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CORRUPTION AND THE RULE OF LAW

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ANALYSIS

Corporate Corruption in Russian Regions

By Alena Ledeneva, London, and Stanislav Shekshnia, Fontainebleau

Abstract

To understand corporate corruption in Russia and to develop both effective anti-corruption policies at the macro level and anti-corruption strategies at the firm level one has to move beyond the predominant paradigm and to disaggregate its measurement. This article outlines the results of a pilot survey of CEOs of leading companies operating in the Russian regions with regard to their use of informal practices.

Informal Practices

Russia finds itself at the bottom of the 22 assessed countries and one place below China in the Transparency International Bribe Payers Index, aimed at measuring corporate bribery abroad. It is the TI's attempt to measure the perception of corporate corruption rather than the perception of public sector corruption reflected in the aggregate Corruption Perception Index, which in 2010 ranked Russia 154 out of 178 countries with an absolute score of 2.1 on the low side of the 1 to 10 scale. In the words of IKEA founder Ingvar Kamprad, the situation in Russia is "something in a class of its own." It is not that the requisite components of the rule of law are absent in Russia; rather, the rule of law has been diverted by a powerful set of informal practices that have evolved organically in the post-Soviet milieu. John Browne, CEO of BP for twelve years, observes in his memoirs, "the problem is not the lack of laws, but their selective application. This is what creates the sense of lawlessness. While bureaucratic legalistic processes are the hallmark of Russia, you never know whether someone will turn a blind eye or whether the laws will be applied to the hilt."

Disaggregating Corruption

The global corruption paradigm that has prevailed since the 1990s is based on three premises: that corruption can be defined; that corruption can be measured; and that measurements can be translated into specific policies. Significant advances in corruption studies and anti-corruption policies have been made since then all over the world. However, the current paradigm and the use of the term "corruption" do not facilitate an understanding of the workings of corruption in Russia for three reasons.

Firstly, corruption is an umbrella term for a variety of complex phenomena associated with betrayal of trust, deception, deliberate subordination of common interests to specific interests, secrecy, complicity, mutual obligation and camouflage of the corrupt act. In order to deal with such diverse practices in an effective way, we disaggregate "corruption" into clusters of practices relevant for business in Russia.

Secondly, the concept of corruption that underlies international regulatory standards presumes completion of the transformation from what Weber described as "patrimonial power structures," where decisions made on the basis of people's relationships and traditional forms of authority, to rational-legal systems, where institutionalized rules become the foundation of governance. In terms of such transformation, the concept of corruption is modern, and the establishment of a rational legal order and the institutionalization of rules should become the norm, from which corruption is viewed as a deviation. The modernization campaign initiated in Russia by Peter the Great in the first quarter of the 18th century is one example of such a transformation. By undermining and subsequently criminalizing the custom of paying tribute to officials, he transformed what was an acceptable practice into the illegal act of bribery. Similarly, the efforts of post-communist societies (especially those aspiring to the EU membership at the time) to synchronize their legislative and institutional frameworks with those of advanced market democracies during the 1990s resulted in the recognition of practices—regarded for decades as commonplace—as corrupt, and in the development of sophisticated instruments to eradicate them. However, despite legislative and judicial reforms in contemporary Russia, sophisticated political and legal institutions have not fully replaced patrimonial governance mechanisms, which often coexist with modern practices and manipulate them. A classic example here is an elaborate set of procedures for the organization of tenders for vendors and suppliers. Tenders are formally open and competitive and conducted according to strictly followed procedures yet also manipulated to the advantage of an informally related vendor or a trusted supplier. In societies where the use of personalized trust compensates for defects of impersonal systems of trust resulting from selectivity in the workings of formal institutions, it is somewhat misleading to apply the term "corruption" as it is understood in modern societies.

Thirdly, the majority of contemporary definitions of corruption presume that there is a clear distinction between public and private realms. Corruption is thus understood as "the abuse of public office for private gain."

However, in Russia this distinction is still vague. Key actors—government officials of different levels, business owners and executives, law enforcement officers, employees of private companies and government agencies—brought up with the communist concept of "public property" under which all land, capital and other significant assets belonged to everyone as a collective owner, often struggle to draw the line between the public and private domain. In the Soviet days such practices as "taking home" valuable resources from the office or using working time to solve personal problems were commonplace at all levels of society. In the post-Soviet period, weak property rights result from the nature of privatization: understanding that fortunes are made with support of the state and informal channels means their owners cannot be fully in possession of their property. As one business tycoon acknowledged in an interview to the FT, his assets will be given up should the state require it. However, the blurred boundary between the public and the private for the benefit of the latter runs much deeper into the national psyche. For example, between the 14th and 18th centuries the so-called "*sistema kormleniia*" (feeding system), under which the tsar gave his regional representatives the right to exploit their constituencies for private gain after the state tax has been collected, constituted an important element of the governance system. Therefore it is not surprising that "internal corruption," that is the use of corporate resources or authority which comes with the job for personal gain, is so common in Russian business.

Shifting Perspectives on Business Corruption

Depending on one's perspective, informal practices are either associated with trust-based relationships, mutual obligations and the power of informal norms (bottom up); or they are associated with the betrayal of trust by agents who bend or break the formal rules set out by the principal (top–down). In this context one should assume that grassroots forms of corruption are not only the outcome of the misuse of corporate office for private gain, but also an expression of entitlement associated with people's expectations regarding social (in)justice and compensation for deprivation.

Informal practices can be a response to oppressive over-regulation and extortion and thus constitute a form of collective whistle-blowing, to be considered as an indicator of administrative corruption. In certain contexts, top–down anti-corruption campaigns should be treated with suspicion, while informal practices should be viewed as being justice-driven and as having an equalizing effect on the society. In other words, we should consider informal practices as indicators pointing to the defects in formal procedures and as the key to understanding "local knowledge," as well as to explore their relation to "corruption", rather than simply identifying them with the latter.

By analyzing informal practices as set strategies used by firms in Russian regions we propose to complement existing approaches to business corruption with a study that does not rely on the universal definition of "corruption." Rather than following the top–down logic of corruption indices or governance indicators, it calls for a bottom–up perspective and shifts the focus of analysis from legal or moral prescription to a relational understanding of specific practices as "strategies of coping" with the larger system. This has the advantage of capturing a range of practices that are often omitted or misinterpreted by the current conceptualization of corruption, especially the strategies based on the manipulative use of the law and extralegal practices that attempt to redress systemic injustice, thereby embodying resistance or mobilization. Such practices are regulated by values and incentives that may not be perceived as corrupt by their protagonists, although they nourish corruption indirectly.

Business Corruption: Research Findings

Although the theme of business corruption in Russia is being widely discussed both in Russia and abroad, there are few comprehensive studies of this phenomenon. This is understandable, considering its complexity and difficulties encountered in collecting data. To a great extent, Business Environment and Enterprise Performance Surveys (BEEPS 1999, 2002, 2005, 2009—see p. 8) have identified trends in the evolution of corrupt practices. For example, the level of direct extortion attempts by organized criminal groups in such countries as Russia, Ukraine, and Belarus has declined significantly since 2000. Government officials at all levels have increased their pressure for economic gains and many former mafia figureheads have entered political life. Another tendency is that lump sum corruption has given way to more sophisticated, legalized forms of income such as shares in business and other forms of long-term participation.

Although economic corruption in Russian regions is part of a much larger phenomenon, eradication of which would require systemic changes, business owners and managers cannot wait for these changes to take place. They have to deal with corruption on a daily basis and provide immediate protection for their enterprises and stakeholders. We argue that by applying a bottom–up approach and by examining specific informal practices as "strategies of coping" with the larger system these owners and managers can build awareness, which will

serve as a foundation for development and implementation of effective and efficient anti-corruption strategies at the company level. Slicing a snake rather than dealing with it as a whole is an imperative for successfully managing corruption anywhere, but especially in the Russian regions. Applying this paradigm we would like to outline a number of important trends taking place in Russian regions and to discuss their impact on the anti-corruption strategies at the firm level.

