

**Corruption and Law in Russia: The View from the Firm**

*For Russia After the Global Crisis*  
*Rowman and Littlefield 2010*

**Timothy Frye**  
**Marshall D. Shulman Professor**  
**Director, Harriman Institute**  
**Columbia University**



## **Introduction**

Of all the challenges of modernization facing Russia perhaps none is more encompassing than reducing corruption and strengthening the rule of law. From human rights to corporate governance to criminal law, Russia's agenda in promoting greater legality is daunting. President Medvedev may have exaggerated in noting that "no European country can boast of such universal disregard for the law" as can Russia, but he was not far from the mark.

Reducing corruption and promoting the rule of law is both a technical and political problem. The technical challenges include creating proper incentives for bureaucrats and legal officials to serve public rather than private interests. The standard tools of legal reform include improving judicial training, increasing funding for judges and bailiffs, and computerizing case loads to improve efficiency. On this dimension, Russia has not done badly in recent years (Solomon 2002; 2008).

Yet bolstering the rule of law also involves creating supporting institutions, such as promoting a free press, empowering autonomous social organizations, and encouraging the spread of non-governmental organizations to monitor violations of human rights, bureaucratic misconduct and consumer fraud. Here Russia has fared badly, in large part because these aspects of the rule of law cut to the core of politics.

At its most fundamental level the challenge of modernizing legal institutions in Russia is inherently political because while corruption and weak rule of law impose tremendous costs on society at large, they also produce concentrated benefits for powerful constituencies within the state and society. Rather than viewing corruption and weak rule of law as driven by the moral failings of state officials or the soviet legacy, it is far more productive to recognize the

underlying political nature of the problem. Each sweetheart tax deal to companies owned by the relatives of powerful state officials, each government contract directed to United Russia supporters rather than to the best qualified firm, and each call from the governor to a judge to decide a case in a supporter's favor is political capital that incumbents are loathe to abandon. While Russia has made progress in rationalizing its legal institutions in the last 20 years, the political obstacles to improving the rule of law remain the fundamental barrier to modernization.

### **Russia and the Rule of Law in Context**

Russia is far from the only low to middle income country struggling under the weight of weak rule of law and extensive corruption as depicted in Table 1. A quick glance at two common measures helps put Russia's problems in perspective. Transparency International's Corruptions Perceptions Index relies on up to 13 surveys to rank countries and the World Bank's Doing Business in the World, uses formal, legal indicators, such as the number of procedures required to start a firm, to rank countries according to their business climate. Compared to a small group of other countries developing and transition countries, Russia fares better on some measures and worse on others.

#### **Table 1 here**

Corruption is perceived to be considerably greater in Russia than in Poland, Brazil, India and China, on par with Ukraine, but less than in Venezuela or Uzbekistan. Given Russia's highly educated populace and relative wealth, its levels of corruption are surprising. However, in light of its dependence on natural resources for state revenue and the institutional legacy of soviet rule, its vast corruption is less noteworthy. Russia ranks somewhat better in the Doing Business in the World Ranking which uses de jure rather than de facto assessments of the ease of doing business. In evaluating corruption and the rule of law in Russia it is important to bear the

broader comparative perspective in mind. Indeed, even Brazil, the recent star of emerging market democracies, continues to experience drug wars that leave large sections of the capital city off-limits to outsiders and recently saw drug gangs shoot down a police helicopter only a mile from the site of opening ceremonies for the 2016 Olympic Games.<sup>1</sup>

These problems are hardly new to Russia. Under Tsarist rule the close ties between state officials and firms limited judicial discretion, and even after the introduction of the legal reforms of 1864, state officials spent much of the following decades undermining this legislation (Owen 1997). In the Soviet period law was reduced still further to an instrument of state power. Khrushchev captured the sentiment of the Communist Party elites towards the rule of law: “Who is the master, the Party or the law?” We must use the law to punish speculators whenever necessary” (Simis 1984). In the 1990s President Yeltsin introduced sweeping rule of law reforms, including life tenure for judges, and expanded court authority over commercial, constitutional and administrative disputes. The Yeltsin administration also created justices of the peace which eventually led to significant declines in the caseloads of overworked judges in the courts of general jurisdiction and the courts of arbitration (Solomon 2003). In addition, the Yeltsin administration transferred the administration of courts from the executive branch to a judicial body under the authority of the Supreme Court (Solomon 2008: 66).

