

European Journal of Political Economy

Vol. 16 2000 113–132

***Corruption and institutions in Russia***

Mark Levin<sup>a1</sup> , Georgy Satarov<sup>b2</sup>

*a Central Economics and Mathematics Institute of the Russian Academy of Sciences, 47 Nakhimovsky prospect, Moscow, 117418, and Moscow State University, Moscow, Russia*

*b Foundation for Information on Democracy, 7 Bolshoy Zlatonstensky per., Moscow, Russia*

Received 1 February 1999; received in revised form 1 September 1999; accepted 1 September 1999

**Abstract**

This paper describes the institutions and social norms that have accommodated corruption in the Russian Federation in the post-transition years. We show how corruption is sustained by ill-defined boundaries between political and private business activity, and how the role of the state facilitates rather than hinders corruption. The paper draws upon a longer document prepared by the authors, the IDEM Report on Corruption on Russia IDEM Foundation, 1998. *Russia versus Corruption: Who Will Win?*, Council of Foreign and Defense Policy, Moscow. in Russian .2000 Published by Elsevier Science B.V. All rights reserved.

*JEL classification:* H1; D73; P26

*Keywords:* Corruption; Russia; Rule of law; Bureaucracy; Political self-interest

**1. Introduction**

The economy of Russia has not performed well in the years of transition. The failures were predictable given the underlying institutions and rules of behavior of the Russia political and economic system. The idea of a market in Russia is combined with the persistence of old institutions and methods of doing business that use the weakness of

---

<sup>1</sup>

E-mail address: [mlevin@mail.com](mailto:mlevin@mail.com) M. Levin .

<sup>2</sup> E-mail address: [satarov@aha.ru](mailto:satarov@aha.ru) G. Satarov

the state for private profit. The competition that exists is principally that of competition for rents. Corruption is an integral part of economic activity, with ill-defined boundaries between politics and private business. In this paper which draws on our broader exposition on corruption in Russia published in Russian as the IDEM Report, IDEM Foundation, 1998, we describe how institutions and norms of political behavior have provided the accommodating framework for a society where corruption is a principal means of acquiring wealth at all levels.

## **2. Corruption in transitional Russia**

Corruption has become a commonplace theme in discussions of the Russian economy<sup>3</sup>. For example, in 1995–1996 national and regional newspapers and magazines published more than 3000 articles on corruption, and there were more than 150 television programs concerned with the subject. More than 60% of respondents in opinion polls reported that they believe corruption is a factor threatening Russia's national security. More than 70% agreed with the statement that Russia may be considered a corrupt state.

### *2.1. The political impact*

Political impacts of corruption are readily observable in Russia. Political goals deviate from the tasks of national development and are directed at securing political power for the benefit of selected oligarchic private groups. As a consequence, trust of authority declines and ordinary people become more and more alienated from society. As a result, good intentions of the authorities are neither credible nor rewarded. The prestige of the country in international affairs is damaged, threatening political and economic isolation. Political competition becomes a farce. Citizens become increasingly disillusioned with democratic values, stimulating the decline of democratic institutions. The potential collapse of the nascent democracy is thereby made more

---

3

Transparency International in 1998 ranked 85 countries according to a "corruption perception index". The index is based on international surveys of businessmen, political analysts, and the general public. Russia was ranked in 76th place, where position "1" is for the least corrupt country. This represented a slight worsening for Russia in comparison with 1997.

likely. The threat, that democracy will be replaced by a dictator coming to power on the wave of an anti-corruption program, then arises.

## *2.2. Estimates of the monetary magnitude of corruption*

The scale of losses inflicted on Russia by corruption can be estimated in monetary terms, but only in a very approximate way. Estimates suggest see IDEM Foundation, 1998 that the sum exceeds the combined expenditures on science, education, health care, culture, and art allocated in the government budget. According to Constitution Society: “Losses are associated with commercial transactions that are made, not on the basis of price or merit, but as the result of bribes, kickbacks, or extortion. It has been variously estimated that such corruption adds between 5% and 15% to the cost of goods and services generally”.

Further estimates made by Russian law enforcement bodies indicate that criminal groups in some branches of industry oil and gas industry, mining of rare metals spend up to 50% of their revenues actual, not declared on bribing officials at various levels. According to the Audit Chamber of Russia, in 1997, the losses from improper uses of state budgetary funds have amounted to tens of trillions of rubles, or billions of dollars.

There is also grassroots corruption. Experts from the non-profit organization “21st Century Technologies” estimated that small entrepreneurs across the country spend a minimum of US\$500 million monthly on bribes to officials. These estimates do not include the payments of small entrepreneurs to their so-called “roofs”. Some 10% of total revenues in small- and middle-size businesses are taken by corruption. In the early stages of a business registration of the company, etc., expenses are considerably higher. “Creating a business” requires permission from about 50 officials. These losses are offloaded to the ordinary customers and clients of small business, since expenditures on bribes are included in the price of goods and services.

One can also note the almost unexplored and virtually uncontrolled corruption within companies and non-governmental organizations e.g., providing a credit from a commercial bank in exchange for a bribe.

