

**Corruption in Russia as a Business:  
Putin's Palace Case Study**

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## 1. Introduction

The problem of corruption is one of the most discussed topics in Russia. It is not surprising, since for the last decade, according to experts' estimations, corruption has reached its pick. The volumes of corruption as well as an average size of bribes increase rapidly. The last widely discussed case of multibillion corruption in the Ministry of Defense confirms this deplorable statistics.

Russian government tries to fight against corruption. For example, both Mr Putin and Mr Medvedev talk about importance of this fight and declare the elimination of corruption as one of the main policy priorities in Russia. As a part of this policy, in 2008, a new anticorruption legislation was adopted. However, experts do not observe any positive results, in contrary, report about further worsening of this problem.

It is little know about the real volumes of corruption since it is always associated with hidden economy where any estimations are very much limited. However, experts guesstimate that the volumes of corruption are enormous and can reach up to 48% of Russian GDP.

There are numerous articles and researches driven on the topic of corruption in Russia. However, most of them just declare the problem but usually do not explain or explain very briefly the reasons of corruption and more often also do not provide any specific solution to efficient solving of this problem. Moreover, the majority of articles talk about corruption at the lowest levels of Russian state system, e.g. in the police, health care, education, housing and communal services, municipalities, etc.

However, corruption is not only the problem at the lowest levels. It occurs also at the highest levels of the state system in Russia and is probably even more dangerous for Russian society than corruption at the lowest levels. However, since many high-level officials are involved in this type of corruption, little is known about it. There is little information about those cases also due to the fact that Russian law-enforcement agencies rarely punish high-level officials for their involvement in corrupt activities, since the judicial system in Russia has itself become a source of corruption and protects the interest of the oligarchy. Moreover, Russian mass media which is highly dependent from the government also do not highlight numerous corrupt cases at the highest level, thereby, the majority of the population in Russia stays uninformed about the real situation with corruption.

In connection with stated above, it is very important to study the problem of corruption since it has a strong negative impact on Russian economy, political system and society. For exam-

ple, it reduces the efficiency of the whole economy and leads to a tense social situation in Russian society.

Therefore, this paper analyzes the available information on the topic of corruption at the highest levels of Russian state system. It explains why several experts call corruption in Russia no longer a problem, but a business. The paper discusses the main reasons of this corrupt “business” and talks about its negative impact on different spheres of life. In the pre-last part of the paper we talk about Russian anticorruption legislation and evaluate its results. We also employ some approaches of the institutional economics to explain the failure of the current fight against corruption in Russia. The paper also illustrates some methods of corruption at the highest levels on the example of Putin's palace case. In the conclusion, we examine the best practice of eliminating corruption as it was done in Georgia and propose some anticorruption measures which can be used in the fight against corruption in Russia.

## **2. The current state of corruption in Russia**

### **2.1. Character, areas, and level of corruption in Russia<sup>1</sup>**

Before focusing on corruption at the highest levels of Russian state system, let us firstly define what we understand under the term “corruption” and discuss its current state in general.

According to Russian legislation, corruption is abuse of authority, bribery (both giving and receiving), abuse of power, commercial bribery or another illegal use by an individual of their official position despite the legitimate interests of society and the state in order to obtain benefits in the form of money, valuables or other property or services of material nature, other property rights for themselves or for the third parties, or illegal provision of such benefits to the specified person by other individuals, as well as on behalf of or for the benefit of a legal entity<sup>2</sup>. In contrary to Russian federal law, we will use a much more specified definition of the term “corruption”, namely, we specify the following forms of corruption: bribery, favoritism, nepotism, protectionism, lobbying, unlawful distribution and redistribution of public assets and funds, illegal privatization, illegal support and financing of political structures (parties, etc.), offering of loans at a discount, placement of orders, use of personal contacts to gain access to public assets such as goods, services, sources of income, privileges, rendering of various kinds of services to relatives, friends, acquaintances, and so on<sup>3</sup>.

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<sup>1</sup> Source: Annual Report Clean Hands, August 2010 – August 2011; Report Putin and corruption.

<sup>2</sup> Federal Law 273-FZ. Article 1, 1) a, b.

<sup>3</sup> Okhotskii, 2011, p. 44.

Now, when we have the same understanding of the term “corruption”, it is important to mention that corruption has occupied all levels of state structure as well as all spheres of life in Russia. Corruption is a huge trouble in the police, public health services, educational system, courts, state services, government, special service structures, and many others. It is a problem which occurs both at very low municipal levels (e.g. a teacher in a country-side school or a doctor in a small town's hospital) and at the highest federal levels (ministers and high-level officials). Moreover, corruption occurs not only in a form of simple bribes, but in many different forms which we have just specified in the previous paragraph.

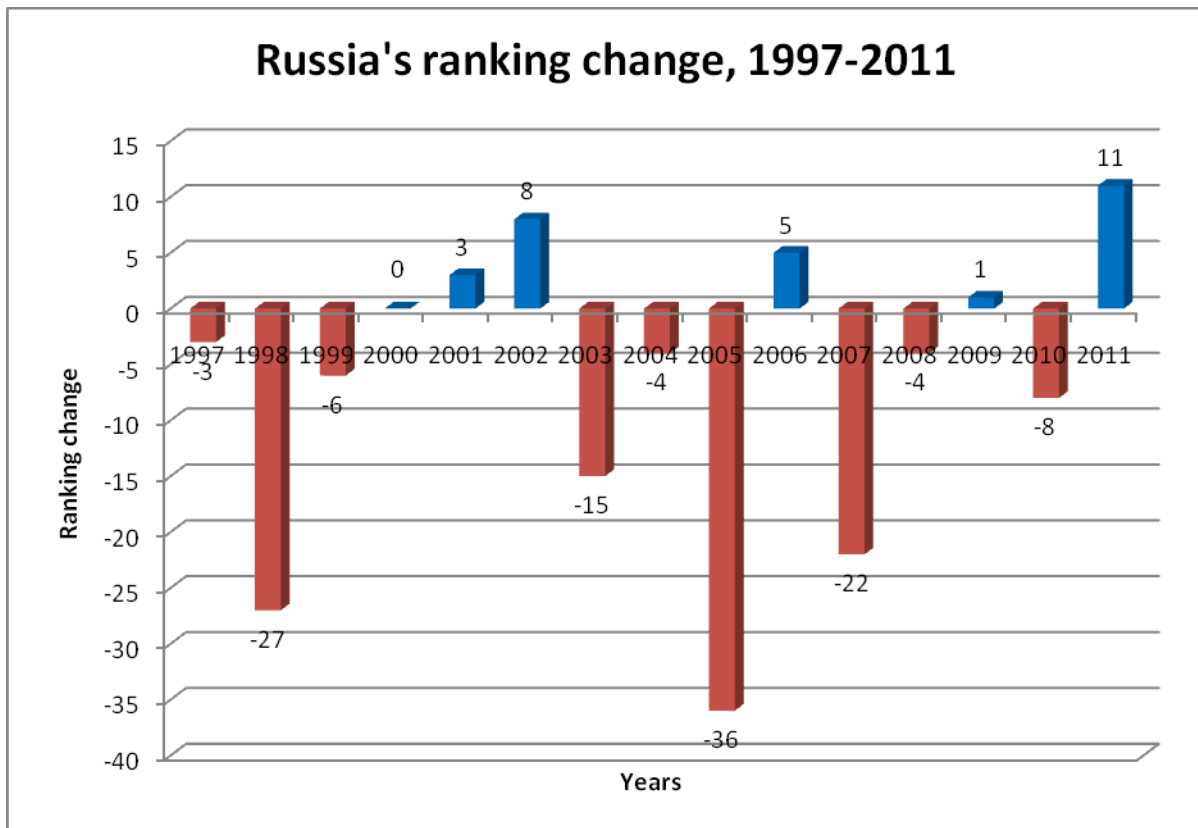
It is extremely difficult not only to count but at least to estimate real volumes of corruption due to the fact that corruption is always associated with the hidden side of the economy and experts can make only very approximate estimation of this phenomenon.

One of the most famous organization that makes such an estimation of corruption levels in different countries is Transparency International. According to their Corruption Perceptions Index, nowadays corruption in Russia is even worse than in many African countries. In 2011, Russia got the 143<sup>rd</sup> ranking (out of 182 countries in total) together with Azerbaijan, Belarus, Comoros, Mauritania, Nigeria, Timor-Leste, Togo and Uganda. Even worse ranking have only the following post-soviet countries: Tajikistan and Ukraine (both place 152), Kyrgyzstan (164), Turkmenistan and Uzbekistan (both 177). At the same time, if we check the 2011 rankings of other three BRIC countries, we will note a much better situation with corruption in there: Brazil (73), China (75) and India (95). Finally, Georgia that was an embodiment of corruption during the USSR and post-USSR (until 2003) periods, got in 2011 quite a high 64<sup>th</sup> ranking. Certainly, if we compare the position of Russia in 2011 with its position in 2010, we will see a slight improvement: Russia came up from the 154<sup>th</sup> to the 143<sup>rd</sup> place (+11 positions). However, the 2011 result should not be perceived as a good one, if we check the Transparency International statistic for Russia since 1996. We will see that this result is, in contrary, far from being optimistic since the Corruption Perceptions Index fell dramatically from the 46<sup>th</sup> place in 1996 to 154<sup>th</sup> in 2010. Especially bad dynamic can be observed starting from the second Putin's presidency term: Corruption Perceptions Index fell from place 90 to place 126 (-36 places!!! only in one year).

Figure 1



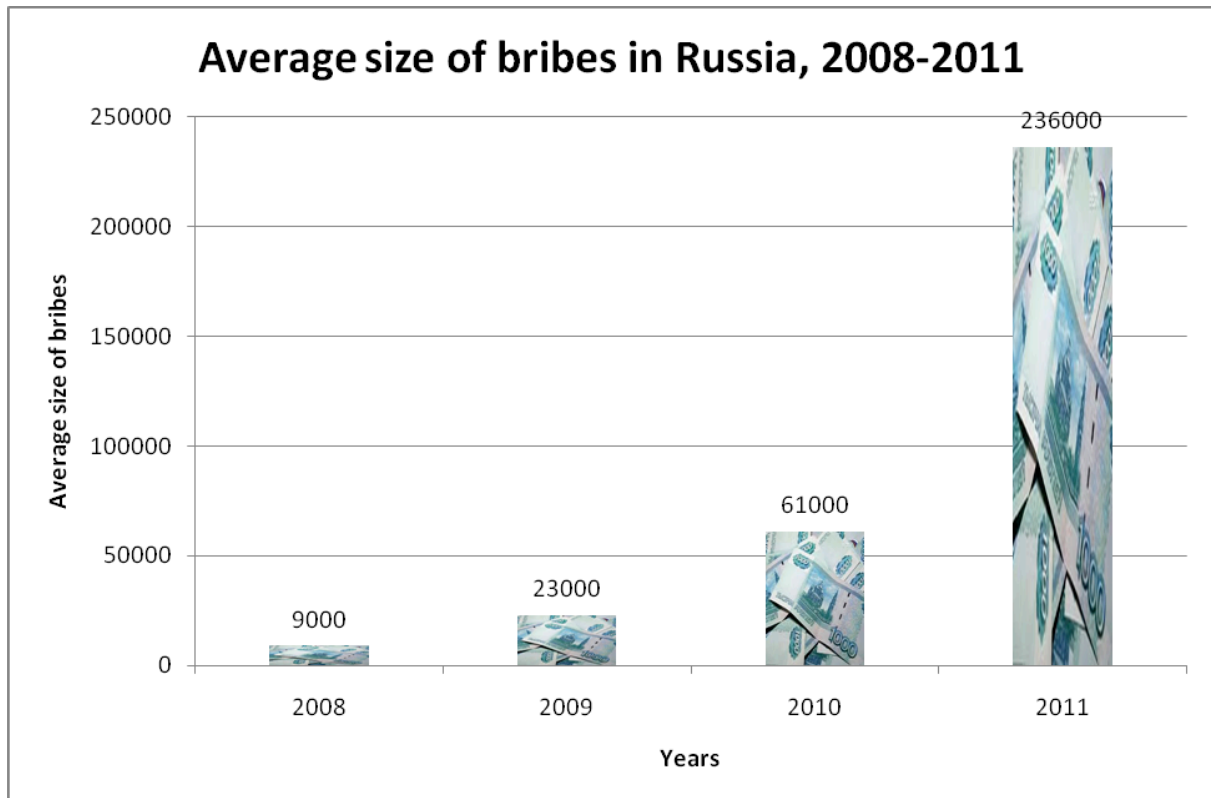
Figure 2



Further, if we check the average estimate amount of bribes and the dynamic of its growth for the last 5 years, we will also get a very pessimistic picture. For example, according to the De-

partment for combating economic crimes of the Department of Interior<sup>4</sup>, the average size of bribes in Russia has grown exponentially over the years: in 2008, the average amount of bribes was 9 thousand rubles, in 2009 – 23 thousand rubles, in 2010 – 61 thousand rubles, and in 2011 it reached 236 thousand rubles. It means that one average bribe in 2011 was equal to more than 26 (!) average bribes in 2008. Such an enormous growth is many times higher than the inflation rate for the same period<sup>5</sup>.

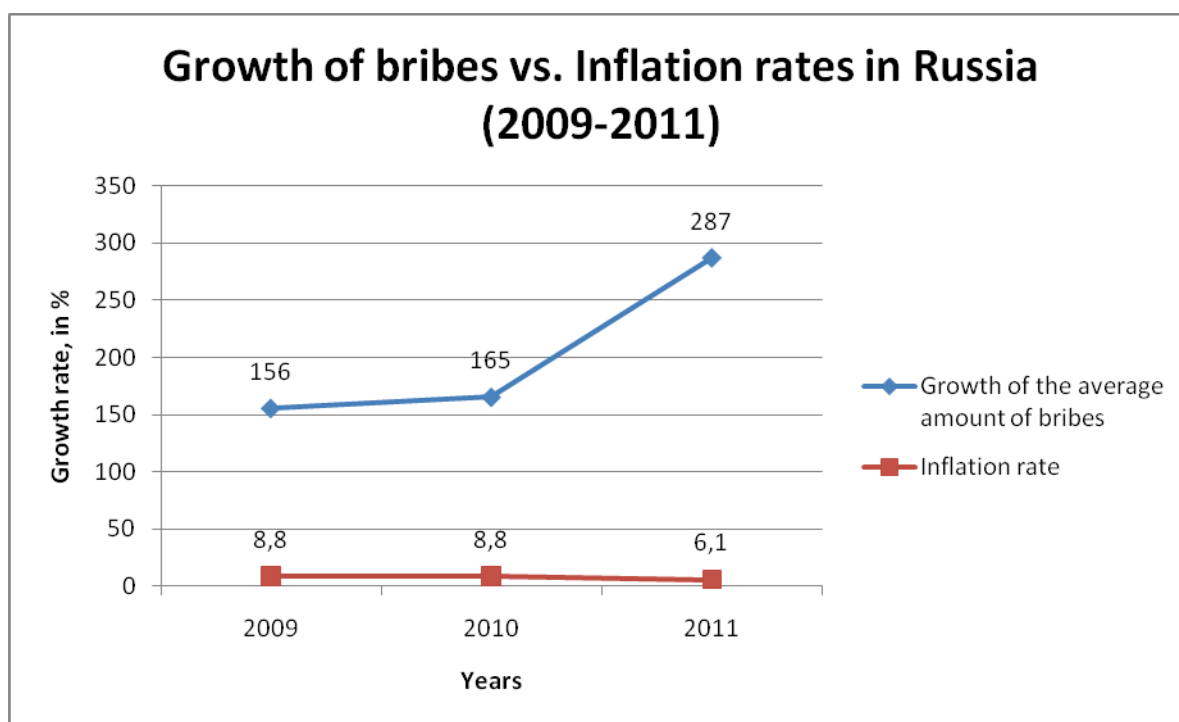
Figure 3



<sup>4</sup> [http://imrussia.org/index.php?option=com\\_content&view=article&id=235&Itemid=95&lang=ru&limitstart=2](http://imrussia.org/index.php?option=com_content&view=article&id=235&Itemid=95&lang=ru&limitstart=2)

<sup>5</sup> [http://www.icss.ac.ru/macro/index\\_year.php?id=6](http://www.icss.ac.ru/macro/index_year.php?id=6)

Figure 4



If we talk about the most corrupt spheres in Russia, they are, according to Mr Sergey Ivanov<sup>6</sup>, health care, education, and housing and communal services<sup>7</sup>. In comparison, independent experts from RBC magazine<sup>8</sup> put law-enforcement agencies (including STSI) on the first place of their ranking of the most corrupt spheres in Russia which is followed by health care, education, housing and communal services, and social security services. And if we talk about corruption at the federal level, the top 5 list will be as following:

1. government orders and purchases,
2. system of permits and certification,
3. law-enforcement agencies,
4. system of land distribution and land relations,
5. building.