The impact of these reforms, however, was limited by severe shortages of funds from the federal government. Court facilities were crumbling, pay for judicial officials declined significantly in real terms, and bailiffs often lacked the resources to enforce decisions against state and private parties. With the decline in federal support, regional officials often helped fill

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<sup>1</sup> Barrioneueva, Alexei. 2009. “Violence in the Newest Olympic City Rattles Brazil,” New York Times, October 21, 2009. <http://www.nytimes.com/2009/10/21/world/americas/21rio.html>

the breach, but typically in exchange for favorable treatment. The reliance on local officials for unofficial financial support, housing, and logistics drastically limited the reach of the central organs of power in Russia's regions in the 1990s (Stoner-Weiss 2006).

President Putin came to power vowing to establish a dictatorship of the rule of law and thanks to the ruble devaluation of 1998 and the boom in oil prices, the Russian state no longer lacked the resources to support judicial reform. The Putin administration pushed through new criminal codes (2002) and civil codes (2003). While far from ideal, these new procedural codes helped to establish the legal rules of the game. Courts were pushed to create websites to post their decisions and to improve the physical infrastructure of their buildings. In addition, on President Putin's watch, jury trials expanded to all regions in Russia (except for Chechnya), despite opposition from the Procuracy and many judges. Perhaps, most importantly, the Putin administration dramatically increased funding for the courts. The Plan for the Improvement of the Courts for 2002-06 called for 44 billion rubles in new spending and additional monies were made available in the Plan for 2007-11. Judges' base salaries are now on the order of 1000 dollars per month, which is fairly high for many Russian cities (Solomon 2008: 68).<sup>2</sup> Thus, there are reasons to expect improved performance of judicial institutions in Russia under Putin.

Yet, great damage has also been done to the supporting institutions that are essential to the rule of law. Media freedom has declined sharply. Freedom House ratings of media freedom from 2000 to 2008 fell from 4.75, which was better than the average non-Baltic country of the former Soviet Union (5.25), to 6.25, which was worse than the average of this same group,

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<sup>2</sup> Even an otherwise highly critical Council of Europe report from 2009 on judicial institutions in Russia noted that the "strong improvement in the social status of judges and prosecutors in recent years have all but eliminated their dependence on executive bodies for housing and other basic needs." See Jordan (2009).

(5.92). More generally, the raucous and open, if hardly unbiased media of the Yeltsin era has been replaced by a staid, non-transparent, and even more biased media in the Putin years.

Business organizations that have been instrumental in defending members against predatory officials in Russia, but the Putin administration has spent considerable effort keeping business associations in line (Duvanova 2007). Non-governmental organizations that monitor corruption, human rights abuses, and protect consumer rights have been squeezed, particularly those relying on foreign sources of funding.

Perhaps as important, spectacular violations of property rights in high profile cases have done tremendous damage to Russia's reputation for recognizing basic legal norms. A few of many examples may suffice. The bankruptcy and subsequent resale of oil giant YUKOS in 2003, the forced sale of foreign-owned shares to Gazprom in the Sakhalin II project in 2006, and the expropriation of three subsidiaries of the international investment fund, Hermitage, in 2008 have further cemented Russia's reputation for weak property rights. In addition, the failure to resolve high profile murders of lawyers, journalists and human rights activists on Mr. Putin's watch has brought a cloud of suspicion about the government's willingness to instill the basic legal norms of its European neighbors.