The combined corruption-related payments appear to be in the range of US\$10–20 billion in a year. The size of the estimates points to another aspect of corruption;

investments to reduce corruption will be socially profitable. The value of the payments received in bribes is the prize available in rent-seeking activities where participants seek the bribes, and resources are used in these contests that could otherwise be productively employed. The elimination of corruption would free these resources for productive use.

### *2.3. The economic impact of corruption*

Expansion of the shadow economy reduces tax collection and weakens government budget. As a result, the state loses leverage for management of the national economy, and additional limits are placed on the provision of public goods and other services that government should provide. Social problems are aggravated because of budget shortfalls.

Market competition is also weakened, since the winners often prove to be not the most competitive agents, but rather those who gain advantages through bribery and special connections. As a result, market efficiency breaks down, casting doubt in people's minds about the merits of market competition.

Government budgetary funds are used ineffectively, in particular when government contracts and credits are distributed. The process puts further pressure on the government budget. Costs of production and distribution are higher because of "corruption overheads". The higher prices necessitated by these overheads are paid by the consumer. Market agents lose their confidence in the ability of the authorities to establish, commit to, and enforce, fair rules of market behavior. The climate for investments deteriorates. Economic growth does not take place, since the renewal or replacement of productive assets is postponed or abandoned.

Corruption in non-governmental bodies companies, non-profit organizations undermines efficiency.

### *2.4. The social impact of corruption*

Corruption distracts resources from the goals of public development and the authorities' ability to solve social problems declines. Wealth disparities and the poverty of the bulk of population are prolonged and increase. Some forms of corruption boost

**the unfair and unlawful redistribution of resources in favor of narrow special interest oligarchic groups , at the expense of the most vulnerable strata of society. The rule of law is not available as the main mechanism regulating the life of the state and society. An image of the citizen lacking protection from both crime and the state emerges in the public consciousness. Corruption within law enforcement bodies, which interacts with corrupt officials and entrepreneurs gaining access to political power and channels for money laundering, promotes the strengthening of organized crime. Social tensions increase, putting political stability in the country under threat.**

### **3. Corruption as a phenomenon of the transition**

**Corruption, its scale, dynamics, and specific features, is a consequence of the general political and socioeconomic problems of the transition from socialism.**

**Historically, corruption has begun when a country enters in a period of modernization and change. The stories of the robber barons of US are well known. It is understandable in a historical context that negative features of radical change should be present in Russia. Russia in the transition underwent a radical renovation of its public, state and economic foundations.**

#### ***3.1. The heritage of the totalitarian regime***

**The withdrawal of government authority in many spheres and the absence of control over this withdrawal created favorable conditions for the flourishing of corruption. It would be relevant to note, in this respect, that fascist Germany was one of the most corrupt regimes in human history. Those who hope to crack down on corruption with a “strong hand” should remember this fact.**

**There is a problem in the intertwined political and economic power that is a characteristic of totalitarian regimes with centralized systems of economic management.**

**In Russia, the natural division of labor between state institutions responsible for creating the conditions for the normal functioning of the economy and free market agents did not emerge in the post-transition years. Administrative bodies in Russia, especially at the regional level, continued to play on the economic field according to**

rules that they established for themselves. The outcome was, almost inevitably, corruption, in particular given the low official salaries of regional government employees.

It is important to note that the rapid and radical changes in Russia have occurred with the majority of state officials keeping their posts. Many of those who retain their former positions are not capable of adjusting to the new market conditions. They are unable to begin a business of their own and cannot use their talent, professional skills, or even their connections in business activities. The people who remain in the bureaucracies are in some sense negatively selected and are those who are most likely to adhere to the old tradition of state interference in all aspects of life. At the same time, there also remain and also come into the office those who consider a governmental administrative post the means for their personal enrichment.

### *3.2. Economic collapse and political instability*

The impoverishment of the population and the inability of the state to ensure a decent existence to public servants combine to result in massive grassroots corruption. This trend is supported by the Soviet-time traditions of protection “blat” as a form of grassroots corruption. Concurrently, the permanently present political risk related to long-term investments and the harsh economic situation often high inflation, the clumsy and purposeless interference of the state in economic affairs, the absence of clear-cut regulatory norms, etc. molds a certain type of economic behavior that aims at extremely short-term goals. The objective, although perhaps risky, is large profit. People of this behavioral type are not averse to seeking profit by means of corruption.

Political instability creates a lack of confidence in public officials at different levels. In the absence of guarantees for survival in these conditions, the officials become more susceptible to the temptations of bribe taking.

In the conditions of an economic crisis, the state attempts to increase taxes as has been done in Russia. These actions enlarge the shadow economy and consequently the field of corruption. For instance, a businessman who evades taxes is at the mercy of a tax inspector and becomes easy prey for demands for bribes in exchange for a promise of protection.

### *3.3. Underdeveloped legislature and legal loopholes*

In the transition period, legislation tends to lag behind the pace of renovation of fundamentals of the economy and economic life. The first steps of privatization in Russia its “nomenklatura” stage were thus made in the absence of any legal regulations or strict controls.

Under the Soviet regime, the main cause of corruption was state control over the distribution of the basic resources. At the first stages of reforms, officials radically diversified their forms of control. They took control over the assignment of credits, privileges, licenses, winners in privatization contests, choice of authorized banks, choice of agents for implementation of major social projects, etc.

