Corruption and Russia’s transition to a market economy

An Honours Degree Dissertation

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This dissertation is dedicated to my long time friend Wei who passed away during the year and helped substantially during the initial stages of selecting this topic. You are greatly missed by your friends and family. R.I.P 2006.
Declaration

This dissertation contains no material that has been accepted for the award of any other degree, diploma or award for any university or educational institution. To the best of my knowledge and belief, it contains no material previously published or written by any person or persons, except where due reference has been made.

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Christian Wells
Melbourne, November 2006
Abstract

This dissertation investigates Russia’s transition to a market economy and the high levels of corruption that accompanied the process. After some sixty years under Communism and a centrally planned economy, Russia began the transition to a market economy at the beginning of the 1990’s. After the dissolution of the USSR in 1991 a power vacuum emerged which was filled to a large extent by organised crime and corrupt government officials. High levels of corruption became a common feature of the transitional process and to this day Russia is still perceived to be one of the most corrupt countries in the world.

The dissolution of the USSR in 1991 was followed by dramatic drops in Russian citizens standards of living, income and even life expectancy. The harsh climate of the early stages of the transition was characterised by mass unemployment and most Russian citizens living in poverty. However some segments of Russian society became extremely rich during the early stages of transition. This was illustrated by the increase in wealth disparity as those with the right connections to government, business and organised crime flourished while those who did not, found their standards of living decreasing and sliding further into poverty.

This study will look at some of the reasons or factors contributing to the high levels of corruption in transitional Russia. Some of the contributory factors to be analysed are the inefficient and weak legal system, the large unregulated economy and the oligarchic networks controlling large portions of the Russian economy. To some degree the political and economic impact of corruption will also be analysed and assessed. The author has used material from texts, journal articles and organisational reports to generate an overall picture of the transitional experience of Russia and the high levels of corruption that have accompanied the process.
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<tr>
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<th>Full Form</th>
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<tbody>
<tr>
<td>CIS</td>
<td>Commonwealth of Independent States</td>
</tr>
<tr>
<td>CPI</td>
<td>Corruption Perceptions Index</td>
</tr>
<tr>
<td>CPSU</td>
<td>Communist Party of the Soviet Union</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GDR</td>
<td>German Democratic Republic</td>
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<td>GNP</td>
<td>Gross National Product</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>NEP</td>
<td>New Economic Policy</td>
</tr>
<tr>
<td>US/USA</td>
<td>United States of America</td>
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<td>USSR</td>
<td>Union of Soviet Socialist Republics</td>
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Chapter 1 – Introduction

1.1 Introduction
In 1991 after some six decades of communism and the centrally planned economy the Soviet Union was dissolved and the ‘iron curtain’ as Churchill once described it was lifted from Eastern and Central Europe. The dissolution of the Soviet Union marked the end of the Cold War and Communist party rule. Russia now embarked upon the path of transition from a centrally planned economy to a market economy.

1.2 Purpose of Study
This study focuses on Russia’s transition to a market economy and the high levels of corruption that accompanied the transition process. It was undertaken as part of the Bachelor of Business (Honours) program. The author’s interest in European studies and a trip to Poland and the East of Germany in 2003 both contributed to ultimately selecting the topic. After the trip to Europe the author’s interest in the aftermath of communism increased substantially, particularly the power vacuum left in the wake of the dissolution of the USSR. During the initial stages of topic selection corruption soon emerged to be one of the more common and dominant themes of the transition experience throughout Central and Eastern Europe. Russia was chosen as the country of focus due to its high levels of corruption and also because of its central importance throughout Soviet history.

The objective of the study is to answer the research question, and a set of corresponding objectives outlined in this introductory section of the report. The ultimate aim of the report is to determine the impact of corruption on Russia’s transitional process and identify key factors contributing to the high levels that accompanied the transitional experience in Russia. The research question is as follows:

- Why has Russia’s transition to a market economy led to such high levels of corruption accompanying the transitional process?
The following sections of chapter one will introduce the topic and the key terminology used, outline research objectives and methodology and provide the structure of the report.

1.3 Key terminology and concepts

As Sloman and Norris state, ‘all societies are faced with the problem of scarcity, they differ considerably however in the way they tackle the problem’ (Sloman and Norris, 1999, p15). One of the main differences between societies is the level of government intervention or control in the economy. The two polar opposites or extremes of economic systems in terms of comparison are a command economy and a free market economy. A centrally planned economy has all economic decisions made by the government, whereas a completely free market economy would have no government intervention at all. In reality all economies have a combination of the two and it is the level of government intervention, which distinguishes between them.

Jackson and McIver state that ‘Historically, many of the industrially advanced economies have differed essentially on two grounds’ (Jackson and McIver, 2001, p49). They include:

- The ownership of means of production
- The method by which economic activity is co-ordinated (Jackson and McIver, 2001).

Mc Taggart, Findlay and Parkin (1999) argue that economic systems vary along two dimensions also but from a slightly different perspective. They include:

- Property Rights.
- Incentives (Mc Taggart, Findlay and Parkin 1999, p1011).

Throughout the study the terms Soviet Union (USSR) and Russia are essentially interchangeable. However it should be stressed that the USSR dissolved in 1991. Thus bringing an end to the Soviet Union and the governing power structure, the Communist Party of the Soviet Union (CPSU). The Soviet Union was a command or centrally planned economy, which is essentially the polar opposite to a free market economy or pure capitalism. It can be characterised by public ownership of basically all property and resources, and decisions being made by a central planning...

Some characteristics of the planned or central economy in the former USSR can be summarised as follows. Factories, farms and shops are controlled by the state and most decisions are made by central planning organizations. Most people work for the state and prices for basics are kept low.

A free market economy is usually associated with a capitalist system and is also known as a laissez-faire (leave alone) system. Jackson and McIver characterise the free market economy by ‘the private ownership of property and resources, freedom of enterprise and choice, and the use of a system and markets and prices to co-ordinate and direct economic activity’ (Jackson and McIver, 2001). A similar description is given by Sloman and Norris, in which the free-market economy is characterised by land and capital being privately owned and all economic decisions being made by individual decisions of households and firms (Sloman and Norris, 1999). These ‘individual decisions’ are commonly referred to as the ‘invisible hand’ of the market. This concept was developed by Adam Smith (1776) in the classic economic study ‘wealth of nations’. Smith basically argued that the state should not interfere with the economy, but rather adopt a more laissez-faire approach and let the invisible hand of the market guide production and consumption. Two assumptions especially relevant when studying economies in transition are Smith’s assumption of full employment and that there be no monopolistic behaviour or industry protection (eg patents) for a market economy to operate efficiently. Some characteristics of the free market economy particularly relevant to Russia’s transition can be summarised as follows. Factories, farms and shops are privately owned and they produce what people want to buy. Prices are set by what people will pay and people are responsible for finding their own jobs.

There are limitless country classification systems all placing a different emphasis on particular data and economic indicators. One of the more commonly used country classification schemes is the one devised by the International Monetary Fund (IMF), which has devised three major classifications of countries. First are Industrial
countries, secondly are developing countries and finally there are countries in transition. The IMF identifies countries in transition as the 28 countries to have emerged from the former USSR and the countries of Central Europe that were closely allied or linked to the former Soviet Union (Mc Taggart, Findlay and Parkin, 1999).

Economies in transition are those, which in the past have relied on a ‘centralised command mechanism’ (Mc Taggart, Findlay and Parkin 1999, p1011) which was found in communist or planned (command) economies. These systems have undergone a dismantling process and essentially been replaced with a market system. According to the IMF since the initiation of reform processes, which has occurred since the late eighties and early nineties under various leaderships, countries in transition have had declining incomes and living standards (Mc Taggart, Findlay and Parkin, 1999).

The reform period in which the first major reforms to the Soviet economy were conducted were made under Mikhail Gorbachev during the mid to late 1980’s under his policy of perestroika. *Perestroika* means a process of reform or re-structure, and Gorbachev’s aim was to re-structure the economic and political system of the USSR. The reforms took place in an atmosphere of newly found openness and freedom to voice opinions, which were contrary to the past where any differing opinion or questioning of the state was not permitted. This policy under Gorbachev of encouraging discussion and openness was known as *glasnost*.

Before engaging in any study concerning corruption one must consider the many different definitions that can be found in the available literature. Many differing definitions and contexts exist and can have a number of ‘figurative meanings’ (Holmes, 1993, p.64). A good general definition of corruption found during the critical literature review is:

‘The use of public office, or other position of responsibility, in which an individual is accountable to others for conduct and performance, to further private interests’ (Poole-Robb and Bailey, 2004, p.55).
As corruption is primarily considered a public sector phenomenon it is the government and bureaucratic structures that tend to be the organizations most frequently accused of corruption. This is mainly due to a general assumption that because unlike many businesses, government and bureaucratic structures are expected to be impartial in actions or idealistic in intention. They are expected not to be acting for their own or an affiliates advantage, but to serve the interest of the people. In relation to this general assumption regarding corruption Leslie Palmiers (1983) definition of ‘the use of public office for private advantage’ (Poole Robb and Bailey, 2004, p54) seems to be one of the more widely referenced and accepted definitions of corruption that exist. John A Gardiner (2002) also concludes that corruption has many definitions and is basically always country specific in terms of legal definitions and public perceptions (Heidenheimer and Johnston 2002). Among ex-communist transition economies plagued by high rates of corruption, it is not valid to consider a single definition of corruption to be all encompassing in terms of analysing corruption in transition economies. This is largely due the sheer size of territory the Soviet Union once controlled and the vast numbers of ethnicities and different cultures spread throughout this territory. This notion is supported by Holmes who argues:

‘A major problem of comparing corruption in different countries- even if these are all communist, let alone they have fundamentally different systems- is that the term “corruption” can have different meanings in different countries. In fact, not only do different cultures and ethnic cultures define and interpret corruption differently, but even within a given culture, different groups – legal specialists, party apparatchiki, workers, etc. - may perceive corruption differently’ (Holmes 1993, p63).

Holmes goes further to state: ‘it must be strongly emphasized from the outset that it is not possible for anyone to provide a universally applicable definition of corruption’ (Holmes 1993, p63). It is hard enough to define an applicable all encompassing definition of corruption for transition economies. For many of the problems associated with studying, identifying and defining corruption, Colin Leys (2002) offers some degree of insight and poses many considerations one may take into account when studying corruption (Heidenheimer and Johnston, 2002), however this is ultimately beyond the scope of this report.
1.4 Objectives, benefits, scope and limitations

Along with the research question are a number of research objectives:

- To investigate the extent and various forms of corruption in post communist Russia.
- To assess how much modern day corruption can be attributed to the previous communist regime.
- Investigate corruptions influence/prevalence in the private sector during and after the period of glasnost and perestroika.
- To examine Russia’s legal framework and political reforms in terms of corruption.
- To draw a conclusion regarding the level of corruption in Russia and its impact on the transition process.
- To determine possible reasons as to why Russia is such an extreme case of ingrained, wide spread corruption.

The research conducted in the study will be of interest to those with a general interest in post-Revolution Russian history, transition economies and in the area of corruption. Because the topic draws from a wide range of disciplines there is a relatively wide appeal to most readers and its increased level of international media attention illustrate it has been an issue of great relevance in transitional Russia. With a substantial amount of literature available on many aspects of Russia’s transition, the intention was to provide an analysis of post Soviet Russian corruption in the context of Russian history since the fall of the Tsar. It is intended that the study will give an overview of the transition process in Russia and identify some of the factors that have caused the dramatic rise of corruption in transitional Russia.

The scope of the study will be from the collapse of Tsardom at the beginning of the twentieth century to the transitional period of Russia, which began in the early 1990’s and continues to this day. Special attention will be given to the immediate period after the 1992 reforms under Yeltsin. This is due to the fact that it was in this chaotic period of rapid reform that many of the causes or roots of high-level corruption in today’s modern Russia can be found.
1.5 Research methodology
The approach taken to conduct the research will mainly be inductive; thereby a theory will be developed as a result of analysis. The data analysis will be based on secondary data such as texts, journals and articles. Much of the analysis centres around existing theories from journal articles academic conferences and books. Corruption reports from different institutions such as Transparency International and Global Integrity are also relevant to analysis of the topic in terms of assisting to define the nature and identify various forms/activities of corruption. Due to the extensive amount of data and literature in the field of corruption, an in depth analysis of secondary data could provide a sufficient grounding to form an eventual conclusion and assess some of the impact of high level corruption in post communist Russia.

Although a brief introduction of the soviet era will be included, the scope of this study is essentially after Russia’s market reforms and privatisation (glasnost and perestroika). The focus will be on major political and private corruption in Russia during this period of transition and how it affected the process. The time frame of the study is from the end of Tsarist rule at the turn of the twentieth century through to Russia’s transition process initiated in the mid-late 1980’s and the aftermath of that process through the 1990’s and beginning of the 2000’s.

1.6 Structure
The analysis undertaken in the study focuses on Russia’s transition to a market economy and the high levels of corruption that accompanied the transition process. The study also provides a general economic history of the USSR since the fall of Tsardom to the eventual dissolution of the USSR in 1991 when the transition process to a capitalist market economy began. The report begins with a literature review covering such areas as Russia pre and post Revolution, the transition period of the 1990’s and some scholarly views on corruption. The literature review covers some of the available literature in the fields of pre and post revolution Russia, its transitional experience and corruption.

