

## TOWARDS PREDATORY STATE? ORIGINS AND MECHANISMS OF STATE OFFICIALS' EXTORTION IN RUSSIA<sup>1</sup>

### INTRODUCTION

PERVASIVE CORRUPTION HAS BEEN A SYSTEMIC FEATURE of the Russian administrative system since the beginning of economic and political transformation. However, the administrative corruption in this country has lately evolved into a new, particularly dangerous form. Many experts argue that in recent years, corrupt officials started to use the coercive tools given them by the state in order to extort bribes and seize citizens' property.

One of the first legal processes which raised international public's awareness about extortionist activity of Russian bureaucrats was the Magnitsky case. In 2008, Sergei Magnitsky, a lawyer from Moscow revealed a corrupt network of mid-level police officers and tax authorities. They made a very profitable "business" on illegal takeover of private companies and their subsequent resale. In response to that, corrupt officials filed a criminal case against Magnitsky. 11 months after being arrested, the lawyer died in prison (U.S. Department of the Treasury, 2012).

Magnitsky is just one victim of state officials' predatory activity among hundreds. Organisation of Protection of the Entrepreneurs *Business Solidarity*, for instance, publishes on its website dozens of similar stories. Each year, Russian law enforcement agencies initiate 130 thousand criminal cases related to the economic crimes, and imprison about 75 thousand entrepreneurs (Centre of Legal and Economic Studies, 2012). Many of them are prosecuted on the ground of falsified evidences.

The phenomenon of state officials' extortionist activity is the main subject of this article. Author's goal was to find out why this dangerous

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phenomenon appeared in the last decade, when Russian state institutions were not getting weaker and decayed, but just the opposite, grew in power.

Administrative corruption is a popular research topic among Russian scholars. Numerous studies on this subject have been published since mid-2000s. They may be divided into three main categories. The first one includes studies of public opinion regularly conducted by sociological research organisations such as VCIOM, Levada Centre or Public Opinion Fund (Transparency International Russia, 2012). They show which institutions are perceived as the most corrupt by Russian citizens, demonstrate people's perception of the causes of corruption as well as their opinions on how to solve this problem.

Another group of authors (Arinin, 2005; Kurakin, 2013; Polkovnit-sky 2002; Bezrukova 2011) analyse the phenomenon of administrative corruption in Russia mainly from the legal perspective. They see the causes of corruption in imperfect regulations giving high discretionary power to the state officials, overgrown bureaucratic apparatus and the deeply rooted "corruption culture."

However, neither analysis of the public opinion, nor the legal studies are able to explain why the administrative corruption has evolved into a new, particularly dangerous form in Russia in the mid-2000s. Studies of public opinion present only subjective information about the causes of corruption. Legal studies do not explain social, political and economic causes lying behind imperfect laws or their selective application.

More information about state officials' predatory behaviour can be provided by the third group of researchers who analyse the administrative corruption from the perspective of sociology of institutions. Scholars working for INDEM Fund (Satarov, 2013; Rimsky and Kalikh, 2013) present a detailed description of petty corruption in Russian administration bodies, education and healthcare system. Researchers from the European University in Saint Petersburg (Volkov et al., 2010; Kosals and Dubova, 2012; Dubova, 2013) as well as the Higher School of Economics in Moscow (Centre of Legal and Economic Studies, 2011) focus on the informal activity in police and courts. These studies describe the functions of informal practices in Russian state apparatus and explain their stability.

However, the majority of these studies overlook the topic of state officials' predatory behaviour. Only the experts from European Univer-

sity in Saint Petersburg (Volkov et al., 2010) have carried out a detailed research on arbitrary activity of law enforcement agencies so far. This phenomenon has been partially analysed by lawyers specialising in corporate raiding (Krasnov et al., 2008; Baykova, 2011; Centre of Political Technologies, 2008; Skidanova, 2010).

A particular attention to the state officials' extortion has been paid by the experts of the Association of Russian Lawyers for Human Rights, (2009, 2010, 2012) and Jordan Gans-Morse from the University of California (2012). The study of Gans-Morse is apparently the only scientific paper on this subject published in English so far. Therefore, this research presents one of the first attempts to look at the problem of the state officials' extortion from the perspective of sociology of institutions.

Of course, the scarcity of data and lack of other studies on this subject impose considerable limitations on the analysis. This research is mainly based on the analysis of secondary sources: reports prepared by the Association of Russian Lawyers for Human Rights, policy papers and articles written by leading Russian experts in the field of corruption fighting. It is also based on the interviews conducted with four well known anti-corruption experts: Evgeny Arkhipov and Dmitri Firsov from Russian Anti-Corruption Civil Society Centre *Clean Hands*, Yuli Nisnevich from the Transparency International Russia and Yana Yakovleva from the Association of Protection of the Entrepreneurs *Business Solidarity*. During the research, the statistics provided by Russian Ministry of Interior and Supreme Court have been also used.

The article begins with a short presentation of theoretical framework which explains why widespread corruption is tolerated by political leadership in many countries. Then I describe the nature of state officials' extortion in Russia and present main actors involved in illegal takeover of citizens' property. Finally, I explain how this dangerous phenomenon emerged and why state officials' predatory activity became the result of strengthening of power hierarchy and not the result of its decay.

#### 1. SYSTEMIC CORRUPTION: A SIGN OF A WEAK STATE OR A WAY TO STRENGTHEN THE "POWER VERTICAL?"

Many researchers agree that pervasive corruption has become a systemic feature of the majority of post-soviet states, including Russia. Bribery, extortion, nepotism, patron-client networks have become integral to the

relations between the state and its citizens (Bezrukova, 2007: 5). The notion of *systemic corruption* implies the situation in which administrative, political, and economic systems of a country are not able to function without corrupt practices, and the majority of citizens have no alternatives to dealing with corrupt officials (United States Institute of Peace, 2010: 26).

When the corruption becomes systemic, state laws and regulations lose their obligatory character. An illegal use of official's position with the purpose of self-enrichment becomes a rule rather than an exception. When the formal regulations and hierarchies are weak and non-respected, the functioning of the state becomes based on informal rules and networks (Stephes, 2007: 6).

