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# Threats to Property Rights in Russia: From Private Coercion to State Aggression

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**Abstract:** This article explores a fundamental shift in threats to property rights in Russia. Whereas extortion rackets and other forms of physical intimidation once posed the gravest threat to property rights, state actors are now the primary aggressors. Based on in-depth interviews and an original survey of Russian firms, the article demonstrates a dramatic decline in threats related to private coercion, due partly to firms' increased reliance on formal legal institutions. By contrast, state threats to property rights have increased sharply. Key threats include seizing firms' assets, illegal corporate raiding, extortion, illicit fines, and unlawful arrests of businesspeople.

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The collapse of the Soviet Union and the ensuing chaos of the early 1990s produced extreme lawlessness. In rapid fashion, a society with massive industrial assets plunged into an institutional vacuum. Courts, law enforcement bodies, and state regulatory agencies capable of enforcing the rules of the game for a modern market economy had to be created from scratch or rebuilt from the remnants of socialist institutions. In the absence of effective state institutions, firms turned to alternative forms of protecting property and enforcing contracts. Criminal protection rackets and private security agencies provided physical protection, collected debts, and adjudicated disputes among firms. When large sums of money

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were at stake, contract killings became a prominent means of acquiring or protecting assets. In short, outright force and the threat of physical coercion became common tools for protecting property and ensuring adherence to business agreements.

Today, two decades later, high-profile cases of property rights abuses continue to dominate accounts of Russia. William Browder, the largest foreign portfolio investor in Russia until government officials attempted to illegally expropriate his assets, recently declared: "Property rights no longer exist, people who are supposed to enforce the law are breaking it, innocent people are victimised and courts have turned into political tools ... with the spectacular recent decline in the rule of law, anything is possible in Russia now" (Browder, 2009). Similarly, a 2009 article in *Forbes* bore the foreboding title: "Why You Should Still Be Worried about Russia: Attempted Assassination of an Executive Shows Country Has Not Thrown Off Its Shadowy Past" (Ram, 2009). Influential academic and policy studies concur with these pessimistic assessments. Hoff and Stiglitz (2008, p. 1774), for example, contend that "In Russia and many other post-communist countries, little progress towards either forming a strong constituency for the rule of law, or establishing the rule of law, has been made since the privatisation of most state enterprises."

This narrow focus on high-profile conflicts is misleading. It offers a skewed and unrepresentative portrayal of modern-day Russian business practices. In no small part, this is because such accounts often concentrate on a handful of tycoons and the extent to which these "oligarchs," as they are frequently called, hinder or promote the development of the rule of law (e.g., Boone and Rodionov, 2002; Guriev and Rachinsky, 2005; Jones Luong and Weinthal, 2004).<sup>2</sup>

By contrast, this article focuses on the threats faced by ordinary, non-oligarchic Russian firms and these firms' everyday practices for resolving property rights and contract disputes. Throughout 2009, I conducted 90 in-depth interviews with Russian businesspeople, lawyers, and private security agencies. In June and July 2010, I then carried out a survey of 301 firms across eight Russian cities: Moscow, St. Petersburg, Nizhny Novgorod, Kazan, Samara, Yekaterinburg, Rostov-on-Don, and Novosibirsk. This survey investigated several themes emerging from qualitative research that had yet to be examined quantitatively in the Russian context, such as firms' reliance on "for-hire" state officials as a means of securing assets.<sup>3</sup>

My research reveals a dramatic decline in extortion rackets, contract killings, and other threats to property rights related to private coercion and violence. Moreover, rarely do firms now turn to criminal protection

<sup>2</sup>For two rare exceptions, see Frye, Yakovlev, and Yasin (2009) and Markus (2012). Neither of these excellent works directly addresses the two key trends examined in this article: (1) Firms' switch from private coercion to the use of formal legal institutions, and (2) the changing nature of threats to firms' property rights from private coercion to state aggression.

<sup>3</sup>Naturally, research on sensitive topics, such as violent or illegal activities, entails challenges. The steps undertaken to address such concerns, as well as details about the interviews and survey, are provided in the Appendix.

rackets and private security agencies for protection. Instead, building on the pioneering work of Hendley, Murrell, and Ryterman (2000, 2001), I find that Russian firms extensively utilize formal legal institutions. In addition to the judicial system, firms also increasingly rely on lawyers to resolve conflicts outside of court and depend upon private arbitration forums.

This is not to say that the ever elusive “rule of law” has emerged in Russia. The findings of my interviews and surveys shed light on *new threats* to property rights that have emerged, even as the physical violence and outright criminality that characterized much of the first post-Soviet decade have declined.<sup>4</sup> These new threats primarily pertain to actors within or with ties to the state. They include (1) attacks by high-level officials, (2) attacks by lower-level state officials acting on behalf of paying private-sector clients, and (3) attacks initiated directly by lower-level state officials, such as regulators and law enforcement agents. Attacks by state actors on property rights manifest in many forms, such as the seizure of firms’ assets, facilitation of illegal corporate raiding, extortion, illicit fines, and unlawful arrests of businesspeople. Yet despite the risks these threats pose to Russian firms, they differ significantly from the outright violence and coercion of the 1990s: The struggle over property rights has moved from the streets and into the courtrooms of the judiciary and offices of the bureaucracy. The conclusion discusses whether this is a step toward the rule of law or a development that will leave institutions mired in corruption.

The first section of this article analyzes the decline of firms’ reliance on private force to resolve business conflicts. The second section turns to the rise of law in the Russian business world. The final section addresses the emergence of a new breed of state-initiated threats to firms and their property rights.

## THE DECLINE OF PRIVATE FORCE

In the wake of the Soviet Union’s collapse, firms frequently settled disputes through threats of violence, eradicated competitors through contract killings, and relied on thugs or private security agencies to enforce contracts. Whereas in most countries organized crime is limited to illegal sectors such as prostitution, drugs, arms trafficking, fraud, and money laundering, many ordinary firms in early post-Soviet Russia relied on criminal protection rackets to provide the fundamental protective and adjudicative functions usually fulfilled by modern states. Private security agencies, staffed with former members of law enforcement and national security organs, similarly provided protection, adjudication, and enforcement services.

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<sup>4</sup>Moreover, even as progress has been made in the economic sphere, political and human rights have suffered throughout the entire duration of the Putin regime (Fish, 2005; McFaul and Stoner-Weiss, 2008).

Yet contrary to popular belief, this era of thuggery peaked before the mid-1990s and then faded in most of Russia's regions by the end of the first post-communist decade. Organized crime remains a significant problem, but it is no longer part and parcel of everyday business transactions in Russia. It is instead limited to those illegal sectors "where it belongs," in the words of Elena Panfilova, the director of the anti-corruption organization Transparency International's Moscow office (Panfilova, 2009). Demand for the services of private security agencies also evolved. Businesspeople came to rely on security agencies primarily for the same types of security services such agencies provide in Western countries: provision of physical protection for buildings, lots, and transport. Along with these developments, criminal and physical threats gave way to a broader definition of "economic security" (*ekonomicheskaya bezopasnost'*) encompassing information security, managing relations with government officials, and protecting owners from crimes by employees.

Criminal protection rackets originally formed to extort kiosks in open-air markets, but they soon evolved into more complex protection operations. Criminal gangs, often referred to as *bandity*, offered entrepreneurs protection from other extorters in exchange for a percentage of their profits, a service known as providing a "roof" (in Russian, a *krysha*). The services of *kryshi* expanded to include enforcement of contracts, collection of debt, and intelligence gathering on prospective business partners (Modestov, 1996; Volkov, 2002). In the absence of an effective court system, a system of "shadow justice" (Skoblikov, 2001) formed in which the *krysha* of one firm would meet with the *krysha* of another to negotiate on behalf of their respective clients, or, if need be, to resolve the dispute by force. Finally, realizing that true profits were not in protection schemes but in business itself, criminals began to request shares as a form of payment and to acquire shares in privatized companies, taking an active ownership and managerial role (Frye, 2002, p. 578; Volkov, 2002, ch. 3–4).

Alarming estimates of the influence of organized crime on the Russian economy soon became widespread. A Ministry of Internal Affairs (MVD) report released in 1994 claimed that up to three-fourths of Russian businesses paid protection money, with the banking sector particularly under the sway of organized crime groups. The Russian Academy of Sciences (RAN) reported in 1995 that criminal groups held 55 percent of capital and 80 percent of voting shares in private enterprises (Webster, 1997, pp. 2–3). These studies became the basis for dire assessments of organized crime in Russia by Western analysts (e.g., Shelley, 2007; Webster, 1997), although the imprecise distinction among protection, control, and ownership of enterprise assets in these reports complicates assessment of their validity (Volkov, 2002, pp. 97–98). Regardless, the reality of harsh violence during this period was undeniable, including extensive contract killings, car bombs, and all-out gang wars on the streets of cities such as Moscow, Yekaterinburg, and Kazan. Shocking tales emerged. Reportedly, the FBI traced connections of a well-known crime boss directly to the Kremlin (Shelley, 2007), while the journalist Seymour Hersh (1994) reported that

criminal rackets even controlled access to the passport line at the US Embassy.