Chapter three gives a brief historical background of Russia’s major political, economic and social climate prior to the reform process initiated by Gorbachev in the mid 1980’s. The chapter covers the end of Tsarist rule, the 1917 Bolshevik
Revolution, Stalin and World War II and the 1970’s and early 80’s stagnation, which was to be the prelude to the reforms of 1985.

Chapter four will discuss Russia’s transition to a market economy and the some of the immense changes that occurred in Russia during the late 1980’s and the early 1990’s. The focus will predominantly be on economic changes but there will also be some background provided in terms of the wide ranging changes to occur during and in the aftermath of the eventual dissolution of the USSR. The section will cover the following areas: The emergence of Gorbachev and an overview of the events of 1989. Some of the elements of economic reform under Gorbachev. The Soviet coup of 1991 and the rise of Yeltsin. And finally a summary of economic reform under Yeltsin.

Chapter five will analyse the high levels of corruption which arose during Russia’s transition to a market economy. The chapter focuses on some of the causes and contributing factors to the high levels of corruption in transitional Russian. Finally the chapter attempts to assess some of the impact that the high levels of corruption have left on Russian political, economic and social life.

Chapter six is the final chapter and is the conclusion of the report. It will summarise the main issues and key points to arise out of the dissertation. The aim of the final chapter is essentially to answer the research question of why such high levels of corruption have accompanied Russia’s transition to a market economy.
Chapter 2 – Critical literature review

2.1 Introduction
This critical literature review essentially covers three areas of authors work relevant to the study. The area to be covered first is historic literature emphasising the economic changes from the 1917 Bolshevik Revolution until the dissolution of the USSR in 1991. The second area to be analysed will be theories and comparisons made between transitional countries. The final area is that of corruption in terms of the various forms, definitions and Russia’s experience with corruption in both soviet and post soviet times.

2.2 Background to Russia’s transition.

2.2.1 The former USSR
Russia’s involvement and ultimate defeat in World War I plus the ensuing economic crisis evolved into the February 1917 revolution. After the February revolution, Tsar Nicholas II abdicated the throne, thus bringing an end to the era of tsarist Russia. The provisional government led by Kerensky replaced the Tsar, but ultimately the provisional government had proved to be no more successful in leading Russia than the Tsar had. The Bolshevik Revolution in October 1917 carried out under the slogan or program of peace, bread and land saw the Bolsheviks assume power from the Provisional Government. The Bolsheviks then consolidated power during 1918-1921, which was the period of civil war in Russia (Lynch, 1992). The Bolsheviks inherited huge economic problems following the October Revolution of 1917 and Lynch (1992) identifies two distinct periods of economic policy. War Communism, which was imposed between 1918 and 1921, and the New Economic Policy, which was introduced in 1921 and was still operative in 1924. (Lynch, 1992) The New Economic Policy (NEP) was Lenin’s attempt at restructuring the Soviet economy and was intended primarily to meet Russia’s urgent need for food.

After Lenin’s death in January 1924 there was essentially a leadership struggle until Stalin consolidated power and became the leader of the USSR (Laqueur, 1992). He set out to strengthen the military and in terms of the economy launched the first ambitious five-year plans in 1928 (Blainey, 2000). Stalin carried out ‘the most
sweeping agricultural change ever attempted by one ruler’ (Blainey, 2000, p550). Agriculture essentially lay at the heart of the soviet centrally planned command economy during the 1930’s and peasants worked on large collective farms geared towards production for the state (Jackson and McIver, 2001). By the 1940’s heavy industrialisation under Stalin had transformed one of Eastern Europe’s most backward countries into an industrial and military superpower. The ability of the command economy to mobilise the masses during war time was in no doubt during the course of the Second World War but after the war the incentives for people to produce more than their state directed quotas severely diminished. This period under Stalin, until he died in 1953 is generally known as one of Russia’s darkest. This is mainly due to the harsh living conditions and dictatorial nature of Stalin’s leadership. It was only in the period of glasnost some forty years later, that the full often disturbing nature of his leadership was revealed in the process known as de-Stalinization which first began in 1956, with Khrushchev’s denunciation of Stalin’s personality cult. This process basically deconstructed the myth’s put forward by the Communist leadership and portrayed Stalin as one of the most ruthless dictators in human history.

The industrial and scientific might of the Soviet Union was no better illustrated than by the being the first country to send a man into space in 1961 (Blainey, 2000). It showed the industrial and scientific know how of the Soviet Union and their ability to match America during the initial stages of the Cold War for the following twenty or so years. The subsequent arms race between America and the USSR escalated well into the 1960’s and 1970’s. In 1968 the Cold War escalated into the possibility of immediate conflict during the Cuban Missile Crisis, however the USSR eventually backed down. The arms race with America put an enormous strain on the increasingly stagnant Soviet economy. Geoffrey Blainey states, ‘in the end the ailing Russian economy could not finance the nations high military and scientific goals’ (Blainey, 2000, p577) and by the 1970’s the strain was starting to show. By the 1970s and through the eighties, harsh conditions, falling living standards and wide spread poverty had became everyday aspects of Russian life. The arms race with America came at a price for the Soviet Union and as the Reagan administration had hoped or expected, it put enormous strain on the Russian economy. After years of economic stagnation and the increasing disillusionment with communism, by 1989 a wave of popular revolutions transformed Eastern and Central Europe (Grenville, 2000).
appeared that almost overnight communism was swept away. Most people saw the
fall of the Berlin Wall on the 9th November 1989 (Paxton, 2001) to symbolise the end
of communist power. However it was not until 1991 and the failed coup of the old
communist guard to overthrow Gorbachev that the Soviet Union disintegrated into a
loose federation of independent republics (Mc Taggart, Findley and Parkin 1995).

There is a substantial amount of literature regarding the fall of communism in the
former USSR. Some of the more frequently used works in terms of the general
political, economic and social changes that took place are Paxton (2001), which
provides a good overview of the Gorbachev era or experiment as he contends.
Grenville (2000) provides insight into the disintegration of the iron curtain and the
death of communism in Eastern Europe. Laqueur (1992) also provides a chronological
sequence of the fall of Communism in the former USSR. Particular attention is
devoted to the Eastern European economic stagnation of the 1970’s, the government
response and the effect on the psyche of the Russian people, which he argues was of
central importance in explaining the decline of the elderly leadership and the
emergence of the reformist much younger Gorbachev who ushered in a new era of
Russian economic reform.

2.2.2 Russian economic timeline
Before proceeding with the literature review any further it is important to develop an
understanding of the key economic events which occurred in Russia from the
Bolshevik revolution. This timeline provides a good general overview of such key
events and ultimately provides fundamental periods of Russian economic history
which are necessary to acknowledge in order to build an understanding of the
economic challenges faced by Russia. The time line adapted from Mc Taggart,
Findlay and Parkin (1999) illustrates key economic events in Russia from the time of
the 1917 Bolshevik Revolution until the eventual break up of the USSR in 1991.
Table 2.1 Russian economic timeline

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
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<tbody>
<tr>
<td>1917-21</td>
<td>- Bolshevik Revolution.</td>
</tr>
<tr>
<td>(Lenin)</td>
<td>- Nationalisation of banking, industry, and transportation.</td>
</tr>
<tr>
<td></td>
<td>- Forced requisitioning of agricultural output.</td>
</tr>
<tr>
<td>1917-21</td>
<td>- New Economic Policy, 1921.</td>
</tr>
<tr>
<td>(Lenin)</td>
<td>- Market allocation of most resources.</td>
</tr>
<tr>
<td>1928-53</td>
<td>- Abolition of market.</td>
</tr>
<tr>
<td>(Stalin)</td>
<td>- Introduction of command central planning and five year plans.</td>
</tr>
<tr>
<td></td>
<td>- Collectivisation of farms.</td>
</tr>
<tr>
<td></td>
<td>- Emphasis on capital goods and economic growth.</td>
</tr>
<tr>
<td></td>
<td>- Harsh conditions.</td>
</tr>
<tr>
<td>1953-70</td>
<td>- Steady Growth.</td>
</tr>
<tr>
<td>(Krushchev to</td>
<td>- Increased emphasis on consumer goods.</td>
</tr>
<tr>
<td>Brezhnev)</td>
<td></td>
</tr>
<tr>
<td>1970-85</td>
<td>- Deteriorating productivity in agriculture and industry.</td>
</tr>
<tr>
<td>(Brezhnev,</td>
<td>- Slowdown in growth.</td>
</tr>
<tr>
<td>Andropov and</td>
<td></td>
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<td>Chernenko)</td>
<td></td>
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<tr>
<td>1985-91</td>
<td>- Perestroika: reforms based on increased accountability</td>
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<tr>
<td>(Gorbachev)</td>
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<tr>
<td>1991</td>
<td>- Dissolution of the Soviet Union.</td>
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Adapted from Mc Taggart, Findlay and Parkin 1999, p1023

2.2.3 Russia’s Transition to the Market

Mc Taggart, Findlay and Parkin (1999), ask the fundamental question of ‘why are Russia and other countries in transition having such a painful time’ (Mc Taggart, Findlay and Parkin 1999, p1011). They contend that part of the solution to this problem is to be found in the economic system employed and the subsequent changes made during the transition process to a new system.

While Stalin died in 1953 the central planning system remained largely unchanged until the late 1980’s when Gorbachev initiated his policies of glasnost (openness) and perestroika (economic reconstruction) (Sloman and Norris, 1999). The reconstruction process had essentially three main elements: ‘Relaxing central plan enforcement, deregulating prices and permitting limited private ownership of firms (Mc Taggart, Findlay and Parkin, 1999, p1025).
The reforms initiated by Gorbachev soon lost momentum and people became disillusioned with *perestroika*. It is a generally held view that it was not the nature of the reforms but the fact they were initiated too late to save the socialist system.

Following the failed coup of 1991 by hard-line communists, Boris Yeltsin strengthened his position after barricading himself in his office during the attempted coup. He became president after Gorbachev resigned on December the 21st 1991 (Mc Taggart, Findlay and Parkin, 1999). By 1991 Yeltsin had become one of the main advocates for more radical reforms and it was during this time when ‘both the Soviet Union and the system of central planning came to an end’ (Sloman and Norris, 1999, p20).

### 2.3 Russian Corruption during transitional process.

According to Transparency International 2005 Corruption perceptions index, Russia ranked 126th out of 158, 1 being the least corrupt and 102 being the most corrupt. Its CPI score was 2.4 with 1 indicating a highly corrupt country and 10 indicating a highly clean country (Transparency International corruption perceptions index, 2005).

![Fig 2.1 Transparency International Global Corruption Perceptions Index 2005](image)

*Source: Transparency International corruption perceptions index, 2005.*
Patrick Glynn, et al (1997) contend that in the short run of the transitional process for ex communist countries:

‘removal of authoritarian controls, decentralisation, privatisation, and opening of these economies to international participation have vastly expanded possibilities for corruption; in some places such as Russia, it is rampant’ (Glynn, 1997, p10).

It is worthwhile to note that according to many of the definitions looked at in the key terminology section of this study, corruption is more often than not associated with ‘government and bureaucratic structures’. The level of corruption in Russia has been described by Federico Varese, as being that of pervasive corruption (Varese 2000). It is generally accepted that corruption in modern day Russia is indeed ‘Pervasive’, being rife throughout the government and state services. Varese basically contends that corruption has permeated virtually every aspect of Russian society and is not simply limited to government and bureaucratic structures.

There is no shortage of allegations of corruption in the post communist world in which the media has played a greater role in shaping public perceptions than ever before. ‘It appears that many of the (corruption) allegations particularly at the highest levels, are motivated primarily by political considerations’ (Holmes 1997 p282). Such ‘political considerations’ during communist rule were usually when senior officials used corruption allegations for retribution rather than any desire for justice. Due to the number of post communist politicians whom have been cleared on suspected corrupt activities one can conclude that a portion of these cleared have often had false accusations directed at them in order to politically damage their reputation. This particular form of false accusations of corruption as a political tool is emphasized by V Marsov and A Poleschuck who argued in the front page of a leading Russian newspaper that, ‘today, the struggle against corruption is above all a struggle against a political opponent’ (Holmes, 1993, p284).

The economic impact of corruption is wide reaching and quite complex. Rose-Ackermann (1999) contends that high levels of corruption limit investment and
growth and lead to ineffective government. Developing countries and those making a transition from socialism are particularly at risk. Ultimately corruption creates economic inefficiencies and inequities (Rose-Ackermann, 1999). Vito Tanzi also argues that corruption leads to ineffective government and states that:

‘When civil servants appropriate, for their own use, the instruments that the government has at its disposal to influence the economy and to correct the short comings of the private market, they reduce the power of the state and its ability to play the intended and presumably corrective role. In a way this represents the privatisation of the state, where its power is not shifted to the market, as privatisation normally implies, but to government officials and bureaucrats. This will inevitably damage the functioning of the market’ (Vito Tanzi, 2000, p97).

As Tanzi (2000) contends, in a way, official and state corruption represents a sort of privatisation of the State whereby many of those in positions of power benefit. He also contends that corruption distorts the functioning of a free market economy.