Finally, if we analyze the estimated volumes of corruption in Russia, we will get a very broad range of results. According to the official statistics from Rosstat, in 2011 the volume of Russian shadow economy was only 15% of the GDP<sup>9</sup> which also includes hidden salaries and other types of nonpayment of taxes. According their official estimates, the volume of corrup-

<sup>6</sup> May 2008 – December 2011, Deputy prime minister of Russia, since December 2011, the head of Russian Presidential Administration.

<sup>7</sup> <http://www.vz.ru/news/2012/1/26/556702.html>

<sup>8</sup> <http://magazine.rbc.ru/2012/01/25/trends/562949982589258.shtml>

<sup>9</sup>

<http://interfax.ru/txt.asp?id=242603&sec=1476&sw=%F0%E0%E7%EC%E5%F0+%F2%E5%ED%E5%E2%EE%E9+%FD%EA%E%ED%EE%EC%E8%EA%E8&bd=22&bm=4&by=2012&ed=22&em=5&ey=2012&secid=0&mp=2&p=1>



tion in 2011 was only 3.5%-7% of Russian GDP. In comparison, some independent experts report that up to 25% of Russian GDP<sup>10</sup> is corrupt money. Finally, according to the World Bank's report<sup>11</sup>, the estimation is much more pessimistic: 48% of Russia's GDP is associated with corruption.

Finally, there is an interesting shift of a purpose of bribery: if before officials used to take bribes to shut the eyes to infraction of the law or short-circuit of the law, in contrary, nowadays officials take bribes to do their direct duties<sup>12</sup>.

## **2.2. Corruption at the highest levels in Russia<sup>13</sup>**

Many experts admit that during the last years corruption in Russia is not a problem anymore – it became a business. If, in the 1990s, businesses had to pay to different criminal groups to receive a so called “roof” (i.e. front), nowadays this function moved to Russian officials. At the present time, we can observe a kind of merge of those criminal groups with government authorities.

Currently, most of the public purchases, public contracts and any other works that are done for or by government or half state-owned companies are related to corruption<sup>14</sup>. Not surprisingly that eventually costs of different work in Russia (e.g. reconstruction and building of roads, gas pipeline construction, house building, etc.) is much higher, sometimes even several times higher, than in any other European country. As the result, the whole Russian population must pay for these corruption activities. For example, some experts suppose that the fast increasing tariffs for housing, water, gas and electricity from year to year which outgo significantly the inflation rates (see the figure 5) are the direct cause of such high volumes of corruption at the highest levels in Russia<sup>15</sup>.

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<sup>10</sup> Milova et al., 2011, p. 6.

<sup>11</sup> <http://www.newsland.ru/news/detail/id/580475/>

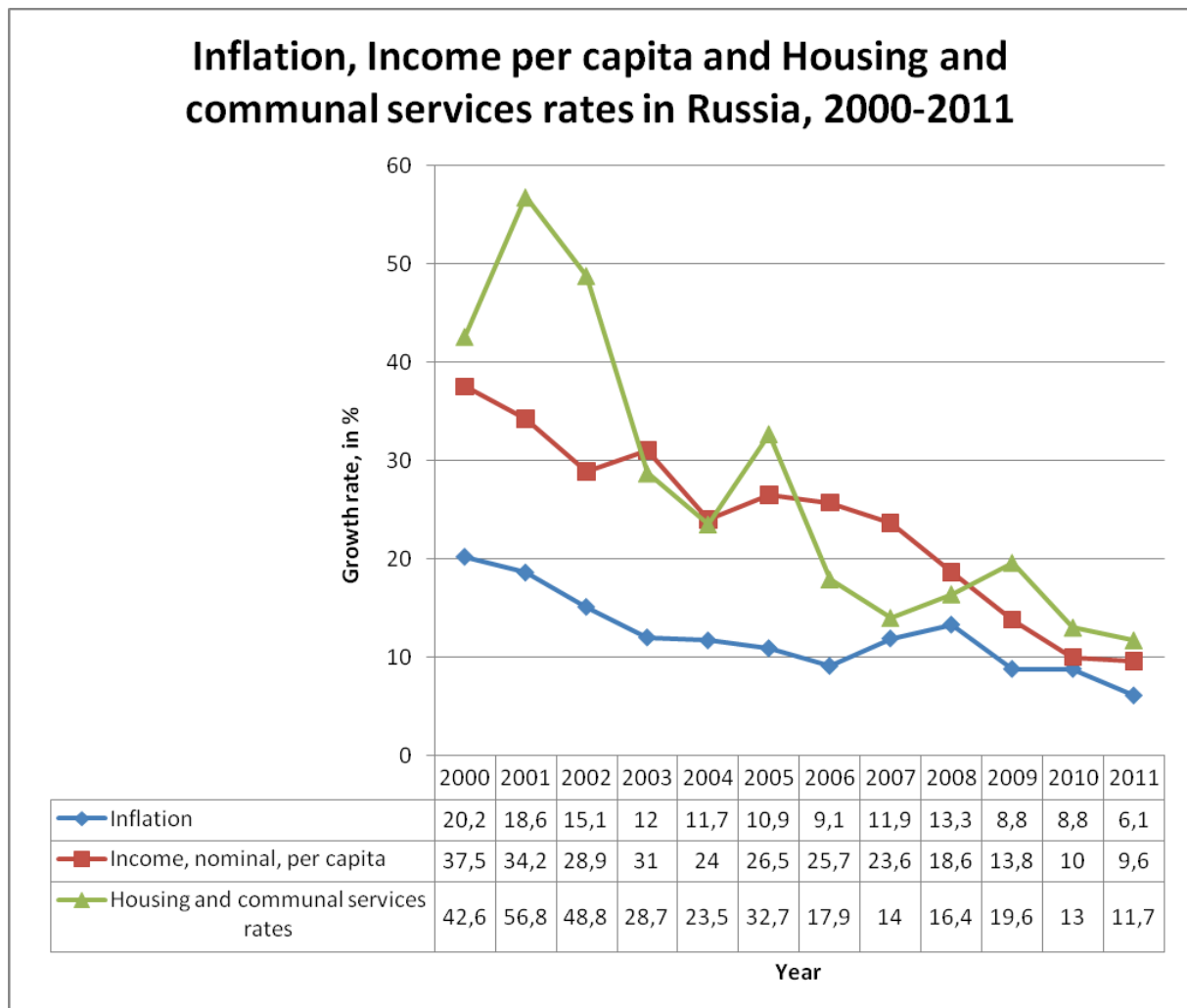
<sup>12</sup> <http://ria.ru/economy/20110201/329132334.html>

<sup>13</sup> Report Putin and corruption (2011).

<sup>14</sup> Milova et al., 2011, p. 6.

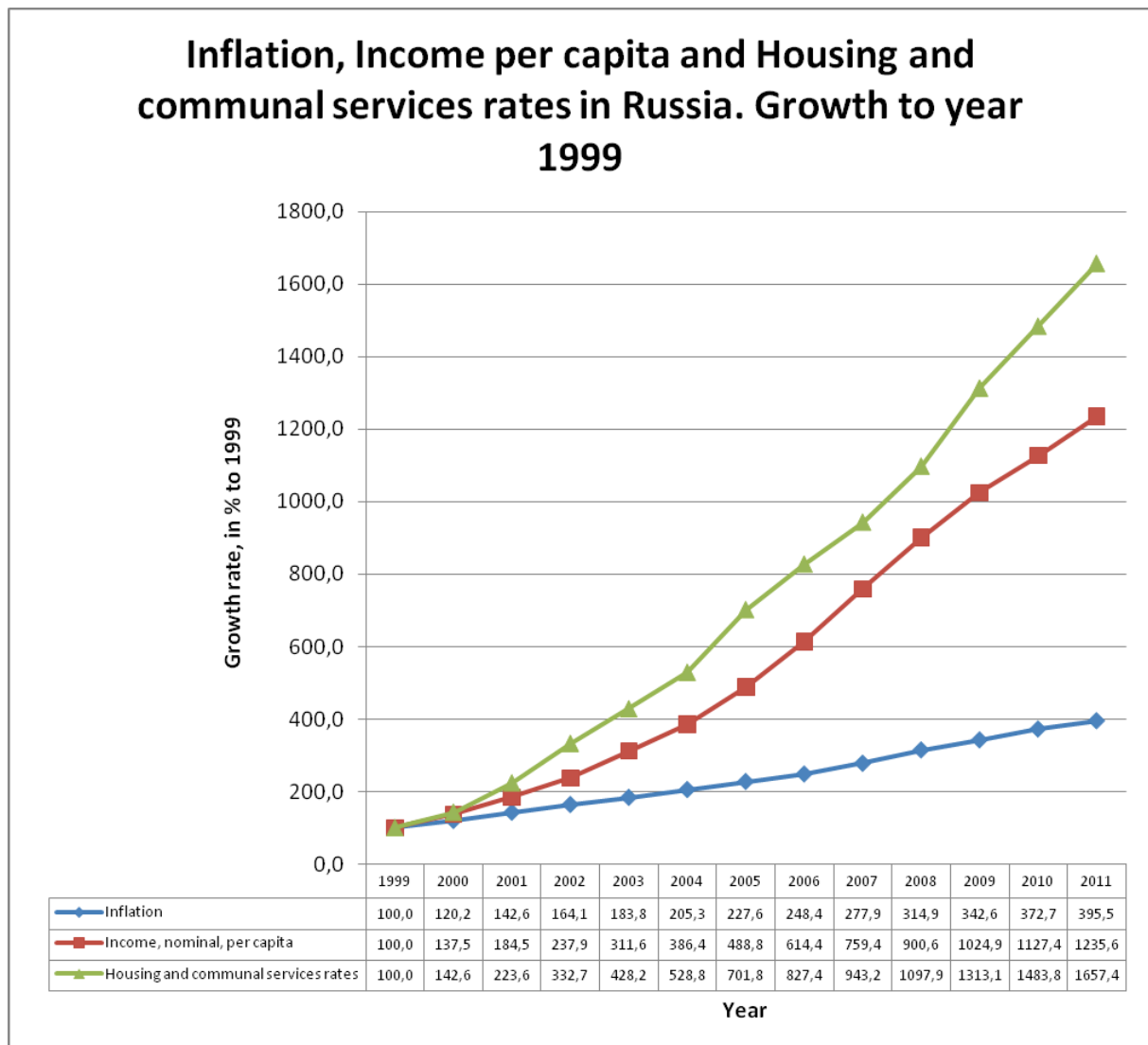
<sup>15</sup> Milova et al., 2011, p. 6.

Figure 5<sup>16</sup>



<sup>16</sup> Federal State Statistics Service, <http://www.gks.ru/>

Figure 6<sup>17</sup>



Experts also insist that currently corruption in Russia has reached its roof and was never that high in the past. Even according to the official statistical data from Rosstat (2011), that are believed to be far below the real numbers, the number of registered bribery cases increased from 2,700 in 1990 up to 13,100 in 2009 and declined slightly to 12,000 in 2010. It means that even the state statistic agency officially declares a significant increase (practically 4.5 times) of corruption levels in the past 20 years<sup>18</sup>.

<sup>17</sup> Federal State Statistics Service, <http://www.gks.ru/>

<sup>18</sup> РОССИЙСКИЙ СТАТИСТИЧЕСКИЙ ЕЖЕГОДНИК. 2011. Пункт 10.1

Figure 7

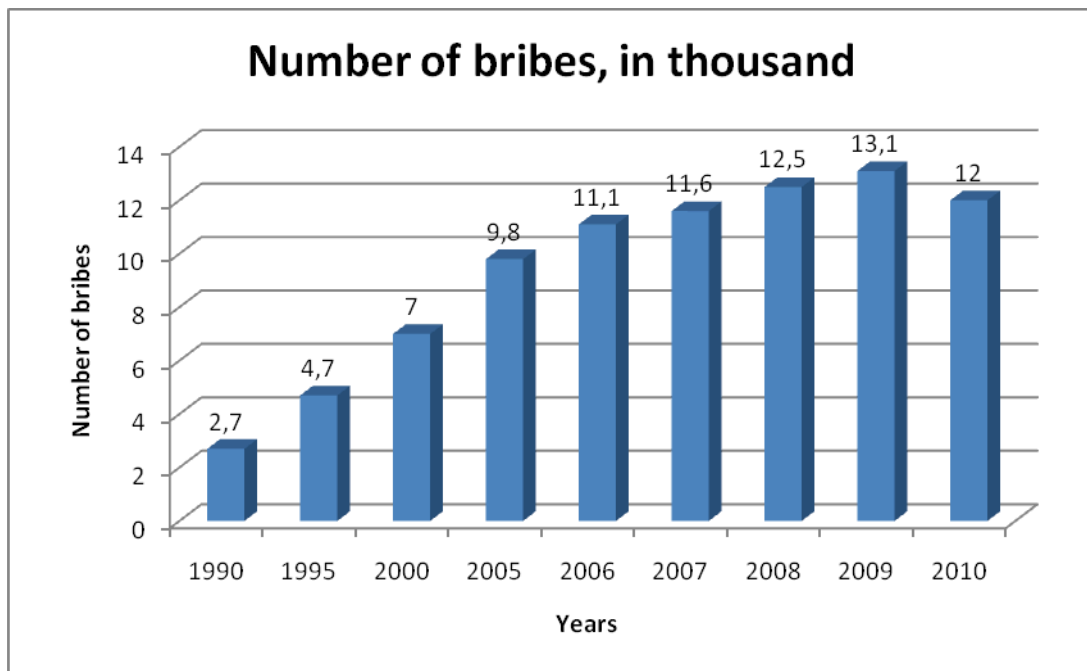
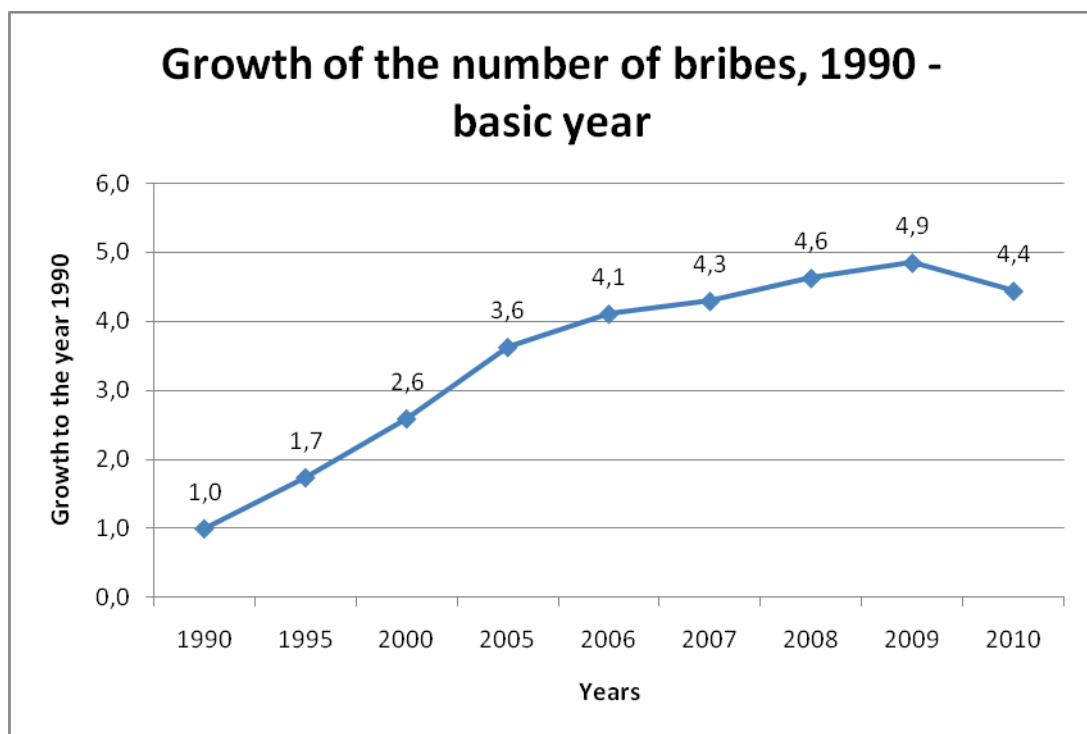


Figure 8



However, 65% of convicted persons received only conditional sentence<sup>19</sup>, meaning that they have practically escaped penalties. And this is again only the information according to the official data which normally tend to embellish the real situation. Moreover, if we take into

<sup>19</sup> Выступление председателя Верховного суда РФ В. Лебедева на совещании председателей судов субъектов Российской Федерации, 27 января 2009 г. — Среди осужденных за взяточничество преобладают милиционеры // Коммерсантъ. 28.01.2009.

consideration the fact that the volume of bribes has also increased significantly and that the lion's share of them stays hidden, we will get even more dramatic results.

So what does it mean that corruption in Russia is not longer a problem but a business? Let us just shortly compare the reaction on corruption during two decades – the 1990s, Yeltsin's presidency, and the 2000s, Putin's two presidency and prime-minister terms. The difference in perceptions can be clearly illustrated by the case with Mr Luzhkov and Mrs Baturina, ex-mayor of Moscow and his wife who was an owner of one of the biggest Russian development company "INTEKO".