The majority of contemporary studies of corruption are based on the agency theory. It sees the major cause of corruption in the conflict of interests between the state officials (principals) and their subordinates (agents). According to the principal-agent model of corruption, this phenomenon occurs when the agents betray their principals and use the entrusted power in their private interests (Persson, Rothstein and Teorell, 2010: 4). Therefore, the main ways to solve the problem of corruption are to strengthen principal's supervision and decrease agent's motivation for the corrupt behaviour.

The main weakness of this model is the inability to explain the phenomenon of systemic corruption, when *both* the principal and the agent are corrupt. It becomes useless as an analytical tool simply because there is no actor willing to detect and punish corruption (Persson, Rothstein and Teorell, 2010: 5). Moreover, the agency theory sees the systemic corruption as a sign of a weak state. Replacement of official regulations by informal rules is considered to be the symptom of state apparatus decay (Kamiński and Kamiński, 2010: 28). However, several researchers argue that this decay occurs only when the strength of the state really depends on the implementation of written rules. If it depends on informal rules and networks, systemic corruption may reinforce the state institutions rather than destroy them.

As the American political scientist Keith Darden argues, many countries whose regimes can be characterised as oligarchic or authoritarian would simply collapse without corruption (Darden, 2002: 1). Corruption there reinforces the power hierarchy in a double way. First, graft plays a role of informal reward for loyalty and obedience. Second, corruption provides the rulers with a very powerful tool to blackmail the

defectors. Any disobedient state functionary can be imprisoned for well documented corruption charges, and the proofs of corruption would be thoroughly collected by an extended secret police apparatus.

Keith Darden presents Ukraine under the rule of President Kuchma, Alberto Fujimori's Peru, Morocco and Pakistan as clear examples of deeply corrupt states having at the same time influential secret services. All facts of high-level corruption in these countries were thoroughly observed by secret services, recorded and reported to the political leadership. Country leaders, however, deliberately turned a blind eye on high-rank officials' illegal activity, and even encouraged their corrupt behaviour (Darden, 2002: 18).

Based on these facts, Darden concludes that the pervasive corruption in many countries does not indicate the weakness of the state power. It rather indicates that under the façade of official state institutions there is a parallel, *informal state*, a set of powerful informal political and economic institutions (Darden, 2002: 2).

Douglas North, Joseph Wallis and Barry Weingast (2006) have raised the discussion about systemic corruption on a new theoretical level. They argue that the phenomenon that we call rent-seeking or corruption is not a pathology of the state apparatus. It is neither a mere reward given by leaders to their subordinates in order to buy their loyalty. Rent-seeking is a fundamental principle behind the political and economic organisation in the majority of contemporary states.

On the ground of the new institutional economics, North and his colleagues have developed a *theory of natural state*. Natural state is a form of political and economic organisation in which leaders give exclusive rights to extract economic rents to the members of the ruling elite. As a result, the elites have a strong interest in maintaining the leaders in power. In order to create and maintain these rents, natural state restricts citizens' access to political and economic activity. It simply does not provide protection for the organisations established by non-elites (North et al., 2006: 14).

Natural state is an integral part of a larger social structure which North calls *limited access order*. North and his colleagues have specified three social orders developed by humanity in the course of its history: the primitive, the limited access and the open access orders. They differ in their ability to sustain and structure social organisations. Primitive access orders are not able to sustain complex organisations. Limited access

orders support complex organisations but restrict access to them and limit their number. Open access orders, in contrast, do not create barriers to political, economic, cultural and social activity of people.

Economic and social systems of the societies belonging to the limited access orders are characterised by constant rent-creation, monopolies, privileges, huge inequality in rights between elites and the rest of the society (North et al., 2006, p. 5). As it has been mentioned above, the glue that holds ruling elites together in a limited access order are *rents*. The natural state functions as a *coalition of rent-seekers*. These coalitions may have different forms: traditional monarchies, aristocracies, different kinds of dictatorships, military juntas (North et al., 2006: 27).

Douglas North stresses that natural states are not failed states. They are not produced by evil leaders; they are not results of social pathologies, and “because natural states are not sick, political medicine will not cure them” (North et al., 2006: 71). Douglas North, like Keith Darden, does not perceive rent-seeking as a sign of inevitable weakening of a state. From the perspective of the natural state theory, graft may be seen as the right to extract corrupt rents intentionally given to the state officials by the leaders. The leaders give this right to their subordinates in order to strengthen the power coalition.

The theories of Douglas North and Keith Darden can provide an original and convincing explanation of the widespread administrative corruption in Russia. I would argue that the generous rights to extract corruption rents are deliberately inbuilt in the Russian administrative system. The purpose of pervasive corruption is to strengthen the “power vertical,” ensure the loyalty of elites and increase the manageability of the country.

## 2. STATE EXTORTION: THE NATURE OF THE PHENOMENON

The subject of the present research is a particular form of administrative corruption which has recently become a widespread phenomenon in Russia. Namely, it is the extortion of citizens’ property performed by state officials. Administrative corruption is usually defined as “institutionalised personal abuse of public resources by civil servants” (Gould, 1991 in Khan, 2004). Traditionally, it encompasses a wide range of phenomena including embezzlement or misappropriation of public funds, abuse of authority, manipulations with public procurement bids, clientage or nepotism (Karklins, 2009).

However, in the last 10 years, Russian state apparatus have produced a new, more dangerous form of administrative corruption. Many researchers have noticed that the interests of the corrupt officials *have shifted from the extortion of bribes to the takeover of citizens' property*. Since the mid-2000s, bureaucrats have started to use their power to intimidate businessmen and seize successful enterprises (Association of Russian Lawyers for Human Rights, 2012: 15). This change has been formulated by the director of Transparency International Russia in the following way: *"In the past, citizens paid bribes to officials in order to solve any problem in their favour. Now officials and the police come themselves to citizens and demand money like racketeers"* (Panfilova, 2012).