2.4 Scholarly views and critical works on transitional Russian corruption.

In the past before the dissolution of the USSR many scholars such as George Schopflin argued that if communist states were to move towards a Western model corruption would decline or even disappear (Schopflin, 1984). After the dissolution of the USSR and the ushering in of perestroika it became painfully apparent this was not the case. The view held by many western scholars that corruption would decline under a western style democratic market orientated economy was basically contradicted, even without reliable accurate data on corruption in Russia. It became quite apparent that reports of corruption had dramatically increased since the initiation of market reforms. L Homes states:

‘Corruption is rampant throughout the post communist world, and it is impossible to provide a comprehensive picture; one reason is that much still does not get reported and/or investigated’ (Holmes 1993).
As Nelken and Levi (1996) also pointed out, many scholars in the west viewed corruption as a problem mainly limited to underdeveloped countries, but after numerous well publicised far reaching corruption scandals in most Western countries the notion of corruptions presence in developed democracies became generally more accepted (Nelken and Levi, 1996). While there are levels of corruption in all countries developing countries and those making a transition from socialism are particularly at risk (Rose-Ackermann, 1999). Holmes builds on this concept, stating,

‘Corruption is potentially more destructive in post communist states than in more established ones. While it can have a destabilising effect in any system, transitional and consolidating societies, especially post communist ones, are much more fragile than consolidated democracies’ (Holmes, 1997, p276).

He goes further by stating:

‘The very nature of post communism encourages, or is at least highly conducive, to the spread of corruption’ (Holmes, 1997, p276).

Other authors to contribute to the recent comparisons of corruption in different kinds of economic systems in various law, social and political science journals have been Della Porta (1999) and Rose-Ackerman (1999). These scholars generally support the notion that corruption can indeed be found in any political system from the highest to lowest levels. Poole-Robb and Bailey take this further by claiming that not limited to particular societies, corruption is a classic feature of countries where there is widespread poverty and inequality and where public sector jobs are one of the major sources of social and financial advancement. (Poole-Robb and Bailey 2004). Holmes supports the notion of corruption not being limited to particular societies by claiming:

‘Corruption is ubiquitous in the contemporary world. It can be found in every type of political system, and at all levels even the highest’ (Holmes, 1997, p275).
There has been much literature written regarding the failure of Russia’s transition to a functioning democratic market economy. Levin and Satarov (1999) contend that, the failures of the transition have contracted considerable attention (Levin and Satarov 1999). Some of the authors to look at causes and factors of Russia’s failure in transition to a market economy have been Gelb (1998), Stiglitz (1999) and Hillman (2000) just to name a few.

Levin and Satarov (1999) support the contention that corruption was indeed a primary cause of the Russian transition failure and conclude that corruption in Russia during the 1990’s has indeed been an intrinsic part of economic and political life (Levin and Satarov 1999). Peter Kneen (2000) contends that the immediate cause of wide spread corruption in Russia was the ‘rapid move to the market in advance of the establishment of a legal infrastructure’ (P Kneen, 2000, p349). A comparative study conducted by Timothy Frye and Andrei Shleifer (1997) also attributed much of the reason for corruption to be Russia’s weak legal framework. The comparative study investigated how after the radical liberalisation among Eastern European economies during the 1990’s, their progress towards reaching a traditional invisible hand market economy model had been hindered. The author’s focus was comparing the two economies of Russia and Poland. Both had recently initiated very similar economic reform packages but during this comparison it became obvious that Russia had a much weaker entrepreneurial response to the reforms than Poland. After a survey they conducted in 1996 among shop owners in Moscow and Warsaw they found the ‘regulatory and to some extent the legal, environment is a great deal friendlier to business in Warsaw than Moscow’ (Frye T and Shleifer, A 1997 p354).

The article also outlines three general views regarding how bureaucrats and entrepreneurs interacted during transitional periods. The first is the invisible hand model, which as mentioned in the key terminology section, was developed by Adam Smith and is commonly referred to as a free market economy. Many countries in Eastern Europe have looked to this model in order to hopefully further integrate with the European Community (Sach’s, J, 1994). In this model Frye and Shleifer claim the government is well organised and generally un-corrupt and restricts itself to providing basic public goods, such as contract enforcement and law and order and leaves most allocative decisions to the private sector. The second model is the helping hand model...
and is essentially the economic model used in China, where there is organised corruption, which is highly interventionalist. The final model is the grabbing hand model where ‘government is just as interventionalist, but much less organised than the helping hand model’ (Frye, Shleifer, 1997, p.354). The government consists of a large number of independent bureaucrats pursuing their own agendas which includes taking bribes. Contracts are not always enforced and private property rights are not always enforced by the state (Shleifer and Vishny, 1993). Frye and Schleifer (1997) argue that neither government in Poland or Russia is an ‘ideal type’ but that Poland is closer to the invisible hand model while Russia has become more of a grabbing hand economy. A grabbing hand economy’s main characteristic is its wide spread and prevalence of corruption. Federico Varese comments in relation to the system to emerge out of Russia’s transition; ‘Russia has not yet reaped the benefits of capitalism but it has lost the safety nets of socialism’ (Varese, 1997, p547).

2.5 Literature gap.
Holmes contends in his 1997 study that many political scientists appear to believe that corruption has become the most politically relevant issue of modern times. He goes on further to state:

‘Insufficient attention has been paid in comparative analyses to the problem of corruption specifically in post-communist states. Nor have the long term implications of corruption for the state, in terms of the new possibility of a new kind of crisis, been adequately explored’ (Holmes, 1997, p276).

Most studies regarding corruption have focused on Western-style democracies, transitional societies like Latin America or in developing countries. Thus with more and more information becoming available and views being expressed regarding post communist corruption, an analysis of the role of corruption in this new form of transitional society can be analysed in relation to its adverse affects on Russia’s economy.

From the literature analysed during the literature review it becomes apparent that while there is a substantial amount of literature concerning Russia’s transition process and the impact of corruption on Russian society, few studies have looked at the
impact of corruption on the Russian economy in a historical context. It is within this area that I have perceived a literature gap to exist which warrants further analysis.

2.6 Conclusion.
Modern day Russia is still feeling the effects of the transitional process which it began in the late 1980’s. Many authors including Holmes (1993, 1996), Rose Ackermann (1999), Levin and Satarov (2000), Varese (1997 and 2000), and Moran (2001) have conducted numerous in-depth analysis of wide-spread and prevalent corruption in eastern European ex-communist states and Russia. From the studies already conducted one can conclude that corruption affects every aspect of Russian society, whether it be the private sector or the day to day operations of Russian society itself. From the rise in corruption allegations and opportunities since the transitional process began it is more than apparent that Russia has not yet reaped the benefits of a free market economy but rather lost many of the safety nets of socialism (Varese, 1997). Arising out of the transitional process, corruption in government from the highest to lowest levels is generally accepted by most scholars to be rife.
Chapter 3 – The Russian historical context

3.1 Introduction
This chapter is designed to give a brief historical background of Russia’s political, economic and social climate prior to the reform processes initiated by Gorbachev in the mid 1980’s. These 1980’s reforms are the fundamental turning points in terms of the Soviet Union moving away from the centralised economy towards a free market economy and so this chapter gives a very brief summary of the period before this turning point. While the study is concerned primarily with post Soviet Russia and the transitional period it is worthwhile having some background of Tsarist Russia, the Russian Revolution, the post war period and particularly the 1960’s and 1970’s stagnation prior to the mid 1980’s. This background is essential in terms of understanding the underlying factors influencing the eventual transition from a centrally planned economy to that of a market economy. It also provides the reader with a basic understanding of how the centrally planned economic system came to be and in what context. The period of the 1970’s and early 1980’s when the shortcomings of the centrally planned economic system became increasingly more evident is especially relevant to the study in giving some insight into the atmosphere of the time and the contributing factors to the eventual abandonment of the centrally planned economy.

3.2 The end of Tsarist rule in Russia.
In 1881 the Tsarist Russian empire covered a vast territory totalling some eight million square miles. From west to east, Tsarist Russia stretched 5000 miles and from north to south measured some 2000 miles. Between 1815 and 1914 the Russian population quadrupled from 40 million to 165 million. The majority of the population in Tsarist Russia were peasants and accounted for approximately four fifths of the total population (Lynch, 1992). The peasants worked for landowners/nobility and it was only in 1861 that Russian peasants emerged from serfdom under the emancipation act of Alexander II (Liebman 1967). Gregory and Stuart in reference to the late 1800’s state:

‘The peasant, not the industrial worker was the dominant figure in the Russian economy’ (Gregory and Stuart, 1990, p43)
The Tsarist regime was generally viewed as being highly repressive of the Russian people and predominantly despondent to calls for reform. In Tsarist Russia industrialisation had been relatively slow in comparison with other West European countries and agriculture still remained the prime sector of Russia’s economy. However there was sustained progress in Imperial Russia from the 1880’s until World War I, but overall the Tsarist economy could be considered backward. Russia’s per capita income was comparable with the poorest nations of Europe and the huge territory it covered disguised the per capita weakness of industrial outputs (Gregory and Stuart, 1990). Hosking attributes Russia’s low level of industrialisation at the beginning of the twentieth century mainly to the isolationist nature of Tsarist rule, he contends:

‘Economically speaking in agriculture, commerce and industry – Russia had lagged behind Western Europe from the late Middle ages onward, largely as a result of two centuries of relative isolation under Tatar rule’ (Hosking, 1985, p1).

Nicholas II succeeded Alexander the III in 1894 and was to be the last of the Russian Tsar’s. Between Tsar Nicholas and 130,000 other landlords, they owned some 95% of the Russian empire. His reign lasted some 23 years until in February 1917 when food ques in Petrograd\(^1\) turned into political demonstrations and demanded an end to what many still viewed as an autocratic system. He finally abdicated the throne to two Duma\(^2\) deputies in a railway carriage outside Pskov on March 2\(^{nd}\) 1917 (Hosking, 1985).

Only seventeen years after the beginning of the twentieth century Tsarist rule had ended in Russia. The Provisional Government led by Kerensky, with the backing of the Soviet, now ruled Tsarist Russia. However the Provisional Government was to only last for eight months until the October Revolution in 1917. Sakwa comments ‘the

\(^{1}\) Petrograd also known as St Petersburg and Leningrad
\(^{2}\) After the 1905 revolution the tsarist regime made some concessions such as declaring to observe the civil rights of all his citizens and also the granting of a parliament known as the duma.
problems that had overwhelmed the Tsarist government engulfed the Provisional Government as well’ (Sakwa, 1999, p69).

The impact of Tsardom on Russian society and politics was to be far reaching. Its isolationist, and repressive nature was to be a legacy set to continue throughout the twentieth century. Tsar Nicholas II’s failure to fully comprehend the seriousness of events transpiring and his own self righteous belief in the divine right to rule made it a regime unable and unwilling of change. Liebman’s summary of the downfall of the Russian Monarchy offers a blunt assessment of the final days of the Romanov dynasty:

‘An obsolete and weak monarchy tried to disguise the emptiness of its existence behind a magnificent, if badly cracked façade of pomp and splendour. In the twentieth century, it set out to remain what it had been since its inception: omnipotent unchallenged and divinely appointed’ (Liebman, 1967, p15).

3.3 The 1917 Bolshevik Revolution and the death of Lenin.

When the Tsarist dynasty came to its abrupt end it was replaced by two separate regimes, which were the remaining politicians from the Duma whom formed a Provisional Government and the Petrograd workers whom re-established the Soviet. The Provisional Government found itself unable to carry out many of the reforms, which the people expected after the fall of the Tsarist regime (Hosking, 1985). The peasants expectations for land reforms was one of the Provisional Governments more pressing areas of reform. Daniels states:

‘The Provisional Government promised a land reform, but the legislative details were delayed. The peasants grew impatient, and with the general breakdown of authority and discipline throughout Russian society they began to take matters into their own hands and seize landlords estates by force’ (Daniels, 1964, p79).

The Provisional Government proved to be unable to introduce the reforms necessary to build their support after the abdication of Nicholas II. This failure to act on reforms
combined with World War I meant that when the Bolsheviks\(^3\) led by Vladimir Ilyich Lenin, challenged the Provisional Government in October. By this stage there was little support base for the Provisional Government and almost no resistance was shown. The Bolsheviks seized power from the Provisional Government in October 1917 and the event became commonly known as the Bolshevik Revolution (Hosking 1985, Lynch, 1992). This seizure of power is still one of the most disputed and researched historical events studied with a vast range of scholars across different disciplines offering a vast number of views interpretations and perspectives. An analysis and summary of all these views is well beyond the scope of this study.

After the fall of Provisional Government in October some scholars such as Daniels state that ‘the Russian Revolution was not over when the Bolsheviks stumbled into power’ (Daniels, 1964, p82). The Bolsheviks inherited huge economic problems following the October revolution of 1917 and the dissolution of constituent assembly. Gregory and Stuart state:

‘The formidable task of creating a modern industrialised economy still lay ahead when the Bolsheviks came into power in 1917’ (Gregory and Stuart, 1990, p43).