### **The Putin Report Card: Corruption**

To explore changes in the legal environment under President Putin with greater precision, I commissioned the Levada Center to conduct two surveys of 500 businesspeople in 8 regions in 2000 and 2008.<sup>3</sup> These eight regions included Voronezh, Nizhnii Novgorod, Ekaterinburg, Moscow city, Smolensk, Bashkortostan, Tula, and Novgorod. We included firms from 23

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<sup>3</sup> I also repeated the survey in these cities in 2005 and 2007. The latter survey was financed by the Higher School of Economics and conducted in concert with Andrei Yakovlev and Evgenii Yasin.

sectors of the economy, including heavy and light industry, finance, trade and construction, but did not include agricultural firms. Interviews were conducted face to face in the respondent's place of work and twenty percent of firms received call backs to check the veracity of responses. The questionnaires went through extensive pilot testing and do not require the revelation of sensitive financial information. The distribution of firms in both surveys was roughly similar as indicated in Appendix 1. We asked respondents to rate the following problems on a scale of 1-5 and report the results in Table 2.

**Table 2 here**

The responses here indicate some improvements under Mr. Putin's presidency in the business environment as firms report that labor shortages and competition are more important obstacles and that taxes and the stability of laws are less significant problems in 2008 than in 2000. Most surprising is that these positive changes are also accompanied by sharp increases in complaints about corruption and its close relative, burdensome regulation. On a scale of 1-5, businesspeople in 2000 rated corruption as an obstacle to doing business as 2.43, but this figure increased to 2.75 in 2008. In addition, regulations as problem for firms was rated as only a 1.98 in 2000, but soared to 3.15 in 2008.

To probe perceptions of corruption in somewhat more detail, we asked respondents to rate the extent to which bribery was a problem at the federal, regional, and municipal levels of government on a scale of 1-5. We also asked respondents to make a similar rating for inspectors.

**Table 3 here**

At each level of government businesspeople perceived stark increases in levels of bribery during the years of the Putin presidency. The problem of bribery was most severe at lower levels of government, including the municipal government and the city inspectors (2.8 and 3.14,



respectively).<sup>4</sup> Even in the wake of an unprecedented economic boom, businesspeople perceived corruption to be a more significant problem in 2008 than in 2000. Russia is not growing out of its corruption problem.

These results are surprising in light of three common biases that may have led businesspeople to give more positive responses in the 2008 survey. First, responses may suffer from a “halo effect” in which respondents during good economic times give higher scores for institutional performance than during economic downturns, even if institutional performance is largely unchanged. Second, respondents may have been less likely to make critical evaluations of the government given the more autocratic nature of state power in 2008. Finally, weak rule of law and high levels of corruption may have driven firms who cannot survive the harsh environment from the sample thereby biasing the sample in favor of firms for whom corruption and burdensome regulations are not especially severe problems. This form of “survivor bias” is likely to be more pronounced among small firms who typically experience the greatest costs of corruption. Each of these effects should deflate perceptions of the severity of corruption and regulation in 2008 relative to 2000, but here we find significant increases in both. They also may be inflating evaluations of improvements in the business environment.

### **Legal Institutions**

To examine changes in perceptions of the performance of judicial institutions, we asked respondents to evaluate the capacity of the courts to protect their legal interests in disputes with different types of parties. Here the focus is on Russia’s state courts of arbitration which are the main public fora for resolving disputes between firms and between firms and the state rather than

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<sup>4</sup> Tula and Novgorod had relatively low ratings on bribery in their regions in both 2000 and 2008, while Moscow had bribery ratings far higher than average in both surveys. Other regions experienced substantial increases between 2000 and 2008.

the courts of general jurisdiction which hear most criminal cases. Almost every region has one arbitration court. The arbitration courts have been a focus for reform over the last 20 years (Solomon 2002).

