them to conduct significant economic analysis to define markets and clarify the market shares of multiple participants, and that as a result the may favour cases in which dominance appears obvious"[61].

Another instrument to prevent the abuse of a dominant position is to keep centrally and territorially a register of enterprises with a share of the relevant market of above 35%. According to the OECD survey "firms may be entered into register on the basis of a finding made during the investigation of an alleged violation of the law, or on basis of studies of the competitive environment on particular markets done by the FAS outside its direct enforcement work"[62]. A firm could disagree with the FAS' conclusion and make a petition for its removal or appeal the decision to a court. Being listed in the register does not formally impose specific duties or consequences for the firm and is important only in regard of merger control requirements. The register is published annually and is open to public. However, the continuing of this register is strongly criticised since the preparation represents a considerable effort which costs valuable resources and its existence often causes misinterpretation (as a list of monopolies and evidence of dominance or market power) by courts, politics as well as by population.[63]

4.3.3 Merger Control

Merger control provisions are to apply to both mergers and similar combinations of entire firms (Article 17) and to transactions involving acquisitions of shares or transfers of control (Article 18). Basic thresholds are calculated on the basis of the most recent balance-sheet value of the assets of the companies involved, without reference to the value of the transaction itself or to the amount of economic activity currently conducted by the company. Pre-merger notification and approval is required for merger and other similar combinations of firms in which the combined value of the assets of the firms exceeds 200.000 times the minimum wage (appr. 600.000 Euro).[64] Permission for the transaction can be refused from the competition authority if the transaction leads to restriction of competition through the creation or strengthening of a dominant position. Permission itself can also be refused in case for

[61] OECD (2004), p. 30.
[62] OECD (2004), p. 27.
[63] OECD (2004), pp. 17-18.
[64] FAS (2005a), Art. 17.1 of the "Law on Competition".

decision significant information is not correct. On the other hand, a transaction may be approved, if the petitioners show that the positive effects of the transaction exceed the negative consequences. The law also here specifically includes socioeconomic effects among those to be considered in decision-making.[65]

Post-merger notification is required within 45 days of the completion in cases where the combined balance-sheet value of the assets exceeds 100.000 times the minimum wage (300.000 Euro). This requirement apply to the creation, merger or other combination of non-commercial organisations if at least two commercial organisations are participants or member in the non-commercial organisations, and also concerning changes in the participants or members of non-commercial organisations if two or more commercial organisations are member.[66] Non-commercial organisations are only affected if they carry out or have the intention to coordinate entrepreneurial activities of their members.

In case of the acquisition, pre-transaction notification and approval are required if the subject to transaction are more than 20% of the voting stock of a company, or more than 10% of the asset value of a company, and also in case of acquisition of the right to control the activity or to serve as the executive body of a company. These requirements apply if the combined balance-sheet asset value of those involved exceeds 200.000 times the minimum wage, if one of the firms is listed in the Register of firms having a share of more than 35% of a market, or if the acquirer in the transaction is a group that controls a firm listed in the register.[67] The legal standards are identical to those for full mergers, with the addition of a specific right to refuse the transaction if participants reject to reveal the sources, conditions for use or amounts of the money or property required for the transaction. If the transaction has not been completed within a year of the issuance of the permission decision for the transaction expires.

After a pre- or post-notification the competition authority has 30 days of time to take a decision. This term may be extended for a maximum of another 20 days.[68] Generally the transaction is rejected if the information is not correctly submitted or if the merger leads to creation or strengthening of dominant position with restriction to competition in the relevant market.[69]

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65 FAS (2005a), Art. 17.4 and Art. 18.5 of the “Law on Competition”.
66 FAS (2005a), Art.17.5 of the “Law on Competition”.
67 OECD (2004), pp. 20-21.
68 FAS (2005a), Art. 17.2 of the “Law on Competition”.
69 FAS (2005a), Art. 17.3 of the “Law on Competition”.

Furthermore, the law (Article 19) provides for the possibility of breaking-up of commercial firms or non-commercial entities engaged in commercial activities, if the entity is dominant and engage "systematically" (twice in three years) in monopolistic activities, defined as the abuse of a dominant position or participation in restrictive agreements. According to OECD "an order of this type may only be issued, however, if it will lead to development of competition, if the technological ties between the parts of the firms to be divided are not tight, if the separated parts can be physically divided from one another and if the part to be separated does not provide more than 30% of its production for the consumption of the other parts of the original entity"[70]. This provision of the law has rarely been used in practice.