In our study we asked CEOs, directors and owners of 49 Russian and international companies to describe to what extent their businesses are faced with informal practices at the regional level. We described informal practices in a user-friendly way, with some colloquial phrasing. We introduced the questionnaire by stating that the listed practices are common and widespread. We have also conducted pilot interviews to make sure that out list of informal practices is comprehensive and covers regional specifics competently and fully.

We have kept the questionnaire simple and focused our questions on the frequency with which informal practices are used in regional branches of the firm: systemic use (systematically), occasional use (sometimes), not used (never). Questionnaires were completed anonymously, but the firm was characterized by its size, age, sector, type of company and number of regions it works in.

Informal practices data are grouped and "tagged" for convenience. For example, the practices that have been marked as never or rarely used are tagged as "dinosaur" practices. These include extorting favors from job candidates; leasing company facilities, offices, and equipment for personal income; and paying exorbitant board of directors' fees to cronies. Extorting bribes by the regional officials appears also to be on the way out as well.

"Predator" practices are organized around informal cash flow extorted by the state inspection organs from businesses. Practices of paying representatives of regional inspection and enforcement bodies—fire inspection, tax, customs—whether voluntarily or as a result of extortion are most systematically used, as well as paying for tax inspections with pre-agreed results and for alleviation of other forms of state control and regulation. Executives also note that companies are engaged in supporting regional governments' pet projects and programs—serving as so-called "relational capital" in the regions.

Although predator practices are quoted as commonly used, other practices associated with "black cash" paid outside business domains (prosecutors, courts, police) tend to decrease in use with the media being an exception. "Enveloped" salaries and bonuses paid to company's employees in order to avoid social tax are also on the decline. Thus, "traditional" forms of corruption such as cash bribes, extortion demands and appropriation of assets give way to more subtle practices such as financing "important" projects, selecting the "right" vendors and suppliers, and selling assets to the "right" companies and at the "right" prices.

Long-term informal relationships between government officials and business executives replace the transactional approach. As one of the business owners interviewed for this article explained: "I am making one of my guys the head of strategy in a state-owned company, which is a major buyer for my products—not as a head of purchasing. I am not interested in signing a contract or even a number of contracts. I am interested in shaping the development of this industry for the next 10–20 years." The businessman is leveraging his political connections to get this job for his protégé. The informal practices become more and more sophisticated to reflect the increasing sophistication of the Russian economy and its legal and administrative structures.

"Rat" practices refer to the use of company resources for personal gain—one of the most acute problems in corporate corruption at a firm level. These include receiving kickbacks or other informal rewards (for example, expensive gifts) by regional managers from vendors, suppliers, buyers and using company funds by heads of regional subdivisions to buy expensive cars, telephones, to pay for travel . The boundaries between "public" and "private" are still blurred in the minds of many managers and employees of Russian companies, who often use corporate resources as an additional source of income. The breathtaking stories from the early years of capitalism's development in Russia, in which future oligarchs allegedly captured assets worth dozens of billions of dollars thanks to their social ties and special relationships, are still popular and make many managers and employees feel relatively deprived and thus justified in stealing, taking kickbacks or selling company assets for personal gain. Internal corporate corruption has become a huge challenge over the last decade and remains so for Russian business leaders. In line with the trend of sophistication, business executives no longer make company employees build dachas or refurbish apartments, but invent complex multi-step schemes to appropriate valuable assets. Thus, a group of senior executives from a publicly traded company—for which the Russian state has a majority stake—managed to consolidate private control over more than 30 firms providing them with engineering services in the regions. They achieved this by forcing their shareholders to sell significant equity stakes to "designated" (by the executives) legal entities. In negotiating these deals, the managers explained that if the vendors agreed, they would retain their contracts and would eventually become minority shareholders of

a consolidated engineering group worth over a billion dollars; if they disagreed, they would lose all their current contracts with the company.

"Penguin" practices are associated with those based on life-long ties and informal connections that account for the blurred boundaries between public and private. It is common for an informal relationship to be confused with the use of that relationship in a formal context, for example the use of informal ties and networks to secure government orders, contracts and loans from state-owned banks. The reverse trend of using company employees for personal needs—assisting family members, building and repairing houses, arranging trips and leisure activities—also occurs. The conflict of interest of regional managers, practices of employing relatives, hiring affiliated vendors are often based on "penguin" affiliations.

The survey demonstrated that practices using "informal hooks" are still in circulation, especially those associated with the use of *kompromat* and security department materials to put pressure on business counterparts, and occasionally for the purposes of internal management.

Fighting Corruption

Our study shows that foreign and Russian business firms alike implement "formal" anti-corruption strategies, such as court cases, regular audits conducted by internal control departments and investigations by security departments, development of internal policies and procedures, and training for employees and business counterparts. However, in Russia, where the governance mode carries features of "patrimonial power" and where decisions are made on the basis of people's relationships and traditional forms of authority, the balance between formal and informal strategies should be adjusted. Fundamental changes require a redistribution of "functions' formerly performed by the informal practices in corrupt settings. The main reason why it is so difficult to get rid of informal practices is because they are also somewhat functional for the economy. They perform the functions of "shock-absorbers" for the system—always in flux and context-bound, they adjust and readjust past-oriented informal codes and integrate them with future-oriented formal rules. They are functional for solving problems posed by defects of the legal system, and they compensate for the imperfections of Russian corporate culture.

If Russia's corporate corruption is to be tackled, a whole set of essential functions performed by informal practices need to be dealt with. In other words, the problem is not the existence of informal practice *per se*, but their indispensability for supporting business' daily operations, stability of cadres and the status quo of the existing system. It is generally assumed that as soon as formal rules improve, these practices will be rendered ineffective or unnecessary and disappear. It might be so, but it takes too long. We believe that simultaneous efforts of refining formal procedures and influencing informal practices will make this process faster. In the short term, it is essential to consider anti-corruption improvement in a disaggregated way, starting with a bottom–up approach to anti-corruption strategies. Companies can play a proactive and positive role in the regions, thus contributing to the overall change of business environment.

About the Authors

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Additional Reading

- Alena Ledeneva (2009) "Corruption in Postcommunist Societies in Europe: A Re-examination," Perspectives on European Politics and Society, Vol. 10, No. 1, April 2009, 69–86.
- Carl Fey and Stanislav Shekshnia, "The Key Commandments for Doing Business in Russia," Stockholm School of Economics in Russia Working Paper #7 – 102, http://www.sseru.org/materials/wp/wp07-102.pdf
- A. Ledeneva, S. Shekshnia, "Doing Business in Russian Regions: Informal Practices and Anti-Corruption Strategies," Russie.Nei.Visions, IFRI, No. 58, March 2011.

DOCUMENTATION

International Expert and Enterprise Surveys on Corruption

Corruption Perception Index

Prepared by: Transparency International
Established: 1995
Frequency: Annual
Covered countries: at present 180
URL: http://www.transparency.org/policy_research/surveys_indices/cpi

Brief description:
The Corruption Perceptions Index is a composite index that draws on multiple expert opinion surveys that poll perceptions of public sector corruption in countries around the world. It scores countries on a scale from zero to ten, with zero indicating high levels of perceived corruption and ten indicating low levels of perceived corruption.