According to the American political scientist Jordan Gans-Morse, Russian small and medium entrepreneurs now perceive the threat coming from state officials, seeing them as "more destructive than bandits" (Gans-Morse, 2012: 32). Regulatory agencies are able to close down business for certain period of time or to impose a huge fine. Law enforcement agencies are considered to be even more dangerous, because they may initiate criminal prosecution and send an entrepreneur into jail. Both the regulatory bodies and law enforcement agencies extensively use their power in order to extort bribes or seize entrepreneurs' assets (Gans-Morse, 2012: 33). This radical shift in the behaviour of the state officials have been noticed by the experts in the field of corporate raiding. They point out that since the mid-2000s, an illegal takeover of enterprises started to be organised mainly by the high-level state officials related to the secret services or the police (Centre of Political Technologies, 2008: 38).

Not only successful enterprises may fall victims of corrupt officials' attacks in Russia. High-level bureaucrats and law enforcement officers may seize private houses and lands. According to the sociological survey ordered by the Russian newspaper *Nezavisimaya Gazeta* in 2012, only 45% of Russian citizens believe that they are able to defend their property from takeover attempts. More precisely, they believe that they are able to repel an attack of criminals, but they feel defenceless against the attacks of state officials (Bashkatova, 2012).

The administrative corruption in Russia has lost its "voluntary" character (Kulikov, 2011). In many cases it is neither an exchange of money for preferential treatment of the "buyer," nor even the extortion of bribes by the greedy bureaucrats. As the experts of the Association of Russian Lawyers for Human Rights (2012: 15) point out,

*[...] the corruption vehicle crosses over even those businessmen who are ready to pay bribes and participate in corruption schemes; [...] the interests of corruptionists are not in extracting bribes but in depriving the businessmen of acquired property and appropriating their successfully developing business.*

State officials have started to use the coercive tools conferred to them by the state for personal enrichment purposes. One can speak about a widespread “privatisation” of state coercive tools by the functionaries. It means that the state is no longer the main sponsor of the state officials. They systematically use state coercion instruments for their private purposes, do not see the difference between state resources at their disposal and their own resources, and higher officials do not oppose to such practices. Such corruption reverses the purposes of the state institutions: instead of providing security and defending citizens’ rights, they become the tool of officials’ personal enrichment and one of the major threats to citizens’ security and property. The behaviour of state bureaucrats becomes, in fact, very similar to the behaviour of organised crime groups.

This particular aggressive kind of administrative corruption has been called by Transparency International Russia expert Yuli Nisnevich a “*state officials’ racket*” (Nisnevich, 2013). As it has been described above, the notion of state extortion refers to the **extortion of bribes and seizure of citizens’ property carried out by state officials threatening the citizens by the use of state coercion tools at their disposal**. Various data collected by social researchers, lawyers and human rights defenders indicate that since 2003, this phenomenon has become very common in Russia. However, the precise figures of attacks performed by state officials are difficult to estimate.

Despite dangerous character of the state officials’ extortion, very few researches have been done in this field so far. On the basis of the available data, the author will try to reconstruct the main actors involved in the state officials’ predatory activity, the main mechanisms of its functioning and the main reasons that caused this phenomenon. The model of state extortion presented in this study will have a rather general and schematic nature; it will not be attributed to a concrete region or sphere of economic activity.

### 3. FSB, POLICE, COURTS, REGISTRATION BODIES: MAIN ACTORS INVOLVED IN STATE EXTORTION

Russian sociologists suggest that attacks on citizens' property are performed by state officials of all ranks. Local authorities and mid-level officials use their power and connections to take control over medium enterprises in their administrative unit. The heads of larger administrative units like *kray*, *oblast* or autonomous republic form corrupt networks with their relatives. These networks of "clans" seize the most profitable and important big enterprises in the regions. Finally, the federal government take over the large national-scale firms as it was during the prosecution of the Russian oligarch Mikhail Khodorkovsky and expropriation of his oil company Yukos in 2003 (Baykova, 2011: 21). However, the present analysis will be focused on the state extortion on medium and local levels.

The leading role in the state officials' extortion belongs to the law enforcement agencies. The most aggressive attacks are performed by a powerful security agency – the **Federal Security Service (FSB)**. According to Yevgeny Arkhipov, even the heads of local administration cannot seize someone's property if it is not tacitly allowed by the representatives of the FSB.

*"Very seldom local business is controlled by the heads of local administration. Usually, this role belongs to the heads of the FSB, their friends and relatives [...]. A corrupt power is not concentrated around the state administration. It is concentrated around the FSB. They decide to which officials they will give an opportunity to make some money, and to whom they won't"* (Arkhipov, 2013).

Officers of the Federal Security Service and people connected to them control the biggest and the most profitable business. The majority of entrepreneurs in Russian regions accept to work under secret services' "patronage" simply because they are afraid that otherwise their business will be closed. *"From our discussions with businesspeople we know that usually the chief of the local FSB or their deputy comes and informs the entrepreneur that they have to pay a bribe. It is senseless to call somewhere and to complain"* (Arkhipov, 2013). While small entrepreneurs are asked to pay bribes, owners of larger businesses have to include the FSB officers' trusted people into the board of directors and transfer from 30% to 50% of shares to the firms pointed by the FSB.

State officials prefer not to register property in their names. Firms are usually registered in the names of officials' relatives. Bureaucrats create complicated *corporate veils* hiding the real owners. "A firm may be even registered in an offshore, Arkhipov (2013) says, the most important is that the final beneficiary of the corporate chain is the local official."

The leading role of the Federal Security Service in the state extortion phenomenon stems from large competences of this agency. This structure can initiate criminal prosecution, enter citizen's dwellings, it has unlimited access to any kind of information, as well as technical and legal means to spy on people, including taping phone calls and reading e-mails.

**Russian police** (until 2011 known as militia), unlike the FSB, extends its "patronage" mostly over small and medium enterprises. Police functionaries control less stable and profitable businesses as well as the activities having explicitly criminal nature, e.g. people smuggling and prostitution. However, Arkhipov (2013) argues that the police can control these business activities as long as they are allowed to do so by the local FSB. According to unwritten rules, the police are not allowed to extend their protection racket over the firms which are already controlled by the FSB.