Along with criminal protection rackets, private security agencies (*chastnoye okhrannoye predpriyatiye*), known widely by their Russian acronym as ChOPs, played a major role in property security in the early 1990s. These agencies emerged in the aftermath of the collapse of the mammoth Soviet security structures, in particular during the reorganization of the KGB, which created a supply of highly-trained unemployed security specialists. Unlike other countries with large private security sectors, such as the United States and Great Britain, "in Russia, the activity of private protection agencies extended beyond mere physical or informational security and into the sphere of business transactions and civil property relations" (Volkov, 2002, p. 141). ChOPs offered a long list of services: debt collection, physical protection, collection of data on lawsuits, market research, information on future business partners, protection of trademarks and commercial secrets, and investigations of future or current employees. The private security sector grew rapidly. By 1993, there were already approximately 5,000 registered private security agencies. This number doubled by the end of the decade, doubled again by 2005, and today is estimated at around 30,000 agencies.<sup>5</sup>

While some analysts continue to spread the impression that nearly all businesses in Russia are under the sway of criminals and protection agencies (e.g., Burton and Burges, 2007; Finckenaue, 2004), *banditry* in their primitive form were largely a threat to smaller businesses. Moreover, criminal protection rackets were already being forced from the marketplace by the early 1990s. In a bloody process of competition among criminal groups, the stronger organizations pushed the weaker from the battlefield (Modestov, 1996; Volkov, 2002, pp. 61–62). The number of criminal groups peaked in 1995, with the number of more powerful groups, those with interregional or international connections, reaching its apex even earlier and declining more dramatically. Likewise, annual assassination attempts of top criminal leaders increased until 1994 and then fell thereafter (Volkov, 2002, pp. 75–78). Criminal leaders who survived the early 1990s became more deeply engrossed in legitimate business investments and politics, and came to recognize the need for order and stability. As one *bandit* reputedly stated, "In this kind of environment, who can do any business?" (Handelman, 1994, p. 93).

Evidence that economic conflicts are less likely to be settled by violence appears in the statistics on annual murders of businesspeople, as seen for Russia's Central Federal District in Table 1. The numbers remain high by Western standards and indicate that Russia is still a rugged place to do business, but they also show a significant positive trend compared to Russia's recent bloody past. Meanwhile, most experts concur that reliance

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<sup>5</sup>Data for up until 1999 are from Volkov (2002, p. 138). Data for the years after 1999 are from Borodkin (2008), Khodorych (2002), Ye. Lashkina (in *Rossiyskaya gazeta*, November 9, 2007), and press releases at [www.mvd.ru/news](http://www.mvd.ru/news).

**Table 1.** Businesspeople Murdered in Central Federal District of RF, 1997–2005<sup>a</sup>

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Number of murders	217	170	159	158	110	103	103	55	33

<sup>a</sup>Source: Matveyeva (2007, p. 86). Matveyeva notes that while these statistics refer to over-all murders of businesspeople, her analysis of the data indicates that all but approximately 5 percent of these deaths were related to the victims' business activities.

on contract killings declined after the early to mid-1990s (Krylov, Krylov, and Sidorov, 2008; Skvortsova, 2000).<sup>6</sup> Contract killings persist to this day, but observant analysts have recognized that an increasing number of targets are outside the sphere of property disputes. While businessmen, bankers, and bureaucrats with control over valuable licenses or permits are still prevalent among the victims, a rising proportion of contract killing targets are journalists and human rights activists (*Kommersant*, December 1, 2008; Ram, 2009; Skvortsova, 2000).

Businesspeople corroborate this decline in physical violence. A survey conducted by Radaev (1999) of 221 enterprise managers across 21 Russian regions in 1997<sup>7</sup> revealed that approximately two out of five respondents reported personally experiencing violent extortion or threats of physical coercion "sometimes" or "often." Businesspeople, however, seemed to be sensing a turning point: Only 14 percent said the risk of threats and extortions was getting worse, whereas 30 percent said it was getting better (Radaev, 1999, pp. 36–40). Indeed, my survey of 301 firms from eight Russian cities, conducted in June and July of 2010, validates these optimistic prognoses: Less than 5 percent of respondents said they or their employees "sometimes" or "often" had been subjected to threats or physical coercion.

Survey evidence paints a similar picture with respect to the disappearance of criminal protection rackets. Frye and Zhuravskaya (2000) found in a 1996 survey of 230 small retail shops in Moscow, Ulyanovsk, and Smolensk that over 40 percent of respondents reported having contact with a criminal group in the last six months; a survey of shops conducted in the same three cities two years later found the respective figure to be less than 25 percent (Frye, 2002). Surveys conducted by the Russian business association OPORA (OPORA-VTsIOM, 2005, p. 91, 2006, p. 52) in 2004 and 2005 across 80 of Russia's 89 regions found that well under 10 percent of small businesses during these years reported frequent contact (although between 30 and 40 percent reported some "irregular" contact).

<sup>6</sup>Contract killings in general are difficult to measure, and different sources report drastically varying statistics, not least of all because in the early 2000s the MVD began reporting only the number of solved cases rather than the number of registered contract killings (Plan, 2008).

<sup>7</sup>To facilitate comparisons, information regarding the samples for all surveys cited can be found in the Appendix.



Meanwhile, my 2010 survey found that less than 8 percent of 105 small businesses in the sample (and less than 4 percent of the 301 firms in the overall sample) reported contact with criminal protection rackets at any point in the last three years.<sup>8</sup>

Firms themselves in the late 1990s were beginning to avoid criminal protection rackets. Radaev's 1997 survey found that in response to threats and extortion, only 15 percent of respondents would turn to criminal groups, while about the same number would turn to the police. The largest category of respondents, 34 percent, said they would rely on themselves to deal with the threat (Radaev, 1999, pp. 42–43). OPORA's 2004 survey similarly found that only 14 percent of small firms reported they would turn to a *krysha* for help should they face a violation of their rights (OPORA-VTsIOM, 2005, pp. 70–71). As discussed below, the results of my survey indicate that this trend away from private force has only continued.

Interviews with security consultants confirm that survey findings of criminal elements' declining role in business conflicts reflect actual trends rather than underreporting of illicit practices. The extent to which criminal *kryshi* have become a thing of the past is perhaps best summarized by the co-founder of a prominent Moscow private security agency, himself a former Ministry of Internal Affairs (MVD) agent specializing in fighting organized crime. In the early 1990s, he explained, the majority of his firm's work involved helping clients deal with *bandity*. But already by 1995—much earlier than commonly recognized—a noticeable shift was occurring: "... criminal groups were disappearing to such an extent that they were becoming simply something exotic. If a client came to us and said that some *bandity* from the street had tried to extort him, well, this was for us something exciting. [It gave us a] sort of nostalgia for the old days" (Co-founder of a Moscow Private Security Agency, 2009). The challenges his security firm faces have continued to evolve, and he noted that today it is even more rare to encounter criminal protection rackets.

The shift away from private coercion is also apparent in the private security sector. In the 1990s, the line between ChOPs and criminal groups was often blurry. Some private security agencies used criminal methods to collect debts and, in some cases, directly extorted businesspeople. In other cases, criminals themselves formed ChOPs in order to carry weapons legally. Some estimates claim that around 15 percent of ChOPs in the late 1990s had criminal ties (Volkov, 2002, p. 143). Moreover, businesspeople at

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<sup>8</sup>Comparison of surveys over time warrants caution (see Frye, 2010, pp. 85–86). First, firms that suffer most from a hostile business environment are more likely to go out of business. Later surveys may disproportionately reflect the views of firms that are least likely to face violence and protection rackets. Such "survivor bias" may lead to inflated assessments of improvements in the business environment. Second, there is the possibility that firms over time have become less inclined to respond truthfully, biasing estimates of the prevalence of illicit activities downward. While these concerns should be acknowledged, it is unlikely that they account for the trends described above given the magnitude of the shift—often 30 or more percentage points—in assessments of violence and organized crime. Moreover, the results of in-depth interviews and analysis of objective indicators, such as murders of businesspeople and caseload statistics, corroborate the survey findings.

times turned to ChOPs with explicit demands for illegal activities, including physical attacks and kidnapping (Shebaldin, 2007). The fact that for many years numerous ChOPs, accounting for as many as 150,000 employees, remained unregistered and therefore unregulated by the state facilitated the persistence of questionable practices (Khodorych, 2002; Pistor, 1996, fn. 91).