Lynch (1992) identifies the two distinct periods of economic policy after the Revolution. War Communism, which was imposed between 1918 to 1921 and the New Economic Policy (NEP), which was introduced in 1921 and was still operative until 1924 (Lynch, 1992). After the 1917 revolution the existing economic structures already functioning would be used until the transitional period was over and a fully-fledged socialist system could be adopted. Two cornerstone policies of the period which initiated Bolshevik policy was the Decree on Land and the Decree on Workers control. The Decree on Land was essentially a nationalisation of land in which peasants seized land under the supervision of the Soviets and Local workers committees. In reality the peasants whom were the majority of the population could

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\(^3\) The Bolsheviks were the majority of the Social Democrats while the Mensheviks were the minority of the Social Democrats.
not be told what to do by anyone. Nove described the Decree on Land reform as not being a reform undertaken by the authorities but rather:

‘a more or less elemental act by peasants, with government organs accepting and by implication legitimising what was happening’ (Nove, 1969, p48).

The Decree on Workers Control was also in many respects legitimising what had already occurred. The decree attempted to recognise the legitimacy of the worker takeover while at the same time bring attention to the need for discipline and order in the industrial workplace (Lynch, 1992). These two decrees illustrate the relative powerlessness of the Bolshevik government in these early stages. By the time of War communism in 1918, the Bolsheviks were attempting to consolidate power while fighting the Civil War against counter revolutionary forces. Welch states:

‘The three years following the October Revolution of 1917 in Russia are generally referred to as the period of “War Communism”, when Lenin and the Communist party were faced with the formidable task of rebuilding- along socialist lines - an economy shattered by the First World War and then by civil war’ (Welch, 1999, p157).

By the summer of 1918 Lenin introduced more restrictive economic policies and began embarking on the process of centralisation. Lynch (1992) claims the chief reason for Lenin’s direction of economic policy was primarily the Civil War. After subsequent economic disasters and a worker and sailors mutiny at Kronstadt in 1921, Lenin abandoned war communism and introduced a New Economic Policy (Welch, 1999). The New Economic Policy was Lenin’s attempt at restructuring the Soviet economy and was intended primarily to meet Russia’s urgent need for food. In October 1921 Lenin addressed the party concerning the New Economic Policy. Lenin’s basic argument was that it did not make sense for the Bolsheviks to pretend they could pursue an economic policy, which took no account of circumstances. The New Economic Policy’s main features were the abandonment of state requisitioning and the re-introduction of elements of a market economy, which allowed the peasants to trade for private profit. Lenin stressed however that the change was only due to the
war and ruin caused by it. He also emphasized that it was to be only a temporary concession to capitalism. Lenin stated in an address to the party in October 1921:

‘Our conception was wrong. We hoped through the decrees of the proletarian government to found state industries and organise the distribution of state products upon a Communist basis in a country that was petit bourgeois! Life has shown that we made a mistake. A succession of transition periods such as State Capitalism and Socialism was required to prepare, through many years of preliminary work, the transition to Communism’ (Lynch, 1992, p137).

From 1917 to 1924 a wide gap between revolutionary theory and economic reality emerged and it could be argued that Bolshevik policy during this period was far from being structured economic planning but rather ‘a set of fragmented responses to a series of desperate situations’ (Lynch, 1992, p142). Lenin died in January 1924 and his New Economic Policy was only to last a short time after his death. His status as the father of the Soviet Union was a legacy set to continue through Soviet history. This reform period under the NEP and its experimentation with market forces was to be re-analysed as Russia approached the transitional period of the 1980’s and 1990’s.

3.4 Stalin and World War II.

Following Lenin’s death in 1924 the most pressing economic issues centred on the peasantry and the best method for Russia to industrialise. There was a ‘left opposition’ led by Trotsky whom essentially wanted to abandon the NEP, put in place by Lenin, and instead focus on a rapid industrialisation at the expense of the peasantry. Many of the left believed that Socialism would only be viable if other European nations also became communist. The ‘right opposition’ was led by Bukharin, Rykov and Tomsky and called for ‘the consolidation of Soviet power based on a prosperous peasantry and for very gradual industrialisation’ (Welch, 1999, p160). The right also generally believed there was no necessity for other nations to have workers revolutions and that the Russian economic system would be viable even in an isolationist scenario. During this time Stalin according to Welch ‘played the role of a moderate’ (Welch, 1999, p160) so when Trotsky and the left opposition among others formed a ‘united opposition’ to challenge the NEP in 1926, Stalin backed Bukharin.
Later through skilful political manoeuvring Stalin had Trotsky and his allies expelled from the party by 1927. After this was achieved, Stalin moved his attentions to his former allies of the right opposition and contended that the NEP must be abandoned. By the time of the Fifteenth party congress of the CPSU in December 1927, Stalin emerged as the dominant figure after the power struggle. By 1929 with the expulsion of Bukharin and others of the right from the party Stalin had eliminated all political rivals and also his one-time allies. He set out to strengthen the military and launched the first ambitious of the five-year plans in 1928 (Blainey, 2000). Under Lenin the financial, manufacturing and transport sectors of the economy were placed under control of the state. Stalin abolished the market and introduced command-planning mechanisms and added agriculture to the list of other sectors under state ownership (McTaggart, Parkin, Findlay, 1996). Stalin carried out the most sweeping agricultural reforms ever attempted by one ruler. Peasants whom had taken possession of land from their landlords following the revolution had created huge numbers of tiny private farms. Under Stalin’s reforms the farms would be collectivised. Many peasants resisted the collectivist policy but were either deported, starved or killed (Blainey, 2000). Gregory and Stuart contend:

‘Collectivisation was introduced as a means to harness the peasants, indeed the rural sector, to the industrialisation drive’ (Gregory and Stuart, 1990, p129).

The 1930’s are viewed mainly as being formative years of Soviet economic policy and also as being a time of unprecedented economic growth and structural change. During this period while costs and sacrifice were high the achievements were great and the Soviet Union made rapid strides in terms of industrialisation (Gregory and Stuart, 1990). By the early 1940’s heavy industrialisation under Stalin had transformed one of Eastern Europe’s most backward countries into an industrial and military superpower. Sakwa states:

‘Industrialisation was proceeding at a breakneck and equally wasteful pace. This was a period marked by huge achievements in terms of industrial objects built but also by chaos and waste of resources’ (Sakwa, 1999, p186).
On 22 June 1941, the German armies began their campaign towards Moscow despite the non-aggression treaty of the Nazi-Soviet pact of 1939. This invasion would destroy many of the achievements made during the prosperous 1930’s. (Hosking, 1985). The invasion took Stalin by surprise and the initial response of the Soviets was extremely lacklustre in terms of providing adequate defences. However the further the Germans advanced into Russia the more ferocious and desperate the fighting became. When the Germans failed to reach Moscow before the harsh Russian winter, and became bogged down in Stalingrad further to the south, the seemingly invincible Germans faced their first defeat. Eventually the Germans retreated with the Russian soldiers seizing lost German territory all the way to Berlin. In the afternoon of 30th April 1945 Soviet soldiers raised the Red Flag over the Reichstag in Berlin (Sakwa, 1999).

It is important to emphasize the sheer size and scale of the war on the eastern front. The victory against the Germans came at a huge cost both in terms of sacrifice for the Russian people and to the infrastructure so painstakingly completed during previous five year plans. It is estimated that some twenty million Russians lost their lives due to the fighting, starvation and exposure. Entire cities were to be rebuilt (Laqueur, 1992). After the war Stalin’s prestige was at its highest point and virtually every Russian saw him as the nation’s father whom had saved Russia from the Nazis. The Fourth Five Year Plan was inaugurated in 1946 and in a surprisingly short time production returned to pre-war levels (Welch, 1999). The ability of a central command economy to mobilise the masses during war time was apparent during the course of World War II but after the war the incentives for people to produce more than their state directed quotas was severely diminished as will be explained later in the chapter. After the war, Stalin’s image ‘displaced that of Lenins’ (Welch, 1999, p170) as he was now able to take credit for not only the defeat of the Nazis but also for the emergence of the USSR as a superpower after the war. At the Yalta conference in February 1945, Stalin, Churchill and Roosevelt decided upon the four occupational zones in Germany and signed a declaration allowing European states to ‘create democratic conditions of their own choice’ (Welch, 1999, p224). Some four months later in mid July, the Potsdam meeting was held and attended by Churchill, Stalin and
new American President Harry Truman. It was at this meeting that the differences between the allies became considerably more evident. Blainey states:

‘After 1945 Europe was divided into two. Democracies dominated the western half. The Soviet Union controlled the eastern half, including part of Germany.... The tension between communism and democratic capitalism was now called the cold war, though in retrospect it contained far more peace than war’ (Blainey, 2000, p565).

The Berlin Blockade was probably the closest that the USSR and the West came to direct confrontation in the immediate period after the war. After about ten months the blockade was lifted. Part of the reason for this uneasy peace was due to the fact that after 1949 Russia became a nuclear power also, after they secretly tested their first atomic bomb. Welch states:

‘The Cold War resulted in a Europe divided into two hostile and irreconcilable ideological camps, sustained by different economic systems and protected by military pacts, which in turn led to an escalating nuclear arms race. The gulf of mistrust continued to separate east and west’ (Welch, 1999, p223).

The USSR under Stalin became increasingly isolationist and demanding of its citizens. The centralised economic system set in place by him was to last until the forms of the late 1980’s and early 1990’s. World War II placed a large burden on the Soviet economic system yet overall the system appeared able to meet the challenges of both the war and reconstruction after the war.

3.5 Prelude to the reforms of 1985.

After 1953 steady economic growth continued in the USSR, but as time passed the emphasis of economic planning shifted from capital goods to consumer goods production (McTaggart, Findlay, Parkin, 1995). Heavy industry also continued to dominate much of the economic planning after the war and was an issue of central importance in the immediate years prior to Khrushchev’s rise to power in the mid 1950’s. Nikita Khrushchev left a lasting impact on many facets of the Soviet Union.
His denunciation of Stalin in 1956 was the first time criticism of Stalin had been conveyed publicly and is credited with being the first step towards the process of de-Stalinisation. He also is credited for allowing more open discussions about the economic problems and challenges facing the Soviet Union and also permitting some reform or tinkering of the economic system. During Khrushchev’s years in power there was a rise in living standards and real wages after two decades of stagnation and in some cases decline. In terms of economic performance, the 1950’s were a very prosperous period with high rates of growth. At the peak of economic performance in the 1950’s Khrushchev boasted the Soviet Union would overtake the United States by the turn of the century (Hosking, 1991). However by the early 1960’s the growth rate across most sectors had declined and this increasingly poor economic performance contributed to Khrushchev’s downfall in 1964. Another contributing factor to his eventual downfall was his penchant for reform and tinkering with the Soviet economic system. According to Gregory and Stuart ‘many of his reform ideas were ill prepared and ill conceived’ and many in the party feared that his ‘hair brained schemes would lead to economic disaster’ (Gregory and Stuart, 1990, p140). How much his policies were responsible for the slackening economic performance or external factors is subject to debate but overall Khrushchev would pay the price for the worsening economic position after the productive era of the 1950’s. Nove states:

‘Khrushchev was dismissed in October 1964. The economic troubles part-causes of his fall. His over ambitious campaigning “hare-brained schemes”, his exaggerated promises, his arbitrary methods, his disorganizing “re-organisations” (of the party structures) were too much. Yet he did achieve considerable successes especially in his first five years, and his defects are explicable by his background and experience… He inherited many perplexing problems and his methods of tackling them belonged to a different epoch, and were now obsolete. He half understood the need and even the required direction of change, and often spoke of managerial autonomy in industry and agriculture, economic criteria, rational investment policy… But in the end he knew only the traditional methods’ (Nove, 1967, 368).
During the 1950’s and 60’s there was a large emphasis placed on military spending due to the ongoing possibility of conflict caused by the tension created during the cold war. Space exploration was another area that was heavily invested into and in April 1961 Russian became the first nation to launch a man into space (Blainey, 2000). By launching a man into space, possessing nuclear weapons and having a huge well-equipped army, the USSR appeared to be the only other world superpower to rival America. However during the 1960’s, the growth rate began to decline and by the 1970’s the Soviet economy was becoming seriously dysfunctional. Productivity was declining, especially in agriculture but also in industry, growth also slowed and income per person began to fall (McTaggart, Findlay and Parkin, 1995). Blainey states:

‘The ailing Russian economy could not finance the nations high military and scientific goals. The costs of the latest missiles, huge armed forces and the space race…combined to weaken the Soviet Union. An inefficient economy could not afford these luxuries; and so the standard of living in the Soviet Union lagged far behind that of western Europe’ (Blainey, 2000, p578).

Leonid Brezhnev came to power after Khrushchev was ousted in October 1964 and remained as General Secretary of the Communist Party until his death in 1982. Yuri Andropov succeeded Brezhnev but died in February 1984 and was replaced by
Chernenko whom died 13 months later in March 1985 (Hosking, 1991). The 18 year tenure of Brezhnev was to be the most influential of the period as the Andropov and Chernenko years were far too short to have a lasting impact on the Soviet Union. Gregory and Stuart state:

‘The most important feature of the Brezhnev era was the declining economic performance of the Soviet Union’ (Gregory and Stuart, 1990, p146).