So, one of the most famous corruption cases of the 1990s was connected with the installation of plastic chairs in Moscow stadium "Luzhniki". The tender was won by the company "INTEKO" and the amount of the contract made up 700,000 US dollars. However, this transaction had immediately received a huge attention of the mass media and drew a wide response in the society. In contrary, in 2008 there was a tender for the reconstruction of the famous Moscow monument "Worker and Kolkhoz Woman" which was again won by "INTEKO". That time the amount of the contract was already enormous 100 million US dollars. However, there was no blanket coverage in Russian mass media or inquiry of this deal.

The next two cases that also perfectly illustrate the difference in the reaction on the corruption between 1990s and 2000s are associated with government officials. For example, in 1997 a number of government officials received royalties for their book about privatization. The amount of those royalties was 90,000 US dollars in total. Consequently, this situation drew a wide response in the society that caused the government crisis and a couple of months later, in the spring 1998, the government has to resign. In comparison, starting from the second half of 2000s, there is more and more information leaking to the independent mass media about villas and other expensive assets of some Russian top-level officials. However, it does not cause any inquiries, wide response in Russian society or resignation of these officials.

Finally, nowadays authorities feel their absolute impunity and even stop to "imitate" the legal status of their operations. For example, before officials have to organize tenders, even if their winners were already known in advance, to "legalize" some government purchases. Nowadays officials do not bother themselves with such an annoying procedure anymore. There is just no need to waste time and energy anymore, since higher authorities have an "immunity" and normally escape punishment for their corrupt activities. Here we can, for example, remember a recent case that was covered by Mr Navalny<sup>20</sup> concerning the state purchases of

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<sup>20</sup> Lawyer, politician, and civil activist, founder of project "Rospil".

autos for the Department of the Interior in Chechnya in the total amount of 113 million rubles (around 3.8 million US dollars). Mr Navalny stresses the attention that in that case no tender was organized, and, indeed, state purchases without organizing tenders was a normal practice in Chechnya<sup>21</sup>. The second recent example is the trail of Mr Gaev, former head of the Moscow metro. He was accused of “creating a system of personal enrichment at the expense of his organization” that caused the Moscow metro and the government of Moscow expense in excess of 112 million rubles (around 3.75 million US dollars). Mr Gaev received this money as a patent for the Automated fare collection system and verification of travel documents for transportation. However, on March, 12, 2012 he was able to leave Russia under the pretext of medical treatment in a foreign country, and on March, 26, the trail was suddenly suspended. On April, 11, however, his trial was started again, but since Mr Gaev is no longer in Russia, it is highly improbable that he will finally get any real punishment<sup>22</sup>.

What are the main causes of such a significant difference in the corruption perception between 1990s and 2000s? And why are there so many unpunished corrupt officials?

Mainly, there are three fundamental causes of that:

1. no independent mass media,
2. no independent judicial system, and
3. no political competition – the role of Russian parliament has been dramatically diminished and at the present time it has no significant influence on executive authorities.

One more possible cause of such a fast growth of corruption volumes is the absence of the civil society in Russia. In other words, there is no more effective control after activities of executive authorities and this assists in the raging of corruption. Not surprisingly that in such conditions we can observe an intensive formation of the oligarchy class. And, as the result of the failure of the above mentioned criteria, the participants of this oligarchy group (e.g. officials at the highest levels, workers of special services, oligarchs, etc.) have no incentives to comply with the interests of Russian citizens and act only to maximize their own benefits. Consequently, it leads to enormous amounts of bribes, high levels of favoritism, protectionism, illegal support and other forms of corruption.

Moreover, Putin favors the formation of this oligarchy group and is guided by the principle “Friends get everything” and “Putin does not betray his people”. Not surprisingly that such

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<sup>21</sup> <http://news.argumenti.ru/economics/2012/02/155898>

<sup>22</sup> <http://kp.ru/daily/25848.5/2818577/>; <http://lenta.ru/news/2012/03/26/caseclosed/>;  
<http://www.ria.ru/inquest/20120411/623420216.html>.

principles support a fast enrichment of some Putin's friends (e.g. incorporators of the cooperative Ozero near St. Petersburg) and relatives.

To understand better why experts see corruption no longer as a problem, but as a business in the modern Russia, let us now illustrate the situation with corruption at the highest levels with the analysis of a fast enrichment of some of Putin's friends and relatives.

For example, Yuri Kovalchuk and Nikolai Shamalov, one of the co-founders of the cooperative Ozero, are nowadays two of the most richest men in Russia<sup>23</sup>. And from the perspective of analyzing the situation with corruption in Russia, the process of their enrichment seems to be very interesting. Currently they are large stakeholders of one of the biggest Russian commercial banks Rossiya which used to be quite a small bank with the amount of assets less than 1 billion rubles at the beginning of 2000s. However, during Putin's presidency the bank Rossiya sequentially received new very valuable assets at a much lower price than a real one. For example, in 2004 Rossiya bought 49.97% (later raised to 51%) of insurance company Sogaz from Gazprom for only 58 million US dollars whereas the real price of Sogaz at the present time is around 2 billion US dollars. After that, in 2006 Sogaz acquired Lider, asset management company which used to manage Gasfond (i.e. Gazprom's pension arm). As well as in the first case, the acquisition price of this deal was very much below the real one: Sogaz bought 75% + 1 stock of Lider for only 880 million of rubles (around 32.8 million US dollars), whereas the net income of Lider for the year 2006 was equal to 1.2 billion rubles (around 44.8 million US dollars). Interestingly, this deal was agreed already in 2005 when Mr Yuri Shamalov, Mr Nikolai Shamalov's son, became the president of Gazfond.

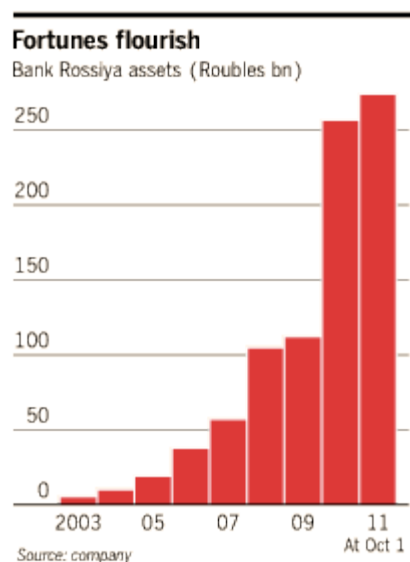
Short after this transaction, in 2007, Rossiya got the control (50% + 1 stock) after Gazprombank, one of the largest Russian banks, in the process of the non-monetary stock exchange. Thereby, Gazprom lost its control after Gazprombank without getting a ruble for that transaction. However, Gazprombank's real market price, according to expert evaluation, is up to 25 billion US dollars. Normally, such clearly disadvantageous operations would not be approved by the board of directors. But not in case of Gazprom where the majority of the board consists of the representatives of the state interest and, therefore, could get instructions directly from the Kremlin. In other words, it means that the described operations clearly encroached on legitimate rights of smaller stakeholders while pursued interests of Putin's good friends in their enrichment.

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<sup>23</sup> In February 2011, Mr Kovalchuk and Mr Shamalov got to the Finansmag's list of Russian billionaires: 29.6 billion rubles (970 million US dollars), 115<sup>th</sup> ranking and 18 billion rubles (590 million US dollars), 184<sup>th</sup> ranking accordingly (<http://m2011.finansmag.ru/>).

As the result of all these speculative transactions, the bank Rossiya's assets grew from only 6.7 billion rubles at the beginning of 2004 up to 300.7 billion rubles on January, 1, 2012 (increased practically by 45 times just in 8 years).

Figure 9<sup>24</sup>



Summing up this case, Rossiya “stole” from Gazprom (or since Gazprom is a half state-owned company<sup>25</sup>, we may say that from the state and its citizens), property to the amount of 60 billion US dollars through all the described transactions.

Further, we see that not only good Putin's friends but also his relatives have benefited from those operations. For example, Mr Mikhail Shelomov, a grandson of Mr Putin's maternal uncle, controls 99.99% stake in the company Aksept which, in its turn, owns 12.5% share in Sogaz. Therefore, Mr Shelomov has clearly profited from above de-

scribed operations too. Other Putin's great-nephew, Mr Mikhail Putin, is also involved in this “business” and is a deputy president of the board in Sogaz. Moreover, in 2004-2007, Mr Mikhail Putin was a head of Gazprom's medical division and during that time we can observe purchases of medical equipment in the total amount of a hundred million US dollars.

To continue, there are two more good Mr Putin's friends and simultaneously stakeholders of the commercial bank Rossiya, Mr Dmitri Gorelov (12.7% stake) and Mr Gennady Timchenko (9.6% stake)<sup>26</sup>. For example, Mr Gorelov does not only receives benefits from being a stakeholder of Rossiya but he is also a president and co-founder of Petromed holding which was found in cooperation with the Committee of the external economic relations of St. Petersburg's city hall in 1991. Interestingly, Mr Vladimir Putin was a head of this Committee at that time which helped Mr Putin and Mr Gorelov became good friends and start their corrupt “business”. Nowadays there is an information about some illegal operations of Petromed concerning money laundering scheme. According to Mr Kolesnikov<sup>27</sup>, Petromed's job was to supply Siemens' medical equipment to upgrade the city's hospitals while 35% of the contract amount had to be sent to some offshore bank accounts. As the result of those transactions, Mr

<sup>24</sup> <http://www.ft.com/intl/cms/s/0/69d1db86-1aa6-11e1-ae14-00144feabdc0.html#axzz1fHH12eEN>

<sup>25</sup> Currently, the state owns 50.002% stake in Gazprom (<http://gazpromquestions.ru/?id=40>).

<sup>26</sup> In 2011, both of them were in Finans' list of Russian billionaires, Mr Timchenko's wealth was 271.2 billion rubles (8.9 billion dollars), 17<sup>th</sup> ranking, Mr Gorelov's wealth was 18 billion rubles (590 million dollars), 182<sup>nd</sup> ranking.

<sup>27</sup> Russian businessman who wrote the open letter in which he described corrupt schemes used for enrichment of Mr Shamalov and building Putin's palace to the Russian President Medvedev on December, 21, 2010.



Gorelov helped accumulate more than 148 million US dollars on the bank accounts which were controlled by Mr Shamalov, the employee in Siemens AG at that time.

Coming back to Mr Timchenko who is nowadays the richest of all Mr Putin's friends and relatives. In 1990s, he worked in the commercial department in one petroleum refinery in Kirishi. Later, Mr. Timchenko together with the St. Petersburg's department of the external relations whose head at that time was Mr Vladimir Putin organized a company Golden Gate. Soon Golden Gate sold 100 thousand tons of oil (in current prices it is approximately 70 million US dollars), however no oil reached St. Petersburg, it was simply "lost" on the way to the city. In the late 1990s, Mr Timchenko continued to export oil and immigrated to Finland.

It is symbolic that with the start of Putin's first presidency Mr Timchenko's wealth began to grow in the geometric sequence. If, in 1999, he declared only 327 thousand euro annual income, in 2000, this amount was already more than 1.5 million euro, in 2001, practically 5 million euro, and, in 2008, he entered Forbes' billionaires list with the wealth equal 2.5 billion US dollars. Finally this year, he got the 12<sup>th</sup> place in the Forbes' Russian billionaires list with the wealth equals to 9.1 billion US dollars<sup>28</sup>. The reason for such a meteoric wealth growth is the volumes of exported oil and petroleum products by Gurnov International where Mr Timchenko has a 50% stake. Moreover, due to Mr Timchenko's good friendship with Mr Putin, his company is able to get some exclusive privilege from Russia. For example, in 2008, during the conflict period with Estonia, other companies-exporters of oil had huge difficulties to transfer oil through Estonia, but not Mr Timchenko's company, that continued to export oil through Estonia. In addition, Mr Timchenko's company sells Yukos' oil that was acquired by Rosneft after a very speculative transaction by using a phony company.

The second Mr Timchenko's business is Novatech (23.49% stake) which also gets some privilege from the state. For example, despite the monopoly right of Gazprom to be the only one exporter of Russian gas, Novatech also got this right by negotiating the nominal contract with Gazprom. Moreover, in 2010, Gazprom sold 9.4% stake in Novatech to Mr Timchenko's company. There would not be anything special in this transaction beside the fact that the contract price was 1.9 billion US dollars while the real price was 1.3 billion US dollars (40.6%) higher. After receiving all these benefits from the state, it is not surprisingly that Mr Timchenko is one of the richest men in Russia, a resident of Finland and currently lives in Geneva, Switzerland.

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<sup>28</sup> <http://www.forbes.ru/rating/bogateishie-biznesmeny-rossii-2012/2012#pages-1>

However, it is not the end of the story about the friends' and family corrupt "business". There are some other important characters involved in this "business". For example, Mr Gorelov's son Vasilij together with Mr Shamalov is a co-owner of Vyborski shipbuilding facility since 2006. And as soon as they became owners of this company, Gazprom suddenly ordered building of two sea platforms for the development of Shtokmanovski oilfield by Vyborski shipbuilding facility. This fact becomes more surprising since the company did not have any huge contracts for 10 years before the change of its owners.

Additionally, both Mr Shamalov's sons also receive benefits from the good friendship of their father. The elder son Yuri is, as already said, a head of Gazfond while the younger son Kiril Shamalov is a vice-president of Sibur oil and gas holding. Interestingly, he became a vice-president of business administrative support just four years after his graduation from the St. Petersburg State University. So, in 2010-2011, there were several speculative transactions as the result of which 57.5% of Sibur's stakes are currently owned by Mr Leonid Mihelson, the head of Novatek<sup>29</sup>, and 37.5% stakes are owned by Mr Timchenko.

Finally, there are some other Putin's friends from the cooperative Ozero who also profit a lot from their beneficial friendship. For example, in 2000, Mr Vladimir Yakunin became a deputy minister in the Ministry of transport and later the first deputy minister in the Ministry of roads. Since 2003 he was the first vice-president of the state-run company Russian Railways. And finally, in June 2005 he became a president of the Russian Railways.

One more Mr Putin's friend and co-founder of the cooperative Ozero, Mr Vladimir Smirnov, has a successful career too. Firstly, he became the general director in the company supplying products for the president's executive office in May 2000. After that, in 2002-2007, he was a head of TENEX<sup>30</sup>, a company of the Ministry of Atomic Energy. And since 2007 Mr Smirnov is an advisor of the director of the concern Atomenergoprom<sup>31</sup>.

Finally, the last two co-founders of cooperative Ozero who also get benefits from their friendship with Mr Putin are brothers Fursenko. In 2003-2008, Mr Sergey Fursenko was a director of Lentransgaz which is one of the largest Gazprom's affiliates. And since 2008, he is the head of the National Media Group (25% stake in Channel One, 30% stake in Ren-TV, 100% stake in the Russian News Service, 50.19% stake in the newspaper Izvestiya, and some others). Moreover, in 2010-2012, Mr Sergey Fursenko was the head of the Russian Football Association and currently is a member of President's Council on Physical Culture and Sports.

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<sup>29</sup> The second largest Russian natural gas producer in the world.

<sup>30</sup> TENEX is one of the biggest supplier of nuclear fuel in the world – it serves approximate 40% of world's uranium enrichment.

<sup>31</sup> A part of the Russian state corporation for atomic energy Rosatom.

And his brother, Mr Andrei Fursenko, worked firstly as a deputy minister of industry, science and technology and then became the Minister of education and science (2004-2012).

However, Mr Putin also favors some of his good friends who are not in the list of Ozero's co-founders. The most famous of them are brothers Rotenberg, Arkady and Boris. They used to practice judo together with Mr Putin already in 1960s. And nowadays their business successes are impressive. They started in 1990s as two average businessmen. However, at the present time, they can be found in the list of the richest men in Russia<sup>32</sup> with the joint wealth of around 3.5 billion US dollars. This wealth is the result of their business with Gazprom: they are the biggest supplier of tubes and contractor of gas pipelines constructions. They had a chance to buy Gazprom's building assets for a very low price and in 2008 founded a company Strojgazmontazh. And already in the same year their company started to win one tender after the other. For example, Strojgazmontazh has won the right to build a gas pipeline North stream, the building costs of which is three times higher than construction costs of other similar projects anywhere in Europe. Or without any tender brothers Rotenberg negotiated a contract on construction of Sakhalin – Khabarovsk – Vladivostok gas pipeline. The contract price is again enormous and equals 210 billion rubles. Moreover, the Olympics gas pipeline Dzhugba – Lazarevskoe – Sochi has been also contracted without any tender to Rotenbergs' company. The contract price in this case is 22 billion rubles.