Yet even if firms' shift from criminal protection rackets to ChOPs did not initially entail the complete elimination of criminal elements from the market for private security, it brought about significant changes. ChOPs were willing to apply force but were more likely than *bandity* to do so only as a last resort. They focused more on conflict prevention and in place of violence often applied pressure to a client's competitors by gathering compromising materials, known in Russian as *kompromat*, which could be used for blackmail. They worked on the basis of formal contracts and usually paid taxes to the state. By law they had to register with the MVD and could have their license revoked if they violated laws and regulations. They encouraged clients to understand and abide by the laws, and they organized business associations to screen out criminal enterprises masquerading as legitimate security agencies (Pravotorov, 2006; Volkov, 2002, pp. 142–143, 147, 151–152).

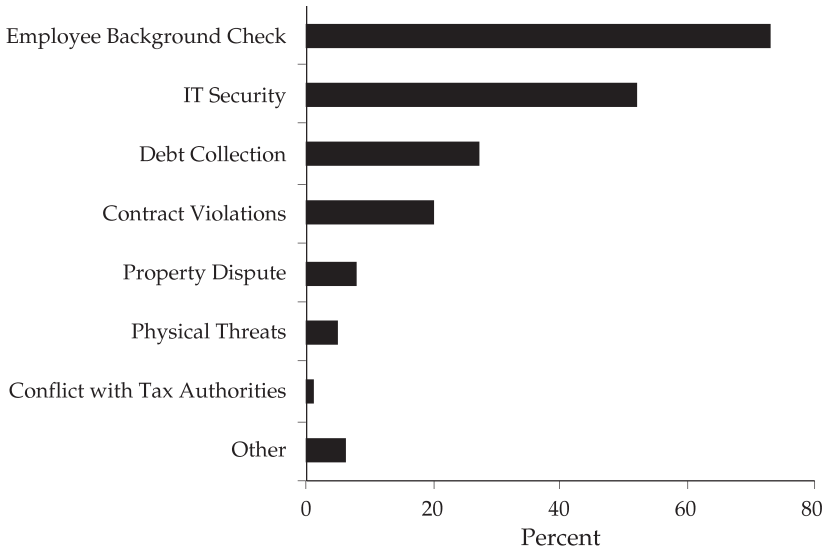
As private security agencies brought legitimacy to the market for protection, they simultaneously became more specialized as providers of physical security and less frequently a substitute for state institutions. Today, the word "ChOP" narrowly refers to security guards, whereas the term "*krysha*" has a clear connotation of criminal connections.<sup>9</sup> Experts estimate that provision of basic physical security accounts for 70 percent of the private security sector's revenues, the rest consisting of information security, legal services, and installment of security systems (cameras, alarms, etc.). Although there has been recognition that profit margins for providing detective services, such as investigating credit histories and locating debtors, are quite high, these services account for a negligible fraction of ChOPs' work (Ivanchenko, 2009; Khodorych, 2002).

Meanwhile, the security concerns of Russian businesspeople have evolved dramatically. Today, "economic security" entails a wide range of threats, including information security, such as computer virus attacks by competitors; espionage by employees with ties to other companies; raids that use complicated legal schemes to acquire assets; and unwarranted inspections (*nayezdy*) by government regulators, some of which are instigated by competitors. To address these sophisticated threats, firms specializing in economic security rely far more on lawyers, accountants, IT specialists, and former law enforcement officials than on the application of violence and force.

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<sup>9</sup>This statement was corroborated without exception in interviews with businesspeople and security specialists. In a typical response regarding the functions of ChOPs, one small businessperson in Moscow explained: "ChOPs? Those are just the guys that stand outside and guard the door" (Small Businessperson, 2009).





**Fig. 1.** Firms' recent use of internal security services.

Of the 301 firms in the survey, 100 report using an internal security service in the last three years. Percentages in Figure refer only to those firms using internal security. *Source:* Data from the author's 2010 survey.

Survey research indicates that private security agencies' narrow focus on physical protection was already apparent by the late 1990s. A 1997 survey by Hendley, Murrell, and Ryterman (2000, p. 643) of 328 industrial firms from six regions found that even though half of the respondents utilized the protective services of a security agency, less than 3 percent of respondents relied on these firms to prevent or resolve problems with suppliers or for evaluating the credit-worthiness of customers. They concluded: "These results suggest that security agencies have the more prosaic mandate of protecting money or property, rather than the task of enforcing contracts through intimidation of trading partners" (Hendley, Murrell, and Ryterman, 2000, p. 643). In a 2001 survey of 304 open joint-stock companies in Moscow, Tomsk, and Nizhniy Novgorod, Yakovlev et al. (2004, p. 71) reported that only 5 percent of respondents whose legal rights had been violated turned to ChOPs to help resolve the problem. Likewise, in the 2010 survey I conducted, less than 10 percent of respondents reported using the services of a private security agency for any reason in the last three years.

On the other hand, 33 percent of firms in my survey, and approximately 45 percent of firms with over 100 employees, reported using their own internal security service at some point in the last three years to resolve a security issue. But as seen in Figure 1, the reasons firms turn to private

security reflect a very different type of threat than the violent disputes of the 1990s. Primarily, firms use private security for dealing with internal problems pertaining to employees and the security of information technology systems. For example, of the 100 firms in the survey sample that report using an internal security service in the last three years, 73 percent used this service to run employee background checks, while 52 percent used the service for issues related to IT security. Such issues as debt collection, contract violations, and property disputes represent a significantly smaller share of the services for which firms turn to private security.

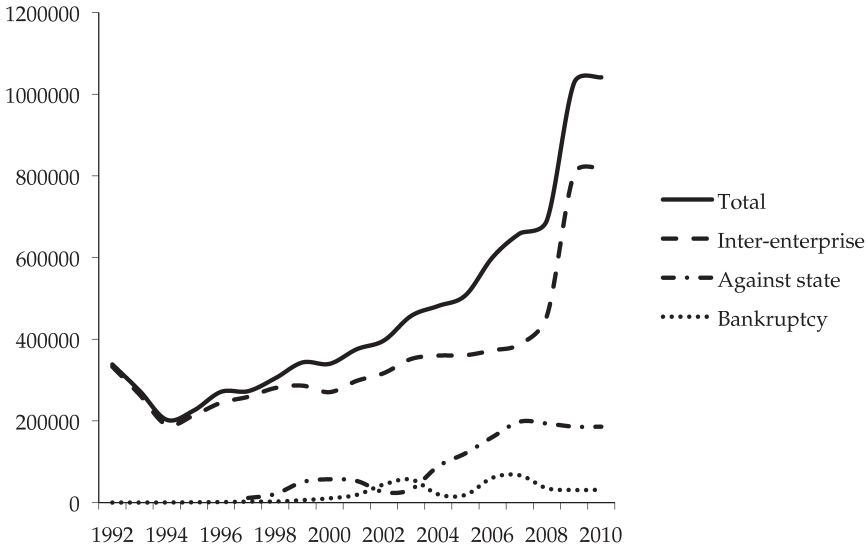
In summary, the era of overt private violence and coercion as a widespread tool of mainstream firms has come to an end. Organized crime today remains a significant problem *in illegal sectors*, but legitimate businesses rely on *bandidy* for protection, adjudication, and contract enforcement services almost exclusively in remote and under-developed regions (Pravotorov, 2006; Volkov, 2002, p. 152). Analysts sometimes speak of a “criminalized” society in which organized crime groups have established formidable contacts within the Russian bureaucracy and security agencies to protect their illicit activities (Dolgova, 2005; Shelley, 2007). Yet such corruption and crime is fundamentally different than a situation in which criminal groups substitute for state institutions on a massive scale.

## THE RISE OF LAW

In the early 1990s, Russian firms rarely utilized formal legal institutions. The Soviet Union had little tradition of politically independent courts, and it naturally had no mechanisms for adjudicating disputes among private firms operating in a market economy. Yet since the mid-1990s, significant evolution in private-sector use of formal legal institutions has taken place in Russia. Caseload data, survey data, and in-depth interviews with businesspeople and lawyers indicate a substantial change in firms’ willingness to rely on law.

At the outset of the 1990s, Russia replaced Soviet institutions with a two-track judicial system. Commercial courts (*arbitrazhnyye sudy*) were built on the remnants of the former *gosarbitrazh* system, an administrative dispute resolution forum for Soviet enterprises. These commercial courts were tasked with economic disputes and administrative conflicts between firms and the state. The courts of general jurisdiction (*sudy obshchey yurisdiktсии*) were set up to handle civil litigation and criminal matters. By the mid-1990s, a new Arbitration Procedural Code, a Civil Code, a Law on Joint-Stock Companies, a Law on the Securities Market, and other legislation essential for the functioning of a market economy also had been established.