Figure 1: Corruption Perception Index 2010: Scores and Ranking

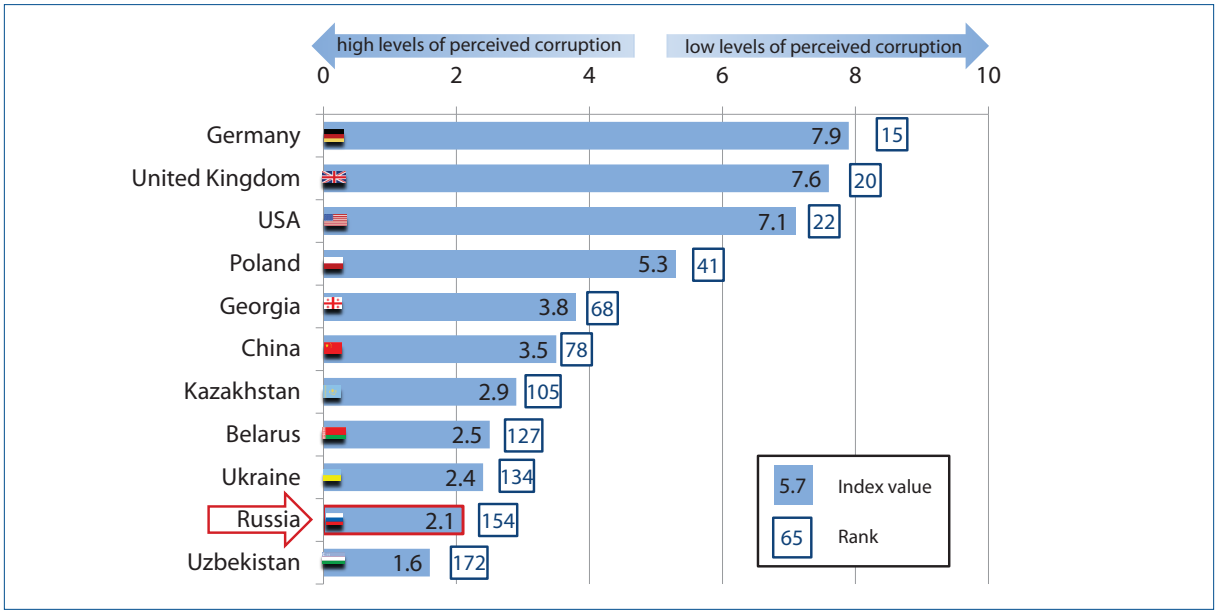
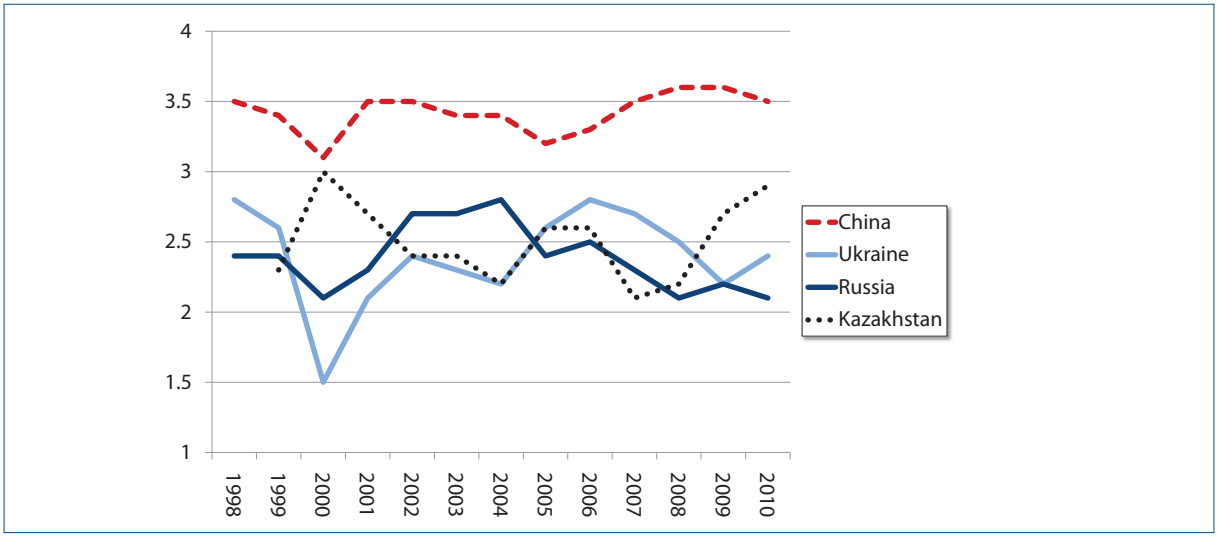


Figure 2: Corruption Perception Index 1998–2010



Bribe Payers Index

Prepared by: Transparency International
Established: 1999
Frequency: irregular (1999, 2002, 2006, 2008)
Covered countries: 22
URL: http://www.transparency.org/policy_research/surveys_indices/bpi

Brief description:
The Bribe Payers Index (BPI) ranks the likelihood of firms from 22 top exporting countries to bribe abroad. These 22 countries account for approximately 75 per cent of total foreign direct investment outflows and export goods worldwide. The Index is based on interviews with almost 3,s000 senior business executives working in 26 countries. Scores range from 0 to 10, indicating the likelihood of firms headquartered in these countries to bribe when operating abroad. The higher the score for the country, the lower the likelihood of companies from this country to engage in bribery when doing business abroad.

Figure 3: Bribe Payers Index 2008: Scores and Ranking

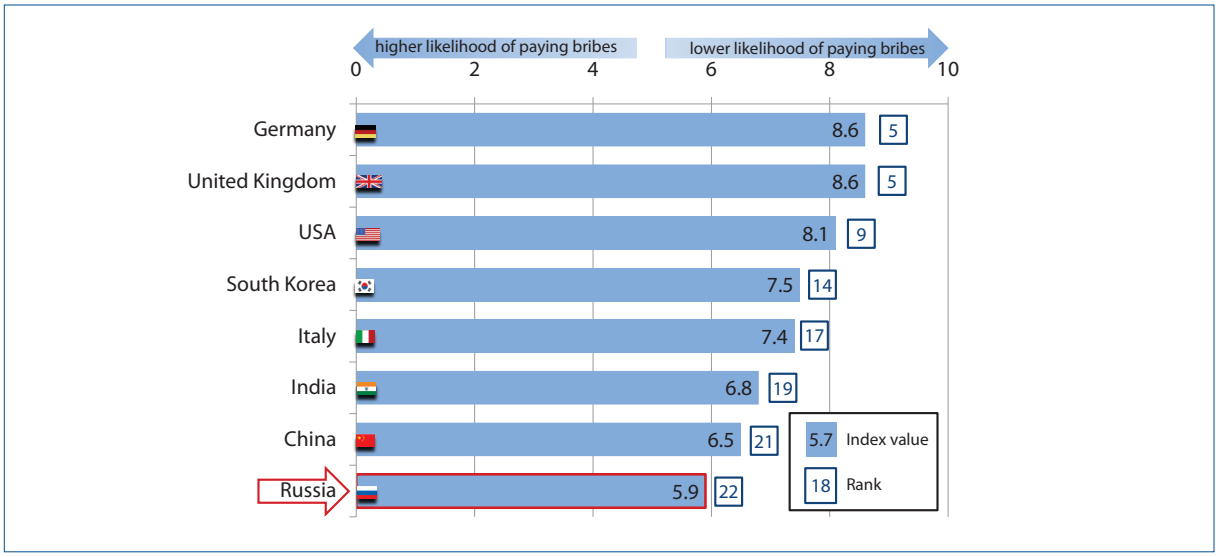
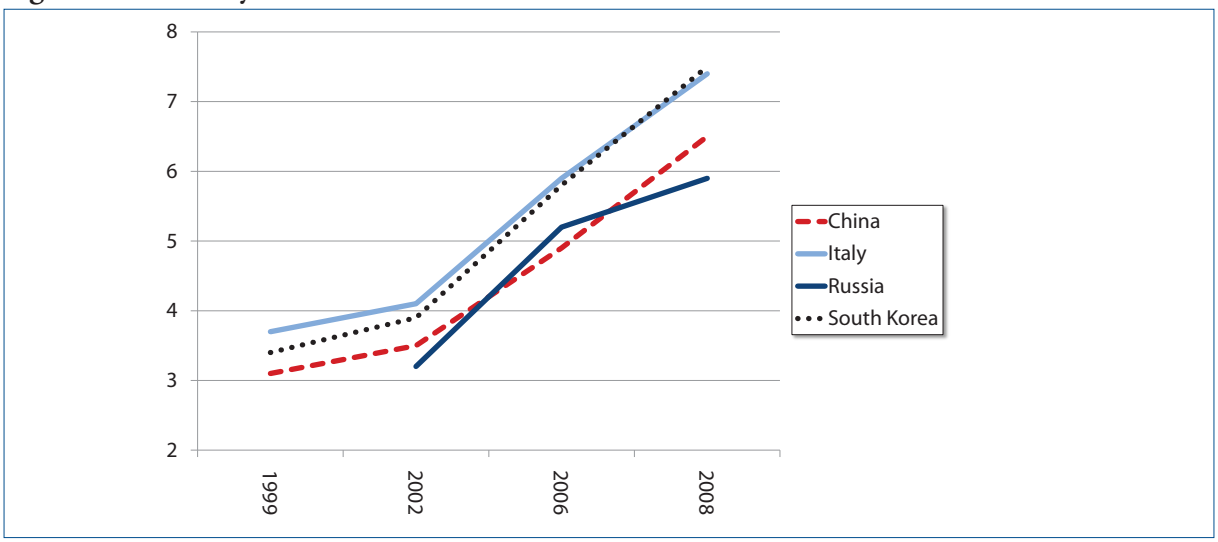