According to statistics, the overall merger control caseload is astonishingly large. FAS received in 2002 10.198 petitions and 9.461 notifications under Article 18 (securities transactions and corporate relationships) as well as 779 petitions and 3.592 notifications under Article 17 (mergers and assets purchases), for a total of more than 24.000 filings. FAS staff members are hardly able to conduct meaningful review of the number of transactions, and the combination of such large numbers of filings with relatively short review time frames obviously hinders the performance of the duties and the conduct of the other investigations.[71]

4.3.4 Restrictive Action to Competition of Administrative Bodies

One particular provision of Russian antimonopoly legislation refers to the behaviour of the state. The "Law on Competition" specifically prohibits acts, actions and agreements of state bodies (central and local) that prevent, restrict or eliminate competition (Article 7 and 8). This provision was included into the legislation due to the historical presence of a strong state power, which could be still observed in many areas of economic activity (in political enforcement as well as in ownership).[72] From a regulatory point of view such a provision seems paradoxical. The state usually creates competition legislation in order to protect competition against powerful private enterprises; in the situation of Russia it protects competition from its own actions.[73] However, the case analysis of violations against the "Law on Competition" clearly shows that too often state bodies are involved.[74]

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70 OECD (2004), p. 35.
71 OECD (2004), p. 32.
72 FAS (2005a), Art. 7.1 of the "Law on Competition".
73 Dillenz (1998), p. 106.
74 FAS (2005b), p. 4.

The prohibitions apply to federal bodies of executive power, to all state bodies of the subjects of the Federation (its constituent parts), to bodies of local self governments as well as to other bodies or organisations to which the functions or rights of such bodies have been delegated. They do not apply, though, to federal law and other acts of the federal representative bodies (the State Duma and the Council of the Federation). Prohibited by the law are actions and decisions of the administrative bodies if they restrict the independence of economic actors or create discriminatory conditions for the activities of particular firms and if those acts or decisions have or may have as their result the prevention, restriction or elimination of competition *and* infringement on the interests of economic actors. The Article 7.1 specifically prohibit: "restrictions on or obstruction of the formation of new economic actors in any sphere of activity or prohibitions on any form of activity or production of any product unless the prohibition is contained in federal law; obstruction of the economic activity of any economic actor; restriction or prohibition of trade among regions or localities or restrictions on the sale of goods or services; mandatory instructions concerning the priority supply of specific customers except where the priorities are established by federal law; and the provision without grounds of special advantages to one or more firms"[75].

Furthermore, the Article 7 contains a general prohibition on combination of commercial activity with the exercise of the state power. This could take place in form of commercial activities by state bodies or in form of delegation of the state power to private commercial entities. Only exception are cases where such combinations are authorised by federal "legislative acts" (may include not only laws but also presidential edicts, acts of the Government and other federal regulations). However this broad exception has permitted numerous state bodies at various levels to engage in commercial activities, resulting in monopolisation of the relevant services and in some cases leading to a tying of the commercial services to the performance of state functions.[76]

The Article 8 also prohibits state bodies from engaging in agreements or coordinated actions (among themselves or with firms or organisations) if these have or may have as result the prevention, restriction or elimination of competition. Moreover, agreements, that may affect market dividing prices, or that restrict the possibility to entry the market, or are subject to elimination of some competitors from it, are specifically listed. A specific exception in the

[75] FAS (2005a), Art. 7.1 of the "Law on Competition".
[76] OECD (2004), p. 36.

law applies for agreements envisioned by federal law, acts of the President of the Russian Federation or acts of the Government of the Russian Federation.[77]

A separate law requires from state bodies to make purchases of goods and services for state needs on the basis of competitive bid. The Article 9 of the "Law on Competition" sets out "antimonopoly requirements for the conduct of competitive bidding". Such cases include prohibition on the creation of advantages for some participants, granting of access to confidential information or reduced fees for participation, improper restriction of access to participation and any coordination of the activities of the participants by the organiser of the competitive bidding.[78] By violation of these rules, FAS may declare the results of competitive bid void by a court.[79]

4.4 Violations of the Competition Law

In order to valuate the effectiveness of the provisions for the protection of competition it is interesting to examine the official statistics of the competition law violations, even if these statistics has to be considered only with caution. The most frequent violations of the competition law could be identified by mergers, by restrictive actions to competition of administrative bodies as well as by abuse of dominance. According to the reports of the FAS in 2004 1.332 cases of violation to the "Law on Competition" regarding merger were revealed, what makes up 49% of all investigations undertaken in this application area of the competition law. [80] More than the half of the law infringements comes from the businesses of the energy industry (electricity 22%, gas 6%, oil 2%), of the transports (26%), of the post and telecommunication (9%).[81] Negative to remark is that the cases of the abuse of dominance have increased by 110,5% and the cases of the restrictive actions to competition of the administrative bodies rose by 477,2% respect to 1996. [82] These percent-numbers the most clearly present the central problems.