Economic liberalization was combined with, first, obsolete principles of state control over resource distribution and, second, with the absence of legal norms regulating new activity. Such a situation, which is specific to the transitional period, served as a breeding ground for corruption.

There were considerable loopholes in the assignment of property ownership, particularly land use. The unlawful selling of land is a source of corrupt deals. One should also add a plethora of ill-defined transitional forms of mixed ownership, which spread responsibility and allow businessmen to operate like public servants and officials to operate like businessmen.

Underdeveloped legislation manifests itself in poor awareness of the law, imperfections of the legal system as whole and ill-defined legislative procedures.

Here, various forms of corruption are created by the intrinsic inconsistency among legislative acts. Some laws effectively allow state officials to create conditions for extorting bribes and blackmailing citizens.

Insufficiently, detailed laws provide ambiguous formulations, loopholes, and numerous cross-references. As a result, the final “production” of laws is often accomplished through regulatory norms set by local authorities without oversight or control. Thus conditions emerge for the issuance of ill-formulated, “closed”, hardly accessible regulations that create a favorable setting for corruption. Absence of standardized

legislative procedures for developing regulatory and executive norms laws, presidential decrees, governmental decrees, etc. thereby opens avenues to corruption. The situation is aggravated by an overall negligence in adhering strictly to or respecting procedural norms.

#### *3.4. The inefficiency of state institutions*

Totalitarian regimes create cumbersome systems of state management. This is the case, first of all, in the executive branch. Bureaucratic structures are moreover very sturdy and survive under most severe shocks.

The more radical the changes are, the more energy and inventiveness are shown by the bureaucratic structures in the struggle for survival. As a result, when general life rapidly changes, bureaucratic institutions and the system of state management as a whole lag behind.

In the times of the late Soviet Union and in early post-Soviet Russia, one could observe the reaction of the bureaucratic system to increasingly complicated and multiplying problems. The shortcomings of the system were evident, but staff was swelling, new hierarchical levels of management were introduced, and coordinating structures responsible for nothing were mushrooming. The result was straightforward:

the more complicated and clumsy the state management system is, the larger is the gap between its structure and the problems it has to solve, and the easier is the entrenchment of corruption within it.

In the first stages of reform, the state could barely employ the authority of state machinery and the law to protect rights of ownership or to ensure unconditional fulfillment of the rules of the game. In the absence of protection provided by the state, entrepreneurs asked for favored private protection from particular state officials. Relations between business people and state officials, established out of necessity in this fashion, continued and developed easily into a corruption-based relationship.

The inefficiency of the state also manifests itself in the inability to establish, after the collapse of the nomenklatura, a new modern system for selection and promotion of public servants. As a result, the new wave of public servants brought many less-than-

**honest people into the state bureaucracy with premeditated plans to misuse their offices for ignoble purposes. Very often, there was direct infiltration of “agents of influence” from private businesses to the state administration.**

### ***3.5. Weakness of civil society and alienation***

**A democratic state can solve its problems only via the institutions of civil society. The worsening of the socioeconomic situation of citizens that accompanied the first stages of renovation, combined with the disillusionment that replaced high initial hopes, alienated society from the authorities. Neither grassroots nor top-level corruption can be turned back without the involvement of the public.**

### ***3.6. Weakly established democratic political traditions***

**The infiltration of corruption into political life is aided by an adverse political culture. When elections take place, voters readily trade their votes for cheap handouts or become prey to obvious demagoguery. An undeveloped political party system does not enable parties to take responsibility for training and promotion of their representatives. Shortcomings in electoral legislation protect politicians and permit fraudulent financing of election campaigns. Corruption consequently enters the representative branch of political authority at election times. Fictitious political life and a political opposition deprived of the possibility of influence push political figures to trade their political capital for economic gain. In this way, a smooth transition is made from semilegal lobbying to undisguised corruption.**

### ***3.7. The weakness of the judiciary***

**The weakness of the judiciary is one of the main problems of the transitional period. The system of total party control taught people to seek protection in party committees and not in courts: suing was considered to be almost an indecent act. After the collapse of the socialist system, judicial weakness left a legal vacuum that remains unfilled. The weakness of Russian judiciary system manifests itself in the failure of the fiscal and executive branches of power to provide for salaries of judges and operation of courts. Court decisions are often not implemented. The low effectiveness of arbitration courts results in long delays in case processing and, consequently, in paralysis of economic**

activity. There is a shortage of skilled and knowledgeable personnel to meet the requirements of the new economic conditions.

The civil courts are consequently unutilized in the confrontation with corruption. The underdevelopment of the public legal conscience originates from the past system of Soviet quasi-law. Besides the weak implementation of laws and regulatory norms, the absence of culture and traditions of using the law by citizens, and the perception of legal immunity for state officials results in little or no resistance to “grassroots” corruption.

The habitual bias of the law enforcement bodies and their representatives is protection of state interests and socialist property. Protection of the legal rights and interests of citizens, including private owners, has not become the main perceived task of law enforcement bodies. Not having found formal legal protection, entrepreneurs are obliged to seek special arrangements by buying unlawful services from state officials.