Figure 4: Bribe Payers Index 1999–2010

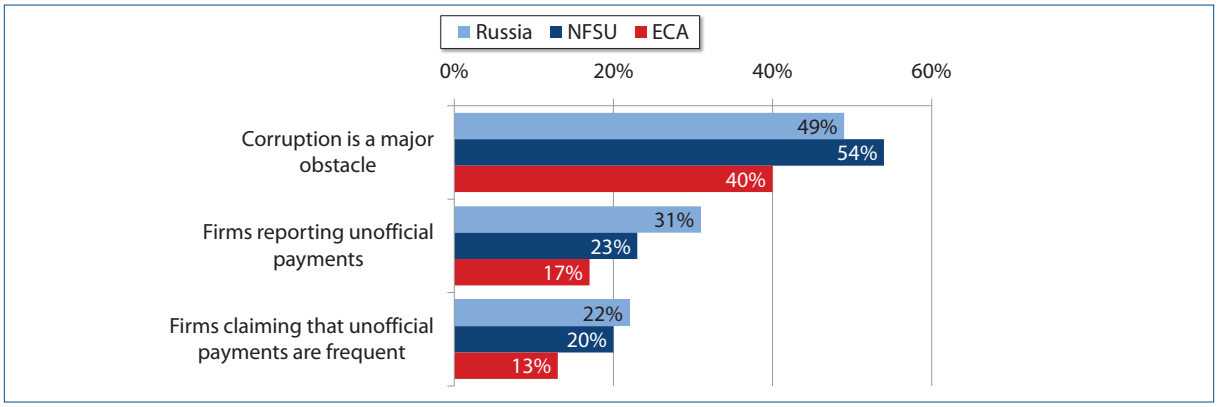


Business Environment and Enterprise Performance Survey (BEEPS)

Prepared by: EBRD and World Bank
Established: 1999
Frequency: every three years
Covered countries: Central and Eastern Europe (including the former Soviet Union and Turkey)
URL: http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/EXTECAREGTOPANTCOR/0,,contentMDK:20720934~pagePK:34004173~piPK:34003707~theSitePK:704666,00.html (2008) and http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/EXTECAREGTOPANTCOR/0,,contentMDK:21303980~pagePK:34004173~piPK:34003707~theSitePK:704666,00.html (1999–2005)

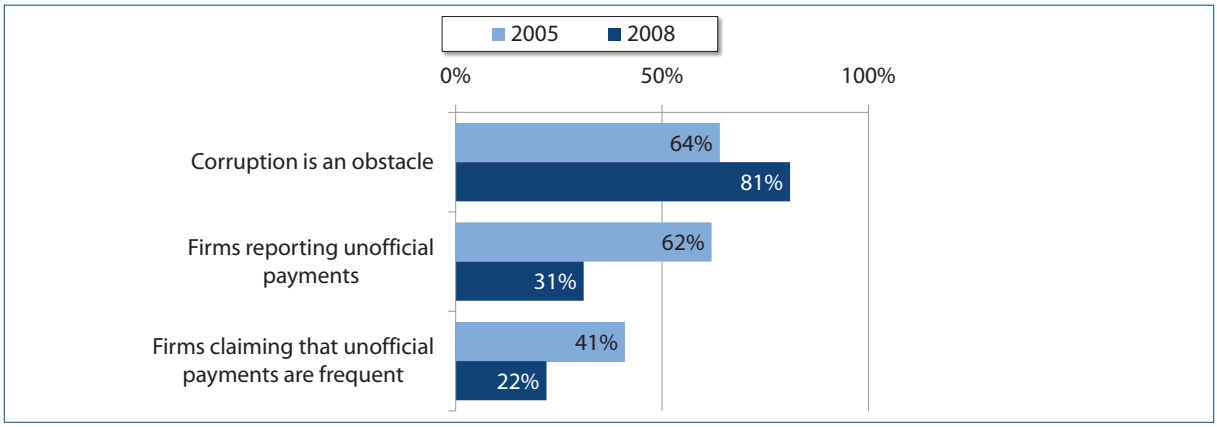
Brief description:
The Business Environment and Enterprise Performance Survey (BEEPS), developed jointly by the World Bank and the European Bank for Reconstruction and Development, is a survey of over 4000 firms in 22 transition countries. For Russia the sample size in 2008 was 1004. The BEEPS examines a wide range of interactions between firms and the state. Based on face-to-face interviews with firm managers and owners, it is designed to generate comparative measurements in such areas as corruption, state capture, lobbying, and the quality of the business environment, which can then be related to specific firm characteristics and firm performance.

Figure 5: Corruption in Russian Business 2008 in Comparison with Neighboring Countries (NFSU=Russia, Ukraine, Belarus, Kazakhstan) and with Central and Eastern Europe in General (ECA)



Source: http://siteresources.worldbank.org/INTECAREGTOPANTCOR/Resources/704589-1267561320871/Russia_2010.pdf

Figure 6: Corruption in Russian Business, 2008 Compared to 2005



Source: http://siteresources.worldbank.org/INTECAREGTOPANTCOR/Resources/704589-1267561320871/Russia_2010.pdf

ANALYSIS

How Anti-Corruption Laws Work in Russia

By Svetlana Tulaeva, St. Petersburg

Abstract

This article examines the corrupt practices that companies use to rent forest plots. The analysis traces the development of the forestry law on auctions, which should have guaranteed honest competition for all participants and blocked informal relations between bureaucrats and businessmen. Unfortunately, in practice, the law's implementation leads to new corrupt practices aimed at circumventing the recently imposed legal barriers.

The Interaction between Anti-Corruption Laws and Corrupt Practices

President Dmitry Medvedev admitted the failure of his anti-corruption policy and the absence of any successes in this area in his January 26 interview with the newspaper *Vedomosti*. The only serious achievement he mentioned was the adoption of anti-corruption legislation in Russia. But even this accomplishment raises severe doubts if you take into account the fact that the implementation of many Russian laws in practice leads to the opposite of the intended effect.

Even though all bills considered in the Duma, regardless of their overall content, are evaluated for their anti-corruption potential, the level of corruption in society has not decreased. In fact, in many cases, anti-corruption efforts do not have the intended effect. For example, in trying to exert maximal control over business and minimize the ability of bureaucrats to intervene, the state has created extremely complicated bureaucratic procedures that waste large amounts of time. These new regulations have stimulated companies to try to reduce the bureaucratic red tape they face through informal agreements with bureaucrats, thereby creating new corrupt practices. Reducing corrupt practices in one area has simply encouraged their growth in another. This experience demonstrates that in any anti-corruption law there can be unforeseen consequences when the legislation is put into practice.

This article examines the problem of corruption through the example of the development of the law defining the procedure for distributing forestry resources in Russia and the unforeseen effects of its implementation. The analysis is based on materials gathered in 2006 and 2010 in the Republic of Komi and Leningrad Oblast. These materials included semi-structured interviews with representatives of big and small business, state agencies at various levels, and NGO experts; excerpts from auction protocols; and publications in the media.