Table 3.2 Plan fulfilment: planned versus actual growth.

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<tr>
<td>Actual</td>
<td>6.3</td>
<td>5.4</td>
<td>2.6</td>
<td>1.8</td>
</tr>
<tr>
<td>Agriculture</td>
<td></td>
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<td></td>
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<td>Plan</td>
<td>5.5</td>
<td>3.7</td>
<td>5.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Actual</td>
<td>3.7</td>
<td>-0.6</td>
<td>0.8</td>
<td>2.1</td>
</tr>
</tbody>
</table>

*Source: Gregory and Stuart, 1990, p151*

Table 3.2 indicates this consistent drop in growth from the late 1960’s where Gross National Product (GNP) annual growth was 5.0% to the early 1980’s where growth essentially stagnated and dropping to 1.8 percent. Prior to the 1970’s the Soviet economy grew in excess of five percent a year, but during the 1970’s growth slowed dramatically. (McTaggart, Findlay and Parkin, 1995). The economic stagnation was characterised by ever growing demand for unskilled workers, labour shortages, and declining productivity and labour discipline. During the Brezhnev years the decline in growth rates was mainly due to deteriorating productivity growth after 1970. Between 1970-87 productivity growth was negative most years (Gregory and Stuart, 1990).
Brezhnev did not experiment with the system as much as Khrushchev had previously. Rather Brezhnev abolished some of the more extravagant and ludicrous reforms carried out under Khrushchev (Laqueur, 1992). During the 1960’s and 70’s there were sporadic attempts at reform but the ‘political system and society were marked by a growing listlessness, alcoholism and the rise of dissent’ (Sakwa, 1999, p351). The Brezhnev regime ultimately sought to improve the soviet planning system however as table 3.2 indicates the changes had very little effect on the declining performance of the planning system. The question of why Brezhnev did not initiate serious economic reform due to the Soviet Union’s deteriorating economic performance is open to debate and there are numerous scholarly views on this. Brezhnev’s critics claim he was captive to the status quo forces and that he led a:

‘Corrupt and listless regime, drawn down by a growing bureaucracy, that would have resisted meaningful reform’ (Gregory and Stuart, 1990, 151).

A different interpretation is that economic reform would have been very difficult to impose on the Soviet bureaucracy in any event, and that Brezhnev’s inability to formulate effective lasting reform cannot be totally attributed to simply pleasing the Soviet bureaucracy.

With worsening working conditions, longer ques and poor quality goods, between 1979-1985 Soviet economic growth stagnated or even declined. Production quotas set by the government were not met (see table 3.2) and local party secretaries exaggerated progress to the point of pure fantasy to give the illusion of fulfilling their quotas. It was in this atmosphere that nepotism and corruption continued to spread, as did mafia like organizations whom basically collected protection money with co-operation of local authorities. Under Andropov some measures against corruption and black and grey marketers were attempted but many of the measures taken were so unpopular they had to be discontinued and overall the measures proved to be ineffective. Neither the tenth nor the eleventh five-year plan was fulfilled and in most cases, growth was half of that set out in quotas (see table 3.2). People’s living standards continued to deteriorate substantially and life became increasingly more difficult for the average citizen. Laqueur (1992) contends:
‘The worst (outcome) was not the stagnation in output and productivity or the failure of living standards to improve. It was the loss of morale among people, the loss of interest in work, the corruption of and abuse of public officials’ (Laqueur, 1992, p510)

He goes further with this notion of apathy and cynicism among the citizens of the USSR when he states:

‘There was a general feeling that not only had the quality of life deteriorated but also the relationship between human beings. Elementary solidarity seemed on the way out, as did compassion. People appeared no longer to care about one another. All that mattered was money and connections with the right people’ (Laqueur, 1992, p511).

Up until the late 1980’s the focus of economic reform had been an attempt to improve the operation of the Soviet economic system though ‘improvement of decision making arrangements, rules and organisational change’ (Gregory and Stuart, 1990, p454). The reforms were predominantly conservative in nature when what was required was fundamental change. Advocates of maintaining a centrally planned economy where activity was directed by plans and the administrative process had the prevailing view right through until the mid 1980’s. Another problem faced by the Soviet leadership in terms of economic reform was that many of the measures outlined in various blue prints for reform through the years simply failed to be implemented. Whether this can be attributed to the blue prints not being detailed enough, or the implementation being conducted in a half-hearted fashion is open to debate and many contend the bureaucratic resistance to change and reform was the dominant factor. Much of the bureaucratic resistance can be explained by reforms threatening vested interests of officials concerned. Overall Brezhnev and his successors choice of a ‘muddling through approach’ in hoping that the current economic system of central planning would generate sufficient performance to allow the Soviet Union to meet high priority goals was false. (Gregory and Stuart, 1990, p151) Only some thirty years ago Khruschev had claimed the Soviet Union would overtake the United States, but by the 1980’s living conditions had declined, growth
virtually stood still and the leadership and people lacked enthusiasm and direction. Laqueur states:

‘Economic dissatisfaction certainly played an important role in the growth of pessimism. But it was of greater significance that the high expectations for a better future were not fulfilled’ (Laqueur, 1992, p510).

3.6 Conclusion
Russia under Tsarist rule was relatively backward in terms of industrialisation in comparison with other European countries. By the 1917 Revolution the Bolsheviks inherited many problems from the Tsarist regime and were faced with the task of developing an industrialised economy in a predominantly agricultural country. During the period of 1917 until Lenin’s death in 1924 there were two distinct area’s of economic policy those being; War Communism (1918-21) and the New Economic Policy (1921-1924). War Communism was a move towards more restrictive policies and centralisation, after initially having some elements of the market present in the immediate aftermath of the 1917 October revolution. After some time under War Communism Lenin claimed that it did not make sense for the Bolsheviks to pretend they could pursue an economic policy which did not take into account current circumstances. The changes to Russia because of the war and the ruin caused by it were Lenin’s main reasons for his temporary concession to capitalism under the New Economic Policy, which re-introduced elements of a market economy.

After the struggle for power following Lenin’s death Stalin emerged as the leader of the Soviet Union. He abandoned the NEP and is credited with implementing the centrally planed economic system and the five-year plans. The brutal, repressive dictatorship of Stalin was a time of great sacrifice and suffering but also a time of rapid industrial development. By the 1940’s one of Europe’s most backward countries transformed itself into an industrial and military super power. The ravages of World War II were felt in Russia more so the rest of Europe and reconstruction was to be the focus of Stalin’s last years. After World War II the diplomatic gap between Russia and the Allies grew further until the virtual setting up of two camps in post war Europe. The cold war as it came to be known added to the already isolationist nature of Stalin’s rule and continued right through until the Gorbachev era.
The Khrushchev years, after initially riding the wave of strong economic performance of the 1950’s and early 1960’s, declining economic performance and ineffectual reforms of the centrally planed system contributed to the downfall of Khrushchev in 1964. Brezhnev took over and ended the reforms undertaken by Khrushchev and moved back towards a more rigid system of economic planning, however minor reforms were forever taking place. Growth rates continued to sag into the 1970’s and 1980’s to the point of virtual stagnation and the once proud super power was economically speaking on its last legs. The resistance to reform and the unwillingness to dramatically change the centrally planned economic system resulted in further decline until the point where the economic system was on the verge of collapse. Corruption, nepotism, crime, apathy and pessimism became increasingly normal aspects of Russian life and the high expectations for a better future and matching the Western economies progress were unfulfilled. These factors contributed to the beginning of the reform process under Gorbachev. However many believed it was too late for reform of the current centrally planed economic system and that a complete transition to a new economic system was the only viable option.
Chapter 4 - Russia’s transition to a market economy.

4.1 Introduction
This chapter will discuss the beginning of the reform process which essentially began under Gorbachev and the early stages of the transition to a market economy under Yeltsin in 1992. An overview of fundamental changes made to the Soviet economic system under Gorbachev and Yeltsin during the departure from the centrally planned model of economic governance is essential in terms of understanding the nature of corruption which was to follow in the early transitional period. The period of 1986-1992 and the economic reforms under Gorbachev and Yeltsin is the prime focus of this chapter. It is a period of Soviet Russian history that caused immense and lasting change not only in Russia and throughout Eastern and Central Europe but the entire world. These were to be the last days of the Soviet Union which eventually dissolved in 1991. It also meant an end to the cold war hostilities. The ‘iron curtain’ had lifted from Eastern and Central Europe in 1989. The Berlin Wall fell and a peaceful revolution swept through Eastern and Central Europe. After years of stagnation and apathy in the Soviet Union, the mid to late 1980’s were a period of rapid change under Gorbachev as the first real reforms of the centrally planned economy were made. Under Yeltsin the process of reform was to be more rapid and ultimately chaotic. By the reforms of 1992 the former Soviet Union was now on the difficult path of making the transition from a centrally planned economy to a free market economy.

4.2 The emergence of Gorbachev and the events of 1989.
Mikhail Gorbachev assumed power in March 1985 and was the first Communist leader to initiate major economic reform in the Soviet Union since Stalin over hauled the NEP some sixty years before (Hosking 1991). Gorbachev at age 54 was also dramatically younger than his predecessors (Laqueur, 1992). His general approach to matters of political, social and economic relevance was to be a departure from the previous leadership styles. Paxton states:

‘What set Gorbachev apart from other reformers, however, was a personal quality of directness and frankness that came as a fresh breeze after years of wooden propaganda. Instead of responding to Soviet decline by either
the inertia of Brezhnev or the violence of Stalin, the pragmatic and self confident Gorbachev proclaimed a new course “openness” (glasnost) and “restructuring” (perestroika)” (Paxton, 2002, p650).

The new openness permitted in Soviet society under glasnost allowed for more political debate and questioning of past and current state policy. It also meant revealing previous aspects of Soviet history of which where never released by the government. Historical events such as the Nazi soviet pact before World War II and the extent of Stalin’s executions were, for the first time publicly admitted by the Communist party. The new openness contributed to the process of De-Stalinization where by the myth promulgated by the State was dismantled and the brutal dictatorial nature of his rule revealed. Glasnost also meant that for the first time ever the Communist government spoke more openly of past and continuing failures in terms of economic performance and social ideals in their speeches and public addresses. Laqueur states:

‘Glasnost meant confronting the past, but it was even more crucial to come to terms with the present state of affairs. This was impossible without honestly analysing the many failures in the economy and social life’ (Laqueur, 1992, p521).

In 1989 a bloodless revolution in the former communist regimes of central and Eastern Europe culminated in the fall of the Berlin Wall on the 9th of November. The fall of the wall symbolised the end of communist power not only in East Germany but also across the whole of the former Eastern and Central European states of the Soviet Union occurring at the same time (Paxton, 2002). The Communist governed citizens of eastern and central Europe’s growing dissatisfaction with the Soviet leadership and worsening economic conditions had been festering particularly among the young for quite some time. Grenville states:

‘In 1989, a wave of popular revolutions transformed eastern and central Europe. Communism was swept away. The Soviet Union withdrew. (Grenville, 2000, p891).
These grievances criticisms and ultimately dissent displayed by people throughout eastern and central Europe eventual had boiled over and the Soviet government was reluctant for various reasons to resort to bloody repression as they had in the past. People no longer feared Soviet intervention as in the past when any such disturbances were quelled by often brutal force by the military, such as in Czechoslovakia in 1986 (Grenville, 2000). Paxton states:

‘The peaceful character of communism’s collapse in Easter Europe was due mainly to the reluctance-or capacity-of the Soviet Union to intervene’ (Paxton, 2002, p650)

4.3 Economic reform under Gorbachev

The radical transformation from 1928 onwards of the soviet economic system under Stalin which placed an emphasis on collectivisation, industrialisation and central planning remained largely unchanged until the late 1980’s under Gorbachev. Boone and Fedorov state:

‘Most people forget that reforms began in 1985 when Gorbachev came to power not in 1991 or 1992. His early reforms set the course for Russia’s changes’ (Boone and Federov, 1997, p161).

In the 1980’s everything was still owned by the state and all major economic decisions were still taken by state institutions such as the ministry of planning. Enterprises and companies were told what they should produce and the amount to produce. Planners also told an individual company what supplier they should get their components from and whom to sell to. This process had initially produced high growth rates especially in the 1950’s and 60’s but nearly always at a low level of efficiency. A poor flow of information between planners and firms led to numerous inconsistencies in the plans that resulted in targets often being completely unrealistic. This caused widespread shortages and much less frequently caused surpluses. The incentive to produce was only to meet targets set out in quotas and goods produced were often of poor quality. (Sloman and Norris, 1999) What was inherent in the Soviet central planning system was a huge waste of resources and with every year the soviet economy wasted more resources, material and labour until it reached a point
where there was little left to be wasted. By end of the 1980’s a large technological gap between advanced capitalist countries and the Soviet Union had developed.

