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Corruption under Yeltsin and Putin:
The pathology of the Soviet 'blat'
in the modern Russian state

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I. INTRODUCTION

For much of Russian history, corruption has been so endemic that it has become a fixture in the modern narrative describing Russian governance. Indeed, the spectacular blunders of post-communist Russia under Boris Yeltsin has become the primary example used to illustrate widespread Russian corruption.¹ The rapid economic transition following the collapse of the Soviet Union and the resulting dysfunction provided fertile conditions for a culture of bribery and kickbacks to take root, reinforcing a pathology of corruption in modern Russia that in fact comes from the days of the Soviet 'blat'. In recent years, the prevalence of Russia's corruption is being evaluated in monetary terms, revealing alarming figures that serve as sobering implications for the country's formal economy. The cost of corruption in Russia under Vladimir Putin made up an estimated \$427 billion over the period of 2000 to 2008, an average of \$53 billion lost each year, making Russia the country with the second highest level of illicit outflows in the developing world after China.²

¹ Unless otherwise specified, the use of the word 'corruption' in this paper refers to the widely accepted definition 'the abuse of public power for private gain'.

² The largest five countries' cumulative illicit outflows during 2000-2008 in declining order of magnitude are China (\$2.18 trillion), Russia (\$427 billion), Mexico (\$416 billion), Saudi Arabia (\$302 billion), Malaysia (\$291 billion). Global Financial Integrity (GFI). *Illicit Financial Flows from Developing Countries: 2000-2009*. 2010.

Despite such losses in the formal economy, the largest oil producer in the world is being closely watched for its rapid economic rise along with China, Brazil, and India. A January 2013 report titled 'The BRICs and Beyond' released by PricewaterhouseCoopers predicts that Russia could become Europe's leading economy by 2030, overtaking Germany before 2020, and pushing the United Kingdom out of the top 10 by 2050.³ In 2012, the pace of economic growth in Russia outstripped that of Brazil, South Korea, and Turkey, a phenomenon considered unconceivable just two years before. But a closer look suggests that not all is well: the country's economic achievements are dependent on domestic consumption as the main driver of growth. The World Bank notes that the contribution of investment to Russian growth has declined since 2011, while consumption growth continues to be driven by low unemployment, wage increases, credit expansion, and government spending. Indeed, fixed investment remains dependent on public funds, and foreign direct investment has been subdued compared to BRIC counterparts, pointing to the challenging business environment in Russia. As more companies seeking growth opportunities look towards emerging markets,⁴ Russia's regulatory environment if unmitigated could present a substantial obstacle to investment growth,⁵ a necessary element of growth for the country to absorb its expanding domestic consumption.

Between 1995 to 1996, national and regional newspapers published more than 3000 articles on corruption, while more than 150 television reports

³ These findings were based on a PricewaterhouseCoopers model that takes account of projected trends in demographics, capital investment, education levels and technological progress. [World in 2050. The BRICs and beyond: Prospects, challenges and opportunities](#). PwC Economics. January 2013.

⁴ A 2011 Ernst and Young study titled *Growing Opportunities: Russia FDI Report* points out that rapid growth in key developing markets has driven global recovery from the crisis. In 2010, GDP in China grew by 10.3%, in India by 10.4%, in Brazil by 7.5%, and in Russia by 4%. In contrast, the European Union grew by 1.8%. The divergent rates of investment growth between emerging and developed markets reflect a shift in the global economy, demonstrating that emerging markets are an increasingly important source of growth.

⁵ According to a 2011 European Attractiveness Survey that asked respondents what are the most attractive places in which to establish operations, Russia is currently ranked lowest of its BRIC counterparts, overtaken by Brazil in 2010.

dealt with the subject.⁶ During this time, more than 70 percent of respondents in opinion polls agreed with the statement that Russia was a corrupt state. With high levels of corruption and low state accountability, post-communist Russia has been characterised as a hostile environment for doing business, a condition that is argued to be the deep-seated legacy of Soviet rule. To its credit, Russia has appeared to make some headway in terms of global data on corruption. In a World Bank Doing Business study, 40 percent of Russian respondents in 2011 said that corruption was not an issue, compared to 21 percent in 2008.⁷ The inconsistencies in Putin's anti-corruption drive, however, undermine the integrity of his efforts. Data on the size and frequency of bribe-giving suggest that corruption may have merely changed in form. Why has corruption persisted for so long in Russia?