In addition to the gas pipeline construction business, Rotenbergs also have not less than 11 alcoholic factories that are the part of Rosspirtprom system. Probably, this is a reason why the government is so reluctant to increase excise taxes on alcohol production even if the situation with alcoholism in Russia is so deplorable. Simply because the increase of excise will harm the interests of Putin's best friends that does not fit Mr Putin's idea "Friends get everything". Also Rotenbergs became a reason of the scandal around Khimkinski forest near Moscow. The toll highway Moscow – St. Petersburg had to be built through Khimkinski forest and therefore would harm the ecology of Moscow and its suburbs. The plans for building this highway drew a wide response in the society, however Mr Putin did not listen to any arguments and did not stop or freeze the building for awhile. Only some time afterwards, in August 2010, the then President of Russia Mr Medvedev suspended the work<sup>33</sup>. Most probably, the reason for not-involvement of Russian government in the situation around the road at the beginning were the brothers Rotenberg who received a contract on construction of the 43 km part of the road

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<sup>32</sup> Brothers Rotenberg have 1.75 billion US dollars each and are on the 63<sup>rd</sup>-64<sup>th</sup> place in the Finansmag's ranking (<http://m2011.finansmag.ru/>).

<sup>33</sup> <http://lenta.ru/news/2010/08/26/medvedev/>

(from 15th km to 58th km). The construction work would cost 63.4 billion rubles and the state was ready to invest 23 billion rubles while all the incomes from the road in the future would go solely to the brothers. At the end of September 2011, the construction worked were finally started<sup>34</sup>. And the latest interesting fact concerning this road came 1.5 months afterwards, in November 2011, when Russian government and Moscow authorities reported that they will allocate 2 billion rubles for the breeding and reproduction of the Khimki forest felled during the construction of the highway Moscow – St. Petersburg<sup>35</sup>. It will be very interesting to observe how the situation around this toll highway will develop in the near future and who will be responsible for breeding and reproduction of the Khimki forest for such a high amount of money.

Finally, at the end of Mr Medvedev presidency term, Mr Arkady Rotenberg received one more generous present from the state. At the end of May 2012, it became known<sup>36</sup> that Mr A. Rotenberg's company Mostotrest received a right to build all roads around the innovation center Skolkovo. The amount of the contract is 1 billion US dollars, and as it has already become usual there was no tender.

The last but not least Mr Putin's friend, about whom we should talk in this chapter is Mr Igor Sechin. Their friendship started already in the late 1980s or early 1990s. They worked together first at the Leningrad State University (nowadays St. Petersburg State University) and later in St. Petersburg's city hall. Currently, many experts argue that Mr Sechin is the second most important person in Russia after Mr Putin. Not surprisingly, that Mr Sechin also got some benefits from Mr Putin. For example, many experts suppose that Yukos case was initiated also because of Mr Sechin, the deputy head of President's administration at that moment and later the chairman of the board of directors in Rosneft, who wanted Rosneft to get Yukos' assets<sup>37</sup>. As the result, in 2004, after a very speculative transaction by using a phony company, Rosneft got the assets of Uganskneftegaz, a part of Yukos, and therefore Rosneft's amount of reserves and production increased many times.

Later, in May 2012, Mr Sechin became the president of Rosneft. At the same time, Mr Putin signed a decree on the sale of shares of the fuel and energy companies which are owned by Rosneftegaz<sup>38</sup>. Some experts consider that Mr Sechin will supervise the process of the privati-

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<sup>34</sup> <http://lenta.ru/news/2011/09/29/trassa/>

<sup>35</sup> <http://www.ria.ru/mosobl/20111112/486709831.html>

<sup>36</sup> [www.vedomosti.ru/newsline/news/1782864/bitva\\_slova\\_i\\_dela](http://www.vedomosti.ru/newsline/news/1782864/bitva_slova_i_dela)

<sup>37</sup> <http://lenta.ru/lib/14160890/>

<sup>38</sup> <http://pravo.gov.ru:8080/page.aspx?13999>

zation and this operation will help transfer assets under the control of Mr Sechin<sup>39</sup>. How beneficial this operation will be for Mr Sechin will become clear in the next couple of years.

In conclusion of this chapter, it is important to mention that Putin stands by his word and protects businesses of Elzin's period oligarchs: Mr Abramovich and Mr Deripaska. For example, in 2005, Gazprom bought Sibneft previously owned by Mr Abramovich and the price of the contract was enormous, 13.7 billion US dollars. Consequently, Mr Abramovich became the richest Russian. Moreover, during the financial crisis 2008-2009, Mr Abramovich's and Mr Deripaska's companies received the state help in amount of 1 and 4.5 billion US dollars accordingly from the Fund of National Welfare and even improved their wealth during the crises. This example once again clearly shows that the interests of oligarchy group in modern Russia are much more important than the interests and welfare of the whole society.

Thereby, this chapter helps us understand the statement of some experts who perceive corruption in Russia no longer as a problem, but as a business. On the examples of the commercial bank Rossiya and some other companies, owned by the best Putin's friends and relatives, we can observe practically the whole list of the corruption forms<sup>40</sup>: favoritism, nepotism, protectionism, unlawful distribution and redistribution of public assets and funds, illegal privatization, placement of orders, use of personal contacts to gain access to public assets, privileges, rendering of various kinds of services to relatives, friends, acquaintances, etc.

### **3. Short historical excursus and reasons of corruption in Russia**

We have just analyzed the current state of corruption in Russia and discussed the reasons why some experts insist that corruption in Russia is no longer a problem, but a business. Let us now briefly check the history of this phenomenon in Russia and see if corruption is really a deeply rooted tradition and an aftermath of Russian history or if the statement about impossibility of fight it down is nothing else but officials' unwillingness to implement real and effective measures to overcome corruption. After this short historical excursus we also identify and discuss the main reasons of corruption in Russia.

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<sup>39</sup> <http://www.gazeta.ru/business/2012/05/24/4599105.shtml>

<sup>40</sup> Compare to the full list of forms of corruption in the previous chapter.

### **3.1. Short historical excursus<sup>41</sup>**

#### ***3.1.1. Corruption in Russia since ancient times till the beginning of the 20th century***

History shows that corruption is neither a new concept nor a phenomenon that is typical only for Russia due to its history and traditions. On the contrary, corruption has been known already since the ancient time and not only in Russia.

For example, historians determine that corruption at the highest levels was always connected with the special class of people called oligarchy. Corruption occurs because the interests of oligarchy are different and often even totally opposite to the interests of the whole society. This difference in interests occurs because the main goal of oligarchy is maximization of their own wellbeing and their power even by violation of social standards. Moreover, historians also believe that intense international trade eventually results in globalization which in its turn can be considered not only as one of the causes of corruption but also as a cause of its intensification. The explanation of this statement is that trade and further globalization are beneficial for formation of the oligarchy class which is considered to be a source of corruption at the highest levels. Thereby, this theory can help to explain the occurrence of the first crises of corruption which were known to happen already since 6000 B.C.

Historians report that the first pick of globalization and consequently the crisis of corruption occurred in the Southern Russia (i.e. Ukraine, North Caucasus, Southern Volga Region) already in the II century A.D. At that time, Russia had a stable and very intensive trade and exported slaves to the Roman Empire. As the result of this process, a very small group of people who were involved in the trade eventually became very rich while the whole other population became poorer and poorer. This situation caused the demographical crises that could be already observed on these territories during the III-IV centuries A.D. Moreover, the consequences of this demographic crisis were so dramatic that during that time historians observe non-monetary economic relations and significant shrinkage of the international trade in this region. Consequently, such economic and demographic decline was a very huge obstacle for the further development of this region for the next couple of centuries.

At the same time, in the North of Russia, in the principality of Novgorod, historians, in contrary, detect lack of international trade relations. The reason for that was a not very advantageous geographical location of this region. That is why these territories were not

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<sup>41</sup> Yuri Kuzovkov. History of corruption in Russia (2010).

faced with a crisis of corruption during these centuries. Moreover, the interesting fact about the principality of Novgorod is its way to fight against corruption. For example, in XII century, knyaz (prince) was forced to sign a contract according to which he, his relatives and retinue were not allowed to have any land property in the same region. This contract helped to prevent big traders from Novgorod who usually already had land property to become a knyaz of Novgorod and therefore get a chance to increase their influence in the region and form the oligarchy class. This is an example of a radical but also very effective way of fight against corruption in the North of Russia during ancient times. As a consequence of such a strict policy which helped to prevent corruption, there was also no huge inequality in the property status among all citizens in the principality of Novgorod.

In contrary, during the next centuries (XII-XIV) we can observe a huge growth of the trade relations in the principality of Moscow and, as the cause of it, a quick enrichment of the trade elite and formation of the oligarchy class there. It also led to a fast growing difference in the property status of the population and increasing power of the trade oligarchy. Moreover, a huge contribution to the fast increasing levels of corruption was made by the system of payments to the officials during that time, so called the system of “kormlenie” (feeding). The main principle of the system of “kormlenie” was that officials did not get salary from the state, but had the right to collect taxes from citizens and return a particular part of those taxes to the budget. Not surprisingly, that the formation of the trade elite along with the system of “kormlenie” caused a bloom of corruption in XII-XV centuries in Russia.

Ivan III (1462-1505) was the first Russian knyaz who started an intensive fight against corruption. First of all, he forbid bribes in the judicial system that used to be a norm before that. Secondly, Ivan III fixed the amount of taxes that had to be collected by governors according to the system of “kormlenie”. Moreover, he started the principle of a frequent rotation of officials in courts and governors. According to this principle, judges and governors were changed each year or even more often. Finally, Ivan III introduced a specific control institution which had to monitor governors’ work. This institution was controlled by a central government directly from Moscow and therefore could not be influenced by the local officials.

Later, during Ivan IV (1547-1584) time, who continued the fight against corruption, the principle of the control after governors was improved further. For example, governors’ work started to be controlled both from Moscow and by the local authorities who were democratically elected by all citizens of that area. Moreover, in 1552, Ivan IV abrogated

the system of “kormlenie: that clearly used to be one of the most powerful sources of corruption in Russia at that time. Since then, governors started to receive a fixed salary that was not influenced by the amount of collected taxes. Also Ivan IV abolished the principle of power handover according to the genealogy. Therefore, governors started to be selected according to their professional characteristics and not according to their belonging to a particular family. Moreover, all judges in Russia in that time were jury trial which helped the judicial system of Russia in XVI century be effective and independent from any clans or powerful groups. Also, following Ivan III who forbade any sale of patrimonial estate without the agreement of the knyaz, Ivan IV forbade all sales of patrimonies at all. Thereby, patrimonies had to be descended from father to the son and, in case there was no son, they automatically became a state equity. Additionally, Ivan IV established a prototype of current parliament meetings called Zemskiy Sobor. And if during the first meeting in 1549 and 1551 only higher classes (boyar, feudal lords and clergy) had the right to take part in them, the later meetings consisted also of low-level officials and representatives from townsfolk.

Unfortunately, all the positive results of Ivan's III and Ivan's IV reforms in fighting corruption were abolished by unstable political situation during the so called time of troubles (1598-1613) as well as by the improper politics of the first Romanov who started to favor interests of the forming oligarchy class while implementing reforms which were clearly not beneficial for the entire society. However, let us skip practically a century and spend more time analyzing the picks of corruption that was achieved during Peter I (1689-1725) and Ekaterina II (1762-1796) times.

Both Peter I and Ekaterina II only made a vision that they were fighting against corruption. However, their politics was not effective and could not help diminish corruption. And as a result, during their governing, embezzlement of state property was on the highest possible level. To cover such a quick embezzlement of the state treasury, Peter I introduced a huge number of new taxes that taxed practically all spheres of life, from having a beard till selling cucumbers. Consequently, this measure led to the increase of tax incomes in real prices by 3.5 times while robbing the population. However, a huge part of those tax incomes were eventually spent not on state needs but on gifts to the favorites or were just stolen. It is important to mention here that both Peter I and Ekaterina II had several favorites for whom they made many generous gifts which were paid with the money from the state treasury. In addition, during Peter I time, a lot of money were spent on building of factories that were afterwards privatized for free by Peter's favorites. Also Peter I abol-



ished the system of self-government that was introduced by Ivan III and developed by Ivan IV. Finally, Peter's I changes in the judicial system and the revoke of former principles (jury trial and presence of public representatives) led to the arbitrary decisions by landowners, officials and guardsmen which significantly increased their power and therefore became a new source of corruption.

Afterwards, Ekaterina's II reforms only worsened the situation with corruption. For example, Ekaterina II started the politics of free trade which led to an increase of globalization in Russia, the growth of the influence of the trade elite and, as a sequence, higher volumes of corruption. On the one hand, the growth of trade volumes was profitable for the trade elite since they received a new opportunity to increase their profits. On the other hand, the politics of free trade led to the dramatic increase of internal product prices especially prices on bread and, as a result, to the robbing of the whole Russian population. Moreover, following Peter's I example, Ekaterina II also made generous gifts in form of serfs, recruits, land, palaces and money to her favorites and lovers. Historians estimate that Ekaterina spent more than 90 million rubles on gifts to her favorites and lovers. In comparison, the annual budget of Russia at that time was only 16 million rubles.

In conclusion of this historical period, let us shortly mention that there were some improvements during Nikolai I time (1825-1855). In contrary to his predecessors, he did not select officials from his friends and relatives but was guided by the professional qualities of candidates. To motivate officials to work efficiently, Nikolai I set high salaries, and provided them with the right to own or rent state lands. As the result of this policy, there was a considerable group of officials who were very honest people with the nature suitable for government service which, in its turn, led to a slight decline of corruption levels at that period of time.

### ***3.1.2. Corruption in Russia during the USSR period***

Since the beginning of the USSR period, there was a huge fight against corruption. First of all, it was forbidden to have private equity and receive any unearned incomes. The punishment for not following this law was a long prison sentence. Also there was a mass propaganda that explained that violation of these principles was shameful and not possible in the USSR. The state had a control over the prices that cut a possibility for receiving a profit from trade speculations. Moreover, the most cruel tool of fighting corruption during Stalin's period was denunciations and repressions.

However, despite that massive fight against corruption, government had created a system Torgsin (state shops where all the goods were sold on foreign currency). Thereto, Torgsin was

established at the period of mass hunger 1932-1933 and made people sell gold and jewellery for the price that was less than 50% from the real price of those things. And people did not have any other choice rather than to sell their jewellery because it provided them with Torgsin's check and they could buy some food on those checks. There were even Torgsin's brothels in Odessa which clearly ran counter to the ideas of communism. However, Torgsin's system was not created for the interest of any oligarchy group, but was aimed to oblige the interests of the state: it brought considerable income to the country budget. And already in 1935 the system of Torgsin was annihilated.

However, during Khrushchev's (1953-1964) period and later, it was already possible to observe a corruption inside the communist party. This corruption was not in forms of bribes (since the amount of bribes during the USSR period was not significant), but was generally in different non-monetary forms such as use of personal contacts to gain access to deficit goods and services, privileges, rendering of various kinds of services to relatives, friends and acquaintances, etc. That is why, despite the presence of corruption in the USSR, it had in whole the non-monetary character, and therefore did not lead to the huge income difference between high-ranking officials and middle class. However, due to corruption, bureaucratic elite had a lot of privileges and opportunities in comparison to normal people. This elite and their children had opportunities to live in private flats, get deficit and import goods, have private cars and drivers, study in elite schools and much more that was not available for an average citizen in the USSR. And that was one of the causes of the total demotivation of the population and low productivity of labor.

However, in contrary to the situation in the Russian SSR, the Georgian and Uzbek SSR were famous for their volumes of corruption and thefts. Distortions in documents in these two republics were so huge that local high-ranking officials were millionaires and the total amount of stolen money were counted in billions of rubles that were enormous money for those period of time. Moreover, the levels of corruption in the Georgian and Uzbek SSR were so high, that not only high-ranking officials but the whole population of these republics were involved in many corrupt activities.

Later, Brezhnev's (1964-1982) cost-financing economic reforms which allowed enterprises to use around 40% of their incomes for their own needs even worsened the situation in the economy. Instead of wished increase in productivity of labor, we can observe the growth of the inflation and deficit of even cheap products. The cause of it was that the enterprises were not motivated to produce cheap products and started to product more expensive ones. The state tried to fight increasing corruption volumes and put thousands of people into the jail. But

those measures were not very much effective since the reforms indirectly favors corruption and growth of the hidden economy.

There was a significant increase of corruption during Gorbachev's (1985-1991) time too. People started to buy oil and a lot of other products in the USSR and export them by giving bribes to custom officers. Afterwards, they used to buy electronics in foreign countries and come back and sell it in the USSR. That all led to a huge deficit of main goods and hidden inflation. Experts count that in 1990 around 1/3 of all consumer goods were exported. All these speculation processes led also to a huge deficit of budget and a hyperinflation. Moreover, during that time enterprises were allowed to cash the money that automatically meant huge volumes of speculations and thefts. The other source of speculation was a state credits: people were able to receive such credits from the government but because of the huge inflation and low interest rates those credits devaluated quickly and it caused even a huge deficit of the national budget.

### ***3.1.3. Corruption in Russia during the 1990s***

In the post-USSR period the most famous illustration of corrupt activities was the privatization of the 1990s. For example, some people were able to receive cheap credits from the state and buy enterprises for very low prices, much lower than their real market prices. Afterwards, new owners were able to sell equipment and other assets of those enterprises, receive a huge income that was much higher than the purchase price of those enterprises and easily return the credits to the state (sometimes even the credits were not returned). The privatization of the 1990s was a start of the quick enrichment of many people, who had good connections to the government and were later called oligarchs. And people who were responsible for privatization (e.g. Mr Gaydar and Mr Chubais), is believed, earned huge amounts of money on those operations.