The tradition in Russia of an official’s commitment is not to the rule of law but to instructions, and the overseer is rooted in times much more ancient than the 70 years of the Soviet regime. As a result, attempts to introduce legal regulation become stuck in an obsolete bureaucratic system operating according to its own rules established several centuries ago. A successful anti-corruption program in Russia would have to be combined with radical reform of the state-service system.

### *3.8. The state as nurturer of corruption*

We now turn to economic activities nourishing corruption where the state is present.

Privatization of state property is a serious cause of corruption. The problem was aggravated in Russia by the scale of privatization and weak control over implementation.

According to law enforcement agencies, in the first stages of privatization, about 30% of all decrees already contained violations of existing legislation. Inclusion of a state official in the pool of shareholders was a widespread practice. The Ministry of Internal Affairs noted that every 10th breach of trust among those revealed from mid-1994 until mid-1997 was committed in the privatization sphere totaling 5600 cases. The most

widespread breaches have concerned financial embezzlement and bribery. In almost half of Russian regions, there have been criminal convictions of officials from the local administrations, territory committees on state property management, or state property funds.

There are numerous cases that involve seemingly corrupt practices, but which are either uncovered or do not meet with criminal prosecution: the cost of privatized property is underestimated, tender conditions are manipulated, or enter-prise and state officials engage in mass purchases of shares of enterprises through trustees. It is not incidental that privatization became a battlefield for political clashes where powerful weapons — compromising materials and accusations of corruption — were widely used.

Budget execution and distribution of budget funds is another breeding ground for corruption. There is poor discipline in executing budgets with almost complete absence of any reaction to audits.

Numerous federal budget practices facilitate corruption. The list has a number of components: (1) receipt of taxes and payments in the federal budget; (2) non-monetary offsets of tax obligations or expenditures; (3) receipt of foreign credits; (4) attraction of the credits of commercial banks under guarantees and surety of the Ministry of Finance of Russia, on behalf of the government; (5) renewal of debts of the enterprises and regional organizations of the Russian Federation regions, etc.; (6) means of allocation of financial assistance to the regions; (7) long and unwarranted delays in the collection of debts receivable; and 8 non-purposive and inefficient use of federal budgetary funds.

Estimates are that around half of all decisions regarding state credits or the distribution of state budgetary resources are accompanied by bribes. The situation is nurtured by the clumsy tax system, which stipulates that money collected in regions first goes to the federal coffers and then returns to the regions in the form of transfers.

Corruption is also boosted by unrealistic budgets that have more legitimate claimants than funds. The budgetary shortfall allows officials to decide who will be the first to obtain financing. For the same reason of underfinancing, off-budgetary funds are

established under the aegis of various state bodies. Manipulation of these funds nourishes corruption. The absence of control and accountability over the expenditures of budgetary funds in the regions also nourishes corruption at the regional level of authority.

The distribution of budget resources also takes place through government contracts and bulk purchases. In the past, these transactions were obscured from public scrutiny. Corruption in procurement in particular affects the use of state resources for the military.

The granting of exclusive rights by the state privileges for export and import operations, taxes, licensing, etc. is a breeding ground for corruption. When a draft project for administrative reform was in the preparation stage, the personnel of government agencies was polled and asked which powers the agency was felt to lack. The right to issue licenses was one of the most frequently expressed wishes. We include here under state nurturing such sources of corruption as special permission for the deferred payment of taxes, privileged access to credits or budget resources, prolongation of credit agreements, provision of state guarantees, and budgetary preferences such as those that can be obtained through the “development budget”. Regional authorities exhibit the same vigor as in the federal level in using their powers to grant privileges in exchange for bribes.

According to the General Prosecutor’s office, in 1995, in Stavropol krai alone, 130 crimes committed by officials were exposed.

### *3.9. Corruption and the banking system*

The banking sector was one of the first in Russia to launch reforms. In the late 1980s and early 1990s, unregulated privatization took place in a considerable part of the state-owned banking system. The establishment of the system of trustee banks, in which state resources were transferred for management, under conditions of extreme inflation, was a source of revenues for the chosen banks. In this sphere, too, corruption became naturally deeply entrenched. The cooperation of state officials with commercial banks allowed a form of bribery to become formalized that was almost legitimate. The traditional envelopes and later briefcases filled with cash were replaced by low-interest

credits, or for lenders, interest rates 10 times higher than regular rates, and other more sophisticated forms of expressing gratitude.

In 1996, the General Prosecutor's office reported its concern about the situation in the Central Bank of Russia and its territorial branches. The number of criminal cases launched against employees of credit and financial institutions who were charged with accepting bribes in the period from 1993 to 1995 was growing: 48 cases in 1993, 93 in 1994 and 143 in 1995.

### *3.10. The legislators*

Unlawful receipt of favors in legislative bodies is virtually beyond any control and criminal prosecution. The main reason is the scope of immunity from criminal sanctions for deputies. Therefore, the number of legislators among officials convicted for misdeeds that can be classified as corrupt though this term is absent in the criminal code is a modest 3%. It is unclear as to what extent one should be calmed by the price list for corrupt services exhibited in the State Duma the list was distributed in the Duma and published in a number of newspapers. The prices are an order of magnitude smaller than those paid for similar services to legislators in countries with a more developed democratic system.