To explore how managers perceive the performance of state courts of arbitration, we asked:

In the case of an economic dispute with a **business partner** do you believe that the state arbitration courts could protect your legal interests?

1) yes 2) more or less yes 3) more or less no 4) no

In the case of an economic dispute with the **local or regional government** do you believe that the state arbitration courts could protect your legal interests?

1) yes 2) more or less yes 3) more or less no 4) no

#### **Table 4 here**

The question establishes a fairly low bar for confidence in the courts. It does not ask the managers whether courts will always defend their rights. It only asks whether the managers expect that that the courts can do so. In 2000, 76 percent of managers believed that the courts could protect their legal interests in a dispute with another firm, while this figure increased to 89 percent in 2008.

Managers were significantly less confident in their ability to use courts against the regional government in both surveys. In 2000, 39 percent of managers expressed confidence that the courts could protect their rights in a dispute with the regional government. In 2008, this figures increased to 59 percent of respondents. The 2008 figures seem high, but may reflect several different factors.<sup>5</sup> First, as noted above, the halo effect may be at work as the first occurred in the wake of the financial crisis of 1998 and the second survey occurred at the peak of

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<sup>5</sup> In 2005 and 2007 roughly 54 and 46 percent of firms believed that the courts could protect their rights against the regional government. Small differences in question wording may also be affecting the results.

an unprecedented 8 year economic boom in Russia. Second, as the Putin administration weakened governors' power between 2000 and 2008, business managers may have expected to have greater leverage over governors in legal disputes in 2008 compared to 2000. Third, increased funding for the judiciary and the legal reform passed in 2000 may have improved the performance of the court. Fourth, between 2000 and 2008 firms that could not use courts against the regional government were more likely to have gone out of business. If so, then on average, more firms that remain in business (and hence in the sample) will expect that they can use courts against the state.<sup>6</sup> Note also that the question does not ask how respondents can use the courts to protect their rights. Some respondents may believe that they can bribe judges to win their case.

On balance, these data suggest that firms have confidence in the ability of courts to protect their property rights in disputes with private firms. They also indicate that a much larger percentage of firms express confidence in the capacity of courts to defend their legal interests in disputes with the regional government in 2008 compared to 2000. But what we would really like to know is how perceptions of the performance of the courts influence economic behavior. For example, do firms who have confidence in the courts to protect their rights in disputes against the state invest at higher rates than those who do not? If so, this would be evidence of an uneven legal playing for firms.

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<sup>6</sup> There is some evidence for this view. For example, in 2000 and 2008 we asked managers to rate the performance of the governor in their region on a scale of 1-5. In 2000, managers who could and could not take the regional government rated the governor, 2.64 and 2.85, ( $t = 2.4$ ) respectively. In 2008, these figures increased to 3.15 and 3.67 ( $t = 5.1$ ). This form of survivor bias would likely therefore inflate the number of firms who believe that they can use courts against the regional government.

To get at this issue, we asked a series of questions about the security of property rights. More specifically, we asked managers whether they planned to make a major new investment in the coming 12 months, whether they had bought new capital equipment, whether they had conducted a major renovation of their building, or constructed a new building. Undertaking each of these activities indicates that the respondent has some confidence in the rule of law and property rights because they require significant up-front costs with only the promise of future gain. If managers expect that their property rights will be violated and that the legal system will do little to protect them, then they are unlikely to take these risky steps in the first place.

**Table 5 here**

Forty-nine percent of managers were planning to make a new investment in the coming year, while 85 percent claimed to have bought new capital equipment in the last two years. Three-quarters of respondents had conducted a major renovation of their place of business in the last two years and just under one-quarter had built a new building within the last two years. These raw figures are not especially revealing about the quality of the legal environment as investment could be driven by many factors, including the economic boom or the significant expansion of credit during Mr. Putin's presidency.