The second famous fraud of Elzin's period was a financial pyramid called GKO, i.e. government short-term obligations (1993-1998). The interest rates of those GKO's were 50, 100 and even 200%. Not surprisingly that in 1997 the national debt was already equal 90% of the annual national budget and finally led to the default of 1998. Several banks were bankrupt and millions of Russians lost a lot of money during that time. However, that pyramid was beneficial for several high authorities and ministers who were able to earn a lot on their speculative operations.

Finally, there are some less-scaled examples of corruption in 1990s. For example, Mr Mikhail Kasyanov, ex-prime minister of Russia (2000-2004), who got his nickname "Misha 2%" due to his possible involvement in corrupt schemes, was accused of embezzlement of the IMF

loan in the amount of 4.8 billion US dollars which Russia received in 1998. Or another outrageous example of corrupt activities in the 1990s is the disappearance of more than 900 works of art from the Hermitage, St. Petersburg.

### **3.2. Reasons of the corruption in Russia<sup>42</sup>**

As discussed above, the problem of corruption has been known already since the ancient time. Historians have established the fact that crises of the corruption are typical for periods of collapses of political systems or may be observed during the transition period between different state systems. For example, on the decline of the Roman Empire the state was faced with an enormous levels of corruption. The reason for that was the formation of an oligarchy group of traders who received huge incomes while robbing their own society by setting high prices on most of the customer goods.

Moreover, corruption is not a problem only in Russia. Many countries, even the most developed ones, used to and are still faced with this problem, however, the situation with corruption differs significantly from country to country. Thereby, it helps disprove the statements that corruption is a specific tradition solely in Russia, it results from its culture and mentality, and there is no “medicine” to fight against it. Such statements just help Russian officials justify their unwillingness to fight against corruption.

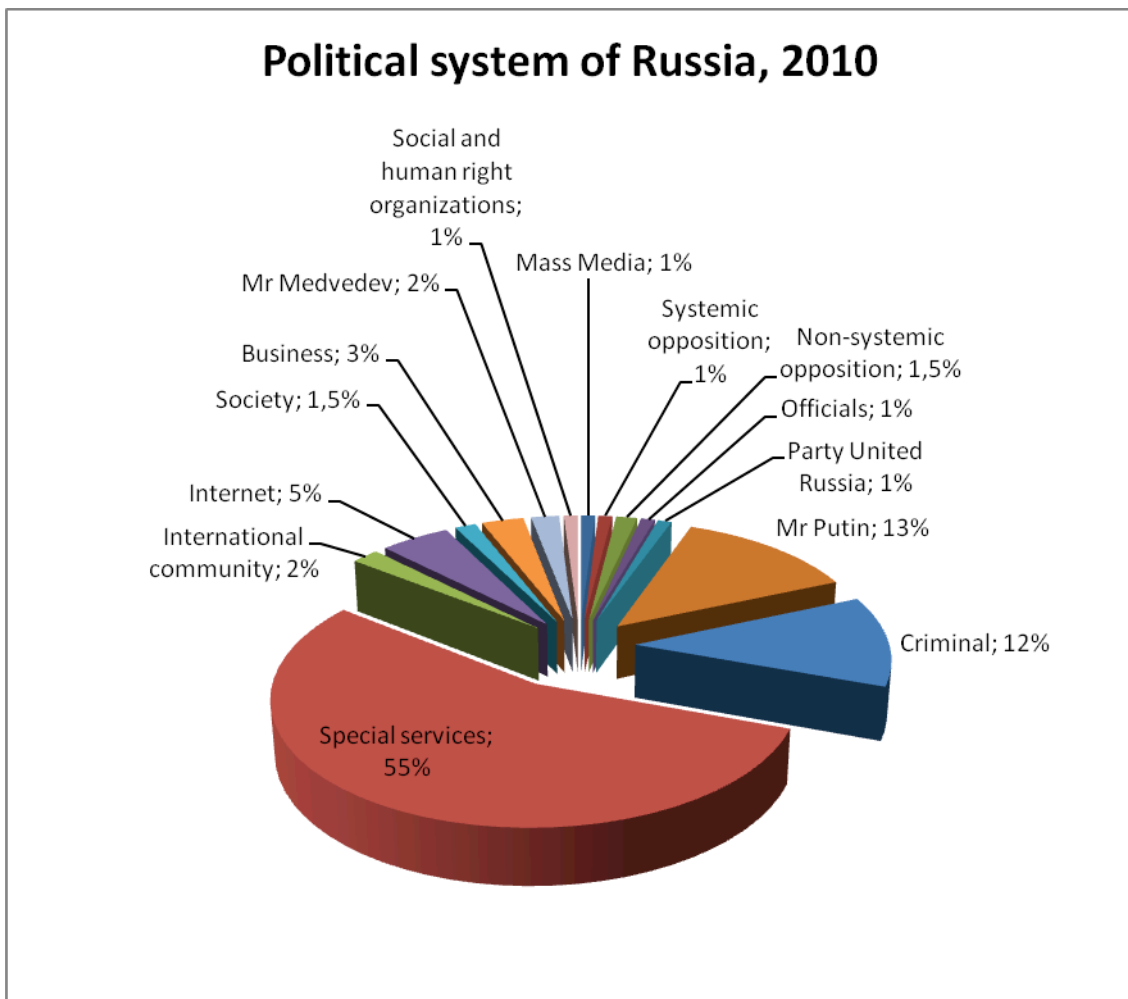
We have already discussed above that corruption is present at all levels of Russian state system and in all spheres of life. We also have already named three main reasons of corruption in Russia. They are absence of 1) independent mass media, 2) independent judicial system, and 3) political competition. However, the reasons of this phenomenon are much more complex than it seems at the beginning. That is why in this chapter we discuss the main reasons of corruption at the highest levels in Russia in details.

One of the most important reasons of such high levels of corruption is the absence of political competition. To prove this statement let us analyze the results of the survey conducted by the All-Russian Anticorruption Public Chamber Clean Hands on the topic of the influence of different groups of people on Russian political system.

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<sup>42</sup> Report of the All-Russian anticorruption public reception Clean Hands (2011); Institute for Public Projecting. The nature and structure of corruption in Russia (2006) (feat. Institute for Comparative Social Research).

Figure 10



As we can see from the above pie diagram (Figure 10), the power in Russia is concentrated mainly in hands of one group of people – special services (i.e. FSB (Federal Security Service), Security Council, Ministry of Interior, FSO (Federal Protective Service), etc.) with their index of influence on Russian political system equaled 55%. The second and third influential power on Russian political system are allocated after Mr Putin (13%) and the criminal (12%). In comparison, all other groups of Russian society (i.e. society, opposition, mass media, business, etc.) has the total volume of influence on the political system equaled only 20%! This situation is evidently not normal for any democratic state and is dangerous both for the society and the government. Obviously, the first groups of people can often use their uncontrolled power not in state's or social interests but in their own, oligarchic interests. All that eventually leads to diminishing of the political competition in Russia (opposition both systemic and non-systemic has only 2% influence on the political system in total!) which, in its turn, causes in increasing levels of corruption.

The second main cause of corruption is the imperfection of Russian legislation and regulatory framework as a whole. First of all, as it was already mentioned, Russian legislation does not provide a complete definition of the term “corruption” which leaves a room for a dual interpretation of this concept. However, it is not a single example since many other laws and subordinate legislation in Russia leave a possibility of their ambiguity. In addition, some laws are also very much unclear or there is still no laws for some particular regulations. It means that there is a huge amount of opportunities for their abuse in personal interests. Moreover, Russian law and constitution do not clearly specify the government function to produce positive results on behalf of the whole society. For example, the constitution mentions only multiple functions of the officials, but does not specify their responsibilities and the purpose of their work in achieving positive results for the whole Russian society. It is only said that they must act as policymakers and control other actors involved in the executive process. Of course, this statement that officials should act for achieving positive results sounds obvious, but until it is not spelled out in Russian legislation, it leaves open the possibility for officials not to be held accountable and therefore to stay unpunished and uncontrolled. Finally, it results in an inefficient government executive system in general and high levels of corruption.

The next reason of corruption is that Russian judicial system can be seen as an institution highly dependent from the government and its interests. For example, there are a lot of court decisions that clearly follow interests of authorities: none or only conditional sentences for authorities, in contrary, unreasonably grave sentences for those who violated authorities' interests. Also many judicial processes are run with numerous violation of the law. For example, courts refuse to take into consideration some evidence or ignore clear conflicts of testimony. Moreover, sometimes courts even refuse to institute legal proceedings explaining that there is no grounds for legal actions. This dependency of Russian courts can be illustrated by numerous recent examples of judicial processes for violations on the parliamentary and presidential elections, or by groundless punishments of some leaders of the non-systemic opposition after several protests in Moscow in December 2011 – May 2012. This dependency of courts from the government and its interests limits the chances of the society to establish an efficient control after state authorities and punish them for their corrupt activities which, in its turn, leads to the fast increasing levels of corruption.

Similar to dependency of Russian courts, Russian mass media can be also characterized as being highly dependent from the government. The editorial policy of the main Russian TV channels (Channel One, VGTRK, NTV, etc.) as well as radio and newspapers is controlled from the Kremlin. For example, it has become well-known that there are so called “black

lists” of people who cannot be invited or even mentioned on the TV because of their opposition views (e.g. Mr Aleksey Navalny, Ms Ksenia Sobchak, etc.). It can be also very good illustrated by Mr Medvedev’s decree on establishing the Russian Public Television. Despite the main concept of such type of the TV, i.e. independency, the decree establishes the President’s right to appoint the general manager and the council of the Russian Public Television<sup>43</sup>. Thereby, the Russian Public Television is going to be per se dependent from the government. Therefore, the absence of the independent mass media in Russia makes the control after corrupt officials even more difficult, since the mass media are not able to create a sufficient public response on many illegal cases in which Russian authorities used to or are involved. And this situation is even worsened by the fact that major part of Russian population receives information from these dependent mass media and not from few independent mass media with a small audience (e.g. Echo of Moscow, TV channel Rain, Novaya gazeta, etc.) or Internet (e.g. blogs, independent information portals, etc.).

Additionally, the distribution function belongs to the state and also stimulates corruption. For example, the state distributes the land, decides on the privatization of enterprises, rents out premises and land, etc. And it is well-known that corruption is even worse in countries where the government has a chance to directly control and meddle in economic market relations. Therefore, the concentration of this responsibility in hands of officials gives them additional power and, as a consequence, a lot of opportunities to stimulate corruption in Russia.

Nowadays, corruption in Russia became such a huge problem that it functions like a cancer inside Russian political system. It starts at the highest levels and then goes top-down and reproduces itself. Nowadays corruption has become a norm for Russian officials at all levels and spheres of life so that you cannot just not be involved in the corrupt activities. For example, there is even a practice of buying a place in the governmental system or the police: people pay a specific “entrance fee” which they are compensating many times by taking bribes later. All that leads to social distrust in the government and its politics. Since there is not a proper system of safeguarding the society from the governmental arbitrary rules, people are afraid of the government and its power. For example, there is no protection of human rights and the right of private ownership. That is why experts see bribes as a peculiar method of people’s protection against officials and their power. And this idea is true both for lower and higher levels of corruption. In the case of corruption at the highest levels, large companies are forced to “pay” for their right to run their businesses further. One of the latest examples of this

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<sup>43</sup> [http://www.gazeta.ru/politics/2012/04/17\\_a\\_4406797.shtml](http://www.gazeta.ru/politics/2012/04/17_a_4406797.shtml)

“payment”, is the situation with the Moscow airport Domodedovo. It is forced to build a new runway investing the company's money and afterwards to transfer the ownership of it together with the ownership of the piece of land to the state. However, usually building of runways should be invested by the state itself since runways cannot be owned by private companies and are a part of state ownership. But this agreement between the state and the airport is beneficial for the current owners of Domodedovo since it gives them a chance to save their ownership of the airport (in February 2012 the airport Domodedovo could be bought by Mr Alisher Usmanov, the richest Russian businessman)<sup>44</sup>.

However, the absence of the civil society and low involvement of Russians in the political life can be also perceived as one of the reasons of corruption. For example, the results of Clean Hands' research indicates that the noninvolvement of Russian society made it even more possible for the government to build such a corrupt state system. The possible reason for that can be a strong believe (which is even more intensified by governmental assurance) that corruption is an incurable problem of Russian society and was progressively created by its history and traditions. Many people truly believe that the only way to eliminate corruption is repression methods that were observed during Stalin's time. That is why people prefer to tolerate this phenomenon and, therefore, corruption becomes a norm for the society. Moreover, corruption increases also because there is a very low public control after the process of decision-making in government or half state-owned businesses. And the establishment of an effective public control is very much limited, first of all, because of the absence of the independent mass media and, secondly, because of the non-transparency of the most decision-making processes (i.e., political, economic, personnel, etc.) at the highest levels.

Summing up, such an inefficient political system multiplied by absence of the independent mass media and judicial system, and the low involvement of the society in the political life of the country does not guaranty safety and makes the system very dangerous and unstable in general. Moreover, corruption substitutes the stability of the system and organized crime steps in for governmental protection of the society. The attribute of such a political system is that the society is voluntarily involved in the corrupt practices and accepts the terms that are established by the government. Therefore, it all leads to very high levels of corruption.

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<sup>44</sup> [www.vedomosti.ru/newsline/news/1782864/bitva\\_slova\\_i\\_dela](http://www.vedomosti.ru/newsline/news/1782864/bitva_slova_i_dela)



## **4. Recent fight against corruption in Russia and its importance**

We have already discussed the current situation with corruption in Russia and analyzed the main reasons of its high levels. Further it is important to study the influence of corruption on Russian economy, political system and society. Only afterwards we will be able to understand the real importance of the fight against corruption and discuss new Russian anticorruption legislation and its results.

### **4.1. Effect of corruption on Russian economy, political system and society**

Corruption at the highest levels of Russian state system has a very complex influence on many spheres of life. It does not only have a negative effect on the economy, but also on the political system of Russia and the society. Let us further discuss the effect of corruption on each of these three spheres in details.

#### ***4.1.1. Economic sector***

There are several negative effects of corruption on the economy. First of all, we can observe the growth of volumes of the hidden economy. And this leads to decline of taxes income volumes and weakening of the state budget. As the result of this process, the state loses financial leverages, followed by a worsening of social problems because the government is not able to keep its promises any more.

Secondly, corruption also leads to less efficient competition mechanisms because not the most effective enterprises but the enterprises that have agreements with officials (and these agreements are normally received by giving bribes or due to some relations) get benefits and higher profits. That means that, finally, the whole population should accept that a very small group of beneficiaries profit from corruption while others should carry losses.

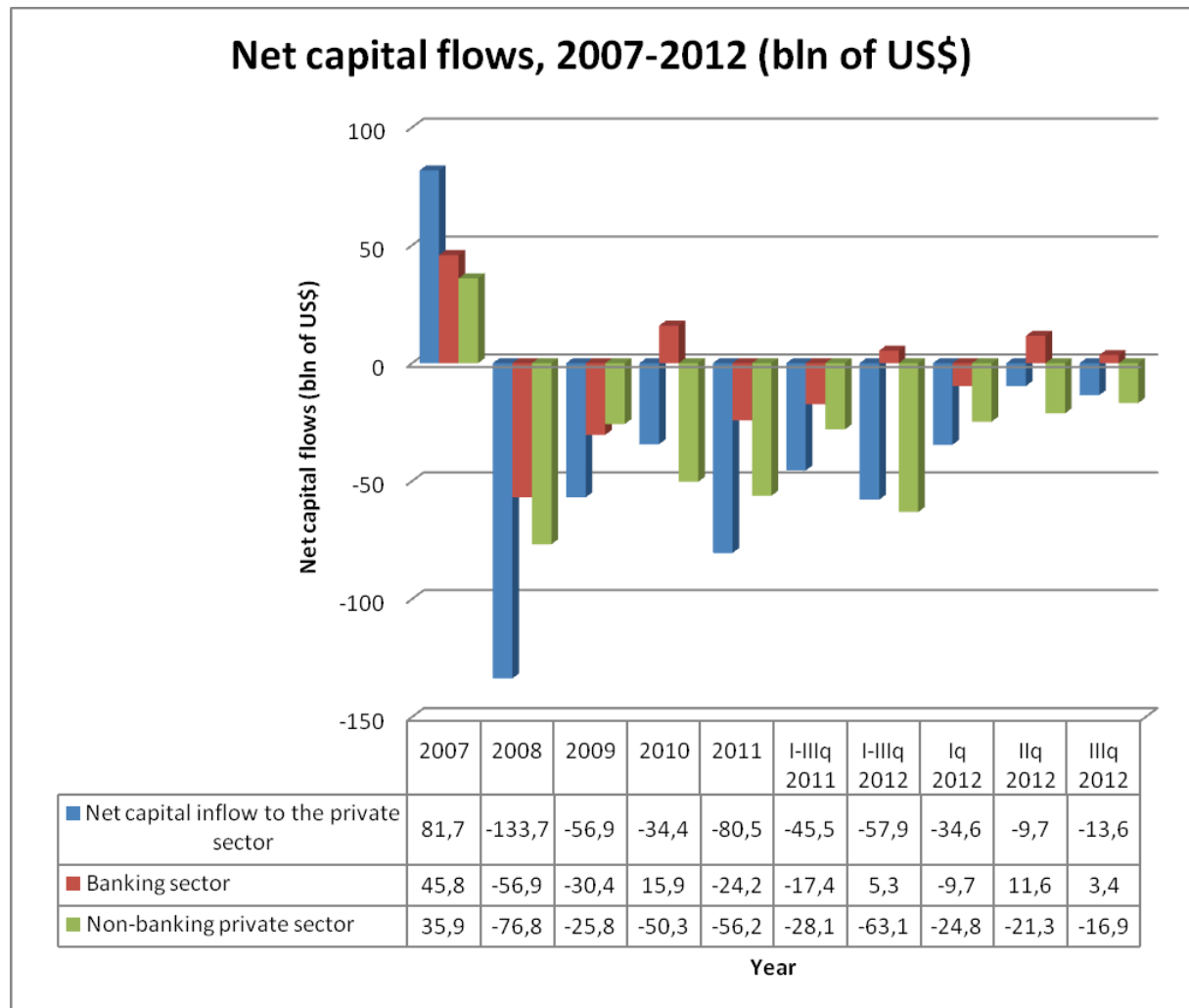
Corruption at the highest levels also causes into non-efficient distribution of national budget and eventually may lead to budget deficit and increasing of social problems.