### *3.11. Law enforcement bodies*

The connection of law enforcement bodies with economic crime creates a medium that limits control of corruption. "Special teams" that are organized make money by undermining criminal cases. Pressure by the law enforcement bodies on one's business competitors can be arranged in exchange for bribes. The same means are used for blackmail. Many cases are known where officers of the law enforcement bodies have been employed "as a part-time job" by commercial entities. Commercial sub-units have been established under the aegis of the law enforcement bodies. Relatives of high-ranking officials from the tax inspectorate or customs service, irrespective of their professional skills, are nominated to well-paid posts in commercial entities. Relatives of some high-ranking officials from other governmental bodies prove to be equally fortunate.

**In 1995, 270 cases of illegal commercial activity conducted by tax inspectors were exposed. In 1996, 404 officers of the internal affairs departments were subject to criminal prosecution. Many crimes in the customs service about 40% are committed with the acceptance of bribes.**

**Corruption infiltrates courts. In such conditions, lawyers can use bribes as an effective tool for the defense of their clients. Polls reveal that 98% of drivers have offered a bribe to a highway patrol officer at least once. This figure not only signals a high level of corruption in this system, but also is evidence of a public coming face to face with corruption. Grassroots corruption is deeply entrenched in everyday life.**

### ***3.12. Incentives***

**The attractiveness of grassroots corruption is explained by the mutual gain and minimal risk for the person accepting a bribe and the person who offers the bribe. A bribe helps to solve routine problems. Bribes can serve as a modest payment for minor violations of laws and regulations. A sufficiently large ruble note attached to the driver's license may prove to be useful when it is necessary to exceed the speed limit or to drive a car under the influence of alcohol. In Moscow, the bribe for avoiding punishment for drunk driving has been known to vary from US\$100 to US\$300, depending on the model of the car.**

### **4. The state**

**Grassroots corruption in Russia penetrates into all spheres where a citizen has contact with the state. Below we set out the main aspects of the problem. Polls show that people consider the housing and communal system to be the most corrupt part of the government administration. The emergence of the housing market might have been hoped to suppress corruption in this domain. However, corruption proved to be strongly entrenched.**

**The law enforcement bodies and, first of all, the police, occupy a disgraceful second place in terms of public perceptions of corruption. One quarter of those convicted for bribery in recent years had been law enforcement officers. The highway militia makes the largest contribution to this figure. Citizens make corrupt deals with the law**

**enforcement bodies when obtaining drivers' licenses, permission to keep firearms, and more.**

**Taxes and custom fees are an “active culture medium” for grassroots corruption. Polling of seasoned Russian “shuttle-traders” reveals that there is not a single one of them who has not offered a bribe to a customs officer at least once.**

**Conscription to the army service has been very problematic. According to preliminary estimates, more than half of the young men exempted from the military service obtained the exemption by means of bribery.**

**In addition to the cases listed above, there are other situations where people confront corruption with high probability. These include collection of fines and other payments from the population by various agencies; the issuing of licenses for various business activities; the granting of permits for construction and distribution of land lots; and the control of activities of various state agencies fire and sanitary inspections, etc. .**

**The interaction of state authority with the citizen occurs in two ways. The first takes place when the state provides the citizen with some legitimate service, in the form of applying regulations that require permission or the issuing of a document.**

**A wide range of activities requires an official permit. Citizens are unaware of their rights to obtain the permits and the officials' duties in rendering the service, and information is concealed for profit of the state officials. The second circumstances of contact occur when the state, in exercising its normal regulatory function, sets fines for violations of regulations. Then the payment due to the state is turned into a private payment to the state official. The citizen does not know how to pay the state, which is presented as a complicated bureaucratic procedure, as opposed to a simple private payment that ends the matter.**

**Morality and the psychological climate in society affect the level of corruption. The majority of officials are sooner or later faced with circumstances in which they have to choose whether or not to benefit from decision. Corruption is often viewed as compensation for losses suffered by an official in relation to his government service. A decline in morality may be a response to a number of considerations — a feeling of social instability, a low salary not commensurate with the skills and the scope of**

responsibility of a public servant, injustice in promotion to higher posts, and boorishness or incompetence of superiors. A corrupt decision may also be considered by an official as an act of sabotage against the new system. A corrupt official may consider himself a champion fighting against the “criminal regime”, while actually he is but an ordinary money-grabber.

At the same time, corruption, especially grassroots corruption, is considered “by default” as a routine element of everyday life. Accusations of corruption become so routine that the division between the norm and an aberration gradually disappears. An official may become corrupt as a result of a smooth transition from “boundary” activities to clearly criminal ones. This transition is facilitated by the absence of clear-cut rules of management and decision-making, which blurs the scope of rights and responsibilities. In the transition period, obsolete but still active traditions and cultural stereotypes facilitate a smooth descent into corruption.

For instance, in the old system there existed special kinds of “securities”: documents with a collection of visas, permissions and authorizations ranging from a village in Soviet to the Politburo. The necessity of obtaining these permissions allowed the informal conversion of administrative capital into economic capital. Such practices existed in all branches of authority and at all levels. The tradition has persisted.

