
Corruption and Rule of Law

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Of all the modernization challenges facing Russia, perhaps none is more complex than reducing corruption and strengthening the rule of law. From human rights to corporate governance to criminal law, Russia's agenda to promote greater legality is daunting. President Dmitri 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.¹

Yet bolstering the rule of law also involves strengthening supporting institutions, such as promoting a free press, empowering autonomous social organizations, and encouraging the spread of nongovernmental organizations to monitor violations of human rights, bureaucratic misconduct,

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1. Peter Solomon, "Putin's Judicial Reform: Making Judges Accountable as well as Independent," *East European Constitutional Review* 11, no. 1/2 (Winter/Spring 2002): 117–24; Peter Solomon, "Assessing the Courts in Russia: Parameters of Progress Under Putin," *Demokratizatsiya* 16, no. 1 (Winter 2008): 63–73.

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 the 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 technical problems, 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 relatives of powerful state officials, each government contract directed to United Russia supporters rather than to the best qualified firm, and each call from a governor to a judge to decide a case in a supporter's favor is political capital that incumbents are loath to abandon. While Russia has made progress in rationalizing its legal institutions in the last 20 years, political obstacles to improving the rule of law remain the greatest barrier to modernization.

In this chapter, I address the following questions: How has the quality of governance in Russia evolved in the last decade? Have the centralization of power in the Kremlin, increased spending on the judiciary, and high growth rates brought a degree of order to the daily transactions of businesspeople? Or has the weakening of checks on central state power heightened perceptions of corruption and undermined the security of property rights? Original data from two large surveys of Russian businesses in 2000 and 2008 reveal that businesspeople perceive that corruption has increased since 2000 (discussed in detail further into the chapter). This perception is especially surprising because many firms that existed in 2000 were likely driven out of business due to corruption, which means that only those firms for whom corruption is less of a problem have survived and were surveyed in 2008. Such a "survivor" bias in the surveys should have led to lower estimates of corruption; however, businesspeople report higher rates of corruption in 2008 than in 2000.

In addition, businesspeople report that in recent years the security of property rights has become more contingent on political connections. Investment decisions greatly depend on whether businesspeople believe that they can take the state to court. Moreover, political connections in legal disputes remain a powerful asset. Controlling for all other factors a small firm can increase its perceived chances of winning a property dispute with another small firm by 9 percentage points if it has good relations with the regional government. Taken together, these results indicate that the playing field for businesses in Russia has become increasingly uneven in the last decade.

Table 4.1 Corruption and business climate in Russia compared with selected developing and transition countries

| Country | Corruption | |
|------------|---------------------------|--------------------------------|
| | Perceptions Index ranking | Ease of Doing Business ranking |
| Poland | 49 | 72 |
| Brazil | 75 | 129 |
| China | 79 | 89 |
| India | 84 | 133 |
| Russia | 146 | 120 |
| Ukraine | 146 | 142 |
| Venezuela | 162 | 177 |
| Uzbekistan | 174 | 150 |

Sources: Corruption Perceptions Index, Transparency International, 2009; World Bank, *Doing Business 2010*, www.doingbusiness.org.

Context

Russia is far from the only low- to middle-income country struggling under the weight of weak rule of law and extensive corruption (table 4.1). A quick glance at two common measures helps put Russia's problems in perspective. Transparency International's Corruption Perceptions Index relies on up to 13 surveys to rank countries, and the World Bank's Doing Business ranking uses formal, legal indicators, such as the number of procedures required to start a firm, to rank countries according to their business climate. Compared with a small group of other developing and transition countries, Russia fares better on some measures and worse on others.

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 level of corruption is 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 ranking, which uses *de jure* rather than *de facto* assessments of the ease of doing business in a country. In evaluating corruption and the rule of law in Russia, it is important to bear the broader comparative perspective in mind.

These problems are hardly new to Russia. Under tsarist rule close ties between state officials and firms limited judicial discretion, and even after the legal reforms of 1864, state officials spent much of the following de-

cedes undermining this legislation.² In the Soviet period, law was reduced still further to an instrument of state power. Nikita Khrushchev captured the sentiment of the Communist Party elites toward the rule of law: “Who is the master, the Party or the law? We are masters over the law, not the law over us.”³ In the 1990s President Boris 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 caseloads of overworked judges in the courts of general jurisdiction and courts of arbitration.⁴ 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.⁵

The impact of these reforms, however, was limited by severe shortages of federal funds. 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 federal support declining, regional officials often helped fill the shortfall but typically in exchange for favorable treatment. Reliance on local officials for unofficial financial support, housing, and logistics drastically limited the reach of central organs of power in Russia’s regions in the 1990s.⁶