The declining growth rate of the 1970’s continued on into the 1980’s and by the time Gorbachev came to power economic reform was the predominant issue the Communist party faced. After his election he outlined his ambitions for the future of the Soviet Union and a course of action regarding the major issues facing the Communist party. However in his first appearances he made no mention of the drastic reforms the Soviet Union was to undergo under *perestroika* (economic reform) and *glasnost* (openness). Laqueur (1992) contends that a change occurred in Gorbachev’s thinking from the latter half of 1986. He states:

‘Perhaps he realised only gradually the full extent of the crisis facing the Soviet Union. And he also understood that, unless he got the economy moving again, economic decline would effect all aspects of Soviet life: the shortages would become even more critical, and the quality of life and the social services would deteriorate still further’ (Laqueur, p516).

He ushered in economic reform under *perestroika* (economic reconstruction) which marked a movement away from the centrally planned economy towards that of a more market orientated economy with the state playing a less central role. While some measures could be taken without affecting fundamental aspects of the system it seemed that any lasting change could be found in dismantling the old system, which was proving to be more and more inefficient as time passed. Smith (1995) states: ‘The concept was of ‘denationalisation’ rather than ‘privatisation’. Boone and Fedorov state: ‘Gorbachev attempted to create a socialist market economy by embarking on gradual reforms’ (Boone and Federov, 1997, p162). Prior attempts at economic reform throughout the history of the Soviet Union from the NEP to Khrushchev’s tinkering and the minor changes of the 1970’s and early 80’s had all been abandoned after they had little success. Some wondered in the initial days of *perestroika* whether the reforms would be drastic enough to cause a genuine reform of the system or whether as in the past they would be temporary measures with no real lasting impact.
Some features of Gorbachev’s gradual economic policy of *perestroika* were that if a firm could not cover the costs of its production then it would now be declared bankrupt, and as opposed to previously, the State may now refuse to bail them out. The underlying reason for this was ultimately an attempt to make firms more efficient and accountable than in the past. The reforms during the period of *perestroika* focused much attention on improving the incentive system by accurately matching benefits for workers to productivity. For too long workers expected bonuses whatever the level of output. Workers were also divided into small teams, which as a group were rewarded for higher productivity in an effort to promote people working more efficiently together. In order to combat the widespread production of inferior or low quality goods the reforms increased checks on quality by state officials and made the criteria more stringent. Substandard goods were to be rejected and not distributed to the public (Sloman and Norris, 1999).

At the time most economists in Russia agreed that some form of a transition to a more market orientated economy was the only viable course of action. The divisive issue amongst those agreeing on the need for reforms was the pace that the reforms process was to undergo. Most party secretaries favoured a gradual approach while others pressed for more decisive measures and rapid reform to avert economic disaster. Those conservatives who favoured a more gradual approach argued that the situation resulting from a more rapid transition would not be politically viable. Outcomes such as unemployment which had not been a problem in the past under communism and the heavy increase of prices following price deregulation and the abolition of state subsidies were put forward as direct results that would occur from a rapid transition. The conservatives were initially headed by Egor Ligachev and were opposed to what they saw ‘as to quick and rapid retreat from Leninist norms’ (Laqueur, 1992, p519). The conservatives whom believed in a gradualist approach essentially claimed that such changes would benefit only a minority of the population and ultimately prove to be to the detriment of the Russian people.

4.4 The move towards transition and the end of *perestroika*.

By 1990 *perestroika*’s momentum had slowed and the economic position of the Soviet Union deteriorated even more substantially and rapidly. The optimistic outlook in the initial days of *glasnost* and reform disappeared and was replaced by pessimistic
predictions about the future (Laqueur 1992). Ultimately the reforms of *perestroika* did not slow the economic decline of the USSR. The economy was now essentially a mixed economy with both elements of a planned and a market economy with many now unsure what role the state was to play in terms of economic management. The Russian people became generally disillusioned with *perestroika* as queues for food and goods lengthened and standards of living did not improve. Mc Taggart, Findlay and Parkin state:

‘By 1990, there was widespread dissatisfaction throughout the Soviet Union with the economic planning system. Incomes were falling and the old political order was under severe strain. It was in this climate that a process of transition towards market economy began’ (Mc Taggart, Findlay and Parkin, 1995, p1025).

The process of transition mentioned above by Mc Taggart, Findlay and Parkin (1995) had three main elements: those being relaxing central plan enforcement, deregulating prices and permitting limited ownership of firms. The basic premise for relaxing central plan enforcement was that by allowing a greater degree of decision making freedom for managers they would have to act more like private firms and theoretically be more efficient and also accountable than they had previously. State enterprises would now essentially be able to respond to changing circumstances without having to wait for orders from central planners. Thus rather than simply being given instructions by planning institutions, managers were encouraged to be more involved in preparing their own plans. This attempted to stimulate initiative amongst business managers and increase accountability as the government now insisted that firms should cover their costs of production. However many managers of state firms were often unclear or even resentful of their increased level of responsibility and accountability. Price deregulation was a process to be more gradual than central plan enforcement and only covered a limited range of products. The notion of removing price controls on a certain amount of goods was to allocate scarce resources to their highest-value uses (Mc Taggart, Findlay and Parkin 1995). The goal of removing price controls was for shortages to disappear and be replaced by available goods and services. The higher prices would in turn strengthen the incentive for producers to increase the quantities supplied. The most gradual of the reforms permitted some
limited private ownership of firms. This essentially aimed to get individuals to respond to price changes and signals opposed to taking instructions from the central planning system. The idea was that heads of enterprises would be much faster than a planning system in responding to demand for goods. This would hopefully result in shortages and surpluses being less common than before.

Davies (1991) summarises the economic reforms announced at the end of May 1990 envisaging ‘the eventual replacement of the present system by a Western European type of mixed economy’ (Davies, 1991, p127). During this time despite their differences, both Yeltsin and Gorbachev believed in a ‘determined gradualism’ (Davies, 1991, p127) which referred to a more gradual transition to the market economy which was more like other Western European socialist democracies. The reforms initiated by Gorbachev lost momentum and people became disillusioned. It is a generally held view that it was not the nature of the reforms but the fact they were initiated too late and too gradually to save the socialist system (Smith, 1995). As political scientist Lizya Shevtsa stated in an interview for an economic documentary:

‘If someone had begun perestroika in the 50’s, in the 60’s there was (a) chance for victory and success. But in the 80’s already our system has outlived itself, it was in vain and so all his (Gorbachev) attempts to re-invigorate the old master died’ (Video Education Australia, 1993).

4.5 The Soviet Coup of 1991 and the rise of Yeltsin.
As the initial optimism and excitement regarding Gorbachev’s reforms diminished Russia was left with a partly functioning mixed economy. During this period Gorbachev launched and then cancelled some twelve plans for economic reform. His indecisiveness about which direction to take in order to make Soviet communism work more effectively contributed to the already vigorous debate of which direction the Soviet Union should now take in terms of economic reform. Those whom had been advocates for more rapid change than had previously taken place under Gorbachev wanted to move more towards democracy, private property and a market economy. Although once in favour of the gradualist approach, Yeltsin now led the call for a more rapid and definitive move towards a market economy. The conservatives thought that Gorbachev’s reforms had already gone far enough and wanted to return
towards communist ideology (Paxton, 2002). In 1991 hard line Communists attempted to reimpose greater state control in a failed coup attempt in August (Laqueur, 1992). After the coup Boris Yeltsin who later became President of Russia strengthened his position. Some months later Yeltsin declared the USSR defunct and proceeded on the 21st of December to negotiate with the local republics about its replacement by the Commonwealth of Independent States (CIS). Yeltsin’s Russian Republic assumed the remaining powers of the USSR and Gorbachev resigned on Christmas Day 1991 bringing an end to the Soviet Union (Paxton, 2002).

The problems faced by the Soviet economy in 1990-1991 were of a severe and urgent nature. It required immediate reform of the mixed economy that had arisen under Gorbachev and it was in this atmosphere that the transition from a once highly regulated centrally planned economy to a market economy was to make rapid progress. Boone and Federov state:

‘The last months of 1991 where characterised by record food shortages, price increases, uncertainties, and the total paralysis of the authorities. The growing crisis played one clear and positive role: it emphasized to the Russian leadership that urgent economic reforms were needed and that the old economic system had irreversibly broken down’ (Boone and Federov, 1997, p166).

4.6 Reform under Yeltsin and the transition to a market economy

Russia under Yeltsin now moved towards more drastic and rapid economic reform in which competition and enterprise were to replace the central planning system. The process of replacing the central planning system with free markets and private enterprise was to cause dramatic and lasting change to the Russian economy and society at large. After the coup, Yeltsin named Yegor Gaidar as Deputy Prime Minister in charge of economic policy. Some of the economic measures taken by Gaidar were almost complete price liberalizations, the liberalization of foreign trade, the start of a mass privatization process and attempts at financial stabilisation (Boone and Federov Sachs, 1997). Sloman and Norris (1999) give an overview of some of the more fundamental policies to cause change in early 1992. The price controls on some 90 per cent of items and goods were abolished. However with shortages being a
common feature of Russian transitional life, prices subsequently rose to a point where most Russians could not afford them. Another significant government policy was that business was allowed to access the foreign exchange more easily than before and foreign companies were encouraged to invest in Russia. During this period of radical policy change, a huge privatisation programme took place (Sloman and Norris, 1999). Many of the new private companies to arise out of the mass privatisation were workers in the company whom now became the principal shareholders. In 1992 there was a vast amount of resources to be divided which included some $600 billion of property and natural resource exports totalling some $25 billion per year. Boone and Fedorov contend that because of this vast amount of resources to be divided:

‘It is no wonder that the political system became corrupt and deadlocked and macroeconomic policies took second place’ (Boone and Fedorov, 1997, p188)

With the collapse of the centrally planned system the traditional trade flows of Russia collapsed. Since Russia was isolated in terms of world trade the majority of trade was between regional groupings known as Republics. The inter-Republic trade was conducted through Moscow and managed by central planners. This basically meant that previous to the reforms of 1992, enterprise managers had no real knowledge of where their inputs for their products came from or where the products produced eventually ended up for usage. Thus after the collapse of the central plan, mangers of firms had to now search for supplies and new markets, as previously such decisions were taken by the central planners. Due to the lack of building of adequate new networks of information, shortages of raw materials along with other material inputs were very common (Mc Taggart, Findlay and Parkin, 1995). This ultimately led to a stunt in production and wide spread shortages of many goods.

Another major complication to the Russian transition to a market economy was that the government was in a state of fiscal crisis especially during and leading up to the collapse of the Russian rouble in 1994. After the collapse of central planning Russia lost many sources of revenue collected under the previous system. Sources of income which were no longer possible, was a tax on consumer goods, which used to be taxed according to scarcity in an attempt to eliminate shortages. Because of the transition to
a market economy, prices now moved according to market forces of supply and
demand, so the tax once collected by the government no longer existed. Another
important source of revenue for Russia under central planning was the profits made
by the state enterprises. Thus with privatisation and the decentralisation of control this
particular source of state revenue has dramatically declined (Mc Taggart, Findlay and
Parkin, 1995).

Table 4.1 Main indicators of the Russian economy 1990-1995

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<td>Real GDP % change</td>
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<td>-13</td>
<td>-19</td>
<td>-12</td>
<td>-15</td>
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<td>Industrial production % change</td>
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<td>-16.0</td>
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<td>0.0</td>
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<td>Retail prices % change</td>
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<td>92.7</td>
<td>1,354</td>
<td>896</td>
<td>302</td>
<td>205</td>
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<tr>
<td>Exchange rate rubles per US$ at year end</td>
<td>1.7</td>
<td>1.7</td>
<td>415</td>
<td>1,247</td>
<td>3,550</td>
<td>4,650</td>
</tr>
<tr>
<td>Inflation (CPI) Average annual increase</td>
<td>-</td>
<td>8.3</td>
<td>31.2</td>
<td>20.5</td>
<td>10</td>
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Adapted from: Boone and Fedorov, 1997, p163 and 177

An important factor contributing to the fiscal crisis experienced by Russia during its
transitional phase, was, that in the Soviet Union under central planning money played
virtually no role. While workers were paid salaries, which they used to purchase
goods and services the State enterprises and government simply used the money for
record keeping. However with the transition to the market and the collapse of central
planning money became much more important to the government. The loss of
traditional sources of revenue for the government such as taxes on goods and income
derived from State enterprises meant that due to government spending not decreasing
at a fast enough rate a huge government budget deficit emerged. The budget deficit
was 1.5 percent of national income in the first quarter of 1992 but in the final quarter
of 1992 it had risen to 15 percent (Sloman and Norris, 1999). As a result of the budget
deficit the government printed more money, which led to a substantial rise of
inflation. During the final six months of the Soviet Union, in early 1991, inflation
reached close to 200 percent. By 1992 inflation had increased dramatically to 1,300
percent and remained so until 1994 when it went back to around 200 percent a year
(Mc Taggart, Findlay and Parkin, 1995). The huge price increases caused a decrease
in demand but also due to this disruption to normal operations of the economy supply also fell. In 1992 output fell by approximately 20 percent and purchasing power of wages fell by 40 percent (Sloman and Norris, 1999).

Even though Russia had moved away from its centrally planned system there were weaknesses inherited from the previous system that were still having an impact on the transition to a market economy. Part of the reason for the huge shortages within the Russian economy was that many Russian companies were monopoly producers. Thus when one company experienced difficulties or ceased production it would cause widespread shortages. Industry was slow to adapt to the marketplace and was extremely wasteful of resources, which further contributed to shortages, inefficiency and economic decline. Also with the freeing of prices many enterprises that were in a monopoly position raised prices and decreased output (Sloman and Norris, 1999).