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77 FAS (2005a), Art. 8 of the "Law on Competition".
78 FAS (2005a), Art. 9 of the "Law on Competition".
79 OECD (2004), p. 39.
80 FAS (2005c), chart. 1.
81 FAS (2005d).
82 From 1996 to 2005. Official statistics of the FAS (2005b), p. 4.

4.5 Problems of the Russian Competition Policy

On one hand, the problems of the competition policy can be explained to a large extent by a still lacking understanding for the meanings of competition policy by political and economic actors as well as by the population. On the other hand, the competition authority has little experience in conducting its tasks and disposes over a virtually limited authorization.

It can be stated that unfortunately significant legal and structural problems still reduce the ability of the competition authority to implement effectively competition rules. The tasks of the competition administration are to broadly composed and don't allow them to focus on concrete matters of competition. The competition legislation shaped in the manner of western countries covers all significant areas. However, sanctions, even for serious violations of the competition law, are insignificant and the enforcement authorisation of the competition authority is strongly restricted. Low limits in merger control, still missing clear regulation rules for natural monopolies, obligation to support state bodies in all legal matters as well as lacking possibility to select cases for consideration, all of this lead to huge caseload and immense burden of the competition authority's staff. Especially negative has to be regarded the necessity to deal with bagatelle, which have only insignificant or even no effect on competition.[83]

All in all, it shows that the sole adaptation of the competition legislation and establishing of the competition authority is not sufficient for the effective and efficient competition policy. In the former Soviet state, the economic structure was marked through a strong geographical and industry-specific concentration. The market and production structure was determined by the old formal institutions and continued at first its existing after the breakdown of the Soviet Union. A fast change in the owner structure without creation of the incentives to enterprise restructuring and the fast liberalisation without a working competition policy hadn't brought expected results regarding a workable competition.

[83] OECD (2004), p. 9.

5 Which Mistakes Russia has made with the Implementation of the Competition Policy?

Russia, that chose the same way of transformation as the others formerly socialistic countries of Central and Eastern Europe, had more difficulties to find a correct strategy. The inconsistence between formal and informal institutions was here essentially stronger manifested as in the other countries of the Eastern bloc. The more than 60 years of socialistic regime have very strongly influenced the country and the social actors. Absence of a legal culture (rule of law) and thereby the lacking familiarity with the new reinforced rules immensely intensified the inconsistence of the institutional development, since the old informal institutions were incompatible with the new formal institutions. Following, the adaptation process was impeded considerably. But also the politics is responsible due to mismanagement (knowingly or unknowingly) for little success of competition policy after 15 years of transformation.

Already in the first years crucial mistakes were occurred. The first mistake related to the sequence of the reform steps after the breakdown of the old system. After the change from a gradual transformation strategy to the Big-Bang too much emphasise was put on privatisation and liberalization of the economy, whereas the creation of legal-institutional framework shall enjoy a higher priority at the very beginning, especially in a country like Russia, where no tradition of the rule of law was existent. Only in retrospect, it becomes clear that the main focuses were placed incorrectly in the transformation process. “Creation and advancement of a legal framework for the market economy should be much higher on the agenda of international financials organizations. It must be put in front, as a more urgent and important issue than liberalization and privatization, since the latter can contribute to sound growth only if the former is secured.”[84]

The second mistake was in the lacking political support of the executing organs and their overloading with all possible tasks that did not directly involve the protection of competition. On the one hand, politicians themselves had very little experience with the new institutions and had to rely on the suggestions regarding the institutional transformation worked out abroad. On the other hand, the requirements of the competition policy as well as the interests of the new Russian economic elite went apart. On the basis of those mistakes occurred by privatisation, the interdependence between politics and economic actors increased

[84] Kolodko (1998), p. 23.

dramatically. With the high degree of oligopolistic concentration and the close connection of business to politics, the competition promoting measures had relatively little chance.[85]