President Vladimir 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 formal, legal rules of the game. Courts were pushed to create websites to post their decisions and improve physical infrastructure such as their buildings. In addition, on President Putin’s watch, jury trials expanded to all regions in Russia (except Chechnya) despite opposition from the prosecutor’s office 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 ad-

2. Thomas Owen, “Autocracy and the Rule of Law in Russian Economic History,” in *The Rule of Law and Economic Reform in Russia*, eds. Katharina Pistor and Jeffrey Sachs (Boulder, CO: Westview Press, 1997), 23–39.

3. Konstantin Simis, *USSR: Secrets of a Corrupt Society* (New York: Simon and Schuster, 1982), 30.

4. Peter Solomon, “The New Justices of the Peace in the Russian Federation: A Cornerstone of Judicial Reform,” *Demokratizatsiya* 11, no. 3 (Summer 2003): 363–80.

5. Solomon, “Assessing the Courts in Russia: Parameters of Progress Under Putin,” 66.

6. Kathryn Stoner-Weiss, *Resisting the State: Reform and Retrenchment in Post-Soviet Russia* (New York: Cambridge University Press, 2006).

ditional monies were made available in the Plan for 2007–11. Judges' base salaries are now on the order of \$1,000 per month, which is fairly high for many Russian cities.⁷ 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 has all but eliminated their dependence on executive bodies for housing and other basic needs."⁸ 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 fell from 4.75 in 2000, which was better than the average non-Baltic country of the former Soviet Union (5.25), to 6.25 in 2008, worse than the average of the same group (5.92). More generally, the raucous and open, if hardly unbiased, media of the Yeltsin era has been replaced by a staid, nontransparent, and even more biased media in the Putin years.

The Putin administration has made considerable efforts to keep in line business organizations that have been instrumental in defending members against predatory officials.⁹ Nongovernmental organizations that monitor corruption, human rights abuses, and protect consumer rights have also 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 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 Capital 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 Putin's watch has brought a cloud of suspicion over 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 eight regions in 2000 and 2008. These eight

7. Solomon, "Assessing the Courts in Russia: Parameters of Progress Under Putin," 68.

8. Pamela Jordan, "Strong-Arm Rule or Rule of Law? Prospects for Legal Reform in Russia," *Jurist* (2009), available at <http://jurist.law.pitt.edu> (accessed on December 28, 2009).

9. Dinissa Duvanova, "Bureaucratic Corruption and Collective Action: Business Associations in Eastern Europe and Eurasia," *Comparative Politics* 39, no. 4 (July 2007): 441–63.

Table 4.2 Characteristics and distribution of firms and respondents in 2000 and 2008 surveys

| Characteristic | 2000 survey | 2008 survey |
|---|-------------|-------------|
| Average age of respondent (years) | 46 | 47 |
| Percent of male respondents | 74 | 70 |
| Average firm size (number of employees) | 840 | 436 |
| Adjusted average firm size ^a (number of employees) | 488 | 436 |
| Modal firm size (number of employees) | 150 | 130 |
| Business organization members (percent) | 31 | 32 |

a. Adjusted by dropping the ten largest firms in 2000.

Table 4.3 Obstacles to doing business in Russia, 2000 and 2008

| Obstacle | 2000 | 2008 |
|-------------------------|------|------|
| Finding qualified labor | 2.60 | 3.16 |
| Competition | 2.89 | 3.22 |
| Taxes | 4.29 | 3.49 |
| Finding credit | 2.75 | 2.65 |
| Stability of laws | 3.46 | 3.15 |
| Regulations | 1.98 | 3.15 |
| Corruption | 2.43 | 2.74 |

Note: Responses rated on a scale of 1 to 5, where 1 equals not at all an obstacle and 5 equals a very serious obstacle.

regions are Voronezh, Nizhnii Novgorod, Ekaterinburg, Moscow city, Smolensk, Bashkortostan, Tula, and Novgorod. We surveyed firms from 23 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 20 percent of firms were called after the survey to check the veracity of responses. The questionnaires went through extensive pilot testing and did not require disclosure of sensitive financial information. The distribution of firms in both surveys was roughly similar as indicated in table 4.2. We asked respondents to rate several obstacles to doing business on a scale of 1 to 5, results of which are reported in table 4.3.