Similar effects arise because of the existence side-by-side of old and new stereotypes of administrative behavior. The Soviet system allowed the legal conversion of authority into personal comfort and the illegal conversion of authority into personal wealth. Forbidden, however, was the conversion from economic to political authority. There were some exceptions. However, these were unacceptable and from time to time punished. One could gain shadowy influence but it was impossible to legally buy political authority for money.

A normal democracy allows some conversion of economic wealth into influence over the state, through electoral mechanisms and the political influence of special interest groups. However, in its developed form, democracy is inconsistent with the conversion of political authority into economic wealth.

**A feature of the transition is the combination of traditions and cultural stereotypes that allow the personal freedom of virtually unhindered conversion of one form of capital into another. Public officials consider their posts to be a continuation of the market. Democracy is seen as the freedom of conversion from the normal market into the market for corruption-based services.**

**Absence of opposition to the conditions creating corruption allows expansion in both horizontal and vertical directions. Corruption captures new offices and spheres of influence, promotes the formation of networks and groups, and allows policy making to be captured for private interest. As economic and political inequality within society increase, social tension increases as well. The very existence of constitutional order is put under threat. Corruption evolves into a problem threatening the country's national security.**

#### **5. Measures taken against corruption**

**In Russian legislation, the following articles of the criminal code relate to corruption: No. 174 — legalization of financial means and other property acquired illegally; No. 285 — misuse of official authority; No. 290 — acceptance of a bribe; No. 291 — offer of a bribe; and No. 292 — forgery of documents. At the same time a number of actions closely related to corruption are not included in the new criminal code. These are: participation of an official figure in a commercial activity for deriving personal benefits; use of an official position for “pumping” state resources into commercial structures for deriving personal benefits with the involvement to this end of other persons or relatives; granting privileges to commercial structures by an official figure to derive personal benefit; granting state financial and other resources to electoral funds.**

**The law “on fighting against corruption” adopted by the State Duma in November 1997 accordingly proved to be very feeble. In 1992, the president of the Russian Federation issued a decree “on fighting against corruption in the state service system.” Because of the absence of mechanisms for its implementation, this proved to be one of the most neglected decrees in the whole history of the Russian presidency. It obligated public servants to declare their income and property, but only beginning five years**

hence. A proposed regulation forbidding public officials to engage in private entrepreneurial activity was never adopted. According to the Ministry of Internal Affairs, more than 800 cases of such violations were revealed in the period from 1994 through mid-1997. The possibility of combining state service with commercial activity was however, allowed to continue as a major pathway for corruption. The Federal Russian law, “on the basis of state service in the Russian Federation” provided for anti-corruption measures, but was also badly implemented. One of the reasons was the absence in the law of mechanisms and procedures to permit implementation.

Measures that sought to restrain corruption in law enforcement agencies were adopted. The Federal Security Service, the Ministry of Internal Affairs, the State Customs Committee, and the Federal Service of Tax Police were given departments of internal security of their own. According to the General Prosecutor’s Office of the Russian Federation, the service of internal security of the Ministry of Internal Affairs is the most effective, revealing 60% of the crimes committed by official figures of the ministry.

Data shows that arrests for convictions have declined by 80% from the time of the Soviet Union, although the population of the Russian Federation is smaller than that of the USSR by 40%. The probability that a defendant will end up behind bars after a case is begun by the prosecutor’s office does not exceed 0.08. For example, according to the State Tax Service, in 1995, criminal cases for bribery were launched against 97 officers of the service; yet only six of them were convicted. Criminal cases under the article “Misuse of Authority” were launched against 17 officers, and no one was convicted. The situation was not much better in 1996–1997.

Experts knowledgeable about how to contain and reduce corruption are basically non-existent within law enforcement agencies. A naive vision of the causes of corruption has not changed. The vision in the Soviet era was described at the beginning of this paper. We offer a quotation from a preamble to a draft program of fighting with corruption dating from 1996: “The current situation corruption occurred because in the state authority, attention to the selection and placement of personnel was loosened.

**There are three reasons why law enforcement agencies fail in their fight with corruption. First, criminal prosecution alone cannot change large-scale corruption.**

**The fight against corruption is not a criminal problem only, but — as we have described — is a systemic one. Second, the quality of the work of the law enforcement agencies is low; they themselves are corroded by corruption, and the professional level of the officers en masse is not a match for the complexity of the problem. Third, the law enforcement system alone cannot cope with the problem, this requires resolution by the combined efforts of the state and society.**

**There is no shortage of pronouncements. In 1997, the president of the Russian Federation announced a transition to open tenders for state procurement orders, and he also announced that budgetary discipline was to be strengthened. New laws were adopted intended to narrow the base for corruption the law “on the executive issues”, the law “on court officials” “pristavakh”, the law on privatization, and the law on bankruptcy . The 1998 budget stipulated an increase of 48% in the financial resources allocated to the judicial system. One could, however, observe delays with the implementation.**

**To assess the prospects of fighting corruption in Russia, it is necessary to establish feasible participation by the main actors: the authorities, key elements of civil society entrepreneurs, mass media, and public institutions, and society as a whole. In the complicated situation of Russia, all the “players” have both positive and negative attitudes in fighting corruption.**