Even though the extortion activity of Russian police mainly focuses on small and medium enterprises, the results of police racket are not less disastrous than the results of attacks made by the FSB. Police units dealing with economic crimes and organised crime groups, as well as the Federal Drug Control Service (FSKN) are particularly infamous for initiating criminal cases against entrepreneurs with the purpose of extorting bribes or taking over their assets. The more prosaic and criminal character of business over which Russian police extends its patronage has a simple explanation: it belongs to the activities the police deal with on everyday basis.

Despite the fact that other state agencies have much more limited possibilities to initiate criminal prosecution, their role in the state extortion is very significant. **Prosecutors, courts and registration bodies** participate in sophisticated schemes organised by high-level officials and law enforcement officers in order to legalise the unlawfully taken property.

Registration bodies, such as the Federal Service of State Registration and Cadastre, are used by raiders to change firm's owner and to sell it to other agents. Corrupt prosecutors are needed to falsify proofs and to put a victim into prison. Judges are used to legalise ownership

rights (Krasnov et al., 2008). Particularly important role is played by **tax authorities**, as they have access to the originals of companies' documents, may confiscate and falsify them (Sukhov, 2012).

Even if a court is not corrupt and a victim of state extortionists is discharged, it does not compensate entrepreneur's losses. Interruption of business activity caused by the initiation of criminal case, sequestration of firm's property and confiscation of documents in the majority of cases leads to the bankruptcy. As it has been mentioned above, even less powerful regulatory bodies use their prerogatives for racket purposes. Researchers have registered extortion attempts made by fire inspectors, sanitary inspectors and even veterinarians (Association of Russian Lawyers for Human Rights, 2012: 11).

**Private actors** may also use state coercion apparatus for illegal purposes. An "ordered" criminal case is not an unusual phenomenon in the Russian business world. By the end of the 1990s, businesspeople in Russia have realised that instead of killing a competitor it was safer and more efficient to imprison them. In order to initiate a criminal case against the rival, it is enough to bribe a prosecutor or police officer. Therefore, the number of contract killings sharply decreased in Russia by the end of the 1990s. They have been replaced by criminal cases initiated by corrupt law enforcement bodies. This opinion is confirmed by Jordan Gans-Morse. He points out that an "ordered" criminal case often abruptly comes to an end when a victim agrees to settle the dispute on terms favourable to the attacker (Gans-Morse, 2012: 28).

Insecurity of property rights caused mainly by the predatory behaviour of police and security services makes businesspeople to address for the protection to the very same law enforcement agencies. The most solid "protection roof" (in Russian *krysha*) is provided by the FSB (Arkhipov, 2011). Some entrepreneurs try to find a "protector" among well-placed bureaucrats. They make a high-level official a member of the board of directors giving him a part of shares. Sometimes such person guarantees better protection against inspectors and law enforcement agencies than an FSB officer (Gans-Morse, 2012: 26).

The role of **organised crime groups** in state extortion schemes is also far from being insignificant. Some experts argue that the extortion of bribes and illegal corporate raiding are one of the main sources of income of police units fighting with economic crimes and organised crime groups. In such illegal activities, the police forces often use or-

ganised crime groups to frighten or physically eliminate intractable entrepreneurs. On the other hand, law enforcement agencies often protect illegal business of mafia and draw profit from it (Association of Russian Lawyers for Human Rights, 2010: 14).

The cooperation between law enforcement units and organised crime groups in Russia started in the 1990s. The reason for it at the time was poor financing of police officers. In the mid-2000s, the situation improved significantly, but in several regions organised crime and police remain tightly interconnected. For instance, mafia groups pay police officers “black salaries,” and appointment of high-ranking police officials requires the approbation by criminal leaders (Association of Russian Lawyers for Human Rights, 2009: 17).

While different law enforcement units and agencies compete with each other fighting for the patronage over business in big cities, they closely cooperate and create **corrupt networks** in Russian province (Firsov, 2013). These networks usually include heads of local administration, chiefs of security services, police officers and judges (Association of Russian Lawyers for Human Rights, 2012: 16). Such corrupt bureaucratic networks may take control over the whole economic activity in a region.

When an entrepreneur wants to establish a firm, they are obliged to give a part of its shares to local officials. Otherwise, they will be unable to work in the local market, because every supplier, contractor or corporate client either already belong to the corrupt officials or are controlled by them. As the ARLHR experts argue, state officials use a standard scheme to take control over “independent” firms. If the entrepreneur refuses to sell their assets at extremely cheap price to the local bureaucrats, all their corporate clients controlled by corrupt officials suddenly refuse to pay, and the firm accumulates huge debts. If the entrepreneur remains reluctant, law enforcement agencies file a criminal case, send such person into jail, arrest their property and subsequently sell this property to the firms belonging to the bureaucrats’ *corporate veil* (Association of Russian Lawyers for Human Rights, 2012: 16). Human rights defenders provide an example of how such corrupt bureaucratic network is coordinated: “[...] *Town’s head prosecutor, head of the FSB, chief of the road police have regular unofficial meetings in sauna. Any person disliked by one of them becomes the enemy of all*” (Association of Russian Lawyers for Human Rights, 2009: 23).

The phenomenon of “storming” which exists in Krasnodar region on the South of Russia shows the power and extension of corrupt networks.

When entrepreneur refuses to give bribe to the local influential bureaucrat or law enforcement officer, they become totally isolated. The local bank refuses to give them a loan, licensing authorities refuse to give any kind of permissions, such person cannot make an appointment with local officials, and even the fire brigade and emergency do not come on call (Association of Russian Lawyers for Human Rights, 2009: 23).

Russian experts find it difficult to define in what region the phenomenon of state officials' extortion is more developed. The data collected by the Association of Russian Lawyers for Human Rights suggests that the highest predatory activity of bureaucrats in 2008-2012 was in Moscow, Russian Far East (Chukotka, Yakutia, Vladivostok) as well as in Russian South (Stavropol and Krasnodar). It is important to note that extortionist attacks in the province are much more bold and violent, while in Moscow the corrupt officials try to preserve an illusion of lawfulness and use more sophisticated schemes (Firsov, 2013).