The responses indicate some improvements in the business environment during Putin's presidency, as firms reported that labor shortages and competition were more important obstacles and that taxes and stability of laws were less significant problems in 2008 than in 2000. Most surprising is that these positive changes were also accompanied by sharp increases

Table 4.4 Extent of bribery in government, 2000 and 2008

| Level of government | 2000 | 2008 |
|---------------------|------|------|
| Federal | 1.83 | 2.61 |
| Regional | 1.92 | 2.74 |
| Municipal | 2.09 | 2.81 |
| Inspectors | 2.35 | 3.14 |

Note: Responses rated on a scale of 1 to 5, where 1 equals not at all a problem and 5 equals a very serious problem.

in complaints about corruption and its close relative, burdensome regulation. On a scale of 1 to 5, businesspeople in 2000 rated corruption as 2.43, but this rating increased to 2.75 in 2008. In addition, regulations as a problem for firms were rated as only 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 on a scale of 1 to 5 the extent to which bribery was a problem at the federal, regional, and municipal levels of government. We also asked respondents to rate bribery among inspectors (table 4.4).

At each level of government businesspeople perceived stark increases in levels of bribery during the years of the Putin presidency. Bribery was most severe at lower levels of government, including the municipal government and inspectors (ratings of 2.81 and 3.14, respectively).¹⁰ 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, which may have led businesspeople to give somewhat more positive responses in 2008 than in 2000. First, responses may suffer from a “halo effect,” i.e., respondents give higher scores for institutional performance during good economic times than during economic downturns, even if institutional performance is largely unchanged. Second, respondents may have been less likely to criticize 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 that could not survive the harsh environment out of business and thus from the sample, thereby biasing the sample in favor of firms for which corruption and burdensome regulations are not especially severe problems. This form of “survivor bias” is likely to be more pronounced among small firms that typically experience the greatest costs of corruption. Each of these effects should have deflated perceptions of the severity of corruption and regulation in 2008 relative to 2000, but we find

10. Tula and Novgorod had relatively low ratings on bribery 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.

Table 4.5 Perceptions of performance of state courts of arbitration, 2000 and 2008 (percent saying “yes” or “more or less yes”)

| Courts can... | 2000 | 2008 |
|---|------|------|
| ...defend interests against another firm | 76 | 89 |
| ...defend interests against regional government | 39 | 59 |

significant increases in both. Respondents might also have inflated 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 courts’ capacity to protect their legal interests in disputes with different 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 on courts of general jurisdiction, which hear most criminal cases. Almost every region has an arbitration court. These courts have been a focus for reform over the last 20 years.¹¹

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

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 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 89 percent believed so in 2008 (table 4.5).

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 figure increased to 59 percent of respondents (table 4.5). The 2008 figure seems high but may

11. Solomon, “Putin’s Judicial Reform: Making Judges Accountable as well as Independent.”

reflect several different factors.¹² First, as noted earlier, the halo effect may be at work as the first survey was conducted in the wake of the financial crisis of 1998 and the second at the peak of an unprecedented eight-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 with 2000. Third, increased funding for the judiciary and the legal reform passed in 2000 may have improved the performance of the courts. 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 remained in business (and hence in the sample) would expect that they can use courts against the state.¹³ 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.

It is difficult, however, to make simple comparisons between the two surveys. While these data suggest that firms in 2008 had confidence in the ability of courts to protect their property rights in disputes with private firms and state agencies, as already noted, it may be due to the halo effect, survivor bias, or changes in respondents' willingness to criticize the government. We are on firmer ground when making comparisons between firms within a single survey.

Moreover, while it is important to understand firms' evaluations of the performance of courts, what we would really like to know is how perceptions of the performance of the courts influence economic behavior. For example, do firms that have confidence in the courts to protect their rights in disputes against the state invest at higher rates than those that do not? If so, this would be evidence of an uneven playing field for firms.

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

12. I also conducted this survey in 2005 and 2007 and found that roughly 54 and 46 percent of firms, respectively, believed that the courts could protect their rights against the regional government. Small differences in the question's wording may also have affected the results. The latter survey was financed by the Higher School of Economics and conducted in concert with Andrei Yakovlev and Yevgeny Yasin.

13. 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 to 5. In 2000, managers who could and could not take the regional government to court rated the governor as 2.64 and 2.85 ($t = 2.4$), respectively. In 2008, these figures increased to 3.15 and 3.67 ($t = 5.1$), respectively. This form of survivor bias would likely inflate the number of firms that believe they can use courts against the regional government.

confidence in the rule of law and enforcement of property rights because they require significant upfront 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.