Forestry Competitions and Auctions in Russia, 1997–2010

Over the course of the last two decades, the Russian authorities have sought to set up effective, market-oriented legislation in the sphere of natural resource use with the goal of providing fair and transparent conditions in giving companies access to the resources. The Forestry Code of 1997 proclaimed that the main mechanism for providing forest-land leases would be tenders or competitions. These forestry tenders were organized by commissions whose membership included representatives of the oblast and raion administrations, the forestry industry, and state environmental protections agencies. In determining the winners of the competitions, the commissions were guided by a variety of sometimes fuzzy criteria, including: the size of the payment for the lease, the firm's capacity for cutting down and processing timber, the work experience of an enterprise in a given territory, the conduct of forestry sustainability work, the creation of new jobs, and contributions to solving social problems in a given locality. The commission could also establish additional criteria at its discretion. Additionally, there were closed competitions where participation was only possible upon receiving an invitation from the members of the commission.

In addition to forestry tenders, it was possible to buy standing timber on the basis of forest auctions. In contrast to the forestry tenders that involve a number of eligibility criteria for participants, here the only requirement for victory was the price.

The procedure for conducting forestry competitions included possibilities for manipulation at various stages. In a number of cases, bureaucrats and businessmen took advantage of these opportunities, leading to collusion between seller and buyer. First, the announcement of the competition could be printed in such a way that only "desirable" insiders found out about it. As a rule, the announcements were published in obscure publications with small readerships. Therefore, in order to learn about an upcoming tender or auction, it was necessary to have direct contacts with the raion administration. Second, the business representatives did not have detailed information about the forest tracts that were to be put up for auction or tender. Accordingly, the bidder could end up with forest land that was not suitable for industrial development. Therefore the participants in the auction sought to find out in advance detailed information about the

tracts to be put up for competitions through their informal connections. Third, the tenders required picking winners according to numerous criteria that often were difficult to rank and evaluate objectively. Therefore leasing a desired tract of forest land often required conducting preliminary informal negotiations with the raion administration. Usually, the basic demand by members of the auction commissions, beyond lease payments, was for social aid to a given raion and the creation of new jobs. Therefore during the informal negotiations, the potential forestry operator discussed the amount of social aid they could provide if they were declared the winner of the tender. According to the manager of one forestry enterprise, "the administration itself set the conditions for us, saying that we should do this and this." There were few audits of how the money received from the companies was actually spent. Additionally, in a few cases, the businessmen sought to agree among themselves before an auction or tender. The result was that the conduct of forestry tenders and auctions only appeared to meet the legal requirements from the outside, while the essence of the competition was deformed. The law, which was designed to create competition and foster the most effective way of using Russia's forestry resources, has enabled collusion between the members of the commission and businesspeople.

In 2004–5 the Ministry of Natural Resources made changes in the rules for conducting auctions and competitions, setting the goal of detailing their conduct and eliminating any opportunities for abuse. Thus, the closed competitions were cancelled and announcements about the other competitions were supposed to be published in well-known regional publications. However, the amendments only led to a transformation in the way that the competitions were conducted, without changing their essence. Interviews with businesspeople working in this field show that they continued to actively use informal agreements with the administration to receive forest tracts.

In 2006, during the effort to rewrite the Forestry Code, the procedure by which companies received leases was one of the most widely discussed issues. The key mechanism for leasing land became auctions which would be open to anyone who was interested in participating. The single criterion which would determine the victor was to be price. The auctions now had to be organized by the Oblast Committee for Natural Resources. The new law had several main goals: 1. Impose more effective control over the sale of forest land, 2. Make it maximally profitable for the state, 3. Eliminate informal agreements between bureaucrats and businessmen by conducting open auctions. The Federal Anti-Monopoly Service (FAS) assumed that the conduct of open auctions would be an effective instrument in fighting corruption.

The new Forestry Code came into effect on January 1, 2007. However, the law is not always implemented in a way that achieves the announced goals. First, some of the information asymmetry remains. Despite the fact that the announcements about the upcoming auctions are published in one well-known periodical, the data provided to the potential contributors are insufficient to evaluate the economic value of the lots being offered. Therefore the potential buyer, as before, must use informal connections and contacts to gain more specific information about the forestry plots up for auction.

Second, the new law stimulated new forms of corrupt practices. On one hand, it eliminated the opaque qualifying criteria and transferred the power to pick the winners from the raion level to the oblast/republican level and thereby removed the ability for raion administrations and businessmen to make a deal. On the other hand, since it was more difficult to reach an informal agreement with the members of the oblast auction commissions, there are now a greater number of informal agreements between the participants in the auctions themselves. These agreements are facilitated by the fact that the number of players seeking a particular plot is usually limited and they are all well known to each other. Therefore the potential competitors preliminarily discuss among themselves the possibilities for dividing up the forest and then prepare official applications for specific lots. In several cases, auction victors who secured a lot at a minimal price sublease the land to other participants involved in the collusion at a mutually advantageous price. According to a manager of a forest products company, "Auctions are collusion. We participated in the auction. We knew in advance the prices and how the plots would be divided."

An analysis of the forestry auctions for Leningrad Oblast shows that there is no competition in the majority of them. Thus, between January and November 2010, there were eight auctions for exploiting forest plots. For 74.6 percent of the plots, the buyer won the right to use the land for the initial asking price. In 2009, there were four auctions and 92 percent of the plots were sold for the initial asking price.

Inspections conducted in 2007–8 by the Audit Chamber and the FAS revealed numerous violations committed during auctions across Russia. These violations involved the procedures for conducting the auctions, including the presence of collusion between buyers and sellers, setting the initial asking price too low, and other efforts to go around the law. An additional cause for concern about the anti-corruption features of the law was the complaints surrounding the auctions for leasing forestry land outside of Moscow for recreational purposes. The initiator of the auction was Rosleskhoz

and its organizer was Mosleskhoz. Numerous flagrant violations were committed during the process of auctioning the plots. Applications to participate in the auction were only accepted during a period of four hours. Not only was there only a narrow window to submit a bid but the rules for gaining a permit to enter the building where the applications were being accepted was so complicated that many potential bidders could not submit their applications. As a result, 990 hectares of land were leased at nominal prices. Plots were leased for 49 years at a price of 25–500 dollars, when their market value was closer to $10,000 to $15,000. Among the buyers were high-level bureaucrats and big businessmen.

Auctions conducted like this achieve the opposite of what they are supposed to do: they reduce the price of forest land and reduce the income to the state. Additionally, market competition between auction participants has been replaced by an informal mechanism of cooperation. The new law did not eliminate corrupt practices in the forestry sector, rather it transformed them. If earlier there was collusion primarily between sellers and buyers, now it is more intensively used among the buyers themselves. At the same time, representatives of state agencies in some cases continue to use administrative levers to acquire the forestry plots they are interested in owning.

Why Has the Battle Against Corruption Been Lost?

Researchers studying Russian corruption typically point to opaque legislation as one of the main reasons for the high level of graft in society. Among the problems are the incompleteness and inconsistency of the laws, the high level of discretionary powers given to bureaucrats, and the possibility of conflict in judicial proceedings. But such an explanation is not complete. As this research demonstrates, the presence of "correct" legislation does not guarantee its effective enforcement. The legislators gradually introduced additional changes into the law on forestry competitions and auctions with the goal of eliminating corrupt practices. But the anti-corruption laws do not always eliminate the corrupt practices; they simply change their form. This shifts attention from the laws themselves to the agents participating in their implementation and the special features of the environment which allows the law to be used in a variety of different ways. Therefore, in analyzing the reasons for corruption in various spheres, it is necessary not only to look at the regulations governing that sphere, but to examine the situation from the point of view of the participants themselves.