Despite reforms, many Western and Russian analysts continue to argue that firms circumvent formal legal institutions, which they perceive as slow, corrupt, or incapable of enforcing court rulings (e.g., Edwards, 2009; Skoblikov, 2001; Tolstych, 2005; Volkov, 2002). Yet, as Kathryn Hendley and her collaborators have demonstrated, firms’ reliance on the



**Fig. 2.** Annual number of cases initiated by firms in commercial courts, 1992–2010. Figure 2 excludes administrative cases initiated by government authorities, as these cases are not indicative of firms' use of law. *Source:* Data are from reports of the Vysshyy arbitrazhnyy sud (High commercial court). These are entitled *Svedeniya o rassmotrennykh sporakh s uchastiyem nalogovykh organov* (Report on cases with the participation of the tax authorities), *Spravka osnovnykh pokazateley raboty arbitrazhnykh sudov RF* (Information on the basic indicators of the work of the commercial courts), and *Spravka o rassmotrenii arbitrazhnimi sudami RF del, vznikayushchikh iz administrativnykh pravootnosheniy* (Information about cases arising from administrative law considered by the commercial courts). Older data were obtained directly from the VAS; for the URL for recent data, see the References section (Vysshyy arbitrazhnyy sud Rossiyskoy Federatsii, various years).

commercial courts was already increasing by the mid-1990s (e.g., Hendley, Murrell, and Ryterman, 2001; Hendley, 2006).

As shown in Figure 2, use of these courts had reached significant levels by the early 2000s. Overall, a host of surveys indicates that Russian firms now utilize formal legal institutions quite extensively, with about one-third of smaller firms and two-thirds of larger firms having used the commercial courts (Hendley, Murrell, and Ryterman, 2001; Johnson, McMillan, and Woodruff, 2002; OPORA-VTsIOM, 2005, 2006; Rimskiy, 2009, Table 2.1; Yakovlev, 2008; Yakovlev et al., 2004, p. 69). While a rising number of court cases can result from a growing number of violations of firms' rights rather than increased willingness to rely on legal institutions, survey data suggest this was not the case. For example, Yakovlev (2008) finds that between 2000 and 2007, there was a decline in the extent of legal violations reported by firms. Indeed, it strains credibility to argue that the late 1990s and early 2000s was a period in which firms found themselves

more in conflict than in the early to mid-1990s, although the 2008–2009 financial crisis predictably exacerbated conflict among firms.

Moreover, extensive evidence indicates that firms genuinely have begun to change their perception and use of the courts. According to the 2010 survey I conducted, 54 percent of respondents reported that in response to violations of their legal rights, they would be more willing or significantly more willing to turn to the courts today as compared to 10 years ago. (Thirty-three percent of respondents said that their willingness to use the courts remained unchanged, and only 6 percent of respondents replied that they would be less willing.) It is also instructive to compare firms' responses to the 1998 and 2008–2009 financial crises. During the recent crisis, the number of inter-enterprise cases skyrocketed as firms turned to the court system to resolve non-payment disputes. No similar spurt in court usage is apparent during the 1998 crisis, indicating that firms instead relied on extra-legal forms of dispute resolution.

An additional indication of the growing reliance on legal institutions is firms' increasing willingness to use legal remedies even in disputes with state authorities. As noted by Hendley (2002, pp. 144–145), turning to formal state institutions when one's adversary is the state itself indicates a significant degree of reliance on law. Between 2000 and 2008, cases against the tax authorities rose from around 13,000 to over 50,000, a 280 percent increase. Cases against other government funds and agencies increased during this period from around 11,000 to 40,000. By 2009, litigation against the state represented nearly 20 percent of all cases initiated by firms, as seen in the rise in cases against the state in Figure 2. Nor were these suits hopeless endeavors. Win rates for plaintiffs in cases against tax authorities grew from around 60 percent at the end of the 1990s to above 70 percent in the late 2000s.<sup>10</sup>

Actual litigation rates are, of course, only the proverbial tip of the iceberg (Hendley, 2001). For any dispute that ends up in court, countless others are negotiated in "the shadow of the law," where the threat of litigation shapes negotiations (Mnookin and Kornhauser, 1979). The increased use of the court system thus captures only a fraction of the actual increase in reliance on lawyers, legal strategies, and the legal system. But there is broader evidence that lawyers and law have come to play an increasingly important role in the Russian business world.

One indicator of the expanding role of law in the Russian business world is the growing population of lawyers (Hendley, 2006, p. 364). The legal community in Russia is divided among *advokaty* and *yuristy*. Only the former are required to take a bar exam and pay bar membership dues.<sup>11</sup> Therefore, only the exact number of *advokaty* is known, even

<sup>10</sup>These data are based on the sources listed in the caption to Figure 2.

<sup>11</sup>The distinction is a holdover from Soviet times, during which *advokaty* were the rough equivalent of defense attorneys, and *yuriskonsulty* were the rough equivalent of in-house counsel. Today, the distinction between the two is less clear-cut. Only *advokaty* can represent a client in a criminal case, but *advokaty* also regularly serve corporate and business clients. By law, however, they must work for an independent law firm and cannot (*footnote continues*)

though they represent the minority of all lawyers. Among *advokaty*, there has been a dramatic increase, from 26,300 in 1996 to 63,740 in 2010, a 140 percent change, even though during this period the overall population of Russia was declining.<sup>12</sup>

Moreover, lawyers themselves see significant changes in their profession and its role in business. As one of Russia's top tax lawyers recalled, today there is booming demand for his services, whereas in the 1990s his "main problem was not winning, but convincing businesspeople that it is worth going to court" (Tax Lawyer, 2009). According to a prominent bankruptcy lawyer in Moscow, one of the reasons for this hesitancy was that "lawyers here are part of a very young profession. In the 1990s businesspeople thought of them as con men (*moshenniki*)."<sup>13</sup> He continued to explain, however, that today the "image of lawyers more broadly has changed. They are like advisors now, not only for legal stuff but more generally in business" (Bankruptcy Lawyer, 2009). Meanwhile, a young litigator confirms that:

There are [now] more commercial disputes between legal entities. That is, companies have switched, well, are switching, to a "white" [i.e., legal] tax regime system. Accordingly, they turn to law firms, conclude civil contracts, and find protection for their contracts in the courts. Previously, everything was decided with a handshake. Previously, there was no point in signing a contract, because nevertheless no one was going to win anything in court, or enforce a court decision. Now it's not like this.... A court case already means a lot, and it's easy to enforce a decision (Young Litigator, 2009).

This same lawyer also finds evidence of the changing attitudes of businesspeople toward lawyers in more subtle indicators, explaining that "Now people pay [for our time]. Previously, people paid only for a result. They would say, you bring us money [i.e., win the case], and we will pay you for the money" (Young Litigator, 2009). Nor is this development limited to Moscow. When asked about the extent to which firms now use the court system, a lawyer from the Siberian town of Barnaul observed that "people more or less have come to resolve disputes in a civilized way, by going to court." Indeed, he noted that the courts are so packed with litigants that "to move through the corridors of a courthouse is now impossible" (Lawyer from Barnaul, 2009).

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<sup>11</sup>(*continued*) serve in-house. For some background on the structure of the Russian legal profession, see Hendley (2010, pp. 8–9).

<sup>12</sup>Biannual data from 1996–2004 on the number of registered *advokaty* can be found in Hendley (2006, p. 385). For more recent data, see the report produced by the Federal Chamber of Lawyers of the Russian Federation (in Russian, Federal'naya palata advokatov Rossiyskoy Federatsii) (Informatsionnaya spravka, 2010, p. 32).

**Table 2.** Number of Cases Related to Private Arbitration Heard by Commercial Courts, 2002–2009<sup>a</sup>

	2002	2003	2004	2005	2006	2007	2008	2009
Number of cases	672	936	1287	1593	1704	1710	2113	3770

<sup>a</sup>Source: Vysshyy arbitrazhnyy sud RF (Supreme Commercial Court of the RF), *Spravka osnovnykh pokazateley raboty arbitrazhnykh sudov RF* (Information on the basic indicators of the work of the commercial courts of the Russian Federation), 2002–2009.

Firms' use of lawyers also extends beyond the formal court system, as seen in firms' increasing reliance on private arbitration. Although temporary legislation laid the foundation for private arbitration at the outset of the post-Soviet transition, it was not until the 2002 Law on Private Arbitration that it was fully incorporated into the Russian legal and business worlds. In 2002, experts estimated that there were just over 400 courts of private arbitration. By 2007, similar estimates put this number somewhere between 700 and 1000 (Sevastyanov and Tsyplenkova, 2007, p. 63).