Moreover, bribes are the direct cause of inflation because these costs are included into the final prices. Additionally, corrupt authorities may not fight against monopolistic collusions since they get bribes and other benefits from the companies, involved in these illegal operations, for being loyal. At the end, the whole population again must carry that loss.

Also due to corruption, people have less trust in government and its ability to control the economy efficiently. There are also lower guaranties of safety of the private equity. All that leads to the worsening of the investment climate inside the country. And the lack of investments, in its turn, means that such problems as decline in output and wear and tear of equip-

ment do not solve properly. Moreover, people fear for their savings and the process of export of capital increases significantly in volume:

Figure 11<sup>45</sup>



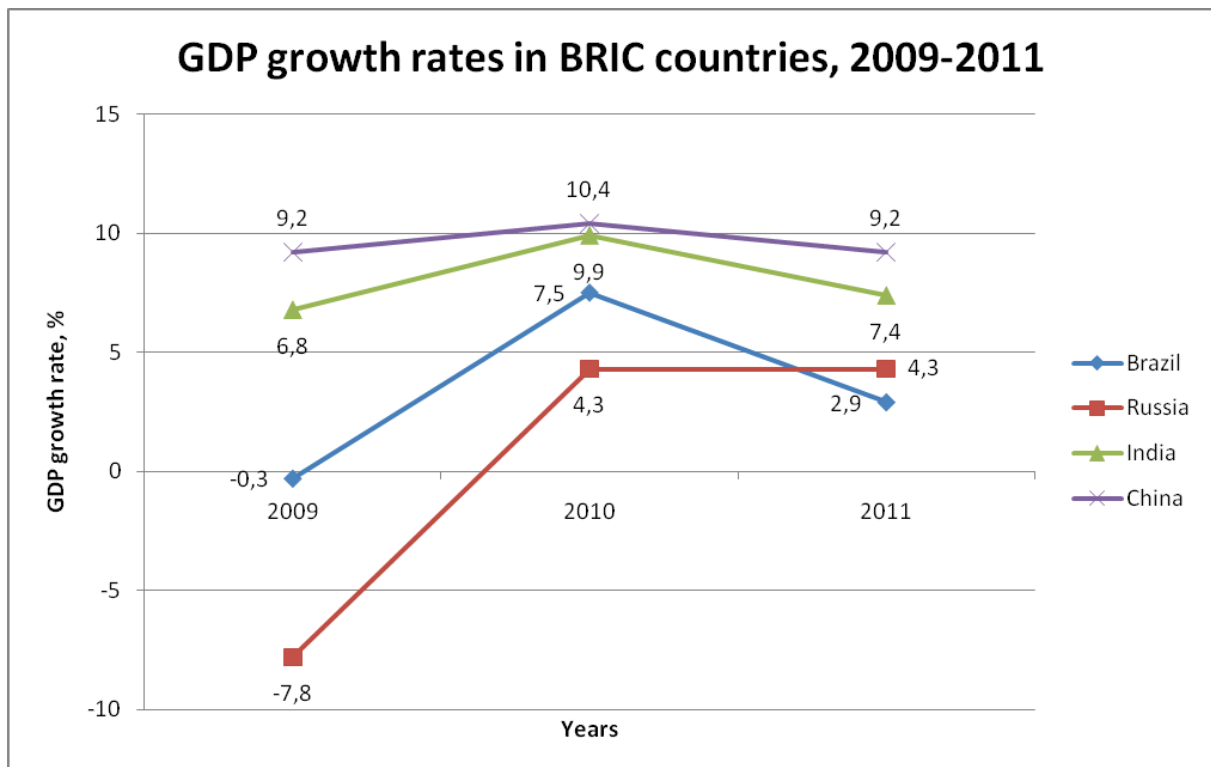
Finally, corruption at the highest levels moves to the lower levels of the state system and even spreads to companies, enterprises and public organizations. At the end, it means that the efficiency of the whole economy is very much lowered.

Currently we can clearly observed the negative influence of corruption on Russian economy. For example, in the post-crisis period, Russia shows the worst GDP growth rate results among other three BRIC countries, where the situation with corruption is much better<sup>46</sup>:

<sup>45</sup> World Bank in Russia. Report on Russian economy. The necessity of economic recovery. Nr. 28, October 2012.

<sup>46</sup> According to the Transparency International's Corruption Perceptions Index, see the chapter 2.1.

Figure 12



#### 4.1.2. Political sector

Corruption has also a negatively influence on the political system of Russia. Due to corruption, authorities starts to act in interests of a very small group of people, i.e. oligarchy class, and not in interests of the whole society.

Secondly, the society loses its trust in government and do not value and accept even its positive reforms. Therefore, the government loses its legitimacy.

Thirdly, the image of the country is also damaged due to the high levels of corruption. It may even cause in economic and political isolation of the country. Magnitsky law is a bright example of the outside reaction on the antidemocratic, corrupt processes happening in Russia.

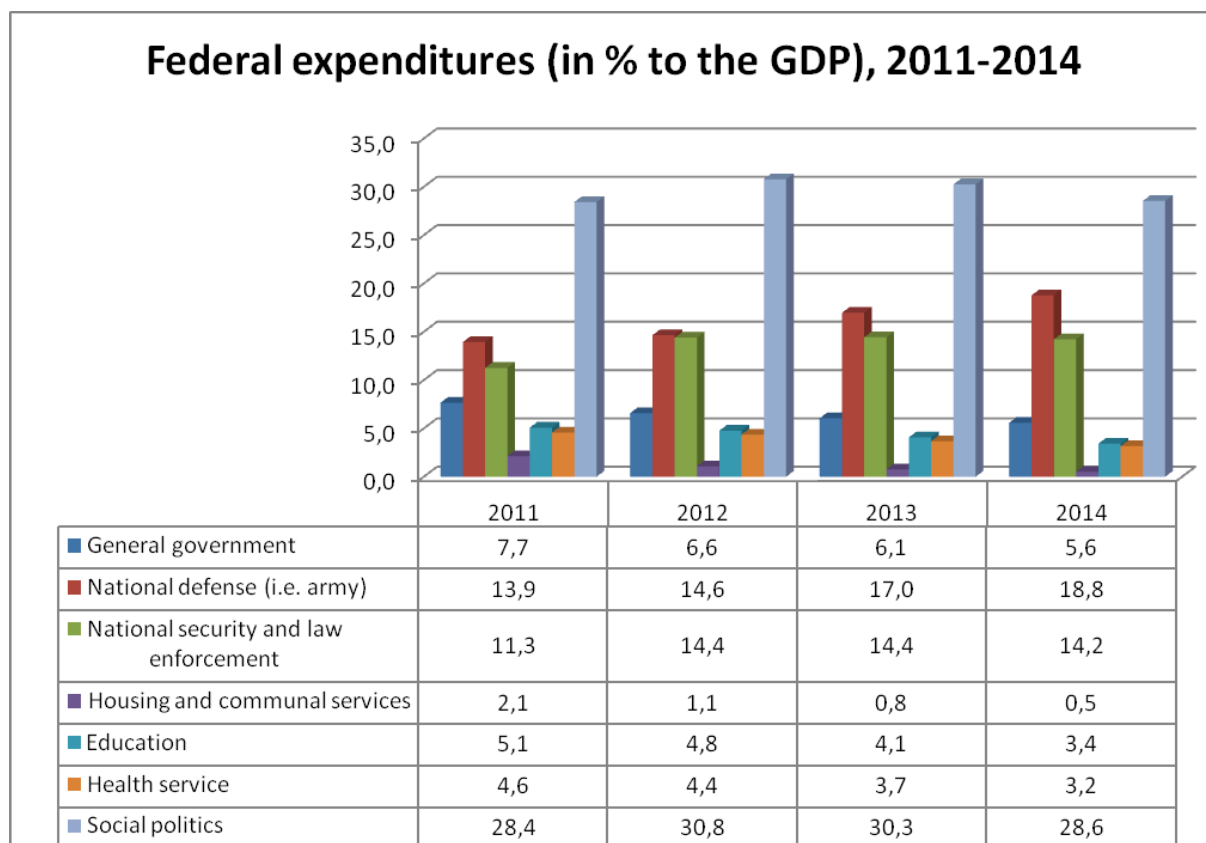
Finally, corruption also lowers the political competition and opportunity of new political leaders to appear in the political elite. This happens because there is no independent mass media and control after current politicians is much lower. There is also a risk of harming and degradation of the democratic institutes inside the country. As a result, it all makes the political system of the country very inert and prevents the improvement of the democracy. In contrary, we can observe a shift to the oligarchy regime.

#### 4.1.3. Social sector

Finally, corruption also influences negatively Russian society. For example, corruption “eats” a huge amount of money that could be spent on social programs and social needs. Eventually,

government may not be able to redeem its promises anymore which normally leads to the growth of social tensions. Moreover, since there is a huge influence of Russian special services on the political system, much higher (2-3 times higher) amounts of budget money are spent on them (i.e. national defense, national security and law enforcement) than on the health care, education, and housing and communal services in total! And this difference in expenditures is going to increase even more in the next couple of years.

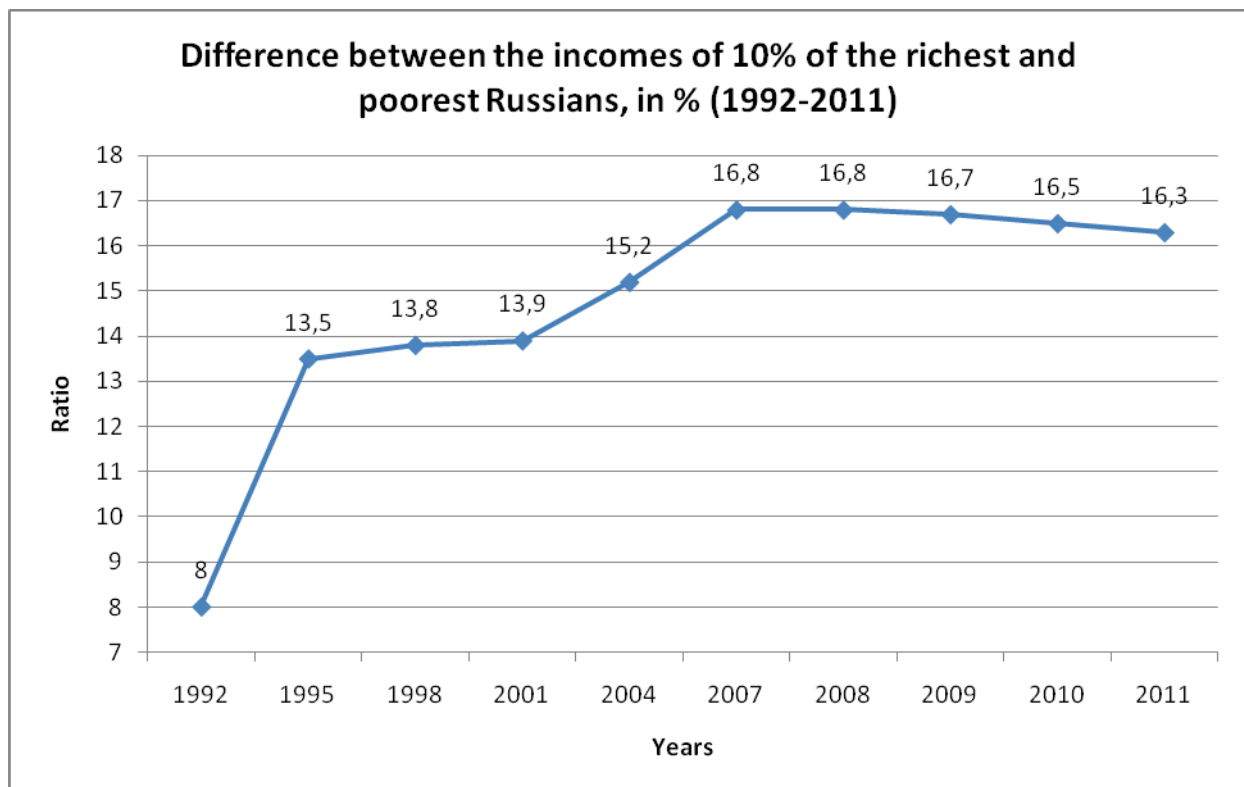
Figure 13



Source: [http://info.minfin.ru/project\\_fb\\_rashod.php](http://info.minfin.ru/project_fb_rashod.php), \*2013 and 2014 - estimated

Moreover, corruption sharpens the stratification of the society and its incomes. The difference in incomes of the 10 percent richest and poorest Russians has become enormous: it is more than twice as high as it was in 1992. Eventually, such a high difference in incomes may lead to the increasing social tension in Russia.

Figure 14



Source: <http://www.kommersant.ru/doc/1877959> and <http://ria.ru/analytics/20120224/573618403.html>

Finally, corruption causes in the decline of trust of the society in the judicial system since people see its dependency from the oligarchy and its interests. People lose the trust in their constitutional rights and feel a higher defenselessness against the criminality and even the state. Overall, corruption harms the morality and cultivates the readiness of the society to take part in the corruption processes (e.g. bribery). Eventually, this leads to increase of social tensions and lower stability in the society. And as a result, it causes in higher volumes of emigration, especially among the most progressive and active people (i.e. middle class) from the country.

#### 4.2. Anticorruption legislation and its results

We have just analyzed the main effects of corruption on the economy, political system and Russian society. Overall, this influence is very much negative for the whole society except the oligarchy class. It leads to less effective economy, political and judicial systems, and social tensions. This negative effect of corruption clearly shows the necessity of the fight against it. For example, both Mr Putin and Mr Medvedev understand the importance of this fight and during their presidency highlighted the fight against corruption as one of the national priori-

ties. Let us see which measures were taken in the last two decades to fight against corruption in Russia and what are the results of this fight<sup>47</sup>.

The fight against corruption in the modern Russia was started already 20 years ago, on April 4, 1992, with the decree of Russian president Boris Yeltsin "The fight against corruption in the public service". This document was the first anticorruption legal act of the new Russian legislation and served as a starting reference point in the fight against corruption in the Russian Federation. The decree forbade officials to engage in entrepreneurial activities. Moreover, appointed state employees have to provide the income statement, information about movable and immovable property, bank deposits and securities, as well as financial liabilities. In case of not providing this information by state employee, they could be dismissed from the office, or there was even stricter punishment. The control after the implementation of that decree was vested in the president's control department. The norms of the decree formed the basis of other laws: "On Combating Corruption", "On State Service of the Russian Federation" (the law was passed in 1995 and expired in July 2004) and others.

Later, in 1993-1997, the State Duma has repeatedly tried to pass a law "On Combating Corruption". The draft law stipulated that the fight against corruption should be conducted by prosecutors, authorities of internal affairs, the Federal Security Service, Customs and Border Protection, the tax police and other law enforcement agencies within their authority. For that purpose, the above mentioned organizations would be obligate to create specialized units to combat corruption. Moreover, a special body to fight corruption, named the Interdepartmental Commission of the Security Council of the Russian Federation to protect the rights of citizens and public safety, crime and corruption, would be created. In November-December 1997, the law "On Combating Corruption" was passed by the Parliament and the Federation Council approved it. However, the president did not sign it and returned it for a revision. On September 29, 1999, the National Anticorruption Committee (NAC) was established, and Mr Sergei Stepashin became its first chairman. Among the main tasks of the NAC was the protection of all who are trying to fight corruption and having the influence on the authorities to intensify anticorruption activities.