Supporters of the more rapid reforms of 1992 argued that the economic hardship was necessary to force inefficient producers out of the market and that this would result in higher productivity and efficiency. Critics of the 1992 reforms maintain, that though some progress was made in terms of making the transition, the costs of the reforms were ultimately too high and did not weigh up with the benefits as a result of the movement away from central planning. The hardship of modern Russia for most of its citizens with the loss of its socialist safety net, was the most compelling criticism of the reform process. Official unemployment stood at around eight percent during the mid 1990’s with an extra six per cent of hidden unemployment. Unemployment varied across the Russian regions. In a fifth of the regions unemployment stood at over thirty percent and in the more extreme cases reached fifty per cent. However those who had a job did not fare much better. Between 1994 and 1996 the average wage dropped by approximately thirty seven percent. (Sloman and Norris, 1999). By 1997 the government’s financial situation had worsened due to not collecting vast amounts of tax owed to it. This resulted in vast numbers of government employees being under paid or even not paid at all for years. However not everyone found increased hardship in transitional Russia. Some have become extremely wealthy using legitimate methods and some through criminal activity. The rise or rapid expansion of the Russian mafia has been one of the more sinister developments to take place during Russia’s transition to the market economy (Sloman and Norris, 1999). Ultimately a
large income disparity has emerged in transitional Russia after privatisation with the minority becoming extremely wealthy while the majority did not reap the benefits of the transition but rather lost the social safety nets of socialism (Varese, 1997). Sloman and Norris state:

‘The old certainties have gone. No longer will the state guarantee employment and a moderate standard of living for all. Today’s market system in Russia is one where the strong gain and the weak lose’ (Sloman and Norris, 1999, p24).

4.7 Conclusion
The fundamental changes to occur in Russia and the former Soviet Union under Gorbachev and the lasting impact of the economic and political reforms makes his legacy more far reaching than any Soviet leader since Stalin. His policy of perestroika and glasnost was his response to the decline of the Soviet Union. Under glasnost for the first time ever the Russian people were encouraged to speak openly of political and economic matters, which had previously been forbidden. It was in this new climate of openness under Gorbachev that immense change within the Soviet Union took place. The process of de-Stalinization and the bloodless revolution through Central and Eastern Europe in 1989 pointed to an end to the once all powerful and repressive USSR. The stagnation and decline of Soviet economic performance since the late 1960’s got progressively worse and in this atmosphere Gorbachev implemented political and economic reforms under perestroika. Gorbachev believed in a gradual approach to reform but once the process began the extent of the reforms eventually far surpassed his initial reforms. He attempted to gradually create a socialist market economy rather than make a rapid transition to a purely free market economy. However while the reforms were well intentioned enough it seemed the reforms were a case of too little too late, and by the time of the early 1990’s most Russians had lost the initial excitement and optimism they once held for the reform process. Gorbachev had not wanted to dismantle the Soviet governing structure but rather re-invigorate central planning methods and increase levels of production and initiative amongst state firms. After the 1991 failed coup Yeltsin took over from Gorbachev and the USSR as it had been known ceased to exist. Yeltsin now moved towards more rapid and drastic reforms and the first real steps towards a free market,
capitalist economy were made. His economic reforms involved a huge privatisation programme, near complete financial liberalisation and attempts at stabilising the emerging financial crisis through a variety of methods. However few Russians benefited from the reforms and a gap between wealthy and poor increased substantially. The legacy of the Soviet planning system and ideology was to play an important role in the problems facing transitional Russia. The loss of social safety nets such as guaranteed employment in the new Russia and the harsh living conditions of the early nineties were some of the criticisms levelled at Yeltsin and his rapid reforms. Another major criticism was that under Gorbachev economic reform had not matched the pace of political reforms, under Yeltsin the rapid economic reforms had not matched the pace of political reform. This in turn created an environment of wild privatisation and a huge distribution of formerly state owned resources with poor legal frameworks. It was during this period and atmosphere of the 1990’s that corruption was to become a common feature of Russian transitional society and politics.
Chapter 5 – Corruption in transitional Russia

5.1 Introduction
This chapter aims to analyse to what extent corruption has hindered Russia’s transition to a market economy. The disintegration of the central planning communist system in the early 90’s created a situation of economic, political and social instability in which standards of living declined, unemployment dramatically increased and the gap between rich and poor also increased. The challenge of moving towards a market economy has been for Russia, quite a painful process. From the literature analysed it becomes apparent that corruption in Russia has indeed been one of the primary factors that has hindered the transition to the market economy. As Glynn, et al. (1997) contend that in the short run of the transitional process for ex-communist countries:

‘Removal of authoritarian controls, decentralisation, privatisation, and opening of these economies to international participation have vastly expanded possibilities for corruption; in some places such as Russia, it is rampant’ (1997, p10).

5.2 Russian corruption during the transition
The high levels of corruption and its persistent nature in transitional Russia has emerged to become one of the most challenging obstacles to the movement towards a democratic free market economy. While there has been amazing progress in terms of Russia’s movement away from central planning, as far as transitional periods go Russia is still in the early stages of transition. The wide spread corruption in Russia is partly explained by the rapid transition to the market. The process of a move towards a free market and democratisation in Russia has transpired for the last fifteen years and is still in its early stages. To hold Russia to the same standards of long established democracies in terms of levels of corruption as those throughout Western Europe is obviously unrealistic. However corruption has become a common topic of discussion regarding the transition to a market economy and one of the more extreme examples of corruption in transitional countries throughout the world. There has been an increasing media interest in Russian corruption not only in the Russian media but also
among the international media. There is a strong perception amongst many of those in
the Western media that corruption and organised crime have made Russia an area to
steer clear of or be wary of in terms of foreign investment. This is despite government
attempts to control the wide spread corruption, however many of Russia’s citizens
have questioned the effectiveness of the governments attempts over the past fifteen
years of transition to reduce corruption. This focus on post Soviet corruption and the
resulting concern about its prevelance in business and politics has exposed many of
the differences between Russia and the West in terms of business and political
standards. Obviously Russia’s Communist past has influenced modern day
transitional Russian society and politics in a far reaching manner and in terms of
studying corruption, many scholars still hold Russia’s transitional experience up to
Western standards not taking into account the monumental changes that occurred in
Russia after the collapse of the Soviet Union. Kneen states:

‘The emphasis placed on post-Soviet societies failure to meet them
(western standards of corruption) often reflects moral judgements arising
from disappointment, that Russian capitalism has deviated so markedly
from western expectations, rather than an historically and sociologically
informed understanding of what is involved in the transformation which
Russia is still undergoing’ (Kneen, 2000, p362).

However Russian citizens themselves as reflected by the high amounts of coverage on
corruption in Russian media (Holmes, 1997) also perceive the problem to be of great
importance to the future of the country, while in many ways seeming somewhat
accepting or understanding of the problem. In some instances the public appear
almost apathetic. In 2000 more than sixty percent of respondents in opinion polls
reported that they believe corruption is threatening Russia’s national security. More
than seventy percent agreed with the statement that Russia might be considered a
corrupt state (Levin and Satarov, 2000). In his 1997 spring address Yeltsin
‘acknowledged that corruption had eroded all levels of public service’ (Glinkina 1998,
p592). While there was political recognition and public discontent regarding the level
of corruption throughout elements of Russian society, according to figures released by
the Ministry of Internal Affairs of the Russian Federation in 1995 show that the number of legal action against corrupt civil servants was on the rise but ultimately the total is relatively small (Holmes, 1997). The total number of cases for corruption in 1995 were 3,504 cases. Of this total 66 percent were in connection with government workers while 24 percent were against law enforcement officials. The most common charge was that of criminal malfeasance with a total of 78 percent of which more than half of the cases were for bribery. During the years of 1992-1995 in the early stages of transition the police uncovered more than 700 cases linking bureaucrats to organized crime according to the Interior Ministry (Glinkina, 1998).

High-level corruption allegations were very prevalent during the beginning of the transition in the 1990’s. Some examples of Russian officials engaging in corrupt activities have been more significant or better publicised than others. Public allegations were made against: Vice President Aleksander Rutoski; former acting Prime Minister Yegor Gaidar; two deputy Prime Ministers (Aleksandr Shokin and Vladimir Shumeiko); Yeltsin aides/advisors Gennadii Burbulis, Sergei Stankevich and Aleksandr Korzhakov; and a number of senior ministers and duma deputies (Holmes 1997). It was alleged in a Russian Civil Service report of 1993 that during this period of rapid sale of state property at very low prices through mass privatisation many corrupt politicians benefited as did local mafia networks whom bought up much of the former state property. The charges were subsequently dropped (Holmes, 1997) after many of the targets of investigations ran for office and in many cases were then elected. It is an interesting feature of the Russian legal system that parliamentary deputies are exempt from prosecution and virtually have immunity from charges. This has led to many figures of organised crime or those with connections to organised crime running for office for this very reason. There are also many complications which prevent pressing charges against other government workers which includes officers of partially owned state enterprises. During the early years of the transition under shock therapy and mass privatisation not a single officer of a part state owned enterprise was put on trial for accepting bribes (Glinkina 1998). This huge legal oversight ultimately led to large partly owned state enterprises not being held accountable for their activities. Managers and top executives of the Russian banking system were in a similar position to with most of the property that they dealt with
being owned by the state. They too were essentially not to be held unaccountable for their actions. During the 1990’s corruption by state officials is alleged to have extracted more than US$100 billion from the Russian economy. A large portion extracted has been from the oil, gas and mineral industries. Of this alleged US$100 billion extracted from the Russian economy by state officials there was approximately US$50-75 billion, which resulted in capital flight (Moran, 2001).

Rasma Karklins (Karklins, 2002) listed three general types of post Soviet corruption. The first being low-level administrative corruption which involves bribing of public officials, over regulation, Licensing and inspection powers for extortion. The second type identified is self-serving asset stripping by officials and includes diverting public resources, profiteering from privatisation and malpractice in public procurement. The third and final type of post-communist corruption is state capture by corrupt networks. Examples or types of state capture by corrupt networks include forming collusive networks to limit political competition, de facto takeover of public institutions for private business or criminal activity and the undermining of free elections through slush funds (Karklins, 2002).

Table 5.1 Typology of post-communist corruption

<table>
<thead>
<tr>
<th>Type of corruption</th>
<th>Characteristics</th>
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<tr>
<td>I. Bribery of public officials to bend rules</td>
<td>1. Bribery of public officials to bend rules</td>
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<td></td>
<td>2. Deliberate over-regulation, obfuscation, disorganisation</td>
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<td>3. Using licensing and inspection powers for extortion</td>
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<td>II. Self-serving asset stripping by officials.</td>
<td>1. Diverting public resources for civil servant spoils</td>
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<td>2. Mismanagement and profiteering from public resources</td>
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<td>3. Profiteering from public resources</td>
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<td>4. Profiteering from privatisation</td>
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<td>5. Malpractice in public procurement</td>
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<td>6. Nepotism, clientelism, and ‘selling’ of positions</td>
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III. ‘State capture’ by corrupt networks.

1. De facto takeover of public institutions for private business or criminal activity
2. Forming collusive networks to limit political competition
3. Undermining free elections through slush funds, hidden advertising etc
4. Misuse of legislative power
5. Corruption of the judicial process
6. Misuse of auditing, investigatory, and oversight powers
7. Corruption of and in the media

Adapted from Karklins, 2000, p13: Typology of post-communist corruption.

One of the more common forms of economic activity in Russia to be facilitated by corruption is Rent seeking. Rent seeking can be defined as:

‘Cutting yourself a bigger slice of the cake rather than making the cake bigger. Trying to make more money without producing more for customers…Whether legal or illegal, as they do not create any value, rent seeking activities can impose large costs on an economy’ (The Economist, 2006).

Rent seeking can take various forms and be conducted by a variety of individuals, organisations or sections of government. It can involve protection rackets in which a gang will take a cut from a shopkeeper’s profit. This has become increasingly more common form of Rent seeking in the small business sector of Moscow (Frye, Shleifer, 1997). Rent seeking can also be conducted through monopoly or cartel situations in which all organizations involved agree to raise prices (The Economist, 2006). A major contribution to rent seeking behaviour is the position of the bureaucracy. There are a large number of Russian government administrative personnel whom have wide discretionary powers for granting or denying necessary permission to conduct business. The bureaucrats use this privileged position to essentially control access to activities or business (Glinkina, 1998).
Levin and Satarov (2000) contend that Russian institutions and norms of political behaviour have provided the accommodating framework for a society where corruption is a principal means of acquiring wealth. The distorted market system that has arisen in transitional Russia involves many business practices, which take advantage of the weakness of the state. They contend:

‘The economy of Russia has not performed well in the years of transition. The failures were predictable given the underlying institutions and rules of behaviour of the Russian political and economic system. The idea of a market in Russia is combined with the persistence of old institutions and methods of doing business that use the weakness of the state for private profit. The competition that exists is principally that of competition for rents. Corruption is an integral part of economic activity, with ill-defined boundaries between politics and private business’ (Levin and Satarov, 2000, p114).