A unified source of data on private arbitration courts does not exist, but data from individual courts indicate that demand for private arbitration—although still low—in recent years has been rising, particularly during the economic crisis of 2009. In some cases, this growth has been dramatic: the Federal Court of Private Arbitration (Federal'nyy treteyskiy sud) heard 72 cases in 2008, 364 cases in 2009, and 956 cases in 2010 (Treteyskiy sud v Rossii, 2011). Further evidence of increased demand for arbitration services can be seen in the data on the number of cases from private arbitration that have been disputed or for which enforcement has been sought via the official commercial court system. Between 2002 and 2009, these cases increased six-fold, from 672 to 3,770, as shown in Table 2.<sup>13</sup>

The most striking evidence of the increasing use of formal legal institutions, however, is how firms evaluate their reliance on lawyers and courts relative to other means of protecting assets. Even by the late 1990s, firms seemed to consider use of the courts to be a relatively attractive option when compared with other strategies for resolving conflicts. Hendley, Murrell, and Ryterman's (2000, pp. 635–636) 1997 study found that with the exception of direct enterprise-to-enterprise formal negotiations, turning to the courts was the most common way of addressing contractual problems with suppliers; likewise, other than stopping trade with a customer, litigation was the most common way of dealing with customer conflicts. Yakovlev et al. (2004, p. 70) found similar results with respect

<sup>13</sup>Russian legal scholars express confidence that this increase did not result from growing problems with the enforcement of private arbitration decisions but instead reflects a genuine increase in the use of private arbitration (e.g., Skoblikov, 2009; see also Sevastyanov and Tsyplenkova, 2007, p. 65).



to open joint-stock companies' preferred methods of dispute resolution: Turning to the courts was stated as a preferred choice by over half of the respondents, and threatening to turn to the courts by over 20 percent.

My survey indicates that these trends toward reliance on law have continued. When respondents were asked to rank on a 1 to 7 scale how likely a firm like theirs would be to utilize various strategies to resolve an asset dispute (with 7 meaning "very likely" and 1 meaning "very unlikely"), the highest ranking strategies were the use of lawyers to resolve the conflict out of court (average ranking 6.0) and filing a claim in the commercial courts (5.7). These ranked higher even than direct negotiations with the other firm's management (5.3), which often is considered to be the first step in resolving a conflict and which topped the list of firms' preferred strategies in previous survey research (e.g., Hendley, Murrell, and Ryterman, 2000; Yakovlev et al., 2004). The high ranking for the use of lawyers out of court is particularly remarkable, providing evidence of the active role lawyers now play in resolving business conflicts. By contrast, the average rankings for the likelihood of turning to a private security firm or criminal protection racket were 2.2 and 1.9, respectively.<sup>14</sup> A similar question that examined firms' preferred strategies for collecting a debt as opposed to resolving an asset conflict produced nearly identical results.

Despite evidence of firms' increasing reliance on the court system, some observers have argued that firms are turning to formal institutions primarily because they can bribe judges or manipulate the legal system to serve private interests. Volkov (2005), for example, claims that "Among entrepreneurs, the judicial system has begun to be used more and more intensively in recent years.... But this is less related to the rule of law than to the realization of the goals of groups with administrative and financial resources" (Volkov, 2005; see also Ledeneva, 2006, ch. 7). Foremost among these abuses are the machinations related to illegal corporate raiding, which are discussed at greater length below.

These considerations warrant attention. Indeed, in the 2010 survey I conducted, nearly 14 percent of respondents admitted relying on "informal connections" in the commercial courts at some point in the last three years to resolve a security-related issue.<sup>15</sup> But even the most shocking estimates of raiding and other abuses do not provide grounds to consider the shift toward legal institutions illusory. Volkov (2004, p. 532) cites figures that as many as one-third of bankruptcy cases in 2001 pertained to raiding, and Lambert-Mogiliansky, Sonin, and Zhuravskaya (2007) offer evidence of bias in bankruptcy cases resulting from regional governors' meddling. Yet, even taking these findings at face value, bankruptcy as a whole is a

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<sup>14</sup>Respondents were asked the following question: *Let's say that a competitor is trying to gain control of some significant physical asset owned by your firm (e.g., office space or a factory). To defend its assets, how likely would a firm like yours be to do each of the following?*

<sup>15</sup>Respondents were asked whether or not they had used various approaches to resolve a security-related issue, including "use of the commercial courts, with informal connections" (*obrashcheniye v arbitrazhnyy sud, s ispol'zovaniyem sushchestvuyushchikh tam svyaziyey*). For additional discussion of the formulation of the question, see footnote 21.

minor fraction of total court usage, as seen in Figure 2 above. Cases pertaining to property disputes are an even smaller fraction of total litigation. The largest class of litigation between firms throughout the 1990s and 2000s has remained the issue of non-payments and unfulfilled contractual obligations, which consistently comprise about 60 to 70 percent of annual inter-enterprise cases.<sup>16</sup> For many of these cases, the sum in dispute is relatively small, calling into question the value of investing in connections or bribery. As the founding partner of a Moscow law firm explained, “Connections are probably needed if the case is high-profile, big or political, or if the opponent is a large company. But for middle-sized cases they are not necessary ... and the majority of cases are rather small, and so connections are not needed” (Founding Partner, 2009).

In short, raiding and corruption within the judicial system are serious concerns for Russian firms. They are not, however, the primary reason why firms are increasingly resolving business conflicts through the use of formal legal institutions.

## **NEW THREATS: THE RISE OF THE PREDATORY STATE**

While the use of outright force may have subsided, this does not imply that all is calm in the Russian business world. The nature of threats and challenges, however, has changed. If the 1990s were a period of lawlessness during which the state was too weak to protect honest businesspeople from criminals and unscrupulous competitors, then the threat in recent years often has emanated from within the state itself.

This threat can be classified into three distinct categories: (1) attacks by high-level state officials; (2) attacks by lower-level state officials acting on behalf of paying private-sector clients; and (3) attacks initiated directly by lower-level state officials, such as harassment by bureaucrats via abuse of regulatory statutes and pressure from law enforcement officials via abuse of the Criminal Code.

### **Attacks by High-Level Officials**

The most high-profile attack by Russian officials was the arrest of Mikhail Khodorkovskiy for tax evasion and fraud in 2003, an attack orchestrated by members of Vladimir Putin’s inner circle. Khodorkovskiy, having amassed a fortune through his exploits in the banking and oil sectors, was at the time Russia’s wealthiest man. The charges ultimately led to the bankruptcy of Khodorkovskiy’s oil company, Yukos, whose most lucrative assets ended up in the possession of the state-owned Rosneft oil company after a series of non-transparent auctions.<sup>17</sup>

<sup>16</sup>For sources, see the caption to Figure 2.

<sup>17</sup>The Khodorkovskiy affair has received a great deal of attention. Among other sources, see Goldman (2004); Treisman (2010) provides details and discussion of the context.

The Khodorkovskiy affair, however, is not an isolated incident, particularly in the energy sector. Rather than continuing to play a dangerous game, the oligarch Roman Abramovich voluntarily sold his oil company, Sibneft, to state-owned Gazprom in 2005 (Kramer, 2005). Others were not so fortunate. In 2006, Gazprom acquired a majority stake in the Sakhalin-2 oil and gas project after Royal Dutch Shell, facing legal proceedings for ostensible violations of environmental regulations, agreed to sell some of its assets (Kramer, 2006; Bradshaw, 2010, pp. 351–353). In 2007, Mikhail Gutseriyev, having fallen out of favor with Kremlin-backed leadership in the Republic of Ingushetia, was charged with tax evasion, fraud, and illegal entrepreneurship. As he fled the country, he sold off his Russneft oil company (not to be confused with the state-owned Rosneft) to Oleg Deripaska, a tycoon known for his friendly relations with the Kremlin (Zarakhovich, 2009).<sup>18</sup> In 2008, a series of office raids, environmental inspections, and back tax claims against TNK-BP raised speculation that Gazprom was seeking to acquire control of yet another oil company (C. Belton in *Financial Times*, May 20, 2008), but TNK-BP so far has remained independent.

These acquisitions transformed the oil sector. In 2000, majority state-owned companies produced 10 percent of oil output; by 2008, they produced 42 percent (Rutland, 2009, p. 175). However, while the state has been active in other sectors, its tactics have not been nearly so coercive. In heavy industry, state-owned corporations have in recent years acquired major firms such as Silovyye Mashiny, OMZ, and the auto manufacturer AvtoVAZ, but the type of pressure applied in the energy sector has not been present. In the financial sector, prominent backers of opposition political parties, such as Igor Linshits and Aleksandr Lebedev, have faced arrest and raids by tax authorities, but a massive transfer of assets to the state has not resulted. Nevertheless, the shadow of the Yukos affair hangs over all major businesses: When in 2008 Putin accused the steel company Mechel of overcharging domestic consumers and issued what appeared to be a personal threat to the company's chief executive, Mechel's shares on the New York Stock Exchange dropped 38 percent for fear of an imminent state attack (Kramer, 2008).<sup>19</sup>

For the majority of firms, however, the most pressing concern is not a Yukos-style raid but rather harassment from lower-level officials, whom the top leadership struggles to control in a country as vast as Russia.