In studying corruption in Africa, Jean-Pierre Olivier de Sardan described the presence of various logics which make it possible for society to legitimize corruption. Such legitimizing logics, as a rule, are closely bound among themselves and do not facilitate corruption per se. But they lead to a specific type of behavior through which corrupt actions begin to be viewed as the social norm. Drawing on this analysis of forest auctions, it is possible to identify several basic mechanisms that legitimate corrupt behavior in Russian society:

- Survival. The difficulties of the Perestroika period, which relegated many forestry-based villages to the verge of extinction, facilitated informal methods of mutual assistance which came to be seen by the participants as the only way to preserve output and the villages that relied on continuing production. The informal relations between business and the administration in questions of forest leases, on one hand, mitigated the transition of the forestry sector from a planned economy to market relations and helped the otherwise abandoned forest villages to survive. On the other hand, they stimulated corrupt behavior.
- Increasing efficiency. In some situations, circumventing formal rules makes it possible to save money and time.
- Trust. When the rules of the game are constantly changing, interpersonal agreements are viewed as a necessary base for the eventual formalization of interactions. The participants use them as insurance, reducing their risks.
- Competitiveness. In some cases, corrupt practices are not primarily focused on achieving personal benefit, but countering other corrupt players. In these situations, companies must use informal agreements with other businessmen or bureaucrats to prevent themselves from being forced out of the market. The failure of a company's leadership to participate in the existing network of informal relations can lead to the loss of a lease and the accompanying production it provides. In these cases, informal agreements among participants are one of the main ways of advancing in the market. Refusing to use these opportunities reduces the "competitiveness" of the company.

The mechanisms of legitimation described here demonstrate that the practice of informal agreements in circumvention of formal rules is accepted as an integral part of life in Russian society and emphasize the routine, deep-rooted character of corruption. In its battle against corruption, the Russian government is similar to the actions of the medieval inquisition, which held show trials against witches, burned "bad" books, and wrote "good" ones. The Russian authorities also diligently rewrite laws and regularly use the media to inform the population about actions taken against bureaucrats who have gone too far. However, these actions do not

change the situation because the people responsible for enforcing the new laws remain the same.

It is possible that inserting civil society into the bilateral relationship between the state and business would improve the effectiveness and transparency of the deals that are carried out. Such a possibility deserves further investigation.

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Further Reading
- Official site of the Federal Anti-Monopoly Service: http://www.fas.gov.ru
- Official site of the Audit Chamber: http://www.ach.gov.ru/en/
- Information site on Russian forests: http://forest.ru

ANALYSIS

The Magnitsky Case and the Limits of Russian Legal Reform

By William E. Pomeranz, Washington, DC

Abstract
Sergei Magnitsky died in November 2009 after spending 11 months in pretrial detention. The reforms adopted after his death highlight the difficulty of fighting entrenched interests to make Russia's criminal justice system compatible with the government's modernization efforts. Medvedev initiated changes in Russian law, but has not succeeded in changing the behavior of law enforcement agencies. Putin's declaration that Mikhail Khodorkovsky should remain in jail just before the court announced its decision in the second trial suggests that the courts will continue to be used for political purposes.

Two Prisoners
Two proceedings dominated Russia's legal landscape during 2010. The first one, obviously, was the second prosecution of former oil magnate Mikhail Khodorkovsky. That trial reached its predictable conclusion on December 27, 2010 with the conviction of Khodorkovsky and his co-defendant, Platon Lebedev. The other prominent case concerned Sergei Magnitsky, a successful corporate lawyer who died in November 2009 after spending 11 months in pretrial detention. But whereas the public greeted the Khodorkovsky verdict with a sense of resignation, the Magnitsky controversy continued to resonate more than a year after his death. The Magnitsky case, in fact, sheds an important light on what has been President Medvedev's signature initiative to date, namely his fight against legal nihilism and call for broader legal reform. In the wake of Magnitsky's death, Medvedev intervened to promote an investigation of the circumstances surrounding both Magnitsky's failure to receive medical treatment and his long imprisonment without trial. Medvedev also pushed forward new legislation to limit the use of pretrial detention procedures, yet by the end of 2010, Medvedev still had not managed to remove the stain of the Magnitsky affair from the Russian legal system.

The Detention of Sergei Magnitsky
The Magnitsky case stands at the confluence of two of the most destructive trends in Russian law: the politicization of the criminal justice system and the spread of corruption within law enforcement. William Browder ran one of the largest foreign investment houses—Hermitage Capital Management—in Russia. Browder was famous both for his rather upbeat assessment of the Russian market and his repeated demands for greater transparency within Russian companies. The latter clearly irked Russian state officials, and in November 2005, Browder was denied a visa essentially for political reasons.

The second shoe against Browder dropped in November 2007, when the Interior Ministry began an investigation into Hermitage that ultimately resulted in the Ministry seizing the company's computers, certificate of registration, and corporate seal. A massive corporate fraud proceeded to occur whereby low level Interior Ministry officials illegally seized control of three of Mr. Browder's subsidiary companies and, through rigged legal proceedings, received a $230 million dollar tax refund.

Into this investigation stepped Sergei Magnitsky, a Russian lawyer for a U.S. law firm who uncovered the fraud perpetrated against Hermitage and so informed the authorities. For this initiative, Magnitsky himself was arrested, denied bail, and charged with tax evasion in what was a less than subtle attempt to pressure him to testify against Hermitage. Magnitsky never turned, however, despite being subject to horrendous prison conditions. As Magnitsky's health deteriorated, his desperate pleas for medical care were summarily rejected by the chief investigator in the case. Magnitsky died in November 2009 of pancreatitis, although the official investigation into Magnitsky's death later claimed he died of a sudden, and unexpected, heart attack.

Magnitsky's death struck a nerve in Russian society. It turned out that he was one of thousands, if not tens of thousands, of Russian business professionals who have landed in jail for engaging in what generally would be considered normal business practices. Instead of creating wealth and pursuing innovation—the supposed objectives of Russia's modernization program—these entrepreneurs increasingly found themselves facing dubious criminal charges that served as a pretext to extort businesses, property, money, or in some instances, all three.

Medvedev's Response

Magnitsky's untimely demise in custody drew significant media attention to the above practice. As a result, President Medvedev authorized an independent probe within two weeks of Magnitsky's death, to be conducted by the Moscow Public Oversight Commission, a non-governmental organization formed under the auspices of the Russian Public Chamber. On December 28, 2009, the Commission issued a scathing report on Russia's prison system and the psychological and physical pressure that Magnitsky endured during his time in pretrial detention. The Commission added that some wards in Butyrka prison (the last prison that Magnitsky was held in) could justifiably be called tortuous. The Commission further criticized the investigator, the prison medical staff, the judge, and the procuracy's office, all of whose actions—and negligence—ultimately contributed to Magnitsky's death. The case of Sergei Magnitsky, the Commission concluded, "can be described as a breach of the right to live."

Medvedev further used the Magnitsky matter to intervene directly into the Russian criminal justice bureaucracy. He fired 20 top federal prison officials in December 2009, including the chief of the Butyrka prison. He also later dismissed the deputy head of the Federal Penitentiary Service and the head of the tax crimes department in the Moscow branch of the Ministry of Interior.

Medvedev moved on the legislative front as well. He quickly signed a law banning the detention of people suspected of tax-related crimes. He also called for more far-reaching changes to the Russian Criminal Procedure Code to stop the abuse of pretrial detention procedures. Medvedev's amendment, ending pretrial detention for certain types of economic crimes (fraud, embezzlement) if they were committed in the area of entrepreneurial activity, subsequently came into force on April 9, 2010. In May 2010, Medvedev once again was drawn into this controversy when a prominent businesswoman, Vera Trifonova, died in pretrial detention in what was again alleged to be an attempt to extract false testimony. In this instance, Medvedev ordered Alexander Bastrykin, the head of the Investigative Committee, to look into Trifonova's death.

Medvedev's initiative was backed up by other actions both inside and outside the government. In June 2010, the Russian Supreme Court issued a plenum decision that sought to clarify the meaning of the phrase "entrepreneurial activity." This term was not clearly defined under Russian criminal law; as a result, judges were refusing to release detained business people, claiming that these persons were not engaged in "entrepreneurial activity" per se. In order both to address this legislative gap and to stop this practice, the Russian Supreme Court's plenum decision referred judges to the Russian Civil Code's definition of this term.

Non-governmental organizations also got into the discussion of how to prevent the criminalization of legitimate business activity. Most notably, the Center for Legal and Economic Studies, a Moscow-based NGO consisting of prominent judges, lawyers, and scholars, issued its "Concept of Modernization of Criminal Legislation in the Economic Sphere." As this report made clear, Russian criminal law had yet to catch up to the changes in civil legislation that had occurred since the adoption of the 1993 Russian Constitution. This legislative disconnect—along with the excessively broad interpretation of criminal statutes by Russian law enforcement—served as the major contributing factors in the arrest of Russian business people. Therefore, the report proposed the elimination of several criminal provisions,

including the article covering "illegal entrepreneurship," to ensure that normal commercial activity was not criminalized. The Center presented its findings on September 16, 2010 to the Russian parliament, which appeared to be seriously considering at least some of the report's recommendations.