Many scholars are in consensus that a rapid economic transition and authoritarian governance lie at the root of the problem. A vacuum in legislative procedures following the fall of the Soviet Union allowed the practice of bribery and patronage to set into business-doing norms, facilitating a 'pathologisation' of corruption. Furthermore, an oligarchic structure of economic organisation under Yeltsin's rule set a corrupt elite in place that has made inequality a prevalent feature in Russia's economy. The concentration of wealth in Russia's biggest businesses has allowed 'patronage' to gain legitimacy over time within such circles, and a trickle-down effect of this way of doing business has normalised to some extent practices that usually fall under the definition of corruption.

This paper will examine three issues: the norms of corruption in post-communist Russia under Yeltsin and Putin as created under the particular historical biases of Soviet Russia, what type of conditions have allowed the pathology of corruption to endure over time, and finally, the future

⁶ M. Levin and G. Satarov. *Corruption and institutions in Russia*. 2000.

⁷ World Bank. *Russian Federation: National and Regional Trends in Regulatory Burden and Corruption*. 2013.

challenges of corruption in terms of the Russian economy and state legitimacy. This paper highlights the debate surrounding the normative definitions of corruption that, for better or for worse, suggest the usefulness of such practices to the economic stability and social fabric of Russia. This paper also analyses the Soviet 'blat' system in terms of the state capture phenomenon, whereby the burden of blame is re-situated away from the state as the usual primary wrongdoer to firms who influence the state for their private gain.

II. SOVIET NORMS IN MODERN RUSSIA

Many studies have acknowledged that a strong institutional framework such as rule of law and enforceable property rights are conducive to entrepreneurial entry levels. In Russia, the absence of substantial legal infrastructure in the wake of a rapid economic transition manifested itself through close connections in the peculiar form of network or 'blat', a tool dating back to Soviet days but that continues to be used by entrepreneurs to circumvent the inadequacy of the environment. 'Blat' denotes the use of informal agreements and exchanges based on strong network ties linking back and forth between political leaders, state authorities, and entrepreneurs, a phenomenon that has led to a small circle of the Russian elite and is argued to be one of the major impediments to business entry.⁸ The particularities of the 'blat' networking principle did not disappear with the disintegration of the Soviet Union. Instead, there is evidence that it has been pathologised in Russian society and governance. Yeltsin's rule was notable for its oligarchic structure that appears to have adapted rather than transformed the 'blat' system. 'Bespredel' or lawlessness marked Russia's years of shock therapy, reforms that came with high expectations but that slid into economic dysfunction with negative growth and a high inflation rate. Yeltsin, determined to quash the Soviet regime and transform Russia into a market economy overnight via the then-fashionable shock therapy programme,

⁸ S. Estrin, R. Aidis and T. Mickiewicz. *Institutions and Entrepreneurship Development in Russia: A Comparative Perspective*. 2007.

ended up creating an economic system with a few 'oligarchs' who had close ties to political leaders and concentrated capital in their hands. Many have observed that the most productive sector of the Russian economy during Soviet years turned out to be within the black market, which formed the "backbone of free market activity and the development of business culture."⁹

These black market operators emerged as the oligarchy of the 1990s, serving as the backdrop to Yeltsin's power. Far from transforming the system, Yeltsin adapted communist legacies of patronage into the cultivation of competing clans, allowing politics to be dominated by tycoons. Thus was the 'blat' system of personality, privilege and patronage slowly re-cultivated into the fabric of the modern Russian state. Communist-era bureaucrats and managers were replaced by "oligarchic capitalists", one which some liberal reformers such as Prime Minister Yegor Gaidar argued was still more constructive than the previous alternative of central planning.¹⁰ Initially, reformers like Gaidar believed that the oligarchic system was a characteristic aberration of a transitional phase that would eventually give way to liberal capitalism. But critics argued that the oligarchs had a vested interest in preserving their influence and control by maintaining a state of "partial reform", since further liberalisation would reduce their oligopolistic profits.¹¹ This argument appears to hold true throughout most of Yeltsin's reign until the crash of 1998: as the oligarchs drained the Russian state of its assets and revenues, they drove up the budget deficit, profited from high interest treasury bonds, and ultimately facilitated the 1998 crash. This massive failure was compounded by their lack of strategy to legitimise their rule in the eyes of the Russian public.

Yeltsin's blunders forced him to scramble for a suitable successor. Since January 2000, Russia's economic crises have given way to stability under

⁹ P. Rawlinson. *Corruption, organised crime and the free market in Russia*. 2012.

¹⁰ Y. Gaidar. *Collapse of an Empire: Lessons for Modern Russia*. Brookings Institution. 2007.

¹¹ J. Hellman. *Winners take all. The politics of partial reform in post-communist transitions*. World Politics. 1998.