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<sup>18</sup>Gutseriyev's story ended on a positive note. He regained the Kremlin's favor, his arrest warrant was canceled, and ultimately Deripaska, facing significant debts after the 2008 financial crisis, returned control of Russneft to Gutseriyev.

<sup>19</sup>Putin, speaking at an industry conference, said: "By the way, we invited the owner and director of [Mechel], Igor Vladimirovich Zyusin, to today's meeting, but he suddenly got sick.... Of course, sickness is sickness, but I think Igor Vladimirovich should get better as quick as possible, otherwise we'll have to send him a doctor" (Kramer, 2008).

## Lower-Level State Officials for Hire

As Russian firms turned away from private force in the mid- to late 1990s, they began to rely on corrupt government officials, who for a fee were willing to appropriate state resources for use against a firm's competitors or counterparties in disputes. Law enforcement protection rackets—known as a *mentovskaya krysha*<sup>20</sup> as opposed to a *banditskaya krysha*, the term for a criminal protection racket—were particularly prevalent in the late 1990s and early 2000s. These rackets offered many of the same services previously provided by criminal protection rackets, such as debt collection, contract enforcement, and adjudication of disputes. Meanwhile, corrupt notaries and judges figured prominently in disputes involving illegal corporate raiding (*reyderstvo*), which became a major source of conflict by the end of the 1990s. These phenomena persist to the present day, intermingling with the legitimate use of formal state institutions discussed above.

Law enforcement protection rackets took many forms. The most sought-after law enforcement *kryshas* were the Ministry of Internal Affairs (MVD) State Directorate for the Struggle with Organized Crime (GUBOP) and its regional branches (RUBOPs), as well as FSB (the KGB successor) units devoted to economic and organized crime (Pravotorov, 2006; Sborov, 2003). Lower levels of police also got into the act. Some estimates suggest that approximately 30 percent of MVD personnel offered some form of *krysha* in the 1990s (Webster, 1997, p. 30). State protection rackets were not limited to law enforcement agencies. Bureaucrats also proved to be valuable sources of protection, particularly as harassment by state officials came to replace physical threats as a major concern for many firms. As a Moscow lawyer explained, a well-placed bureaucrat (known as a *pokrovitel'*, a "protector" or "patron"), sometimes serving as a shareholder on a firm's board of directors, could at times offer better protection from overzealous tax authorities or inspectors than could law enforcement officials (Moscow Lawyer, 2009; Pravotorov, 2006).

The line between legitimate and illegitimate use of state resources for the purpose of property security was further obscured by the role of the extra-departmental security division of the MVD, known as the VO (*vnevedomstvennaya okhrana*). Founded during the Soviet period to guard state property, it received the right to provide commercial services in 1992. While analysts have devoted extensive attention to the role of Russian private security agencies, VO guards have actually formed a larger slice of the private security market, both in terms of personnel and the number of objects guarded (Brusov, 2007; Khodorych, 2002; B. Orlov in *Komsomol'skaya pravda*, September 9, 2008). This remained true until 2005, when a quasi-state enterprise, FGUP Okhrana, was spun off from the VO. For businesspeople, VO guards were an enticing option, for they had the

<sup>20</sup>*Mentovskaya* comes from the term *menty*, which is a common but semi-derogatory term for police.

advantage of wearing police (*militsiya*) uniforms and being able to carry any type of gun, unlike the limited arsenal allowed to ChOPs (Khodorych, 2002; B. Orlov in *Komsomol'skaya pravda*, September 9, 2008).

By the late 1990s, there was little question that firms had come to depend almost fully on state officials, rather than on criminal rackets, for protection services. Observers estimated that criminal kryshas maintained control of around 10 to 20 percent of the total market for private security, while law enforcement protection services or private security agencies with ties to state officials divided up the remaining clients (Khodorych, 2002; Skoblikov, 2001; Taylor, 2007, p. 45; Volkov, 2002, pp.169–170). One journalist summarized the situation as follows: “By the end of the 1990s, the majority of entrepreneurs capable of making money were ‘voluntarily’ providing support to the law enforcement authorities. It could be said that the country had been divided into zones of ‘police patronage’ (*militsyevskoy otvetstvennosti*)” (Sborov, 2003). Internal cables from the US Embassy in Moscow to the State Department in Washington came to a similar conclusion: “Moscow business owners understand that it is best to get protection from the MVD and FSB (rather than organized crime groups) since they not only have more guns, resources and power than criminal groups, but they are also protected by the law. For this reason, protection from criminal gangs is no longer so high in demand” (Chivers, 2010). Among those using state security services, small firms primarily turned to the MVD, large firms turned to the FSB, and the MVD and FSB divided medium-sized clients nearly equally (Pravotorov, 2006).

The services that law enforcement and other government officials provided to firms went far beyond mere protection. Businesspeople learned that there were safer, more efficient means than private force to undercut competitors or settle disputes—namely, to “order” (*zakazat'*) an investigation by a government agency. In the words of one businessperson, “In the past, if someone refused to pay they could damage the shop or just burn it. Now they’ve understood that it is cheaper and safer to get fire inspection to close it down for a week or two. And the effect is the same” (cited in Volkov, 2002, p. 51; see also Radaev, 1999, p. 48). An even more fearsome tool described by some Russian businesspeople was the “ordered” criminal investigation, whereby a competitor or counterparty in a dispute would bribe a prosecutor to open a criminal case. Rather than the loss of financial resources or property, victims of an ordered criminal investigation faced an extreme form of pressure—the threat of a prison sentence. Once the victim agreed to settle a dispute on terms favorable to the attacker, the criminal investigation abruptly would come to an end (Russian Businesspeople, 2009).

Corrupt judicial officials also became entangled in attacks on property rights, particularly those involving illegal corporate raiding (*reyderstvo*). While the term is taken from the American usage, it involves far more than buying up a company’s shares in order to change management. Prior to a 2002 reform to the Law on Bankruptcy, one common scheme was to acquire a company’s debt and then utilize legal loopholes to initiate forced

bankruptcy, despite the firm's sound financial health. Raiders would then bribe a judge to appoint a loyal bankruptcy trustee, who would facilitate the seizure of the firm's assets. Other schemes that continue to be used involve forgery of internal corporate documents or the creation of a second set of documents by paying corrupt government officials. These documents are then used to acquire a majority of voting stock or to create a friendly board of directors. A third tactic relies on civil suits filed with corrupt judges, who then issue a judgment allowing acquisition of assets as a form of compensation. In other cases, raiders pay law enforcement or tax officials to initiate criminal cases against target companies, reducing the market value of the firm they wish to buy or forcing a recalcitrant owner to concede to selling her assets (Firestone, 2008; Volkov, 2004).

Precise measures of firms' reliance on corrupt officials are for obvious reasons difficult to obtain, but my 2010 survey indicates that reliance on such corruption remains significant in today's Russia. Unlike previous studies, my survey sought to distinguish explicitly between the legal and illegal use of state resources. When respondents were asked about the extent to which they rely on law enforcement agencies, members of the judiciary, and government officials (e.g., inspectors, regulators, and other bureaucrats), they were also asked to clarify whether they sought support from these officials in an official capacity or in a private capacity.<sup>21</sup> During the past three years, approximately 33 percent of firms reported using bureaucrats and 27 percent reported using law enforcement agencies in a formal capacity to address a security issue. Meanwhile, 20 and 17 percent reported turning informally to bureaucrats and law enforcement agencies, respectively. Similarly, while 46 percent of all firms reported using the courts in the last three years, nearly 14 percent admitted that they also used informal connections within the judicial system. To the extent that respondents may be prone to underreport informal use, these figures should be considered a lower bound and therefore indicate that the corrupt use of state resources is far from insignificant.

Similarly, when firms were asked to rank on a 1 to 7 scale how likely a firm like theirs would be to utilize various strategies to resolve an asset dispute (with 7 meaning "very likely" and 1 meaning "very unlikely"), respondents reported widespread use of strategies that rely on corrupt officials.<sup>22</sup> The average ranking for using informal connections in court was 4.3, for using law enforcement officials in an informal capacity was

<sup>21</sup>The phrasing was formulated based on the author's experience conducting in-depth interviews with Russian businesspeople and private security agencies. The questions were piloted extensively before conducting the actual survey. The goal was to identify phrasing that was not directly incriminating yet was immediately recognizable among Russian businesspeople as an allusion to government protection rackets and similar types of phenomena. For law enforcement officials and bureaucrats, respondents were asked to clarify whether they used these resources in an "official capacity" (*obratitsya kak k dolzhnostnym litsam*) or an "unofficial capacity" (*obratitsya kak k chastnym litsam*). For judicial officials, respondents were asked if they went to court fully in a "formal manner" (*v formalnom poryadke*) or whether they also used "informal connections" (*s ispol'zovaniyem sushchestvuyushchikh tam svyaziyei*).