Russian Law Enforcement Fights Back

The above efforts were not without consequence. Some entrepreneurs, with the notable exception of Khodorkovsky, were released from pretrial detention as a result of the new legislation. In his case, the court found that the criminal charges levied against him in the second prosecution were not related to the types of entrepreneurial activity covered by the new amendment to the Criminal Procedure Code. There was also a noticeable decrease in the number of people arrested during the first half of 2010, a drop that was attributed, in part, to the new restrictions on pretrial detention. At the same time, however, Russia's law enforcement authorities found ways to thwart Medvedev's initiative and the intent of the new legislation. Indeed, the Russian Supreme Court felt compelled to issue the above plenum explanation because investigators were not observing the new procedural requirements. According to Chairman of the Russian Supreme Court, Viacheslav Lebedev, in 80 percent of the cases involving persons charged with economic crimes, investigators simply did not refer to the appropriate provisions of the Criminal Procedure Code, thereby failing to indicate that the alleged charges were related to entrepreneurial activities.

Russia's investigative organs began to wage a more aggressive counter-attack during the second half of 2010. Far from being punished, the Magnitsky investigators were honored by the Ministry of Interior for their work on the case. The procuracy further chose not to investigate the lavish spending spree of the principal investigator in the case. Colleagues of Magnitsky had alleged that the investigator's family had spent upwards of $3 million dollars in 2007 and 2008. Finally, in a truly Kafkaesque twist, the Interior Ministry accused Magnitsky, the whistleblower, of being the actual mastermind behind the scheme to defraud the Russian state of $230 million.

There were other more subtle messages delivered as well. A judge in Astrakhan found herself under criminal investigation for releasing a businessman from pretrial detention based on the new amendments to the Criminal Procedure Code. The head of the law firm that originally hired Sergei Magnitsky fled to London, alleging that he had been implicated in a multi-million corporate fraud scheme similar to the one that had ensnarled William Browder. Finally, new nominees were put forward for membership to the Moscow Public Oversight Commission with no apparent connection to the human rights community.

Magnitsky and the "Innovation Society"

Despite such cynical attempts to whitewash the investigation, the Magnitsky affair has continued to resonate inside Russia and internationally, with the U.S. Senate, the European Parliament, and the United Nations looking into the matter. Undoubtedly, the Magnitsky case highlights the need for new legislation, particularly in the area of criminal law. It is highly discouraging that some 16 years after the introduction of the Russian Civil Code—the Russian economic constitution—the Duma still has not gotten around to revising Russian criminal law to correspond to the nation's market economy. As a result, business activity permitted under Russian civil legislation somehow remains punishable under criminal law. On a positive front, Russian jurists have taken definitive steps to address this situation, although how their proposals get translated into law remains to be seen.

New legislation, by itself, however, will not solve the deep-rooted problems within the Russian legal system. As the Magnitsky case demonstrates, Russia also must confront certain entrenched, highly corrupt institutional interests predominant throughout the agencies responsible for law enforcement. Finding the political will for such a major assault appears more difficult. First Deputy Prime Minister Igor Shuvalov referred to the Magnitsky case as a "sad story" but argued that Russia still needed time to reform the system: "We cannot just fire all these people," he insisted. And yet, unless and until there is a fundamental overhaul of the personnel—and mentalities—of Russia's lower level law enforcement agencies, the strong likelihood remains that there will only be more Magnitskys in the future.

Such a prospect naturally gets in the way of Russia's attempt at economic modernization, the oft-stated objective of Russia's current president and prime minister. The Magnitsky case exposes just how far Russia remains from promoting such an environment; instead of encouraging entrepreneurs—and a culture of economic risk-taking—Russia has a disturbing habit of putting its business people in jail. And as the Magnitsky affair further shows, this tendency touches not just domestic economic activity but foreign investment as well. To attract those foreign investors, the Russian government has been busy over the past year promoting the Skolkovo Center for Innovation, a proposed model for modernization that holds out as one of its primary advantages the opportunity to go around the Russian legal system. Foreign companies who agree to partici-

pate would receive special legal treatment in such areas as tax, customs, land use, migration, and advertising.

Skolkovo can be seen as an indirect response to the Magnitsky affair. Its special legal regime is meant to assure international companies that they can invest in Russia with being dragged into the Russian legal system. Unfortunately, this option has been tried before (see the 1999 Law on Foreign Investments, production sharing agreements), with limited success. Skolkovo also does not cover all foreign investments—just those projects engaged in certain defined "research" activities (energy, nuclear technology, space, medical technology, computers). Finally, most Russian entrepreneurs do not have the luxury of opting out of the Russian legal system, so for most business people—foreign and domestic—Skolkovo provides little shelter from the legal risks associated with the Magnitsky case.

It appears that the Kremlin still prefers the legal bypass route of attracting foreign investment as opposed to more fundamental legal change. The Magnitsky case, in fact, exposes the outer limits of legal reform in early 21st century Russia. In this instance, Medvedev actually put his rule of law rhetoric on the line, firing top law enforcement officials and introducing concrete legal proposals to try and eliminate the abuse of pretrial detention procedures. The Russian Supreme Court backed up Medvedev's efforts, while prominent jurists introduced sound legislative solutions to address the problem.

And yet, despite this coherent—and surprisingly swift—response, these efforts still could not crack the intricate defenses of Russia's law enforcement bureaucracy. Indeed, investigators seemed far more concerned with breaking the will of a single whistleblower than with recovering $230 million stolen from the Russian treasury. Medvedev continues to talk about the need to ease criminal penalties for economic crimes. Nevertheless, the lower ranks of Russian law enforcement—in particular, the investigators—not only have weathered the storm surrounding the death of Magnitsky, they have emerged unpunished, and seemingly emboldened, from the process.

Conclusion

The Magnitsky case increasingly is looking like the high water mark in Medvedev's effort to reform the Russian legal system. By the close of 2010, it was Prime Minister Putin who seemed to be setting the tone on legal reform, most notably, by announcing on the eve of the Khodorkovsky verdict that a thief like Khodorkovsky belonged in jail. Such a blatantly prejudicial statement indicated that the Russian legal system once again would be called upon to achieve certain political ends, particularly as a new electoral cycle begins. Medvedev could only issue a mild rebuke of Putin, suggesting that—absent his own political mandate—he has taken legal reform as far as he can.

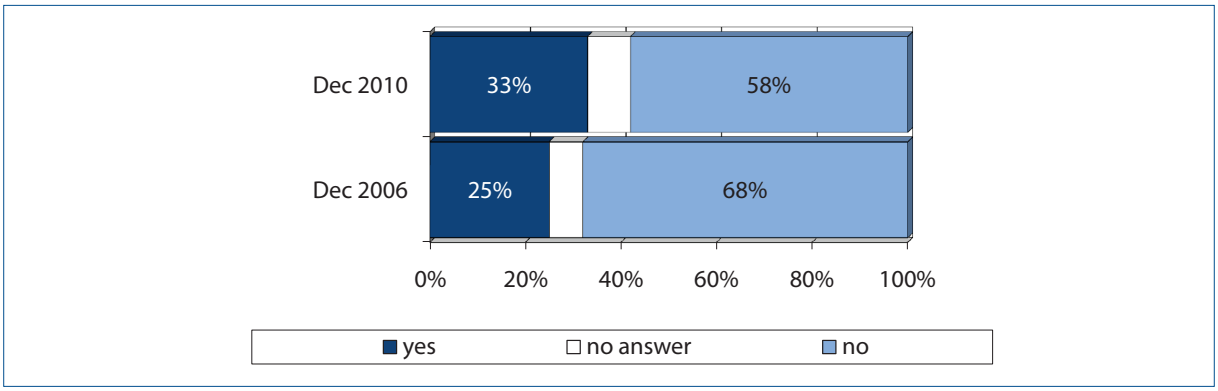
About the Author

William E. Pomeranz is Deputy Director of the Kennan Institute, a program within the Woodrow Wilson International Center for Scholars.