#### 4. FROM POWERLESS OBSERVERS TO ACTIVE EXTORTIONISTS. GENESIS OF THE STATE EXTORTION PHENOMENON AND ITS EMPIRICAL EVIDENCE

As one can see, the state extortion phenomenon was produced by the corruption in Russian law enforcement agencies. In the last 20 years, they underwent a significant evolution. While at the beginning of the 1990s they were powerless observers of lawlessness and rapid enrichment of several social groups, by the end of the 2000s they became powerful and active extortionists.

After the fall of the Soviet Union, Russian law enforcement agencies were unable to ensure security of property and compliance with the law in the economic sphere. Therefore, organised crime groups and private law enforcement agencies took the role of main providers of physical protection to businesspeople (Gans-Morse, 2012: 1). Poor financing made the police and tax authorities sell their services to private firms on a part-time basis. In the mid-1990s, many law enforcement bodies established special commercial sub-units working, in fact, as private security agencies (Levin and Satarov, 2000: 124). At the same period, the police started to provide "protection roofs" for businesspeople. They performed the same tasks as previously did criminal protection rackets: debt collection, provision of physical security, contract enforcement and dispute settlement (Gans-Morse, 2012: 25).

Law enforcement agencies were more efficient than organised crime groups, because they had more sophisticated weapons and were protected by the law. Therefore, by the end of the 1990s, the majority of small and medium firms already paid for protection to law enforcement officers (Gans-Morse, 2012: 27). By the beginning of the 2000s, after Vladimir Putin's coming to power, secret services grew in importance. The "protection" market has been quickly divided between the FSB and the police.

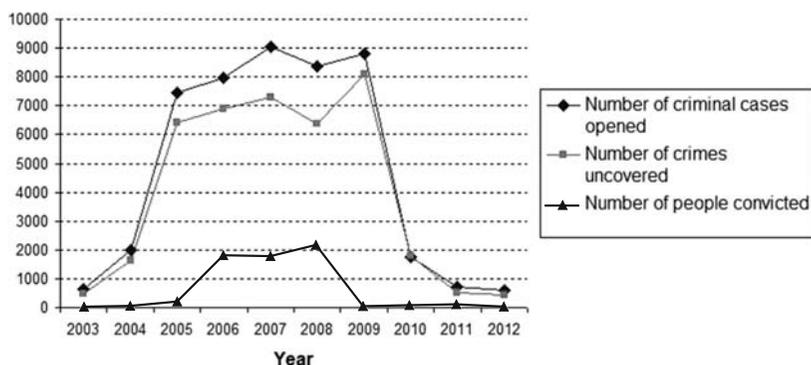
While in the mid-1990s law enforcement agencies were "hired" by private actors to participate in illegal corporate raids, in the mid-2000s FSB and the police become active raiders themselves. As it has already been said, the most efficient tool of coercion they had was their ability to initiate a criminal prosecution. According to entrepreneurs, the most popular tools of pressure in the second half of the 2000s were the articles of the Criminal Code related to fraud (Article 159), misappropriation or embezzlement (Article 160), and money laundering (Article 174) (Volkov et al., 2010: 5).

The arbitrary activity of law enforcement agencies can be proved empirically. In 2010, the Russian researchers Volkov, Paneyakh and Titaev carried out an innovative study of this phenomenon, based on the police statistics. They discovered that only from 20% to 40% of criminal cases initiated by the law enforcement bodies in the field of economic crimes lead to the court sentence. Such statistics contrast drastically with "classical" criminal prosecutions initiated in case of rape or murder. Once opened, these criminal cases result in court sentences in 75% and 90% of cases respectively. Usually, law enforcement officers prefer not to initiate a criminal prosecution if there is a low probability that the crime will be uncovered. Their reluctance to initiate proceedings is explained by the fact that their promotion directly depends on the number of uncovered crimes. Therefore, if an FSB or police officer opens a criminal case which lack of merit, one can assume that it is done with the purpose to extort bribes or assets from entrepreneurs (Volkov et al., 2010: 7).

The methodology of Volkov, Paneyakh and Titaev has been used to compose the three following tables. They show the number of misappropriations, money launderings and frauds registered and uncovered during the last decade, as well as the number of people sentenced on the basis of these three Criminal Code articles often used with predatory purposes.

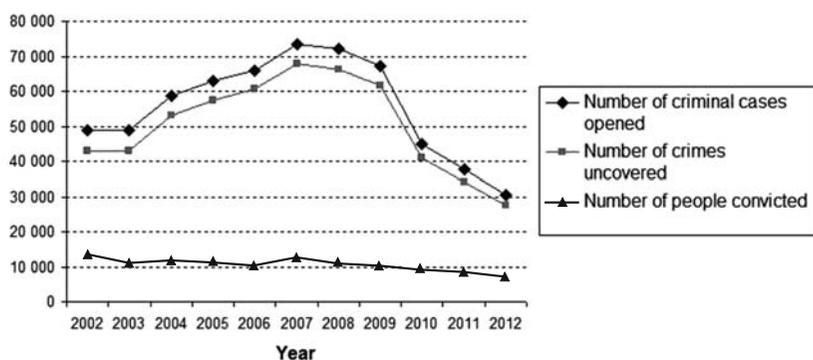
GRAPH 1

## Money Laundering Registration Dynamics 2003-2012



GRAPH 2

## Misappropriation Registration Dynamics 2003-2012



Source: Ministry of Internal Affairs and Judicial Department of the Supreme Court of the Russian Federation<sup>2</sup>.

As one can see, the number of misappropriations which was stable during the 1990s dramatically increased after 2003 and almost doubled in 2007, while the number of convicted people remained almost the same. In other words, a significant increase in the number of

<sup>2</sup> The data from 2003-2012 is from the Ministry of Internal Affairs statistics *Sostoyanie prestupnosti* [Status Report on Crime], available at: <http://mvd.ru/presscenter/statistics/reports/>. The data about the number of convicted people from 2009 to 2012 is taken from the statistics of Judicial Department of the Supreme Court of the Russian Federation *Dannye sudebnoy statistiki* [Judicial Statistics Data] available at <http://www.cdep.ru/index.php?id=79>

people accused in misappropriation did not result in increase in the number of people recognised guilty. The change in money laundering registration was even more drastic: from 2003 to 2007 it increased by eight times.