<sup>22</sup>For the phrasing of the question, refer to footnote 14.



3.8, and for using bureaucrats in an informal capacity was 3.6. These are lower than the rankings for the use of formal legal institutions, but much higher than the rankings for reliance on private coercion (see discussion on page 277 in the section on firms' increasing use of law).

Firms' shift from the use of private coercion to reliance on the corrupt use of state protection resources marked a significant transformation. Rather than being fought in the streets, property rights conflicts were increasingly fought via courts and other government agencies, even as the abusive practices associated with raiding and law enforcement protection rackets threatened to subvert the state's formal institutions.

### **Attacks by Lower-Level State Officials**

Government officials were not content for long to offer for-profit services to private actors. Increasingly, they sought to expropriate assets for themselves. Bureaucrats, for example, came to abuse regulatory codes to extort firms. Law enforcement officials adopted harsher techniques, transforming the threat of jail time into a tool for extortion.

A key element of a predatory state is that bureaucrats create or maintain excessive regulations, which force firms to pay bribes in order to cut through red tape, acquire necessary permits, or avoid fines and sanctions. Particularly cognizant of the regulatory burden faced by smaller firms, the Russian government initiated significant reforms in the early 2000s. These reforms restricted the frequency of government agencies' routine inspections and created stricter procedures for conducting "unplanned" inspections (i.e., inspections of firms suspected of violating laws). They also reduced licensing and certification requirements and sought to accelerate the process of registering a new business, such as the establishment of a "one window" rule mandating that firms should not have to visit more than one government agency during the process of registration (Shetinin et al., 2005).

According to surveys conducted by the Centre for Economic and Financial Research in Moscow (CEFIR), the reforms had a significant one-time effect. But after the initial reduction in regulatory burdens, bureaucrats were able to stall reforms well short of legally mandated goals. Overall, the average number of inspections firms faced in the first half of 2002 was 33 percent lower than the average number faced in the second half of 2001 (Shetinin et al., 2005, p. 5). Yet progress tapered off thereafter, and the average number of inspections faced by firms remained relatively constant. Moreover, agencies continued to violate the law's ban on repeat inspections during a two-year period. In 2004, of firms inspected by the police, over 40 percent reported a repeat visit; fire inspectors and tax inspectors likewise returned to around 20 percent of firms that had already faced recent inspections. CEFIR further found that for many agencies, more than half of their unplanned inspections were conducted without warrants, in violation of the law (Shetinin et al., 2005, p. 6).

The effects of the laws on licensing and registration were similar. Following the introduction of the licensing law, the share of firms applying for licenses fell from 31 percent in the second half of 2001 to 14 percent by the second half of 2004, showing a reasonable amount of deregulation of economic activity. Yet by the mid-2000s, more than half of all licenses remained illegitimate, in that they were issued for activities that by law do not require licensing (Shetinin et al., 2005, p. 7). With respect to the law on registration, in 2004 nearly half of firms were able to register in less than a week, whereas prior to the new law, a mere 20 percent of firms managed to do so (Shetinin et al., 2005, p. 9).<sup>23</sup> Yet despite the progress, these figures indicated that half of all firms were still facing delays longer than the legally mandated five-day registration period.

A follow-up survey conducted by CEFIR in 2009 found that the burden imposed by inspections, licensing, and registration remained largely unchanged since the mid-2000s (Bessonova et al., 2010). Indeed, during interviews conducted by the author throughout 2009, businesspeople, especially owners and managers of small firms, regularly referred to bureaucrats as the primary threat to the security of their assets—a threat more destructive than the *bandity* of the 1990s. In the words of a consultant to small businesses in Moscow: “Who cares about criminals? Inspectors can close you in a matter of seconds. This is in itself a kind of mafia system” (Consultant, 2009). Or as a small businessman pointed out, “The *bandity* who were here 15 years ago wore a sign that said ‘*Bandit*.’ It was easy to distinguish between *bandity* and non-*bandity* ... Today, in Moscow alone, there are over 50 organizations that have the direct right to inspect and block the work of an enterprise” (Small Businessman, 2009). Likewise, in the 2010 survey I conducted, 25 percent of firms reported a violation of their legal rights related to collection of fines or payments by a government agency, while 17 percent reported a violation by tax authorities.

In short, bureaucrats proved resilient to reforms aimed at restraining their influence over business. By maintaining an excessive regulatory burden, bureaucrats have managed to divert a large share of firms’ profits to their own pockets by selling illegitimate licenses, collecting bribes from firms seeking to overcome red tape, and forcing firms to pay bribes to avoid inspectors’ sanctions.

While regulatory officials can slow a firm’s operations or potentially shut down a firm, the most fearsome threats are those posed by law enforcement officials. In such raids, officials usually charge or threaten to charge entrepreneurs with criminal prosecution in order to force firms to pay bribes or to sell off assets at below market prices. For cooperative entrepreneurs, the charges may never materialize. For others, the fear of imprisonment may induce cooperation, after which charges are dropped. For the most recalcitrant, the authorities make use of judges’ willingness to allow pre-trial detention without bail for extended periods of time, even

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<sup>23</sup>These figures refer to firms that did not hire a consulting firm or other type of intermediary to help with the registration process.

for non-violent crimes. Although such raids are by no means a new invention, Russian businesspeople widely perceive the aggressiveness of law enforcement officials to have increased after the Yukos affair. In the words of Yana Yakovleva, the founder of *Biznes Solidarnost'*, an association dedicated to aiding entrepreneurs who have been wrongly imprisoned, after 2003 every official was looking for his "own little Yukos" (Yakovleva, 2009).

When authorities attack larger firms, such raids can be high-profile, as was the case in the affair of the mobile-phone retailer Yevroset'. Yevgeniy Chichvarkin and his business partner, Timur Artiyemev, founded the company in 1997. The company's growth was explosive. By 2002, they had become one of the top retailers in Moscow; by 2005, using a franchising business model, they had over 3,000 outlets throughout the former Soviet Union. Such lucrative assets fell under the gaze of the authorities. Beginning in 2005, Yevroset' clashed with law enforcement officials, who claimed the company was selling illegally imported contraband. In 2006, Yevroset' fought back, pressing charges against Ministry of Internal Affairs officials who had wrongfully confiscated Yevroset' merchandise and then unlawfully destroyed some of the assets before returning them to the rightful owners. The case resulted in hefty fines for several of the officials involved and a jail sentence for one. Thereafter, Yevroset' faced several rounds of police raids on its offices, which many observers viewed as retaliation for their bold challenge to the authorities. Members of Yevroset's internal security service were then charged with kidnapping and extortion of a former employee whom they had suspected of embezzlement. By 2008, the authorities had managed to implicate Chichvarkin himself in the affair, and he fled to London after selling his assets (Lyubavina, 2006; Sergeev, 2010).

Chichvarkin is hardly the only entrepreneur to have run afoul of the authorities. Yakovleva, the *Biznes Solidarnost'* founder, herself spent more than half a year in jail after refusing to pay bribes when her chemical company was charged with selling illegal substances. Since her release, the organization she founded has helped publicize the plight of dozens of similar cases. Meanwhile, nearly 6 percent of respondents—more than 1 out of every 17 firms—in the 2010 survey I conducted reported having been charged with crimes they did not commit. Data on economic crimes offer further evidence of the scale of law enforcement raids. Favored charges used to apply pressure on firms include fraud (Article 159 of the Criminal Code), misappropriation or embezzlement (Article 160), money laundering (Article 174), and a range of other charges related to what in Russia are called "economic crimes" (*ekonomicheskkiye prestupleniya*) (Volkov, Paneyakh, and Titayev, 2010, pp. 5–6). Unlike crimes such as murder or theft, which are reported to the police by citizens, these economic crimes require proactive investigation by legal authorities, providing officials with significant discretion to probe a wide range of firms. As can be seen in Table 3, after 2003, the initial year of the Khodorkovskiy affair, there was a notable increase in the number of economic crimes uncovered by

**Table 3.** Number of Economic Crimes Uncovered, 2000–2010 (in thousands)<sup>a</sup>

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Fraud	47.8	46.2	45.7	45.7	54.1	58.5	66.1	69.5	75.0	78.3	58.2
Money laundering	1.8	1.4	1.1	0.6	2.0	7.5	8.0	9.0	8.4	8.8	1.8

<sup>a</sup>Source: Data for 2000–2002 are from Rosstat (2003, Table 7.1). Data for 2003–2010 are from various years of the RF Ministry of Internal Affairs's reports entitled "Sostoyaniye prestupnosti (Status report on crime)." See the References section for the URL for these reports.