Forty-nine percent of managers in 2008 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 (24 percent) 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 Putin's presidency. The biases mentioned earlier should be less important in exploring differences in responses within a single survey because the halo effect is likely to equally influence firms that believe they can take the state to court and those that do not.

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 security of property rights than those who did not (table 4.6). 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 just short of statistical significance (26 percent versus 21 percent, $p = .14$). These results indicate the importance of placing legal constraints on the regional government in order to foster investment.¹⁴ 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 favor of more legally powerful firms relative to less legally powerful firms.¹⁵

These differences are even more pronounced if one examines perceptions of the ability of firms to use courts to protect their rights against

14. 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 can 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.

15. 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 than in 2008.

Table 4.6 Investment decisions based on firms' perceived ability to use courts to protect their property rights against regional and federal governments, 2008 (percent saying "yes" or "more or less yes")

| Investment decision | Firms that cannot use courts against the regional government | Firms that can use courts against the regional government | Firms that cannot use courts against the federal government | Firms that can use courts against the federal government |
|--|--|---|---|--|
| 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** |

Note: *, **, *** indicate significant differences at the .10, .05, and .01 levels, respectively.

the federal government, as depicted in the last two columns of table 4.6. In three of the four cases, differences in responses between groups that believe 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 ($p = .12$).

The differences in the responses between these two groups illuminate a central reality for firms in Russia: Property rights remain quite contingent on a firm's ability to protect itself against predation by the state. Ideally one would like to make investment decisions 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 levels of investment and managers' perceptions of the capacity of courts to protect their rights in disputes with other private firms: Both firms that did and did not have confidence in the courts to protect their rights in disputes 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 and more to do with increasing legal constraints on the power of state officials.¹⁶

16. 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 that had and had not actually used courts to resolve a dispute in the last two years. Thus, the experience of actually

The Power of Friends in High Places

To explore the value of having close relations with the regional government, we tried a slightly different strategy in the 2008 survey. Rather than asking the same question of all respondents and reporting the average response, I created four slightly different hypothetical disputes (with firms of different sizes and having different relations with the regional government) and randomly assigned one to each questionnaire. I asked whether respondents expected that the courts would protect their rights in the hypothetical dispute assigned to them. Because the versions of the question were randomly assigned, the differences in responses can be attributed only to the small differences in the question. 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 in the hypothetical dispute as well the individual characteristics of respondents.

To be specific, we asked:

Let's say that your firm fulfilled a large order worth about 10 percent 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. What do you think, can your firm defend its legal interests by turning to the state courts of arbitration?

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

Half of the respondents were also told that "the buyer firm has close relations with the regional government."¹⁷

It is not surprising that firms on good terms with the regional government were thought to receive better treatment from state courts of arbitration. The size of the benefits of political connections is more interesting. When respondents were told that the disputant had only 100 employees, 79 percent said that the courts could protect their rights (table 4.7). How-

using the courts did not seem to have a significant impact on perceptions of the performance of state courts of arbitration.

17. The four versions were:

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

Table 4.7 Percent of respondents who expected the courts would protect their firm's rights in a hypothetical dispute (percent saying "yes" or "more or less yes")

| If the disputant was a... | No information on disputant's relations with the regional government | Disputant had good relations with the regional government |
|----------------------------------|---|--|
| Small firm (100 employees) | 79 | 70 |
| Large firm (3,000 employees) | 70 | 64 |

ever, when told that the disputant also had good relations with the regional government, this figure declined by 9 percentage points, to 70 percent. When told that the disputant was a large firm with 3,000 employees, 70 percent expected that the courts could protect their rights, but the number declined to 64 percent when the large disputant also had good relations with the regional government. Because this analysis controls for all other factors that could be helping a firm protect its property rights, the benefits of political connections appear to be substantial.

Caveats and Observations

Some caveats are in order. This analysis focuses almost exclusively on nonstrategic firms, and the results should not be generalized to the large politically important firms in the natural resources sector of the economy. Nor should they be extended to foreign firms whose relations with the state likely differ from those of run-of-the-mill Russian firms in the surveys. The latter are less likely to grab headlines than are Russia's natural resource giants or high-profile foreign companies but nevertheless merit attention as they employ most Russians, are critical for efforts to diversify the economy away from 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. There is, however, evidence that the courts of general jurisdiction that handle most criminal cases have historically performed significantly worse than the courts of arbitration under study here.¹⁸ Finally, these results were obtained before the financial crash of the fall of 2008. The

18. Kathryn Hendley, Peter Murrell, and Randi Ryterman, "Law, Relationships, and Private Enforcement: Transactional Strategies of Russian Enterprises," *Europe-Asia Studies* 52, no. 4 (June 2000): 627–56; Kathryn Hendley, Peter Murrell, and Randi Ryterman, "Law Works in Russia: The Role of Law in Inter-Enterprise Transactions," in *Assessing the Value of the Rule of Law in Transition Economies*, ed. Peter Murrell (Ann Arbor: University of Michigan Press, 2002).

increased role of the state in the economy and the heightened dependence of many firms on the state for resources after the crisis do not bode well.