OPINION POLL

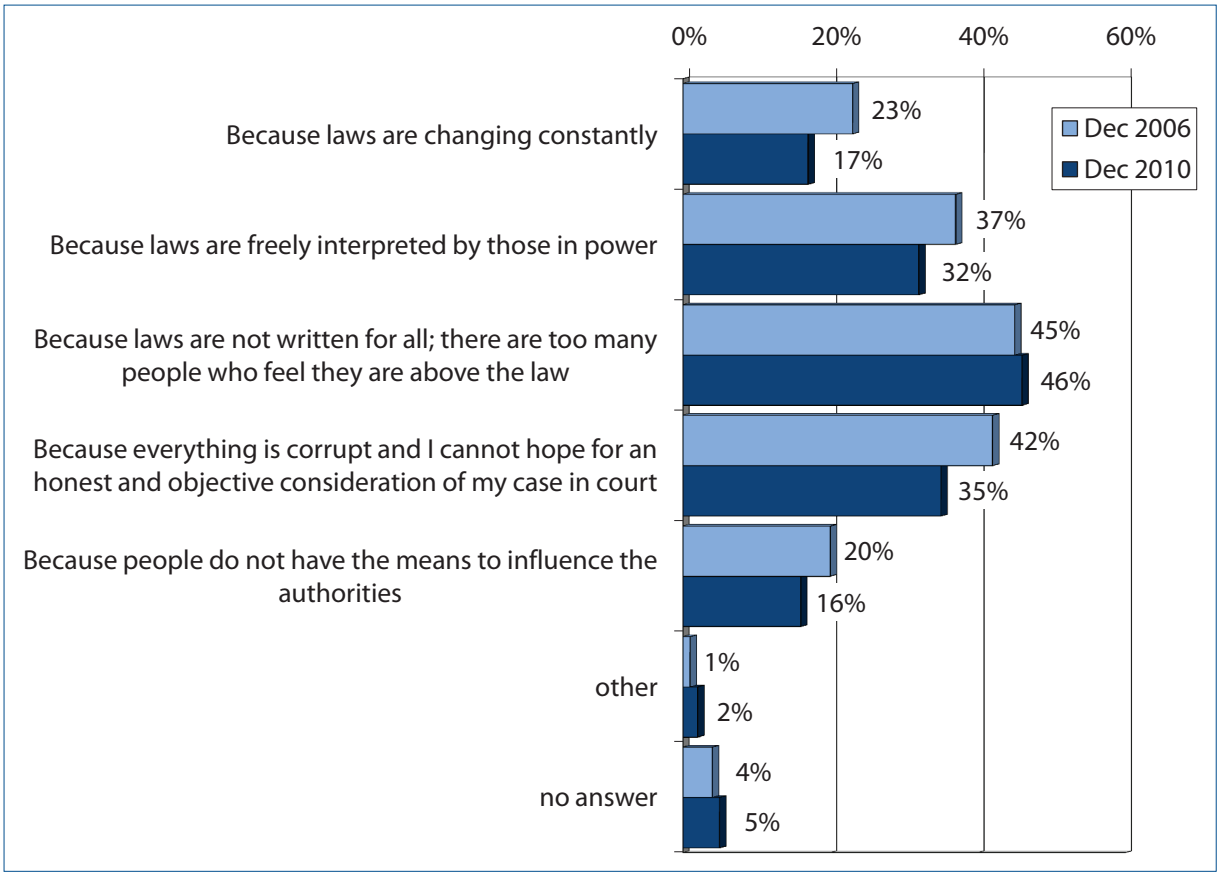
Russian Public Opinion on the Legal System

Figure 1: Do You Personally Feel Protected by the Law?



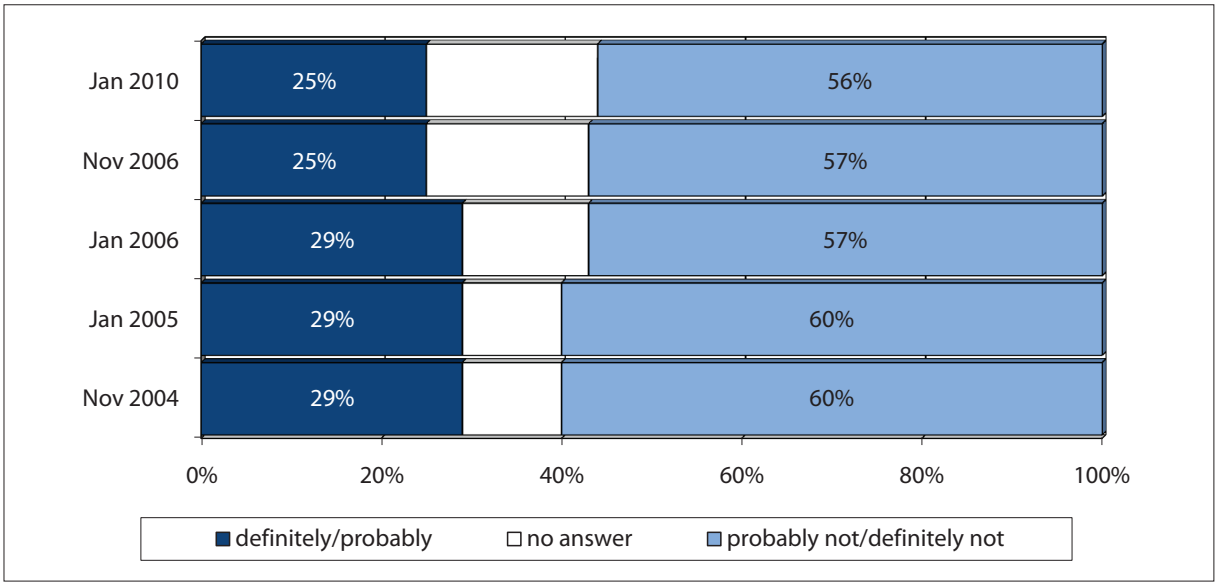
Source: representative polls by Levada Center, 17–21 December 2010 http://www.levada.ru/press/2011012000.html

Figure 2: Why Do You Not Feel Protected by the Law?



Source: representative polls by Levada Center, 17–21 December 2010 http://www.levada.ru/press/2011012000.html

Figure 3: If Your Rights Are Violated by a Court, Is It Possible to Restore These Rights by Legal Means?



Source: representative polls by Levada Center, 17–21 December 2010 http://www.levada.ru/press/2011012000.html

ABOUT THE RUSSIAN ANALYTICAL DIGEST

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In the area of post-socialist societies, extensive research projects have been conducted in recent years with emphasis on political decision-making processes, economic culture and the integration of post-socialist countries into EU governance. One of the core missions of the institute is the dissemination of academic knowledge to the interested public. This includes regular email services with nearly 20,000 subscribers in politics, economics and the media.
With a collection of publications on Eastern Europe unique in Germany, the Research Centre is also a contact point for researchers as well as the interested public. The Research Centre has approximately 300 periodicals from Russia alone, which are available in the institute's library. News reports as well as academic literature is systematically processed and analyzed in data bases.

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The Center for Security Studies (CSS) at ETH Zurich is a Swiss academic center of competence that specializes in research, teaching, and information services in the fields of international and Swiss security studies. The CSS also acts as a consultant to various political bodies and the general public. The CSS is engaged in research projects with a number of Swiss and international partners. The Center's research focus is on new risks, European and transatlantic security, strategy and doctrine, area studies, state failure and state building, and Swiss foreign and security policy.
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The Institute of History at the University of Basel was founded in 1887. It now consists of ten professors and employs some 80 researchers, teaching assistants and administrative staff. Research and teaching relate to the period from late antiquity to contemporary history. The Institute offers its 800 students a Bachelor's and Master's Degree in general history and various specialized subjects, including a comprehensive Master's Program in Eastern European History (http://histsem.unibas.ch/bereiche/osteuropaeische-geschichte/).

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