To examine the relationship between confidence in the ability of managers to use courts and the security of property rights, I explore whether the investment decisions of managers depend on their confidence in the ability of courts to uphold their property rights and report the results in Table 5. The biases reported above should be less important in exploring differences in responses within a single survey because the halo effect is likely to influence firms who believe that they can take the state to court and those who cannot equally.

Managers who expected to be able to use the courts against the regional government were much more likely to take actions that indicate some confidence in the rule of law and secure property rights. They were significantly more likely to be planning a new investment in the coming year (54 percent versus 40 percent), to have bought new capital equipment in the last year (89 percent versus 79 percent), and to have conducted a major renovation of their place of business (77 percent versus 70 percent). They were also more likely to have built a new building in the last 12 months although this difference falls short of statistical significance (26 percent versus 21 percent,  $p > t = .14$ ). These results indicate the importance of placing legal constraints on the regional government in order to foster investment.<sup>7</sup> Managers who viewed themselves as unable to use courts against the regional government were much less likely to invest than their competitors who expected that they could use courts to protect themselves. Thus, the playing field in 2008 is decidedly tilted in the favor of more legally powerful firms relative to less legally powerful firms.<sup>8</sup>

These differences are even more pronounced if one examines perceptions of the ability of firms to use courts to protect their rights against the federal government as depicted in the last two columns of Table 6. In three of the four cases, the differences in responses between groups who believe that they can and cannot use courts in dispute with the federal government are statistically significant. In the fourth, the difference between groups lies just beyond standard levels of significance ( $p > t = .12$ ).

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<sup>7</sup> These relationships hold in more demanding analyses as well. For example, controlling for region, sector, and the age of the manager, respondents who believe that they could use the courts against the regional government were significantly more likely to have built new buildings, and be planning to make an investment in the coming year.

<sup>8</sup> This relationship was also present in 2000, although the magnitude of the effect of being able to use courts against the regional government appears to have been smaller in 2000 than in 2008 (Frye 2004).

### **Table 6 here**

The differences in the responses between these two groups illuminate a central reality for firms in Russia: property rights remain quite contingent on firms' ability to protect itself against predation by the state. Ideally one would like investment decisions to be made primarily on economic grounds in an environment in which legal power matters less than economic efficiency, but this is far from the case in Russia.

It is interesting to note that there is no relationship between managers' perceptions of the capacity of courts to protect their rights in dispute with other firms and their levels of investment. Both firms who did and did not have confidence in the courts in dispute with private firms invested at roughly equal rates. Thus, the problem of strengthening property rights in Russia has less to do with the capacity of the state to make and enforce decisions in disputes between private firms than in increasing legal constraints on the power of state officials.<sup>9</sup>

### **The Power of Friends in High Places**

Finally, to explore the value of having close relations with the regional government, we embedded a question in the 2008 survey with an experimental design. This design requires a brief explanation. Rather than asking a single question to all respondents and reporting the average response, here I create four very slight different hypothetical disputes and randomly assign which respondent receives which version of the question. Here their disputants differ in their size and in their relations with the regional government and I ask whether respondents expect that the courts will protect their rights. Because the versions of the question are randomly

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<sup>9</sup> The evaluations of the ability of the courts to protect property rights against the regional government and against private firms did not vary between those who had and had not actually used courts to resolve a dispute in the last two years. Thus, the experience of actually using the courts did not seem to have a significant impact on perceptions of the performance of state courts of arbitration.

assigned the differences in responses can only be attributed to these small changes in the question wording. In other words, the results here are quite powerful because the design of the question implicitly controls for all factors that may be affecting responses, such as the size, location, and sector of the firm as well the individual characteristics of respondents.