Later, in November 2001, the draft law "On Combating Corruption" was re-introduced in the Duma, and was even adopted on the first reading. However, Russian government criticized it and the work on it has never started again.

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<sup>47</sup> According to the information from <http://ria.ru/spravka/20120404/615122656.html>.

Furthermore, on November, 24, 2003, the Council under the President of the Russian Federation to fight against corruption was established. The main objective of the Council was to assist the Russian President in the determination of priority directions of the state policy in the fight against corruption and its implementation. The Council consisted of the chairman of the government, Federation Council Chairman, Chairman of the State Duma, and the chairmen of the Constitutional, Supreme and Supreme Arbitration Courts. The Council also included Anticorruption Commission and the Commission to resolve the conflict of interest.

In 2006-2010, the new laws and reform program which were supposed to make a special contribution to the fight against corruption were established (i.e. the concept of Administrative Reform of the Russian Federation and the law of the Russian Federation "On Civil Service of the Russian Federation" [2004]). Moreover, in 2006, Russia ratified the UN Convention against Corruption. However, Article 20 of the Convention (i.e. "Illegal enrichment") was not been ratified.

In February, 2007, the interagency working group, the aim of which was to prepare proposals for the legislation of the UN Convention against Corruption (2003) and the Council of Europe Criminal Law Convention on Corruption (1999), was established. At the same time, the Anti-corruption Council under the Presidential of the Russian Federation was abolished.

The task of fighting corruption was a priority for Mr Medvedev during his presidency. So right after his inauguration, in May, 2008, the Council on combating corruption under the President of Russia was established. The Council had a task to provide the President with an anticorruption plan within one month time.

Already in July, 2008 the "Anticorruption Plan" was signed by the president. The first section of the paper ensured the legislative measures to fight against corruption. The law provided a possibility to prevent the corruption through the development of the institute of public and parliamentary control over the compliance with anticorruption laws. The plan provided such an anticorruption measure as a liability of state and municipal officials to notify about any known corruption cases. The second section of the paper was devoted to improve governance in order to prevent corruption. The third section of the Plan contained the task of raising the professional level of legal training and legal awareness of citizens. Its last section contains the priority list of the directions for the authorities to combat corruption.

In December, 2008, Mr Medvedev signed a package of laws on combating corruption. The package consisted of four laws: the basic law "On Combating Corruption", a bill amending the law on Russian government, and another two laws, which made changes and amendments to 25 federal laws. For example, the law provides that within two years after leaving govern-

ment service ex-officers are not allowed to work in the commercial and noncommercial organizations, the influence on which they had during their government service without a special permission. Or it even sets the limit value of the gift, which can be presented to official by visitors (i.e. up to three thousand rubles), and more expensive gifts will be automatically considered as a state property. Additionally, according to the new anticorruption legislation, officials must provide their employers with the information about their income, assets and property obligations. Also, they must provide the information about income, assets and liabilities of the members of their families (i.e. wife (husband) and minor children). Finally, it determines that both individuals and legal persons bear criminal, administrative, civil and disciplinary liability for taking part in the corruption activities. The law were extended to police officers, prosecutors, law enforcement bodies of the Russian Federation, the Federal Security Service, customs authorities and the military.

Later, in April 2010, the president Medvedev signed a “Decree on The National Anticorruption Strategy” and “The National Anticorruption Plan for 2010-2011”. The National Anticorruption Strategy has identified the main directions of the state anticorruption policies in the medium term and the stages of its implementation. The National Anticorruption Plan, which must be updated every two years, called for the development of legal framework, organization of personnel services in government body for the prevention of corruption, sociological studies of corruption and the effectiveness of anticorruption measures, training of civil servants, who are responsible for combating corruption, etc.

In mid-March 2012, Mr Medvedev made a proposal under which Russian officials, who cannot explain the excess of their expenditures over incomes, will be dismissed and their property may be denied. Furthermore, the new “National Anticorruption Plan for 2012-2013”, involving a number of innovations in this field, was promulgated: the institution of lobbying and a single budget portal, the introduction of special computer programs in the anticorruption units in government agencies, mandatory reporting of received official gifts, as well as grants for the media and public organizations should be involved in the fight against corruption. The Plan includes not only instructions on the development of set of measures to fight corruption, but also guidance on inspections in a number of departments. In particular, the President instructed the prosecutor to inspect many departments, including the Pension Fund, Social Insurance and the Federal Mandatory Medical Insurance Fund in the third quarter of 2013 to verify compliance of the legislation on combating corruption in those departments.

However, despite such an active recent development of Russian legislation and formation of different councils and commissions whose main purpose is to fight corruption, the real results



of diminishing corruption are fruitless. For example, Mr Anatoly Golubev, a chairman of the Committee on the Fight against Corruption, says that there is no significant results because there is no real fight against corruption<sup>48</sup>. He also admits that currently there is no department which would have dealt with this issue (i.e. fighting corruption) from the professional point of view. Mr Golubev states that there is also no institutions of the civil society in Russia, which would be doing it, because they do not possess real mechanisms for the implementation of civilian control. Moreover, Mr Golubev argues that the current fight against corruption uses mainly repressive methods (e.g. arrests, criminal cases, prison terms) and have nothing to do with the required systematic prevention of corruption at all levels of Russian state system. Mr Golubev as many other experts notices that recently corruption has increased several times (see the statistics in the chapter 2.1). According to his explanation, it happens due to not efficient repressive measures of the fight against corruption: corrupt authorities are increasing amounts of bribes since they are pushed to increase the number of intermediaries in order to safeguard themselves from those repressions.

Moreover, experts conclude that the recent anticorruption methods of fighting corruption in Russia brought to unexpected results: much more ordinary people, giving bribes, are convicted than corrupt authorities<sup>49</sup>. According to the report of the General Prosecutor of Russia Mr Yuri Chaika, in 2011, the number of recorded crimes of corrupt pattern continued to decline. For example, the report says that, in 2011, security forces found 7% less corruption than in 2010. There is also a reduction in the number of facts of bribery – by 10.3%. In its turn, the number of cases of commercial bribery, as compared to 2010, decreased by 11%.

Despite these optimistic data, Mr Chaika is dissatisfied with the work of investigators and argues that the declining data is not related to the improvement of the work of law enforcement agencies or the success of the anticorruption measures that were taken in Russia, both at federal and regional levels. Mr Chaika considers that these results just indicate a further deterioration of the performance of preliminary investigation, reducing the efficiency and quality of the work of law enforcement agencies. For example, out of 91 cases of bribery of FSB investigators, prosecutors returned 11 cases, and 11 other legal cases were stopped. Moreover, Mr Chaika notes that bodies of the Investigative Committee of Russia quite often refuse to institute criminal proceedings which officials, particularly police officers, are involved in. For example, according to the statistics from the prosecutor's office, in 2011, investigators filed only 250 cases from received 17 thousand (!) statements.

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<sup>48</sup> <http://www.com-cor.ru/ru/anticorruption-vs-sex-in-ussr>

<sup>49</sup> <http://www.gosrf.ru/news/3848/>

Finally, Russian anticorruption policy usually comes down to fight against usual bribes rather than to combat with corruption at the highest levels. In recent years, there have been practically no judgments of the court, which punished any policymakers or Mr Putin's friends and relatives. The most severe "punishment" a person could get, in the case when their corrupt work became a public response, was they official dismissal (for example, the most recent case of Mr Anatoly Serdjukov, ex-Minister of Defence). But even in this case, a person could be appointed to the new position. Single criminal cases or sentences for any senior official (e.g. the case of Mr Alexander Belevitin, former head of the military medical department of the Russian Defense Ministry<sup>50</sup>), could be observed as a show trial rather than a systematic case. The reasons for that were already discussed before: no political will, no independent judicial system, no independent mass media, and no influential public organizations which could control the work of authorities at the highest levels of Russian state system. Therefore, we can make a conclusion that Russian anticorruption legislation has not achieved significant results in fighting corruption in Russia, especially if we talk about corruption at the highest levels.

#### **4.3. Unsuccess of the fight against corruption: Institutional perspective<sup>51</sup>**

Let us now discuss the reasons of unsuccess of the fight against corruption from the perspective of the institutional economics. The state has not succeeded in its fight against corruption, first of all, because there is no political will and interest to fight per se against themselves. In that case, who else can correct such a failure of the state as corruption? How is it possible to be done? And what are the expenses that may occur in this "correction" process?

First of all, it is important to mention the conditions which should be fulfilled to start an efficient process of fight against corruption. Obviously, if there is no political will to fight against corruption, there should be a strong party which could efficiently influence the state to do so, from the outside. For example, P. Milgrom and J. Roberts identify two conditions that may lead to occurrence of such an influence as well as the costs, connected to this process. Firstly, there must be a group of actual or potential decisions that may lead to distribution of benefits and costs within the organization. Secondly, during the decision making process, the parties to which these decisions affect, should be able to communicate with decision makers as well as be able to influence them. Additionally, the arising influencing costs can be reduced through the introduction of rules, that protect the interests of all members of the organization, and through distribution of the whole amount of benefits, that may occur after any change among all members of the organization. However, the costs which occur in the process of influencing

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<sup>50</sup> <http://ria.ru/inquest/20120117/541316051.html>

<sup>51</sup> Alexandr Auzan. Institutional economics.

the state decisions are much higher in comparison to the same costs in the private sector. The reasons for that is, firstly, there is an overlapping of jurisdiction of different political bodies, enabling involved parties to defend their interests in many institutions. Secondly, democratic governments are unable to make final decisions without systematic revisions and agreement of the society.

Additionally, there are other opinions concerning the way of correction of state failures while seeking the rent<sup>52</sup>. In our case, we analyze these ways from the perspective of fighting against corruption. There are several conditions to be fulfilled before the correction of the state failure (i.e. corruption) can become possible. Firstly, private agents should be able to influence the government. If there is no possibility to influence the state, there is no reason to incur costs. Secondly, there should be agents who are ready to be involved in the process of rent seeking. Thirdly, there should be a competition in the process of rent seeking, since if there is no competition, there is also no reason to spend resources on its receiving.

Let us discuss all three conditions in details. The first condition is the possibility to have the influence on the state and its decisions. However, nowadays only a very small oligarchy group has a real influence of the government's decisions while the influence of the entire Russian society is only 1.5% (see Figure 10). Therefore, this statement cannot be fulfilled in the current situation.

The second condition is the presence of agents who are ready to fight against corruption. However, before we discuss this condition from the perspective of corruption in Russia, we should also mention the so called problem of free riders. The benefits which occurs if the corruption is defeated will be distributed among the whole society. However, not all are ready to participate in this fight and bear a part of emerging costs. Some people will refuse to participate in the process of fighting against corruption even though they will eventually receive benefits if there is no more corruption or its volumes are much lower. And there is no mechanism to exclude those free riders from receiving those benefits (we cannot make those free riders perform in the system with only corrupt authorities while ourselves living in the state with honest authorities). It means that those who are ready to participate in the fight against corruption and influencing the government have to incur much higher costs (i.e. also cover the costs that are not covered by free riders). But these costs are usually significantly higher than the benefits these agents will receive personally at the end. Unfortunately, currently there is no enough huge and influencing group of people who will be active enough and who will be

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<sup>52</sup> Economic rent is the amount of money an owner of a factor of production must receive in order for that owner to rent out that factor of production. Factors of production include labor, capital and land (<http://www.investopedia.com>).

able to cover all the costs which will occur in the fight against corruption. In contrary, the costs of the oligarchy group to maintain such a high level of corruption in Russia is relatively low, while their benefits are enormously high. Therefore, they have a very high motivation to maintain the high levels of corruption in Russia. Moreover, this oligarchy group is much smaller and thus it is faced with much lower costs of coordination and less possibility of free riding. So the second condition has also failed to be fulfilled.

Finally, the third condition is the competition in the process of rent seeking. However, this condition is also not fulfilled in Russia, because, as it has been already discussed, the influence of the oligarchy group is times higher than the whole Russian society. Therefore, we can observe practically a monopoly of the oligarchy. And since there is no competitive process of rent seeking, the society have no motivation to incur costs to fight against corruption.

Finally, Prof. Shastitko identifies several ways to restrict the state abuse: vote-by-hands, vote-by-feet, vote-by-ruble, insubordination and creation of special control mechanisms. However, we can see that none of these mechanisms works in the modern Russia. There is no real parliament or president elections anymore, since the results of those elections are significantly falsified. The government does not do much to prevent the enormous levels of emigrations and loosing the most active, well-educated citizens. In contrary, they invented a principle: "If you don't like the current situation, you are free to leave". The high levels of emigration are even more preferable for the government and the oligarchy class, because emigration of those active people declines the risks of losing their oligarchic power and the stable sources of income (i.e. it declines the risk of any kind of protests since the most active citizens leave the country). Vote-by-ruble does not work as well, because there is no alternative to the state and its services (for example, there was such an alternative in the 1990s when businesses preferred to pay criminal authorities rather than the state, but it is no longer a case in the 2000s or the 2010s). And the other option, nonpayment of taxes, is not a very powerful option because it has no influence on the interests of the oligarchy class. Further, insubordination does not work efficiently as well, because it is highly ignored by the highest levels of Russian government. Moreover, the government uses the power methods (e.g. dispersals of demonstrations by the police, arrests of the leaders of the opposition, etc.) which prevent or quickly end protests and other ways of insubordination. Finally, there is no control mechanism that would be able to restrict the state abuse, since there is no independent mass media, judicial system or political competition in Russia. Therefore, based the institutional economics' models, unfortunately, at the moment, there is no real prerequisites to tackle corruption in Russia.

## 5. Putin's palace (case study)<sup>53</sup>

We have already discussed the general situation with corruption in Russia and how it became a business that pursues the interests of the oligarchy class, Mr Putin's good friends and relatives. In this chapter we analyze one example of the corruption at the highest levels of Russian state system more in details, namely, Putin's palace case.

This story began with Mr Sergei Kolesnikov's open letter to the president of Russia Dmitri Medvedev on December 21, 2010. Mr Kolesnikov is a Russian businessman who worked closely with some of Putin's good friends and relatives for 17 years. In September 2010 he had to emigrate to prevent possibility of being pursued by Russian authorities and repeat Mr Magnitski's case. In his letter to Mr Medvedev, he explains the corruption schemes that were used for Mr Shamalov's enrichment and for building of Putin's palace on the shore of the Black sea.

In 2000, Mr Shamalov, a representative of Siemens AG in the North-Western Russia, proposed Petromed, medical company which was found in 1992 and had already done a lot for health care system in St. Petersburg and some other Russian regions, the following deal: Russian government would order medical equipment in Petromed on the conditions that Petromed transfers 35% of the contract amounts on the bank accounts in some foreign countries. Mr Shamalov explained that this condition was an agreement with Mr Putin. According to Mr Putin's scheme, the money for those investments had to be received from generous oligarchs, and afterwards 35% of each contract amount would be invested in foreign banks and later would be returned to Russia for further investments. It sounded like this money would not only help Russian government to buy modern medical equipment but also bring investments into Russia, create new work places and improve Russian health care system. So the first payment came from Mr Roman Abramovich in 2001 in amount of 203 million US dollars from his fond Pole of Hope. Later there was one more investment (14.9 million US dollars) from Mr Alexei Mordashov and his company Severstal. This investments were used to buy medical equipment for Russian health-care agencies in the value of hundreds of millions of US dollars. As the results of those transfers, Mr Shamalov got more than 148 million US dollars on bank accounts that were controlled by him.

Later, at the end of 2005, according to Putin's directions, Mr Shamalov initiated foundation of Rosinvest Ltd which became an active investor in several projects in different in-

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<sup>53</sup> Mr Kolesnikov's open letter.

dustries, for example, in shipbuilding (Vyborgski shipbuilding manufacture, Primorskaya shipyard), in building (Rosmodulstroj, Modul), wood processing (projects in Nizhnij Novgorod and Komi), and some others. In addition, there were two more projects that were leaded directly by Mr Shamalov. The first one was started in 2005 with projecting of small recreation complex on Black sea near village Praskoveevka. The start budget of this project was 14 million US dollars. The building of this complex was started at the end of 2006. Russian government transferred the land ownership of 73.96 hectares of the forest reserve to the owners of this project. In early 2007, the second project was started. The aim of it was to create a vineyard and manufacture of luxury wine near Praskoveevka. Later both projects were called the Project South.

Due to 2008 financial crisis, Rosinvest was faced with huge financial problems and was not able to run most of its projects further. The company did not receive any financial help from Russian government, as some other companies did, and had to cut most of its projects. As a result, several thousand people lost their jobs. However, the Project South was not stopped, moreover, all financial resources from other suspended projects were transferred into it. At this point of time, the "small recreation complex" grew into a huge palazzo in Italian style, in which billions of rubles had already been invested. There were casino, cinema, summer amphitheatre, chapel, swimming pools, sport complex, helicopter pads, parks with rich landscape designs, tea houses, staff houses, engineering and utility services buildings, etc. on several thousand of square meters of the protected land. It became such a modern variation of Petergof, the emperor palace near St. Petersburg. In October 2009, the cost of this Project South reached one billion of US dollars.