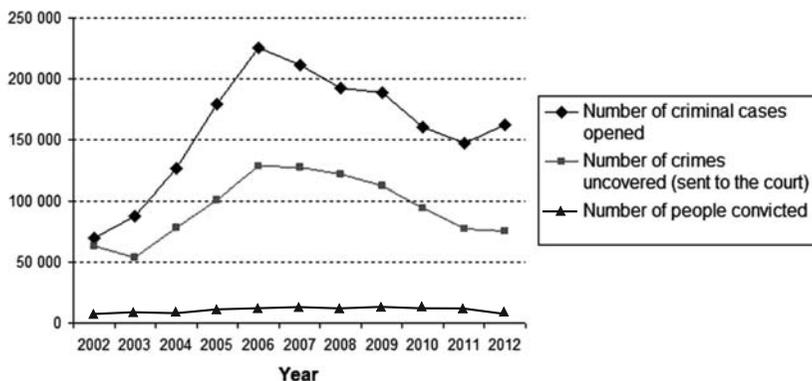
The high percentage of uncovered crimes in case of money laundering and misappropriation relates to the police methodology. Such crimes, as Volkov explains, are considered to be uncovered almost automatically when they are reported (Volkov, 2010: 7). In 2008, the number of registered money launderings and misappropriations started to decline, and fell significantly after 2010. Such decrease is caused by important amendments to the Russian criminal law which came into force in June 2010. They prohibited a pre-trial detention of businesspeople accused in several economic crimes including misappropriation, fraud and money laundering. It limited the ability of the law enforcement agencies to put pressure on entrepreneurs, however, this was not eliminated completely (Gans-Morse, 2012: 36).

While after 2010 the number of crimes related to misappropriation and money laundering decreased by about two and nine times respectively, the number of frauds decreased less than by 25%, and increased again in 2012. It may suggest that the article of the Criminal Code related to fraud is still used in the state extortion schemes. Discrepancy between the number of criminal cases opened and those sent to the court also illustrates how many prosecutions have been initiated with the extortionist purpose. Since 2005, about 40% of criminal cases in the field of fraud are opened and subsequently closed by law enforcement officials without any result. The growing gap between the number of crimes registered and those sent to the court in 2004-2007, as well as in 2012, also indicates a growing predatory activity of law enforcement agencies.

The number of registered economic crimes peaked in 2006-2007, and then started to decline. Such decrease in initiation of criminal prosecution may suggest that the predatory activity of law enforcement officials came to an end as the officials had taken control over all profitable local businesses. However, such decline may have another explanation. The entrepreneurs probably learned from their colleagues' sad experience that the resistance to the state raiders would end up in a tragic way. Therefore, they now prefer to give up their assets without waiting for the initiation of criminal prosecution.

GRAPH 3

## Fraud Registration Dynamics 2002-2012



Source: Ministry of Internal Affairs, Judicial Department of the Supreme Court of the Russian Federation, Volkov et al. (2010)<sup>3</sup>.

## 5. WHEN POWER PRODUCES LAWLESSNESS.

## MAIN CAUSES OF STATE OFFICIALS' PREDATORY BEHAVIOUR

Usually experts provide a long list of causes of predatory administrative corruption in Russia. Such list includes lack of democratic supervision, absence of political competition, lack of change in political and administrative elites, widespread legal nihilism of the population as well as disappointing passivity of Russian citizens (Arkhipov, 2011). All these factors are indeed very important. However, I assume that the main direct cause of state extortion is a weak, or rather selective accountability of public officials inbuilt in Russian administrative system. In the 2000s, such impunity was coupled with the increase in power of state officials, and the decrease in their democratic accountability.

Several Russian researchers argue that a large discretionary power of state officials and lack of supervision are distinctive features of the Russian administrative system. Some of them explain this lack of su-

<sup>3</sup> The data for 2002 is from Volkov, Vadim, Paneyakh, Ella, and Titaev, Kirill (2010). *Proizvol'naja aktivnost' pravookhranitel'nykh organov v sfere bor'by s ehkonomicheskoj prestupnost'ju. Analiz statistiki* [Arbitrary activity of law enforcement agencies in the sphere of the struggle with economic crime. Statistics Analysis], European University in Saint Petersburg. The data from 2003-2012 comes from the same sources as in tables 1 and 2.

pervision by poorly constructed laws (Bezrukova, 2011: 23). Others argue that the laws are designed well, but they are not respected. They stress that state officials' impunity is an important part of informal rules which regulate the functioning of the Russian state apparatus.

The Russian lawyer Andrei Sotnikov argues that administrative corruption flourishes due to an informal deal: higher officials close their eyes on unlawful activities of their subordinates as far as they provide good economic results and political support (Sotnikov 2008: 53). In other words, bureaucrats and law enforcement officers are given free hand in their corrupt activity in exchange for complete loyalty and thorough execution of their superiors' orders.

The Russian lawyer Evgeny Arkhipov calls this institutionalised impunity *corruption sovereignty*:

*"Higher officials in Russia may perfectly control their subordinates: if they want to dismiss someone, they can easily do so. However, they have no will to introduce proper order in the regions. They are happy with the system as it is: 'You do whatever you want, as far as you provide us with positive statistics and secure our power. By what means you would do it – by robbing, extorting or killing – we don't care. You must ensure the stability of our power and execute the tasks we assign to you. All the rest is not important. We give you complete control over the region'"* (Arkhipov, 2013).

Arkhipov (2013) stresses, however, that local officials may enjoy such sovereignty only in economic matters while the *"political power remains exclusively in the hands of Kremlin."*

High-level officials are not apparently interested in fighting this pathology, which suggests that it has functional character for political and administrative system. As it has been shown by Keith Darden, this corruption sovereignty given by the state leadership to lower-level officials motivates them to be loyal. Such tolerance for corruption decreases the costs of supervision and allows the rulers to punish potential defectors on the basis of well-documented corruption charges. On the other hand, it allows law enforcement officers and executive branch functionaries to enrich themselves by transforming their power into property.