More specifically, we asked:

Let's say that your firm fulfilled a large order worth about 10% of your annual revenue for a **[small company with about 100 employees/a large company with about 3,000 employees]**. The buyer paid 50 percent in advance, but is now refusing to pay the rest of the bill because it claims that the product is defective. You are sure that the product is in good working order. **[XXX<sup>10</sup>/In addition, the buyer firm has close relations with the local regional government.]** What do you think, can your firm defend its legal interests by turning to the state courts of arbitration?<sup>11</sup>

1) yes                      2) more or less yes      3) more or less no      4) no

#### **Table 7 here**

It is not surprising that the firms on good terms with the regional government expected to get better treatment by the state courts of arbitration. More interesting is the size of the improvements which are quite substantial, particularly in disputes with small firms. Take for example the responses in the top row. When businesspeople were told that the disputant in this

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<sup>10</sup> The XXX indicates that respondents received no information about the firm's relations with the regional government.

<sup>11</sup> To be more precise, we asked described four scenarios.

- 1) Let's say that your firm fulfilled a large order worth about 10% of your annual revenue for a small company with about 100 employees.
- 2) Let's say that your firm fulfilled a large order worth about 10% of your annual revenue for a large company with about 3,000 employees].
- 3) Let's say that your firm fulfilled a large order worth about 10% of your annual revenue for a small company with about 100 employees. In addition, the buyer firm has close relations with the local regional government.
- 4) Let's say that your firm fulfilled a large order worth about 10% of your annual revenue for a large company with about 3,000 employees. In addition, the buyer firm has close relations with the local regional government.

case had only 100 employees, 79 percent said that the courts could protect their rights. However, when told that the disputant also good relations with the regional government, this figure declined by nine percentage points. To put the size of this 9 percentage point decrease in perspective, it is equal to the change produced by adding 2900 workers to a firm as indicated by the responses in column 1.<sup>12</sup> When the respondent faced a small firm with only 100 employees, 79 percent of respondents expected that the courts could protect their rights, but this figure fell to 70 percent when the disputant had 3000 employees.

### **Caveats and Observations**

Some caveats are in order. This analysis focuses almost exclusively on non-strategic firms and the results should not be generalized to the large politically important firms in the natural resource sector of the economy. Nor should they be extended to foreign firms whose relations with the state likely differ from those of the run of the mill Russian firms described here. The run of the mill firms under are less likely to grab headlines than Russia's natural resource giants or high profile foreign companies, but merit attention as they employ most Russians, are critical for efforts to diversify the economy away from a reliance on oil and gas, and are understudied. Moreover, these firms would most benefit from reduction in corruption and improvements in the rule of law.

These results focus only on firms' relations with the state and tell us little about the state of the rule of law and corruption in criminal or human rights cases.<sup>13</sup> Finally, these results

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<sup>12</sup> The impact of good relations with the governor is even greater if respondents use negotiations rather than the courts. For example, if only negotiations are used then having close relations reduces the percentage of firms who report that their rights will be protected in a dispute with a small firm drops from 50 percent to 37 percent.

<sup>13</sup> There is however, evidence that the courts of general jurisdiction that handle most criminal cases perform significantly worse than the courts of arbitration under study here.



occurred before the financial crash of the fall of 2008, however, the increased role of the state in the economy and heightened dependence of many firms on the state for resources does not bode well.

### **President Medvedev's Turn**

President Medvedev has put great rhetorical effort in promoting rule of law reform, but his deeds to date have been modest, and at times, contradictory. He has decried Russia's "legal nihilism" and its "eternal corruption which has choked Russia as long as one can remember."<sup>14</sup> As a lawyer without experience in the security services, his criticisms have evoked optimism about an improvement in Russia's commitment to legality in some quarters.

His record on legal reform has, however, been mixed despite his rhetoric. In the summer of 2008, he signed amendments to the law non-governmental organizations which eased the rules for registration, but did little to ease other regulatory burdens on these organizations. He has highlighted the importance of judicial independence, but also backed a proposal to change the rules for selecting the chair of the Russian Constitutional Court that would allow him, rather than other justices, to elect the chair. In addition, during his tenure, the state brought another criminal case against Mikhail Khodorkovsky and ended jury trials in cases involving treason and other politically sensitive topics.