**The mass media does write about corruption, and these articles enjoy a high demand by readers. No group has an exclusive monopoly in the commercial mass media, so issues of corruption are on the agenda.**

**The business elite is aware of the influence of the mass media. We witness, as a result, conflicts between different groups, for the control over information channels in a broad sense of the word. With no norms regulating judicial and economic relations between journalists and their “masters”, the private mass media degenerate to a tool for fighting between economic and bureaucratic clans.**

Russian business consists of three unequal parts. Its first and minor sector includes those major financial groups that grew up on state budgetary funds and on the access to administrative resources. These groups fiercely fight with each other and new groups emerge. Part of their antagonism to each other is expressed in claims and counterclaims of corruption. The emergence of scandals reveals the real situation to the people and inhibits some impudent corruption-related actions.

The second sector of Russian business embraces representatives of the “second echelon” of business. They were not allowed and often did not strive, because of fear or principle to secure access to the budget feeding trough, and for that reason are interested in fair rules of the economic game. Entrepreneurs who succeeded under conditions of real competition are not interested in the intermingling of political power and business that nurtures corruption. This part of Russian business is fragmented and did not develop permanent effective mechanisms for the protection of their interests. The authorities, following the already formed tradition, maintain contact with the representatives of the first group of businessmen, while basically ignoring the much more numerous second group.

The third group of the Russian businessmen, often referred to as “small and medium business”, which is a base for the middle class, is literally ensnared by grassroots corruption. For them, corruption hinders business activity and debases the entire social stratum. This becomes a source of social tension for these groups, which, as history shows, were the catalyst not only of bourgeois revolutions but also of fascism.

The mainstream of Russian society is disillusioned by the incompetence and lack of will of the authorities. This disillusionment is maintained by a stable stereotype of deep state corruption. Russian public opinion, which is still not protected by the entrenchment of civil responsibility and adherence to democratic principles, is prone to the temptations of simple solutions. One of the most widespread myths is in the desirability of a “strong hand”. For that reason it will be very hard to gain the trust and support of the people for the implementation of an anti-corruption program.

The Russian authorities themselves are, at the same time, concerned with losing the trust of society. They need the approval of voters when elections take place.

**Declaring opposition to corruption is one way of gaining popular support. Representatives of all parts of the political spectrum gladly use anti-corruption rhetoric.**

**Measures aimed at constraining corruption prove to be either symbolic or fragmentary. Several obstacles hinder the launching and implementation of anti-corruption measures. High-ranking figures may themselves be accused of involvement in corruption. There is a large group of officials not interested in changing the status quo. Old stereotypes dominate within the state bureaucracy and they dictate straightforward non-effective approaches to the solution of corruption-related problems.**

**Eliminating corruption is inseparable from the radical redesign of the mechanisms of state management. The implementation of an anti-corruption program requires political support from political elites who benefit from the continuing system. The state, which should lead the fight against corruption, is the instigator of conditions that facilitate corruption. This makes the design of public policy to combat corruption difficult. At the same time, the public has no reason to change their perceptions and behavior, which accommodates corruption as part of normal life. No systemic change can therefore take place to affect the basic concepts, values and behavioral stereotypes of public officials and the people they serve.**

## **6. A basis for change**

**There are nonetheless measures that can make corruption more difficult. A realistic and realizable budget would limit the budget deficit, and reduce the scope of “personal factor” in decision making by officials. Ensuring the rights of property owners and shareholders and making the activities of business enterprises “transparent” for shareholders would also limit corruption by reducing the scope of the need for bribes as a means of protecting private commercial interests.**

**Reform of the tax system would decrease the shadow economy where corruption is extensive by limiting possibilities for blackmail of private businessmen by officials of the tax collecting bodies. A decrease in the size of the cash sector by broader use of**

**modern electronic ways of payments and the introduction of modern forms of financial reporting would hinder bribes in cash. This would restrain grassroots corruption.**

**Commercializing social services including housing and communal services and the introduction of competition into this domain would transform a corrupt market artificially maintained in excess demand into a normal clearing market.**

**Broader use of modern methods of social payments in electronic form would diminish dependence of applicants on the will of state officials and, in this way, will restrain grassroots corruption. Delegation by tender to the private sector of some government tasks with state control over the expenditure of resources would also counteract grassroots corruption.**

**Revival of the judicial system would hinder corruption. Reasonable salaries could be paid to judges and other court officials. A system of training and selecting personnel for court appointments could be set up. The arbitrage courts could be made reliable.**

**Grassroots corruption can be restrained by efficient accountable local self-government. Experience shows that local highway police supervised by the elected bodies of the local self-government are less corrupt than their counterpart that reports to the Ministry of Internal Affairs. Local self-government should, of course, not be allowed to fall under the control of criminal elements. Changes could also take place in executive authority power and in the state service bureaucracy, including an increase in the salaries of public servants and abolition of the obsolete system of privileges in the everyday life of officials. Corruption can be defeated only with the involvement of the institutions of civil society. Grassroots corruption cannot be restrained without the involvement of the people, since corruption entrenched at the low levels of the authority is almost insensitive to the authoritative pulses going downwards from the top. However, corruption can be held back by pressure from below, by the combined efforts of citizens and the institutions of civil society. When implementing an anti-corruption program, therefore, the authorities should actively involve the public and, first of all, the entrepreneurs and the independent mass media. Special attention should be paid to forming of a law-based and civil conscience and to training of citizens in the basics**

of behavior in a democratic and law-based society; and in particular, in the basics of anti-corruption activity.