President Medvedev's Turn

President Medvedev has put great rhetorical effort into promoting rule of law reform. He has decried Russia's "legal nihilism" and its "eternal corruption which has debilitated Russia as long as one can remember."¹⁹ As a lawyer without experience in the security services, his criticisms have evoked optimism in some quarters about Russia's commitment to enforcing rule of law.

His record to date on legal reform has, however, been modest and at times contradictory despite his rhetoric. In the summer of 2008, he signed amendments to the law on nongovernmental organizations, which eased 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, which would allow him, rather than other justices, to elect the chair. In addition, during his tenure the state brought another criminal case against Yukos' Mikhail Khodorkovsky and ended jury trials in cases involving treason and other politically sensitive topics.

Medvedev has been maddeningly vague on the details of his proposed policies 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" and reward those who follow the law. On the other hand, the 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 anticorruption efforts, 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 Medvedev's speeches on the need to reduce corruption and strengthen the rule of law. For his efforts, Alexei Dymovsky, the whistle-blowing policeman who appeared in a YouTube video publicizing corruption

19. Dmitri Medvedev, "Krasnoyarsk speech," February 15, 2008, www.medvedev2008.ru; "Go Russia!" [in Russian], *Gazeta.ru*, September 10, 2009, www.gazeta.ru.

among his peers, was recently charged with “fraud committed by a person using his official position” by the prosecutor general.

On a potentially more hopeful but tragic note, President Medvedev dismissed 20 employees of the Federal Penitentiary Service, the head of Moscow’s prisons, and the head of the tax crimes department of the Moscow branch of the Interior Ministry, Anatoli Mikhalkin, in the wake of the death while in detention of Sergei Magnitsky, a lawyer for Hermitage Capital.²⁰ Magnitsky had made detailed charges of state property theft by subordinates of Mikhalkin in the Interior Ministry.

One may attribute President Medvedev’s lack of concrete measures to his cautious nature or 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 dims.

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 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 has increased. This suggests that corruption and political connections will continue to define the business environment at least in the short run.²¹

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 the rule of law? Certainly, these factors are not encouraging, but it is also the case that Russia’s corruption ratings are worse than expected given its level of education and wealth. Nonetheless, while there is still much work to be done, Russia has made considerable progress in modernizing the technical aspects of its legal institutions over the last 20 years.

20. Nataliya Vasilyeva, “Russia’s Medvedev Fires 20 Prison Officials after Death of Jailed Lawyer,” *Washington Post*, December 12, 2009, www.washingtonpost.com (accessed on April 28, 2010); Charles Clover, “Medvedev Fires Head of Moscow Tax Crime Unit,” *Financial Times*, December 16, 2009, www.ft.com (accessed on April 28, 2010); and Gregory L. White, “U.S. Investor’s Lawyer Dies in Moscow Jail,” *Wall Street Journal*, November 18, 2009, <http://online.wsj.com> (accessed on April 28, 2010).

21. One issue worth watching is how quickly and transparently Russia privatizes assets in which the state has taken positions during the crisis.

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. Indeed, some argue that Russia has moved from state capture by private business to capture of private business by the state.²² 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 finding ways to check state power short of political liberalization. As noted earlier, Russian courts do not work badly in run-of-the-mill disputes 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 interests of their members. As Dinissa Duvanova²³ shows, firms in Russia often join business associations to defend themselves against petty corruption. Similarly, William Pyle²⁴ 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 for them to form close relations with governors. Surely, governors (and many judges) would oppose this move, but the benefits to society as a whole could be significant.

22. Andrei Yakovlev, "The Evolution of Business-State Interaction in Russia: From State Capture to Business Capture," *Europe-Asia Studies* 58, no. 7 (November 2006): 1033–56.

23. Duvanova, "Bureaucratic Corruption and Collective Action: Business Associations in Eastern Europe and Eurasia."

24. William Pyle, "Organized Business, Political Competition and Property Rights: Evidence from the Russian Federation," *Journal of Law, Economics and Organization* (forthcoming).