Putin, who pronounced that one of his main goals was to eliminate the oligarchs as a class and to hold all businessmen at an equal distance. His background as an outsider to St Petersburg and a former KGB officer led many to hope he would follow through. To some extent, Putin has made good on his promises: where Yeltsin's rule was notorious for the concentration of wealth and power in the hands of an oligarchical elite, Putin engaged in an open fight with many of them. Using the "dictatorship of the law", he washed out corrupt administration. For example, he introduced a new team of executives into the semi-privatised gas monopoly giant Gazprom and managed to get former Railways Minister Nikolai Aksenenko to resign. Putin wrestled power back to the federal centre, moving political and economic power away from the regions and back to the federal centre. Under his anti-corruption drive, some governors such as Rutskey in the Kursk region and Nazdratenko in the Primorsky region were not allowed to run for re-election. Under Putin, Russia moved up 10 notches in Transparency International's Corruption Perception Index (CPI) from 154th in 2010 to 143rd in 2011. In 2011, Russia signed the OECD Anti-Bribery Convention and a recent report from the Group of States against Corruption (GRECO) has pointed out that Russia's anti-corruption drive is making some progress in fulfilling its obligations.

That said, studies analysing the real redistribution of power and capital in Russia suggest that Putin's anti-corruption measures may not have been particularly effective in mitigating the business environment in Russia. Even as Putin pronounced his commitment to an anti-corruption drive during his presidential campaign in 2011, vowing to make Russia one of the world's top places for entrepreneurs in the next 10 years, his rhetoric was cautiously applauded by a skeptical international community. According to the same World Bank Doing Business study, the data appears contradictory: there seems to be less companies giving bribes, but the size of the bribes are increasing.¹² According to the Russian Interior Ministry for Combating

¹² Pekka Sutela. *Lecture 11: Challenges ahead: how to face them*. Economic challenges in Russia and the post-Soviet Union states. Paris School of International Affairs. April 2013.

Economic Crimes, the average bribe paid has risen 26 times over the last five years, from 9,000 rubles in 2008 to 236,000 rubles in 2011¹³, many times the inflation rate for the same period. Also, the average time needed to obtain selected permits and licences has gotten worse. These contradictions undermine the legitimacy of Russia's improvements, as they suggest other factors are disguising the extent of corruption in the country.

In terms of inequality, Putin's anti-corruption drive has not managed to eliminate the capitalist class. Although Putin has managed to squash the oligarchs, other rising capitalists are taking form. Realising that there were now new rules to the game, those who played along were allowed to hold on to their businesses and especially flourished under the conditions of economic and political stability created by Putin. Moreover, capital is even more concentrated today than a few years ago. The top ten companies in Russia accounted for 61 percent of total net profits in 2000, compared to 57 percent in 1997. The number of small business has shrunk by 48,000 in Putin's first two years.¹⁴ Indeed, Russia appears to be sending mixed signals about corruption under Putin's regime. Transparency International notes that while there are commendable government efforts to crack-down on officials trying to hide illicit wealth, civil society organisations and independent surveys dealing with corruption in Russia are being curtailed. Non-governmental organisations have faced suspect inspections by Russian authorities and have openly criticised Russia's recently passed laws on restricting the rights to "freedom of expression, association, and assembly" that they claim significantly hamper the operations of civil society. Another common complaint about government investigations into various corrupt individuals is that the findings are often not released, calling into question the integrity of Putin's anti-corruption drive.

¹³ Institute of Modern Russia. *The Simulacram of a President*. 2012. <<http://imrussia.org/en/politics/235?start=2>> Accessed April 7th, 2013.

¹⁴ P. Rutland. *Putin and the oligarchs*. 2009.

The Soviet 'blat' may no longer exist in name in modern Russia, but its legacy has left a pronounced impact on the informal practices of doing business and, by extension, on the way power and society interact. Russian governance, highly characterised by authoritarianism, has to some extent been oiled into place by a social fabric peopled by large firms accustomed to informality and who continue to generate relationships that are favoured institutionally. This suggests that the usual definition of corruption as the abuse of public power for private gain may unduly place an onus on the government and under-appreciate the role played by private actors.

III. GOVERNANCE AND STATE CAPTURE: AGENTS OF PATHOLOGY

In trying to explain Russia's deep social entanglement with corruption, most prominent is the argument that focuses on the rapid transition from a planned economy to an extremely fluid one under Yeltsin's shock therapy programme. The collapse of the Soviet Union opened up a void in political and economic power, and in the chaos of transition, power shifted from 'formal political institutions to informal networks of influence among individuals who had political connections of economic resources at their disposal.'¹⁵ One only needs to look back in Russian history to identify further instances of rapid changes and observe how they have facilitated corruption: programmes implemented from above such as by Peter the Great and later by the Bolsheviks have also contributed to the adaptation of old informal practices. Various studies on countries in transition show that legislation tends to lag behind the renovation of fundamentals of the economy and economic life.¹⁶ Indeed, the large-scale privatisation of state assets under Yeltsin took place in the context of weak legal and political institutions. Within the vacuum of rule of law, there was little mechanism to regulate the life of the state and society, allowing informal practices such as the 'blat' to foster.