He has been maddeningly vague on the details of the policies that he proposes and taken few steps to put his ideas into action. His recent decision to downsize the police by 20,000 and to raise the salary of those remaining on the forces captures the duality of his approach. On one hand, the decision to reduce the police force raises the possibility that the government can weed out "bad apples" from the bunch and reward those who follow the law. On the other hand, the

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<sup>14</sup> See Dmitrii Medvedev's "Forward Russia," speech at [http://www.gazeta.ru/comments/2009/09/10\\_a\\_3258568.shtml](http://www.gazeta.ru/comments/2009/09/10_a_3258568.shtml).

move gives the Interior Ministry a year to implement the policy; allows it to count positions that have gone unfilled toward the 20,000 figure, and relies on the Interior Ministry itself to implement the reform. Moreover, Medvedev assured that no senior Interior Ministry officials would be dismissed and put the incumbent head of the Interior Ministry in charge of efforts to develop anti-corruption efforts in the ministry - a move that hardly inspires confidence. Given the numerous recent scandals involving the militia, including a murderous rampage by a Moscow police officer in a grocery store in April 2009 and a video appeal by a policeman from Novorossiisk decrying corruption among his peers, these steps hardly echo the radical rhetorical flourishes of his speeches on the need to reduce corruption and strengthen the rule of law.<sup>15</sup>

On a potentially more hopeful, but tragic note, President Medvedev dismissed twenty employees of the Federal Penitentiary Service, the head of Moscow's prisons, and the head of tax crimes department of the Moscow branch of the Interior Ministry, Anatolii Mikhalkin, in the wake of death while in detention of Sergei Magnitsky, a lawyer for Hermitage Capital. Magnitsky had made detailed charges of the theft of state property by subordinates of Mikhalkin in the Interior Ministry.

One may attribute President Medvedev's lack of concrete measures to a cautious nature or his weak position relative to his mentor, Prime Minister Putin who has much better relations with the security services. Yet President Medvedev has been in office for almost two years and each month that passes without concrete actions to improve the legal environment, optimism about his intentions and capacity to make real changes in Russia dim.

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<sup>15</sup> For his efforts, Alexei Dymovskii, the whistle-blowing policeman who appeared in the You Tube video publicizing corruption among his peers was recently charged with "fraud committed by a person using his official position" by the Prosecutor-General. For the video, see <http://www.youtube.com/watch?v=R4vB2a15dOU> under the title Russian Police Officer part 1.

To be sure President Medvedev's task has been complicated by the global economic crisis which has hit Russia especially hard. The expansion of state ownership in high profile firms and the increased role of state banks may have made macroeconomic sense, but in Russia, these steps are also likely to have the side effect of increasing opportunities for corruption and abuse of state power. As many firms have become more dependent on state banks and state ownership, their vulnerability to abusive state officials increases. This suggests that trends of higher corruption and importance of political connections highlighted in the survey above will continue at least in the short-run.<sup>16</sup>

### **Implications**

Given Russia's long history of failed reforms, autocratic government, and heavy reliance on natural resources, is it reasonable to expect significant improvements in rule of law in Russia the future? Certainly, these factors do not bode well, but it is also the case that Russia's corruption ratings are far too low for a country with its level of education and wealth. Indeed, while there is still much work to be done, Russia has made considerable progress in modernizing its legal institutions over the last 20 years.

However, strengthening the rule of law requires changes in political relations that level the playing field between the powerful and the powerless and, on this front, Russia has made far less progress. Barring significant political liberalization that increases the power of the voter to constrain state officials, Russia will continue to face daunting problems with legality. Some modest proposals to improve the quality of the rule of law in Russia include findings ways to check state power short of political liberalization. As noted above, Russian courts do not work

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<sup>16</sup> One issue worth watching is how quickly and to whom Russia privatizes assets in which the state has taken positions during the crisis.

badly in run of the mill dispute between private firms, but are much less effective in politically sensitive or high profile cases involving large stakes. One suggestion to curtail state power is to empower autonomous business organizations that can protect the interest of its members. As Duvanova (2007) shows firms in Russia often join business associations to defend themselves against petty corruption. Similarly, Pyle (forthcoming) finds that members of business organizations in Russia are more willing to contest government predation, to lobby for institutional reform, and to invest in physical capital.