Yet, none of these measures is sufficient for resolving the problem. The state is being asked to reform itself. The persons who gain from the blurred boundary between business and political life will not necessarily be anxious to define the boundaries. As we have observed above for this reason, the fight against corruption becomes a struggle to restructure civil authority, when civil authority is, however, itself a bastion of corruption.

## **7. Conclusions**

The failures of the transition have attracted considerable attention. See for example Gelb et al. 1998 , Stiglitz 1999 , and Hillman 2000 . Our purpose in this paper was to make clear the prominence of corruption as a primary cause of the Russian transition failure. We have provided a systematic account of corruption in transitional Russia, explaining the sources of corruption and how corruption affects and is affected by economic activity. Our study leads us to the conclusion that corruption in Russia during the transition in the 1990s has been an intrinsic part of economic and political life. We have characterized the different ways in which corruption has affected the lives of the Russian people and have described activities of corruption that reach from grassroots levels to the highest levels of government authority. Russian society is one where government officials see their reward from their positions as being the privilege to use their authority to extract income from the private persons with whom they come into contact. Private persons come to expect to have to pay government officials. The outcome is a society where corruption becomes part of the social norms of everyday life. Such a society is a continuation from past norms of behavior that existed in Soviet times, and indicates absence of change in the basic principles of conduct<sup>4</sup>. We have suggested changes in economic, political and judicial conduct that would make

---

<sup>4</sup> See for example Hillman and Schnytzer 1986 on corruption in Soviet times.

corruption more difficult. Most fundamentally, however, the norms of behavior are needed to be changed so that corruption will not be viable<sup>5</sup>.

There is a substantial theoretical literature in the western economics tradition that investigates the types of corruption-related phenomena that we have described<sup>6</sup>. A primary purpose of this paper was to make theoretical analysis less speculative in application to Russia by setting out clearly the principles of behavior and the institutions that the theoretical models should describe when portraying the Russian experience with the transition.

### Acknowledgements

This paper is based on the IDEM Report on corruption in Russia. We thank the Office of the President of the Russian Federation under whose auspices the IDEM Report was prepared. An earlier version of the paper was presented in February 1999 at Erasmus University at the conference on Economic Performance, Economic Policy, and Political Culture. We thank the participants at the conference for their helpful comments. We particularly thank Arye Hillman for his assistance.

### References

- Applebaum, E., Katz, E., 1987. Seeking rents by setting rents: the political economy of rent seeking. *Economic Journal* 97, 685–699.
- Falkinger, J., 1999. Social instability and the distribution of income. *European Journal of Political Economy* 15, 35–51.
- Gelb, A., Hillman, A.L., Ursprung, H.W., 1998. Rents as distractions: why the exit from transition is prolonged. In: Baltas, N.C., Demopoulos, G., Hassid, J. Eds. , *Economic Interdependence and Cooperation in Europe*. Springer, Berlin.

---

<sup>5</sup>

On prospects for change of norms via education, see Guttman et al. 1992 . On hopes via a moral revival, see Grossman and Minseong 2000.

<sup>6</sup>

See for example Marjit et al. 2000 and the references therein. On the issues of social instability associated with income distribution that we have described, see Falkinger 1999 . On issues of autocracy, see Tullock 1987 . Tullock 1989 observes the relation between privilege and rents. Applebaum and Katz 1987 describe how rents are created to be shared by the officials who create them.

**Grossman, H.I., Minseong, K., 2000. Predators, moral decay, and moral revivals. European Journal of Political Economy 16.**

**Guttman, J., Nitzan, S., Spiegel, U., 1992. Rent seeking and social investment in taste change. Economics and Politics 4, 31–42.**

**Hillman, A.L., 2000. In transit to the promised land: ten years in the wilderness without Moses. In: Blejer, M., Skreb, M. Eds. , Ten Years of Transition. Kluwer, Dordrecht, and Boston.**

**Hillman, A.L., Schnytzer, A., 1986. Illegal activities and purges in a Soviet-type economy: a rent-seeking perspective. International Review of Law and Economics 6, 87–99.**

**IDEM Foundation, 1998. Russia versus Corruption: Who Will Win?. Council of Foreign and Defense Policy, Moscow.**

**Marjit, S., Mukherjee, V., Mukherjee, A., 2000. Harassment, corruption, and tax policy. European Journal of Political Economy 16, 75–94, this issue.**

**Stiglitz, J.E., 1999. In: Whither Reform? Ten Years of the Transition. World Bank Annual Conference on Development Economics. The World Bank, Washington DC.**

**Tullock, G., 1987. Autocracy. Kluwer, Dordrecht, and Boston.**

**Tullock, G., 1989. The Economics of Rent-Seeking and Privilege. Kluwer, Dordrecht, and Boston.**