Another key factor producing state extortion was the *centralisation of the state* undertaken by the President Vladimir Putin as well as the increase of law enforcement agencies' role in the Russian administra-

tive and political system. In 2000-2004, the President of the Russian Federation Vladimir Putin initiated 3 major reforms which recentralised the country and increased the influence of the military, police and secret services in Russian politics.

In 2000, 89 Russian federal units were regrouped into 7 federal districts; an additional federal district was established in 2010. The president has appointed his plenipotentiary representatives (in Russian: *polnomochny predstavitel* or *polpred*) in each of these new administrative units. Their primary function is to supervise the activity of regional administration and law enforcement bodies. They also submit candidates for top-level official positions in their federal units for the president's approval.

Quite naturally, the former KGB officer Vladimir Putin assigned people with military, secret services and police background as heads of the federal districts. 5 out of 7 *polpreds* appointed in May 2000 originated from the Soviet KGB or Russian FSB, armed forces and the police. People with such career path are called *siloviki* (from *silovye struktury* – power ministries) in the Russian political jargon. In general, 11 out of 16 *polpreds* appointed during two Putin's presidential terms (2000-2008) were *siloviki*.

*Polpreds* recruited a very significant part of their subordinates from the environment they were familiar with. According to an American political scientist Brian Taylor, in 2002 as well as in 2007, more than 40% of federal district second-tier officials (deputies of the president representatives, federal inspectors in the regions etc.) came from power ministries. In the administration of some federal districts, for instance in the Northwestern one, the share of *siloviki* exceeded 60% (Taylor, 2011: 132).

During Dmitry Medvedev presidency (2008-2012), the number of strongmen at the head of federal districts significantly decreased. 5 out of 10 *polpreds* appointed by Medvedev were civilian. While at the beginning of 2008, representatives of the president in all 7 districts were *siloviki*, by 2012 there remained only 3 of them in 8 districts. This proportion remained untouched at the beginning of Vladimir Putin's third presidential term.

President Putin's second major reform was the recentralisation of law enforcement. The control over state coercion has been taken from the governors and transferred to the Kremlin. Heads of police, public prosecutor's office and tax authorities have been subordinated to the newly established federal district structures, and through them, to Moscow (Taylor, 2011: 131).

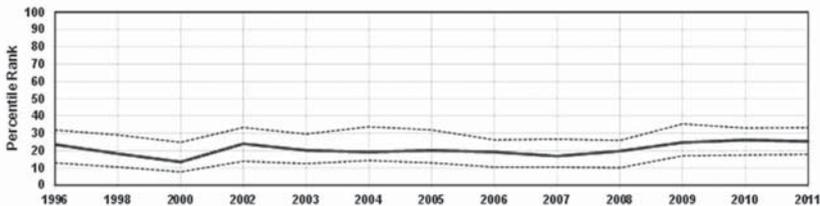
The third centralisation reform was the cancellation of the popular elections of governors. From 2005 to 2012, heads of federal units (presidents, governors and mayors of Moscow and Saint-Petersburg) were confirmed by regional parliaments after the recommendation of the president. It is important to note that after two consecutive rejections of the president's nominee, the president had the right to dissolve a regional legislature. Therefore, when the system of governors' nomination was working, there was no single case of presidential nominee's rejection (Taylor, 2011: 147).

The result of Putin's reforms was "militarisation" of the state administration. *Siloviki* moved up in power hierarchy at all levels, including the local one. Such change has been noticed by the experts from the Institute of Situational Analysis and New Technologies (ISANT). In 2000, 2003 and 2007, they published study reports on the most influential figures in Russian regions. Whereas in 2003 among 10 influential positions of regional politics only one belonged to *siloviki*, in 2007, four most powerful regional figures were representatives of the law enforcement: chief of the regional FSB, regional prosecutor, chief of police, and a judge. In addition, among these 10 most influential positions in regional politics, one was a federal inspector subordinated to *polpred* (Petrov, 2007: 82).

Such recentralisation of the country and transfer of the control over state coercion from regional authorities to the central ones apparently diminished separatist tendencies. At the same time, it didn't improve the situation with the rule of law and corruption, as the World Bank's Worldwide Governance Indicators clearly show.

GRAPH 4

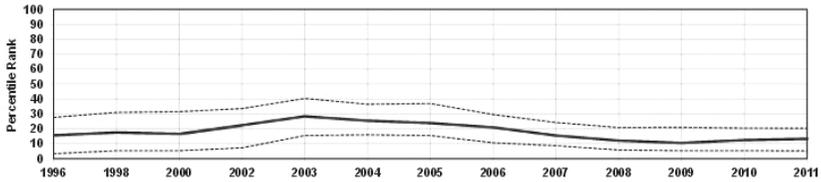
Russian Federation, 1996-2011  
Aggregate Indicator: Rule of Law



Source: World Bank

## GRAPH 5

Russian Federation, 1996-2011  
Aggregate Indicator: Control of Corruption



Source: World Bank

Both indicators improved at the beginning of the 2000s, but after 2003 they started to deteriorate, and by the end of the decade they fell below the 1996 level. As we already know, arbitrary activity of law enforcement agencies has become a widespread phenomenon just in this period.

State extortion didn't break out when the *siloviki* were poor and their abilities were constrained by other influential actors (local administrative elites, business or organised crime groups). It emerged when they became strong and self-confident, when they became an embodiment of the Russian state. Predatory activity of law enforcement agencies peaked in 2007. It is important to note that this year alone the salaries of secret services and police officers rose by 47%, the number of professionals in law enforcement structures significantly increased, and personnel defections common in the 1990s and the beginning of the 2000s were stopped (Taylor, 2011: 201).