Ministry of Internal Affairs investigators: Between 2003 and 2004, fraud-related cases, which since the late 1990s had remained relatively constant, increased nearly 15 percent. The number of money-laundering cases nearly doubled and then continued to skyrocket as the decade proceeded.

Interpreting crime statistics, of course, presents many challenges. An increase in the number of recorded crimes can result from a crime wave, more aggressive policing of genuine criminal activity, or, in the post-communist world, an increase in abuse of the Criminal Code. To address this issue, Volkov, Paneyakh, and Titayev (2010) conducted an innovative analysis in which they examined the percentage of reported crimes that actually led to a court sentence. Honest law enforcement officials usually prefer not to initiate cases with a low likelihood of being brought to fruition, for a high number of cases that fail to lead to prosecution affects the indicators on which promotions are based. On the other hand, officials who are seeking to apply pressure on firms will be more likely to initiate cases that lack merit, simply as a means of frightening entrepreneurs. Volkov, Paneyakh, and Titayev found that in 2007, only 10 to 15 percent of cases relating to fraud and embezzlement resulted in sentencing, in stark contrast to murder and rape, which once initiated, led to sentencing in 90 percent and 75 percent of cases, respectively.

While recognizing that the complexity of economic crimes creates legitimate challenges for investigators, leading them to drop some cases, they concluded: "The basic proposition supported by the data is that a significant part of criminal cases related to economic crimes are initiated and carried out in connection with the commercial interests of the law enforcement agencies" (Volkov, Paneyakh, and Titayev, 2010, p. 5).

The abuse of the Criminal Code to pressure entrepreneurs has become grave enough to attract attention at the highest levels. In April 2010, then-president Dmitriy Medvedev signed a law prohibiting the pre-trial detention of businesspeople accused of fraud, embezzlement, or the damage of property by deceit or breach of trust. It is too early to evaluate the effects of the law, although the number of recorded economic crimes did fall drastically in 2010, as seen in Table 3. Nevertheless, one of the most serious

threats to property rights in Russia remains the harassment and attacks carried out by lower-level government officials.

## CONCLUSION

Whether secure property rights take root in Russia will depend on the outcome of the clash between two countervailing tendencies: the private sector's reliance on law on the one hand and the increasingly predatory state on the other. And even if the rule of law triumphs in the economic sphere, Russia will still face significant challenges. Secure property rights do not guarantee other fundamental aspects of the rule of law, such as human rights, freedom of the press, and the accountability of political leaders.

Yet arguably, increasing reliance on law in the economic sphere may have a far-reaching impact through spillover effects. First, the use of law by firms may be a stepping stone to broader societal demand for law. Victims of property rights violations have a direct material incentive that may provide a stronger stimulus for action than that which results from violations of political, social, or human rights. Moreover, an emerging capitalist class possesses the resources to react to violations of its rights (Hendley, 1996). Once reliance on law is established for some spheres of society, this may provide a blueprint for legal action that spreads to other spheres. Second, once legal doctrine is established in one realm, it may spread to others. For example, the doctrine of substantive due process in the United States, based on clauses in the Fifth and Fourteenth Amendments, originally was applied as a source of property rights protection. Over time, however, it came to be used to protect rights as diverse as the right to travel or the right to marry across racial lines (Silverstein, 2003).

It remains to be seen whether the spillover effects of private-sector reliance on law will have a beneficial effect on society and politics more broadly, or whether other negative developments will eventually overwhelm the positive trends in the economic sphere of the rule of law. The barriers to the rule of law in Russia remain severe. Yet when one considers the chaos and lawlessness of the 1990s, the fact that firms today regularly turn to courts and lawyers represents a significant step in a positive direction.

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## APPENDIX

### Data

#### *Interviews*

Ninety semi-structured interviews were conducted by the author throughout 2009. The breakdown across firms, lawyers, and private security agencies is presented in Table A1. Seventy-seven interviews were conducted in Moscow; the remaining interviews were conducted in Barnaul.

**Table A1.** Characteristics of Interview Respondents

	Number of interviews
Fifty-six firms broken down as follows:	
Firms with fewer than 15 employees	15
Firms with 15 to 100 employees	12
Firms with 101 to 250 employees	12
Firms with more than 250 employees	17
Lawyers	22
Private security agencies	12
Total interviews	90

**Table A2.** Distribution of Respondents by Firm Size and City

	Micro	Small	Medium	Large	Very large	Total
Number of employees	<15	15–100	100–250	250–500	500+	
Moscow	16	19	21	23	22	101
St. Petersburg	11	15	16	16	17	75
Regional	22	22	28	26	27	125
Total	49	56	65	65	66	301

Seventy-five of the respondents were Russian; the other 15 were expatriates with extensive business experience in Russia. Thirty-six supplementary interviews were conducted with business journalists, academics, non-governmental organizations, and business association representatives.

### *Survey*

The survey sample consists of 301 manufacturing and service firms from Moscow, St. Petersburg, and six regional cities: Yekaterinburg, Nizhniy Novgorod, Samara, Novosibirsk, Rostov-on-Don, and Kazan. Firms were selected using stratified random sampling. As shown in Table A2, the stratification was conducted to ensure that the sample would include a sufficient number of micro, small, medium, and large firms, as well as a sufficient number of firms in Moscow, St. Petersburg, and regional cities. Each cell was further divided evenly between manufacturing and service firms.

The response rate for the survey was 41 percent. Survey-related interviews were conducted face-to-face during June and July 2010 by interviewers from the Russian survey-research firm Bashkirova and

Partners with the firm's owner, general director, deputy general director, or chief financial officer. All questions were close-ended.

## Methodological Concerns

Research on sensitive topics, such as violent or illegal activities, entails challenges. Firms that are most likely to engage in activities outside of the law may be less likely to participate in the research. Among participants, there may be hesitancy to provide truthful answers. While these concerns cannot be ignored, they also should not be over-exaggerated. First, many types of unlawful behavior in countries such as Russia are open secrets that are more culturally appropriate to discuss than imagined by outside researchers. This observation is supported by other analysts. For example, Daniel Kaufmann, formerly one of the World Bank's foremost experts on corruption and the rule of law, has concluded that "With appropriate survey instruments and interviewing techniques, respondents are willing to discuss corruption with remarkable candor" (Kaufmann, Pradhan, and Ryterman, 1999). Second, the magnitude of the changes examined in this article is overwhelming. As many as half of all firms reported contact with criminal protection rackets in surveys conducted in the 1990s, while fewer than 10 percent report contact in recent surveys. Unless firms have become dramatically less inclined to tell the truth over time, a genuine transformation has occurred. Thus, even if surveys provide rough estimates of difficult-to-measure illegal activities that in some cases may be downwardly biased, large changes over time are informative indicators.

Multiple steps nevertheless were taken to ameliorate concerns about the sensitive nature of the research. Following techniques used in World Bank surveys on corruption, interview and survey questions were phrased in an indirect manner designed to elicit information without requiring respondents to incriminate themselves. For example, respondents were asked questions such as "Many people have told us that firms like yours pay protection payments to local rackets. Can you estimate how frequently a typical firm in your line of business makes such protection payments?" Additionally, the combination of multiple methodological approaches—in-depth interviews, survey research, and the collection of objective data such as court caseload statistics—allows for triangulation. The fact that multiple methods lead to similar conclusions indicates the validity of the findings. Moreover, these approaches complement each other. Whereas larger-scale surveys offer insights into the generalizability of the findings, in-depth interviewing allows respondents to answer sensitive questions using non-incriminating gestures and "code words" (e.g., referring to bribes as "fines" while using hand gestures to put the word in quotation marks).



## SURVEYS CITED

To facilitate comparisons, the table below provides information about the samples for all surveys cited in this article.

Researcher(s)	Sample	Year
Frye (2000)	240 small retail shops in Russia (Ulyanovsk, Moscow, Smolensk) and Poland (Warsaw)	1998
Frye and Zhuravskaya (2000)	230 small retail shops in Ulyanovsk, Moscow, and Smolensk	1996
Hendley, Murrell, and Ryterman (2000, 2001)	328 manufacturing firms of various sizes in the Moscow, Barnaul, Novosibirsk, Yekaterinburg, Voronezh, and Saratov regions	1997
OPORA (2005, 2006)	80 regions, 50 small businesses from each region with the exception of Moscow (300 firms) and St. Petersburg (150 firms)	2004 and 2005
Radaev (1999)	221 small businesses from 21 regions	1997
Rimskiy (2009)	602 manufacturing and service firms from 16 regions	2008
Yakovlev (2008)	500 enterprises broadly representative of respective regions, drawn from the Moscow, Bashkortastan, Voronezh, Nizhniy Novgorod, Novgorod, Sverdlovsk, Smolensk, and Tula regions	2000 and 2007
Yakovlev et al. (2004)	304 open joint-stock companies in Moscow, Tomsk, and Novgorod regions	2002