The third mistake involves the lacking education of all interest groups that shall increase the understanding for the meaning and the importance of competition policy. So, the population majority still supports the existence of conglomerates and state owned enterprises that build geographical and/or structural monopolies.[86] Apart from the population of the economic centres like Moscow and Petersburg the most of Russian citizens connect the term "economic competition" with insecurity, unemployment and poverty. All negative developments that occurred in the first years after the breakdown of the old system are associated with market economy and competition. The lacking comprehension for the advantages that competition brings to consumers and to the national economy, and thus the necessity of competition policy to protect competition and facilitate positive effects interrelate very narrowly with the fact that Russia has no tradition of the "rule of law". The lacking trust in the judicial system and into the enforcement of legally well-founded interests make it not easy for the competition authority, on the one hand, to enforce the competition law and, on the other hand, to control the behaviour of the market actors. Politics, from its side, doesn't undertake enough in order to get rid of this disgrace. Neither sanction by violation of the competition law nor control mechanisms as well as the legal proceeding are elaborated clear and effectively.

6 Is a Lacking Effectiveness of Transplanted Institutions Inevitable?

The effectiveness of transplanted institutions can barely be influenced consciously because institutional developments are to a large extent unpredictable and difficult to plan. If, however, the determinants of effectiveness would be taken into account in the structuring process of the reform steps many mistakes can be avoid and thereby the effectiveness might be increased.

The first solution would be a gradual transformation that is strongly adapted at the country-specific circumstances. This means that the previous development of formal and informal institutions shall be stronger taken into account, namely already in the preparation phase of the institutional transformation. With this scenario, the political strategy of the institutional

[85] Guriev/Rachinsky (2005).
[86] Guriev/Rachinsky (2005), p. 146.

change gets one evolutional component that is crucial for the effectiveness and thereby for the success of new institutions.

However, it is not merely the speed of the reform process that is crucial for their success. Almost all East and Middle European countries followed the Big-Bang transformation strategy. The results, however, to an extent radically differ. For example, Poland[87] gets attested positive results in protection and advocacy of competition[88] while Russian effectiveness of competition policy is rather poor.[89] If the legitimating of institutions is assumed as given, very important for a fast successful adaptation of the new institutions become such parameters as the strength of the politics and its commitment to the reforms as well as professional support of foreign specialists. If the institutional change is fast and has been imposed from the top to the bottom (by political decision) the process would deal with a more or less strong resistance from different interest groups. The situation will be determined by behaviour of individuals respectively groups of individuals that see their advantages restricted or even lost as well as by the interplay of social and political power-groups. This variables decide about success of institutional reforms "...if there are lobbies that fight with any and all means for their own present interests, there are no lobbies fighting with such determination and force in favour of long term development and remote policy targets."[90] Therefore, a government's strength is especially significant in a reform process in order to be able to impose reforms and to guarantee an effective control at the beginn. If the legislative institution itself is too weak, due to the increased insecurities (inherent to the situation of change) and the widespread disorientation, the threat of corruption and crime occurs.

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87 Poland, in contrast to Russia, was already familiar with the rule of law before the World War II and had in the socialistic period more polypolistic market and production structure that consisted of many small and middle sized enterprises.

88 Wise (2003).

89 OECD (2004).

90 Kolodko (1998), p. 18.

7 Concluding Remarks

At the end can be concluded that several mistakes have been made in Russia regarding the process of institutional implementation of competition protection that explain the present-day condition of the Russian competition policy. First of all, a little effectiveness is evident because of little changes in the market structure and low social significance of decisions made by the competition authority. Widespread corruption, violations of the rules just as their not-compliance still represent the biggest problems. On the other hand, the high transaction-costs point at economic inefficiency. High educational costs arise due to lacking of experience of the practical realization just as information procurement costs, because politic and economic actors are completely or partially not familiar with the new regulations. Legal consequences of an injury to competition rules often are opaque, which leads to an elevated insecurity of the market participants. To sum up can be stated, that competition policy in the Russian Federation is still not capable to protect and to support competition effectively.

This experience suggests that an adjustment of institutions is a very complex process, whose exit cannot be predicted exactly. It is a difficult task to implement new institutions, copied or transplanted from other countries, in a way that they also in a new environment remain effective. The process must be carefully planned and prepared. The most important determinants of the success are a strong on enforcement political power inside the country and external experts that accompany the reform process and assist to the government. In addition, even further factors must be taken into account, like country’s economic-historical heritage, the legal culture (founded on the rule of law) as well as existing informal institutions. The consideration of all these factors yet admittedly doesn't represent success-guarantee, thought increases considerably the chances for a successful implementation of institutions.

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