¹⁵ P. Rutland, *Putin and the oligarchs*. 2009.

¹⁶ Idem.

Some studies have focused particularly on how Soviet institutions perpetuated the 'blat' system. The rapid changes in post-Soviet Russia occurred without a change in the majority of state officials, who were not capable of adjusting to new market behaviour and carried on with their patron-client relationships. Libman and Obydenkova (2013) show that even 20 years after the collapse of the Soviet Union, regions with a higher share of Communist Party members in the 1970s have substantially higher corruption today. They explain this by the fact that, unlike other countries, post-communist Russia did not impose any constraints on former communist party members, allowing them to become influential bureaucrats, politicians, and businessmen during the phase of transition.¹⁷ Other studies have taken on a more political economy perspective, examining the relationship between totalitarian regimes and corruption, suggesting that the intertwining of political and centralised economic power creates an environment that facilitates corrupt practices. A social psychology perspective on the extent to which Russia's political history has shaped the pathology of corruption, however, remains a relatively untouched field.

These studies highlight the role of institutions and governance, but what of the private actors? Corruption as discussed in terms of 'the abuse of public power for private gain' has usually implicated the state as the primary wrong-doer. What many studies show, however, is that in the case of Russia, the flip-side holds true: firms can influence the state for their private gain. The ubiquity of the 'blat' as an organising principle for business has been studied in terms of 'state capture', which moves beyond the usual definition of corruption by examining relationships that are, in fact, favoured institutionally. Around the turn of the millennium, major institutions such as the World Bank started paying special attention to the state capture phenomenon, "the most pernicious and intractable problem in the political economy of reform", which is defined as "the efforts of firms to shape the

¹⁷ A. Libman and A. Obydenkova. *Communism or communists? Soviet legacies and corruption in transition economies*. 2013.

laws, policies, and regulations of the state to their own advantage by providing illicit private gains to public officials."¹⁸ This study focused on transition economies such as Russia and other Eastern European states, where 'grand corruption' was emerging in the form of so-called oligarchs who had the influence to manipulate policy and shape the rules of the game, enormously to their own advantage. Other studies such as by Slinko et al. (2005) provide empirical evidence for the effects of state capture on politically influential firms between 1992 and 2000. They find that, compared to firms without political influence, politically powerful firms invested more, enjoyed higher profits, higher rates of growth in sales and employment, and that their performance moved in tandem to the growth of state capture. Meanwhile, firms without any political influence stagnated as their productivity, sales and investments declined with the increase in capture. This suggests that informal practices in Russia do not necessarily follow a top-bottom dynamic: certain large firms have the power and the incentive to perpetuate corruption bottom-up.

Here, the definition of corruption has occasionally been called to question. To what extent can a bribe be considered a bribe if it is a reciprocal exchange? A small camp of scholars have tried to differ from the popular argument that corruption is inherently 'bad' by examining the nature and impact of corruption in developing countries in terms of the stability it brings in social and political relationships.¹⁹ According to Le Billion (2003), "corruption is not systematically 'naked self-interest' but can respond, for example, to codes of reciprocity within (neo)patrimonial political systems based on legitimate patronage." Others such as Chabal and Daloz (1999), Cohen et al. (1981), and Charap and Harm (1999) have equally contributed to the argument that corruption can be "endogenous to many political structures in which it serves key hierarchical functions, thereby contributing to political order." While this did not hold true at the end of Yeltsin's rule,

¹⁸ J. Hellman and D. Kaufmann. World Bank. *Confronting the challenges of state capture in transition economies*. 2001.

¹⁹ Le Billion. *Buying peace or fuelling war: The role of corruption in armed conflicts*. 2003.

since the oligarchs failed to establish any form of public legitimacy, it is an interesting exercise to consider whether the system would have prevailed if a more staggered economic reform programme had been implemented, thus minimising the bizarre and harmful impacts of the 'shock therapy'. Studies such as Kaufmann and Vicente (2005) point out that corruption in transition economies like Russia often arise through less obvious forms.²⁰ They challenge the idea that corruption is necessarily illegal in the country where it takes place, highlighting the extent to which corrupt practices may have been institutionalised, hence their use of the term 'legal corruption'. For example, lobbying contributions by the private sector in exchange for particularly advantageous legislation in favour of those agents, and allocation of contracts based on connections are often touted as interactions between the public and private sectors that are made at the expense of public welfare. This systemisation of collusion between the private and public sectors is a key characterisation of corruption under Putin's rule.