Moreover, in 2009, the ownership of all buildings and the land used in the Project South were transferred to a private company Indokopas Ltd which was owned by Mr Shamalov. However, Mr Shamalov whose wealth is estimated at 590 million US dollars obviously could not have enough money to get an ownership of this complex.

In 2005-2010, several billions of rubles were invested in infrastructure of the region close to the complex (i.e. in building of the mountain road, power supply lines, extra gas pipeline, etc.). And all that infrastructure goes directly to Mr Shamalov's complex.

It is also known that the biggest Russian building company Spetsstroj Russia is responsible for building of this complex. Moreover, several companies controlled by Italian architect Mr Lanfranko Cirello are responsible for the architectural engineering, décor and materials delivery. For example, the materials for the décor have to be imported by different foreign

companies. And in order to hide the real costs of those materials, the contracts were paid in cash or by bank transfers through different offshore zones.

After several criticism of illegality of those operations from Mr Kolesnikov, he was totally excluded from any information on this project. Therefore, today we can only wonder what is the real current price of this palace and how many other palaces are unofficially being built for Mr Putin.

The most interesting point in this case is that it was very poorly highlighted in Russian mass media. For example, the first information about the building of this palace leaked into the press already in 2006. However, there was no concrete details and it did not cause in a broad public response. However, after Mr Kolesnikov's open letter to the president, none of the federal Russian channels or popular newspapers have commented the situation around the palace. Only some independent newspapers with a very limited readership (e.g. Novaya gazeta, RBC Daily, Ria novosti, The Moscow Times, Snob) and several Internet portals have reported about Mr Kolesnikov's open letter to Mr Medvedev and Putin's palace. Putin's spokesman Mr Peskov commented that this and many other attributed palaces have no connection to Mr Putin. "Putin never had and does not have any connection to Bank Rossiya, nor to any transactions or deals through any of the offshore companies or companies that are mentioned". Mr Peskov commented that all this rumors are nothing else than nonsense and "insinuations" short before the parliamentary elections. In its turn, Mr Shamalov dismisses the claims as "inventions", declining to respond further.

Not surprisingly that in the situation, when most of Russian major mass media channels are dependent from the government, Putin's palace case was much more actively discussed in the main foreign mass media, for example, in German Spiegel, Handelsblatt, Welt and Bild; French Le Figaro, Le Monde, France 24; British The Telegraph, Daily Mail, The Independent, Financial Times, Sunday Guardian, BBC; American New York Times, Washington Post, and many others.

## **6. Conclusion**

### **6.1. Fight against corruption in Georgia: an example of successful anticorruption policy<sup>54</sup>**

Before we discuss measures which may be effective for the fight against corruption in Russia, let us analyze the example of Georgia that managed to decline its levels of corruption signifi-

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<sup>54</sup> The World Bank. The fight against corruption in public service. Chronicle of reforms in Georgia (2012).

cantly in the past decade. What were the success factors there? First of all and the most relevant factor that helped Georgia in its fight against corruption was a political will to start the reforms and achieve a real progress in a short term, i.e. prevention of corruption, its identification and realization of a special politics in different spheres of the state services.

As it has been already mentioned before, Georgia was a typical example of a highly corrupt country during the whole its history, both the USSR and the post-USSR periods. Until 2003, corruption penetrated each and every sphere of Georgian life. There was an extremely high corruption in the police, government services, educational and judicial system, housing and communal services.

In 2000, the government launched an initiative to curb the growing menace of corruption in the public sector. President Shevardnadze (1995-2003) created a group of seven experts to develop a national program to fight corruption and work out measures for its implementation. In April-May 2001, based on the suggestions of experts, Mr Shevardnadze signed two decrees, according to which the coordinating council of 12 members was formed and set up an office to fight corruption. The Council, chaired by the President himself, continued its active work until November 2003. The results of the Council's work were that several board members raised accusations of corruption against prominent government officials.

However, despite the high positions of the authorities and a level of their commitment to the council, the results of its work were very modest. The government has virtually no political will and the ability to change the situation. Nevertheless, these first timid steps marked the start of the subsequent reforms of the new government.

In 2003, when Mr Saakashvili became a president of Georgia, he and his government were faced with a huge problem: criminal structures were merged with state authorities and the main interest of them was their own enrichment. That is why the state was very much disable and practically bankrupt. The new government focused on two main areas: the increase of tax incomes and the fight against corruption. One of the first steps of the minister of finance, Mr Zurab Noghaideli, was his meeting with tax officials, where he unequivocally declared zero tolerance towards corruption, and that their work will be evaluated solely on the basis of their ability to collect taxes. Simultaneously, the Georgian government sanctioned the arrest of well-known criminal authorities, as well as some government officials and businessmen suspected of corruption. As a result of those steps, the treasury was filled, and every citizen realized that corruption, which affected all spheres of life in Georgia, became an intolerable phenomenon.

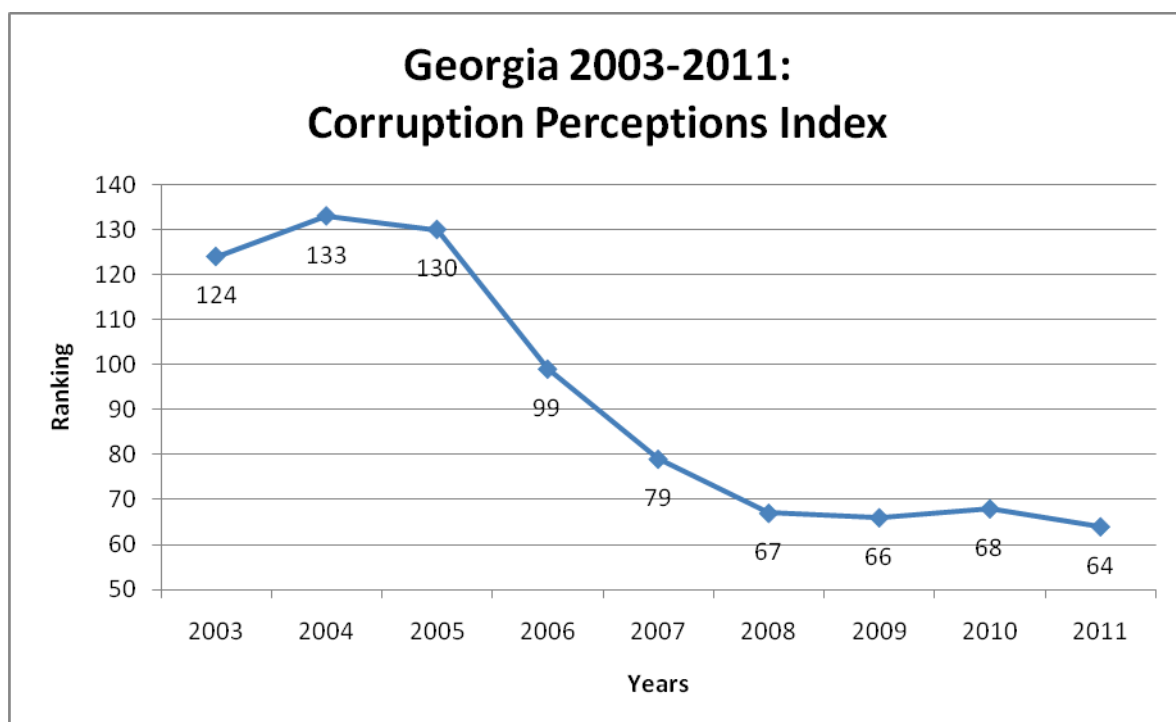


Simultaneously with the filling of the budget and large-scale attacks on organized crime, the government began rooting out corruption and improving services in the key government agencies. The first priority for Georgia was the provision of electricity. The government set a rather ambitious task of restoring the electricity supply round the clock throughout Georgia by the end of 2005. Achievement of this goal was dependent on how to overcome the corruption and on improving the collection of payments for electricity, as well as investing in energy recovery system, which was on the verge of collapse.

At the same time, the Georgian government began the reforms in other areas, including tax collection, maintenance of public registers, the regulation of economic activity, customs, traffic police, the system of university entrance, and a system of local government. In each of these areas the government pursued the same objectives: to eradicate corruption and improve services. Although the goals and objectives were shared, the reformers had enough flexibility in the design and implementation of reforms in each area.

In a very short period of time, Georgia has made significant progress in overcoming corruption. For example, in 2010, the Global Corruption Barometer of “Transparency International” put Georgia on the first place in the world in terms of the relative reduction of the levels of corruption and on the second place according to the public perception of the effectiveness of the government in its fight against corruption. As the result, in 2010 only 2% of the Georgian population responded positively to the question of bribery in the past 12 months.

Figure 15



Georgia also managed to break the vicious link between the state and organized crime. According to the international research conducted by the International Bureau for the Study of Public Opinion in Georgia in 2011, the crime rate has fallen sharply and reached the lowest level in Europe. In 2012, Georgia's ranking of the business conditions rose to the 16th place, hitting a single group with many developed countries of the Organization for Economic Cooperation and Development (OECD). The successes of the country led "The Economist" describe the situation in Georgia as "evolution of mentality", and dispel the myth that corruption in Georgia was a part of its culture.

What are the main results of the Georgian anticorruption program of 2003-2010? First of all, bribery in different spheres of life, i.e. in the police, state services, medicine, education, is practically total defeated. Also most of the corrupt authorities were convicted. However, those who were convicted in nonpayment of taxes and admitted their guilty were made to pay huge penalties and were released.

Moreover, the number of officials was significantly declined while the efficiency of their work increased a lot. For example, the number of law-enforcement authorities declined from 63 thousand in 2003 up to 27 thousand in 2011 (decreased by 2.3 times). The procedures of opening a business or building a house and many others were appreciably simplified. For example, instead of receiving 909 (!) required certificates and licenses for opening a business, starting from year 2011 this number is only 137. Further, the number of days required to get a building license decline from 195 till 98 and the number of procedures declined from 25 up to 9. Finally, many state services were digitalized that minimized the possibility to take a bribe. Secondly, the quality of communal services became much better and the communal infrastructure was improved. Currently the population in Georgia can use electricity and water supply practically round-the-clock.

Thirdly, there is an enormous increase of tax funds. For example, the number of taxpayers in 2003 was only 80 thousand and the tax funds accounted only 12% of the GDP. In 2010, already 252 thousand people were taxpayers and the tax funds accounted 25% of the GDP. Overall, Georgia significantly improved its place in the "Transparency International" Corruption Perceptions Index (see the figure 15) and the trust in the government increased a lot.

How was it possible to achieve such incredible results? There are some main "secrets" that helped Georgia in its fight against corruption:

1. The strong political will.
2. Establishing of trust already on the start of the reforms. Reforms were definite and consistent. Corrupt authorities were strictly punished.

3. The immediate implementation of the reforms: there was no long strategic planning periods or postponing of the reforms.
4. Involvement of new personnel on a competitive basis.
5. Limitation of state involvement.
6. Higher incentives for authorities to perform legally: higher salaries and therefore less interest in bribery together with higher probability of unavoidability of punishment.
7. High coordination between all members of the reformation process and therefore its highly efficiency.
8. Adaptation of world experience in fight against corruption with its adjustment to the local realities.
9. Usage of new technologies and modernization in state services: application of on-line services.
10. Strategic usage of communication channels: explanation of reasons and processes of reforms to the population, making corrupt cases and the names of criminal / corrupt authorities public.

## **6.2. Proposing some visible ways of solving the corruption problem in Russia**

Based on the recent experience of the successful fight against corruption in Georgia, let us now talk about what should be done in Russia to defeat or at least significantly decline the levels of corruption at the highest levels.

Here we should mention, that based on the current situation in Russia, it is difficult and very naively to wait that authorities at the highest levels will suddenly start a real, effective and not fictitious fight against corruption, i.e. per se against themselves and their friends and relatives. Therefore, we can state the absence of the political will to initiate any real reforms and implement effective measures which will end their era of well-being and Putin's palaces. Consequently, there should be an outside the system, down-top impulse and, thus, this initiative should come from the opposition and Russian society.

What are the key components of an effective fight against corruption at the highest levels? First of all, it is important to start with the elimination of systemic barriers:

- There should be political competition.
- There should be independent mass media.
- Development of the civil society in Russia.

How can these statements be fulfilled? Russian opposition, both systemic and non-systemic, and politically active public figures (e.g. journalists, artists, human rights activists, bloggers, etc.) should create a united program with a detailed plan:

1) how to increase the influence of those recent few Russian independent mass media, so that significantly higher percentage of Russians would be able to receive true information about the current situation in Russia (including the information about corrupt cases involving high authorities).

2) how to found and develop a political party which would have a broad public support already at the next parliament elections in 2015, and before that, how to find united candidates for the municipal elections 2014 who would be able to win them and become new political leaders in the near future.

3) how to involve a higher percentage of Russians, especially from the most active middle class, in social projects for the establishment of the civil society (e.g. through organizing different public lectures, forums, conferences, social events, etc.). This process has been already started since more and more Russian public figures start to organize different public events which attract a high attention of the society. The Coordination Council of the Opposition should also play an important role in the process of people's consolidation and developing a strategy, including actions aiming to fight corruption, for the short- and middle-term.

4) finally, how to found an enough powerful public organization for the fight against corruption which will be able to cover the costs that will occur in this process. For example, on May 30, 2012, Mr Navalny announced that he had received the first required investments (4.4 million rubles) for starting the project Fund to fight corruption<sup>55</sup>. So far there are 16 sponsors of the project: businessmen, journalists and even writers. Hopefully, the project will be able to increase higher attention of the society and will become a party influential enough to fight against corruption efficiently. Moreover, the Fund should be financially secured to be able to cover that seeking rent the occurrence of which was discussed in the previous chapter.

In addition, there are some other measures that should be implemented for a successful fight against corruption. The following measures have shown their efficiency by the examples of Italy, Hong Kong and Singapore where the fight against corruption was very successful<sup>56</sup>. Obviously, it will not be efficient enough just to copy all the measures implicated by these countries because there are many cultural and situational differences. However, we should base the process of corruption elimination in Russia on the experience and knowledge received from these best practices to make the fight against corruption in our country more successful. The measures that were efficient in the fight against corruption in above mentioned countries and could be successfully implemented in Russia:

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<sup>55</sup> [http://tvrain.ru/news/navalnyy\\_raskryl\\_svoikh\\_sponsorov-274228/](http://tvrain.ru/news/navalnyy_raskryl_svoikh_sponsorov-274228/) and <http://top.rbc.ru/society/30/05/2012/652763.shtml>.

<sup>56</sup> Harvard Business Review. Russia. Falaleev. They have overcome corruption (2007).

- independent justice and unavoidability of punishment for all corrupt authorities,
- amnesty opportunity for those officials and oligarchs who, by a certain date, will be ready to legalize their capitals while paying significant taxes on them,
- transparency of the government,
- creation of a special independent (!) anticorruption commission / agency,
- implementation of the principle of meritocracy and careful personnel policy in all public offices (i.e. involvement of new personnel on a competitive basis),
- often rotation of office and permanent monitoring of corruption in all public offices in Russia (the results of the monitoring should be published in the mass media),
- creation of special monetary and non-monetary incentives for officials.

Additionally, experts also highlight the importance of changing Russian legislation. First of all, it is very important to examine modern Russian legislation from a criminologist and corruption point of view because currently many articles are clearly “corrupt”. For example, there should be a new, full and detailed definition of the term “corruption” (see the definition we provided in the chapter 2.1.) which will eliminate any ambiguity and minimize the possibility for officials to use the current gap in the law in their private interests. In addition, it is essential to eliminate all other numerous legislation gaps. Secondly, currently, the lawmaking process has always a lag with reality, so it is important to implement a different principle of forming laws: new laws should be issued in accordance to the real life’s needs and normal practices. In other words, if there is any request in making a particular law, it should be issued without any large lag to prevent situations when business starts to regulate this norm on its own by giving bribes. Also it is a normal international practice to legalize lobbying (e.g. USA, Australia, Canada, EU in general, UK, Italy, Hungary, Poland, Israel, Georgia, and some other countries). This practice can be also implemented in Russia, after the special changes in Russian legislation would be made.

The final important step which will contribute to the fight against corruption and building Russian civil society will be making changes in Russian education. New educational programs should change the perception of the corruption in the society starting from the school as well as it should explain the high importance of the strong civil society and its involvement in the political life of Russia. The new educational programs should become a kind of a healthy propaganda explaining the negative influence of corruption on the economy, political system and society, so that the new social principles would be established: respect of law, non-acceptance of corruption, etc. Additionally, there should be special programs that will

reduce the current legal nihilism of Russian citizens, in other words, it will increase the level of juridical knowledge in the society.

In conclusion, it is important to mention that none of the above discussed measures will work efficiently until there is no will to change the situation as well as no strong believe that corruption is not a heavy heritage of Russia which can never be overcome. Corruption and especially corruption as a business in Russia can be and will be exterminated.

## **7. References**