At the beginning of the 2000s, *siloviki* saw themselves (and were seen by the society) as a real elite, the only uncorrupt and non-partisan force able to "save the country from a definitive degradation" (Cherkesov, 2007). However, they started to use their power for private enrichment incredibly quickly. The first and most famous high-level attack was made in 2003. It was an expropriation of Yukos, an oil company belonging to disobedient oligarch Mikhail Khodorkovsky. After Khodorkovsky was sent to prison on a charge of tax evasion, main assets of his company were sold to the oil company Rosneft run by a close comrade of Vladimir Putin, former intelligence officer Igor Sechin.

The recentralisation of law enforcement agencies and subordination of local elites to Moscow was intended to solve the problem of separa-

tism. However, instead of improving transparency and manageability of the state administration, it created strong patron-client networks going from regional level through federal district structures to Kremlin (Petrov, 2007: 79). The system of power in the present-day Russia looks as a hierarchy of protégés.

Each local official and law enforcement officer has to prove their loyalty to superiors. At the same time they look for protection of well-placed officials on a regional or federal district level. Political loyalty towards the capital and loyalty to superiors allows such local officials to abuse their power for private enrichment. In case of a conflict, it is not the law but connections with more powerful protectors which decide on whose side the victory is going to be. Of course, the strongest protectors are the officials on federal level with the power ministry background (Association of Russian Lawyers for Human Rights, 2009: 14). Instead of a real centralisation, Putin's reforms have given large opportunities for predatory behaviour to local officials, and especially to law enforcement officers. They transformed the state hierarchy in a system of multi-level protection "roofs."

Brian Taylor points out that Vladimir Putin improved the state capacity but failed to improve the state quality. He didn't transform state officials in public servants (Taylor 2011: 203). Moreover, at that time it was almost impossible. State quality could be increased by making local executive authorities and law enforcement bodies more accountable to citizens, by promoting democracy at a local level. State unity could be ensured by developing other mechanisms of national cohesion, like political parties and courts (Taylor, 2011: 153). However, at the beginning of the 2000s, all these measures were seen as unrealistic by the Russian authorities and a large part of the society. *Siloviki* were of opinion that further democratisation will destroy the Russian state, not unify it. The priority has been given to the "power vertical" building and fighting oligarchs. Corruption fighting has been pushed into the background.

#### CONCLUSION. IS THE CORRUPT STATE SUSTAINABLE IN THE LONG RUN?

As one can see, the predatory corruption in Russia was not a result of the state decay. Just the opposite, it emerged after state institutions were radically reinforced and the discipline in power hierarchy was

strengthened. This paradox is perfectly explained by Keith Darden's theory of corruption as informal tool strengthening power hierarchy. Russian leaders intentionally decided to turn a blind eye on illegal activity of their subordinates in order to increase their loyalty. At the same time, widespread corruption documented by powerful and numerous secret services gave the high-ranking officials a very powerful tool to control potential defectors. In other words, state extortion was an unavoidable consequence of building the "power vertical" deprived of democratic control.

State officials' predatory activity may be also explained in terms of Douglas North's theory of *natural state*. Russian state may be easily presented as a coalition of rent seekers. It is composed of *siloviki*, "civilian" politicians and influential businesspeople close to the President Vladimir Putin. President Putin plays a role of mediator settling disputes between different power groups. At lower levels, the situation is quite similar. There, the role of mediators and power groups' leaders belongs to the regional *siloviki* and the governors protected by federal authorities (*polpreds*). In such a model, state officials' extortion is neither a sign of state degradation. It is just a predatory activity of the ruling elite against those who do not belong to the power coalition. Illegal takeover of citizens' property and monopolisation of economic activity helps state officials to increase their rents.

Both North and Darden suggest that political and economic systems based on graft may be very stable. However, long-term effects of tolerated state officials' predatory behaviour may be disastrous for the Russian economy, state apparatus efficiency and even territorial integrity. First of all, state officials' extortion provides small and medium enterprises with *strong disincentives to expand*. Entrepreneurs don't want to invest and increase their turnover as they know that after their firm reaches a certain threshold, it may fall victim of state extortionists.

The second negative consequence of state officials' attacks is the *decrease in economic activity* and capital outflow. As experts from the Centre of Legal and Economic Studies of the Higher School of Economics (2012) point out, every sixth Russian entrepreneur has been subject of criminal prosecution at least once. Lack of security and weak protection of property rights discourage people from starting their own business and motivate those who have already started to emigrate. According to the experts from Moscow's Higher School of Economics, in

2011 about 49% of Russian entrepreneurs were either thinking about emigration or did not exclude the possibility to emigrate (Centre of Legal and Economic Studies, 2011). Since 2005, about 60 billion US dollars have been leaving the country each year.

The third negative economic effect of the state officials' predatory activity is the monopolisation of local markets. Only entrepreneurs closely connected to the local power elites are allowed to operate. Even though such practice allows businesspeople to extract some monopolistic rents, it negatively affects both prices and quality of goods and destroys incentives to innovate.

State extortion is likely to affect not only Russian economy. It may impede social development of the country. Predatory corruption deprives many people of the perspective to develop their own business and therefore blocks social lifts. It may be one of the factors encouraging migration and brain drain. Moreover, attacks on small and medium enterprises may hamper the development of the middle class which is considered to be a "watchdog of democracy" in all countries.

In the North Caucasus, the system of appointments based on political loyalty to Moscow and an absolute impunity in corruption matters makes the Russian state hated and stimulates Islamic fundamentalism (Remizov, 2013: 40). The corruption sovereignty principle reverses the goals of public institutions and destroys the quality of administrative elites. Many Russian experts argue that illegal income has already become the main factor motivating people to make career in public service (Association of Russian Lawyers for Human Rights, 2010: 14, Sotnikov, 2008: 37).

State officials' extortion does not apparently destroy the authority of state apparatus, but it certainly destroys the authority of law, without which no efficient state is possible. It is important to remember that the efficiency of state and its very survival does not depend only on the strength of the state hierarchy. It also depends on the ability to provide citizens with basic needs. These primary needs include security and order based on written laws. The state in which the power hierarchy is based on graft and the state officials are above the law is unable to ensure neither security, nor predictability and order. Therefore, Darden's opinion that such states can be stable for very long time remains arguable.

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