Russia would also benefit by redrawing its legal districts. As it stands, Russia's legal jurisdictions coincide with its political jurisdictions. That is, almost every region has one arbitration court and therefore is vulnerable to pressure from a single governor. Redrawing the jurisdictions so that each arbitration court includes several regions might increase the independence of arbitration court judges by reducing their dependence on any single governor. Similarly, it would be helpful to rotate judges among several regions to make it harder to form close relations between judges and governors. Surely, governors (and many judges) would oppose this move, but the benefits for society as a whole could be significant.

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## Appendix 1. Descriptive Statistics

	2000	2008
Average Age	46	47
Percent Male	74	70
Average Firm Size	840	436
Average Firm Size Adjusted (drop ten largest in 2000)	488	436
Modal firm size	150	130
Business organization members (%)	31	32

**Table 1. Russia in Comparative Perspective**

	<b>Corruption Perceptions Index Ranking, Transparency International 2009</b>	<b>Doing Business In the World Ranking, World Bank 2009</b>
Poland	49	72
Brazil	75	129
China	79	89
India	84	133
<b>Russia</b>	<b>146</b>	<b>120</b>
Ukraine	146	142
Venezuela	162	177
Uzbekistan	174	150

**Table 2. Obstacles to Doing Business**

	<b>2000</b>	<b>2008</b>
Finding qualified labor	2.60	3.16
Competition	2.89	3.22
Taxes	4.29	3.49
Finding credit	2.75	2.65
The stability of laws	3.46	3.15
<b>Regulations</b>	<b>1.98</b>	<b>3.15</b>
<b>Corruption</b>	<b>2.43</b>	<b>2.74</b>
The Racket	1.43	1.41

Responses on a scale of 1-5 where 1 equals not at all an obstacle and 5 equals a very serious obstacle.



**Table 3. Bribery at All Levels of Government**

	<b>2000</b>	<b>2008</b>
Federal Government	1.83	2.61
Regional Government	1.92	2.74
Municipal Government	2.09	2.81
Inspectors	2.35	3.14

Responses on a scale of 1-5 where 1 equals not an all a problem and 5 equals a very serious problem.

**Table 4. Using Courts Against Firms and the Regional Government**

	<b>2000</b>	<b>2008</b>
Can defend interests against another firm	76	89
Can defend interests against regional government	39	59

Reports percent yes or more or less yes.

**Table 5. The Security of Property Rights**

	<b>Percent Yes</b>
Plan new investment	49
Bought new capital equipment	85
Conducted major renovation	75
Built new building	24

**Table 6. The Security of Property, the State, and the Courts**

	Regional Government		Federal Government	
	Cannot use courts against the <i>Regional Government</i>	Can use courts against the <i>Regional Government</i>	Cannot use courts against the <i>Federal Government</i>	Can use courts against the <i>Federal Government</i>
Plan new investment in coming year	40	54***	35	58***
Bought new equipment in last two years	79	89***	78	88***
Conducted major renovation in last two years	70	77*	69	76
Built new building in last two years	21	26	18	27**

\*, \*\*, \*\*\* indicates significant differences at the .10, .05 and .01 level,

**Table 7. Courts can protect rights in a dispute with ...**

	<b>No information on connections to the regional government</b>	<b>Good relations with the regional government</b>
<b>Small firm (100 employees)</b>	79	70
<b>Large firm (3000 employees)</b>	70	64

Reports percent yes or more less yes.