IV. ECONOMIC CHALLENGES

Definitions notwithstanding, there is a general consensus that these informal practices have a corrosive effect on the economy. Russian think tank Indem estimates that bribes accounted for 20 percent of GDP in 2005.²¹ The extra cost of 'doing business' makes up roughly 5 to 15 percent of production costs, a margin that is transferred onto consumers and contributing to increased price levels.²² In an interview with business school INSEAD,²³ Professor Stanislav Shekshnia likened the challenge of fighting corruption as a whole to "trying to prevent winter from coming." In a survey of Russian firms, Shekshnia identifies bribe extortion by government officials,

²⁰ D. Kaufmann and P. Vicente. World Bank. *Legal corruption*. 2005.

²¹ Indem has yet to publish an explanation of their methodology.

²² M. Levin and G. Satarov. *Corruption and institutions in Russia*. 2000.

²³ INSEAD interview with Professor Stanislav Shekshnia. <<http://youtu.be/XdHV5d29ffI>>

administration, and supervisory bodies as the most common incidence of corruption out of a list of 27 practices. Shekshnia points out that these practices destroy value for Russian companies, who also suffer from internal corruption. One company that decided to implement a zero-tolerance policy for kickbacks, with a target of becoming kickbacks-free in three years, reported a reduced cost per unit of 15 percent. It is a compelling example, argues Shekshnia, of how liberalisation and trade-openness are forcing Russia to be more competitive and to preserve value. Another example is the oil company Yukos: after adopting transparent financial reporting and paying regular dividends, its stock market valuation soared from less than \$1 billion to more than \$10 billion. If these numbers are to be relied on, then corruption has situated Russia poorly in comparison to its international trading partners and in comparison to its true economic potential. The estimated losses from corruption theoretically have some bearing over the estimated loss of government revenue as well. A shadow economy reduces tax collection and consequently weakens the government budget, which in turn limits the provision of public goods and other services that the government should provide.

Furthermore, since companies are contracted less on the basis of merit than on their willingness to participate in bribes and kickbacks, the lack of true market competition reduces the quality of goods and services in the formal economy and furthermore makes it challenging for small businesses to operate. In a study of Russia's institutions and its impact on entrepreneurship development, Estrin et al. (2007) point out that entrepreneurship levels in Russia are low compared to relatively large emerging economies such as Poland and Brazil, and this continues to hold true for a number of countries that have transitioned from a centrally planned economy to a free market one. They argue that institutional weaknesses have provided greater opportunities for existing businesses to develop new ventures but not for new entrants who are trying to establish start-ups. In the same vein, commentators are also quick to point out that

this sort of environment contributes to a 'brain drain', driving out the country's best and brightest.

V. CONCLUSION

In the eighteenth century, leading ideologue of the Russian Enlightenment Prince Shcherbatov lamented how "luxury and voluptuousness laid the foundation of [Russians'] power...and, to the ruin of the laws and the detriment of the citizens, began to penetrate the law-courts."²⁴ After a fashion, his disappointment has reason to prevail today. The widespread corruption of Yeltsin's years following decades of communism have since been thought to have pathologised bribery and kickbacks, turning patronage into a commodity and serving as a platform of further evolution for corruption. Unmitigated over an extended period of time, it has become a fixture of everyday life, deeply ingrained in socio-political relations and business transactions. Putin may have dismantled the oligarchic system of Yeltsin's time, but Russia continues to see an elite group of billionaires in systemised interaction with authorities. And despite Putin's anti-corruption drive, observers remain skeptical of the integrity of his motivations, as there are basic inconsistencies in the way civil society continues to be tightly monitored and in the lack of transparency in handling investigations of corrupt individuals. These are challenges that touch upon every aspect of the state and society and that have enormous repercussions economically, but that are difficult to uproot because of the way corruption infiltrates activity at all levels. The state capture phenomenon suggests that the 'abuse of public power' definition requires more nuance as it places the onus on the state as the primary wrongdoer, under-emphasising the role of private actors when situating the sources of corruption. Moving forward, it is unclear how the handling of corruption will evolve in Russia, but unless there are clear signs of mitigation, Russia is likely to fall back on its trajectory of economic growth and competitiveness in relation to its rapidly rising BRIC peers.

²⁴ Prince Shcherbatov. *On the Corruption of Morals in Russia*. 1797.