5.3 Wild privatisation and the inadequate legal infrastructure during the transition

After the reforms of 1992 which came to be known as the largest privatisation in history the opportunity for high-level corruption increased dramatically. In reference to this period Roaf states:

‘Enormous opportunity for high level corruption arose particularly in the early years of transition, as vast sections of state property came up for grabs’ (Roaf, 2000, p3).

One of the main contributors to this situation was the immense national wealth that Russia possessed and the issue of how and to whom that wealth was to be divided and distributed amongst after the reforms. According to official Soviet records written just before the collapse of the Soviet Union in 1992 an estimated three trillion rubles worth of public property was held by the Soviet state (Varese, 2000). While this estimation is indeed large it is only slightly reflective of the immense wealth of
Russia. The estimate did not take many things into account such as the value of land, forests, mineral and fossil fuel deposits, or armed forces property. The most notable and obvious exception from the government estimate of public property was Russia’s vast fossil fuel reserves especially gas and oil, which were estimated to be worth some 30 trillion Russian rubles (Glinkina, 1998). This in turn led to the economic infrastructure of Russia being rapidly privatised through semi official means. Under reporting the value of state assets during the privatisation process by state contributed largely to the dramatic increase in corruption in the early years of transition. In this atmosphere of rapid privatisation of Russia’s vast amount of resources, corruption not only increased but began to thrive. The huge changes that took place in the Soviet economy from 1988 to 1993 was essentially a process of transferring previous state control in areas such as industry and banking into private ownership (Kaminski and Kaminski, 2001). Many during the time particularly many optimistic Western observers and advisors believed that the ‘shock therapy’ reforms of 1992 which led to mass privatisation would produce a relatively well functioning market economy. However Varese contends:

‘Privatisation per se is not, however sufficient to produce a well functioning market economy. The cornerstone of a market economy is the presence of property rights’ (Varese, 1997, p581).

One of the major problems in Russia in the years following the initial period of transition was that there was a lack of clarity in terms of what constituted a corrupt act and what did not. This was partly due to many of the laws and decrees often contradicting each other. Also a law detailing the rights and obligations of government services was only implemented on the 1st of January 1998. (Glinkina, 1998). This occurred some six years after the shock therapy reforms of 1992 and was essentially the first law regarding corruption in post-Soviet Russia. Another contributing factor to the lack of clarity regarding corruption was that there was a substantial amount of conflict between the executive and legislative branches of Russian law. The executive branch of Russian law proved to be the more dominant of the two. Glinkina States:
‘In most cases the definition of specific legal rules is set not by the parliament but by presidential decree or ministerial decision. Often the laws and decrees regulations contradict laws passed by the parliament. And new decrees and legal decisions are not published or appear with great delay. In many cases it is difficult to determine whether a certain economic process is being conducted on legal, illegal, or even ‘semilegal’ or unofficial grounds. Such uncertain legality, together with the extensive practice of “telephone rule” (the exertion of influence on court decisions by high officials), gives politicians, bureaucrats and judges an unusually free hand to apply their own assessment of right and wrong. The facts of blatantly obvious corruption becomes legally unprovable (Glinkina, 1998, p594)

The lack of clarity of administrative rules has made corruption very hard to prove in Russia during the first five years after the 1992 reforms. This is also partly due to the more complicated methods involved in bribery payments that have emerged since the reforms. The methods have evolved from quite basic money transfers between parties to more complicated and hard to trace methods such as favourable privatisation conditions and stock ownership (Glinkina, 1998).

The privatisation that took place after 1992 under Yeltsin as part of the ‘shock therapy’ reforms has created a situation where those with the right connections have prospered while the vast majority of the population’s standard of living, wages and quality of public services has dropped substantially. During these rapid reforms it does in fact seem there was insufficient attention paid to political and legal reforms. Because legal rights could not be guaranteed to be enforced during this time of rapid privatisation an unstable and uncertain legal climate developed. Essentially there was a power vacuum left in the wake of the collapse of the Soviet Union, where private forms of protection became the primary method of enforcing contracts and protecting assets. This contributed largely to the involvement of organised crime in transitional Russian politics and business. While all ex-Communist countries in transition have had problems concerning inadequate and unclear political and legal controls, Russia
has proved itself to be one of the more extreme cases. In their comparative study of regulatory environments between Poland and Russia, Frye and Shleifer (1997) state:

‘The regulatory and to some extent legal environment is a great deal friendlier to business in Warsaw than in Moscow’ (Frye and Shleifer, 1997, p354).

Taking this notion further Glinkina (1998) states:

‘All the post-Communist countries have been faced with the problem of inadequate political and legal controls. None had inherited a clearly defined concept of administration, nor sufficient oversight to prevent workers from abusing power. But in Russia in particular objective complications and the continuing failure of economic reforms have further aggravated the situation. For a number of reasons, Russian society became rent-orientated, virtually dependent on the decisions of corrupt officials’ (Glinkina 1998, p598 in Williams Moran and Flannery 2000).

Another important factor to consider was the ideological dilemma posed by the movement towards capitalism. After decades of living under a command economy the concept of a free market economy was foreign to most Russians. Previously all decisions came from above with no real allowance for initiative. After fifty years of the Russian people living under a socialist dictatorship a legacy of values and memories alien to capitalism and a market economy would not suddenly disappear as some Western observers had hoped. Mc Taggart, Findlay and Parkin (1995) state:

‘People had been educated both formally and informally, to believe in a political creed in which traders and speculators are not just shady characters, but criminal’ (Mc Taggart, Findlay and Parkin, 1995, p1026).

The legal system was unsuited to needs of a market economy. It was insufficient in basically two ways, those being: that there were no well-established property rights and there were no effective methods of protecting those rights. Varese (1997)
highlights property rights and their ineffective enforcement as being the cornerstone of a market economy and contends ‘the transition to the market amounts to the spread of property’ (Varese, 1997, p595). Before the implementation of new laws in the Soviet system, the economic plans and decisions made by government was the only real law and any activity taken outside plans or decisions were considered illegal. One of the main contributing factors to modern day Russian transitional corruption was that since the wide reaching reforms of the late 1980’s and early 90’s, the pace of the reform had not matched the pace of creating appropriate institutional processes and enforceable laws. Central planners had lost the ability to control production and distribution by mid 1990 and yet the legal foundations of a market economy had still not been established (Smith, 1997). Kneen (2000) states:

‘The necessity to replace the bureaucratic and ideological disciplines of the Soviet system with an adequate framework of law to accommodate the economic and other changes initiated by perestroika was recognised by Gorbachev who assigned priority to constructing the foundations of a law governed state. The failure to achieve this under both Gorbachev and Yeltsin has allowed improvisational coping practices imbedded in the command economy to be applied to the widening array of opportunities offered by the move towards the market’ (Kneen, 2000, p352).

5.4 Political corruption in transitional Russia and the Soviet legacy

Since the dissolution of the USSR in 1991 and even the years before it under Gorbachev, Russian economic policy and political reforms seemed to lack any real direction. Whether it was Gorbachev’s attempts at more gradual reforms combined with gradual political reforms or Yeltsin's mass privatisation with it’s lack of accompanying political and legal reforms, the political and legal situation in transitional Russia has essentially been chaotic. This was especially evident during the period of financial collapse in 1994 (Sloman and Norris, 1999). Under Gorbachev his policies were criticised for being to gradual and ultimately indecisive. However the political instability that followed the failed Soviet coup in 1991 and the emergence of Yeltsin lead to an unpredictable political and legal environment in which the economic reforms had not been accompanied by the necessary legal and political reform. This political atmosphere mixed with worsening social conditions such as
mass unemployment and low incomes created a fertile environment for political corruption to thrive. Moran (2001) in reference to the political situation in transitional Russia states:

‘Government has been racked by political instability, chaotic and indecisive policymaking, and lack of clear purpose. Crime and corruption have subsequently escalated’ (Moran, 2001, p385).

During Gorbachev’s reforms and especially under Yeltsin's 1992 rapid privatisation program, many ties between members of the business community and the government were formed. This process became known as nomenklatura capitalism, which Kneen (2000) describes as:

‘The emergence of nomenklatura capitalism, whereby elements of the privileged stratum of the soviet hierarchy were able to translate their political power into economic advantage’ (Kneen, 2000, p349).

Or as Holmes puts it ‘the old power elite sought to become the new economic elite’ (Holmes, 1993, p170). Ericson concludes that ‘rather than a market, a distorted ‘transition system arose’ (Ericson, 2006, p74). Glinkina (1998) states:

‘During the process of privatisation, informal, mutually beneficial ties were established and secured among prosperous businessmen, state officials, and financial institutions, which resulted in the formation of a financial-industry oligarchy closely tied to political groups and corrupt state officials’ (Glinkina 1998, p597 in Williams Moran and Flannery 2000).

Some of the relationships were formed in the years prior to Gorbachev's reforms when the private manufacture of goods was illegal. During Soviet times when there was a shortage of particular goods sometimes it was illegally obtained or manufactured and sold for a lucrative profit on the black market. This unauthorised and illegal economic activity resulted in criminal gangs extorting those in this illegal business, as they had
no means of protection. Often corrupt Soviet officials would act in a similar manner to the extortionist criminal gangs and receive cuts from the profits whether they are for money or other services (Elder, 1999). Glinkina 1998 states:

‘The main function of state officials thus became the organization of a widespread “shadow barter” network. The volume of corruption was great, but there was natural limits to its spread, basically connected to the position of a bureaucrat in the state apparatus’ (Glinkina, 1998, p598).

These soviet era networks of Communist party officials and workers, organised crime and unauthorised manufacturers of goods were in the best position to benefit from the rapid privatisation under Yeltsin as their networks were already in place and now that people could conduct free enterprise many of the illegal manufacturers now found themselves with the capital, connections and facilities to begin conducting business in transitional Russia. Elder (1999) states:

‘After the Soviet system collapsed in 1991, “thieves in law” made out like bandits. The government largely ceased to function, and the Soviet legal system-crude, inefficient, and communist-driven-ground to a halt. New businesses sprouted like mushrooms. Who was going to enforce their contracts and mediate their disputes? Thieves-in-law stepped into the vacuum left by the state. Within two or three years they became a major quasi-legal force in Russia’ (Elder, 1999, p73)

Those with the right government connections benefited enormously from the privatisation program under Yeltsin. Since the beginning of the transition under Gorbachev and especially after the dissolution of the USSR political aspirations have moved away from the focus on the national interest as in Communist times to that of achieving political power for personnel benefit. Levin and Satarov state:

‘Political goals deviate from the tasks of national development and are directed at securing political power for the benefit of selected oligarchic private groups’ (Levin and Satarov, 2000, p114).
While many analysis of corruption focus on the ‘private gain’ element of the corruption definition often the latter part of the definition; the abuse of position of power or influence tends to be neglected. Karklin (2002) contends that when there are high levels of corruption present in government and politicians and bureaucrats focus on their own personal interest the very foundation of public institutions is undermined. As all governments around the world the Russian government is the supplier of many fundamental services to the Russian population thus when there are high levels of corruption it is the citizen whom pays the cost in the form of poor government services. Karklin (2002) states:

Officials in charge of securing the public good instead focus on securing their (own) private good. Next to the misappropriation of tangible public goods such as budget funds, the basic purpose of public institutions is undermined. This means that the public pays a cost in terms of poor public safety, services, judicial enforcement of contracts, democratic representation, and otherwise. Not surprisingly, the public reacts with anger distrust, and cynicism’ (Karklins 2002 p12).

A consequence of the high levels of corruption in Russian politics is that Russian society in general does not trust authority or believe them to be acting in the national interest but rather for their own personal benefit or the benefit of their clan/oligarchic group. Russians today generally see politicians and bureaucrats to be acting in their personal interest and ultimately abusing their privileged position. This translates into a disillusionment among people even when measures against corruption are announced. As the public becomes more and more disillusioned with democratic values when elections appear to be nothing more than a farce the very notion of democracy is itself threatened (Glinkina, 1998). As democratic institutions are already undermined through political corruption there is a greater chance that a more dictatorial regime may emerge riding a popular wave of anti corruption programs (Levin and Satarov, 2000).

The widely accepted notion of pervasive corruption throughout Russian politics and its subsequent highlighting by the Western media at the end of the 1990’s has
damaged the international reputation of Russia to some extent. This has resulted in some degree of economic and political isolation. However as with most media, the reports tend to focus on the more extreme aspects of organised crime and tend to sensationalise. This conception among many in the West is not without justification, but the picture painted by the international media is often more gloomy than exists in reality. Obviously this perception among the media is cause for alarm for Russia as it directly influences the rates of foreign investment due to the perceived risk for foreign investors. However one could argue that the attention placed on political corruption and its links to organised crime in the international media and the hesitance of foreign investors will make Russia begin to tackle corruption more vigorously than in the past.

5.5 Economic impact of corruption in transitional Russia

After the fall of Communism and the dissolution of the USSR, corruption has emerged to become one of the greatest if not key obstacle to the transition to a democratic market economy throughout Central and Eastern Europe. Karklins states:

‘A decade after the transition from communism, it has become clear that corruption is the key obstacle to democratic and economic progress in the post-communist region’ (2002, p12)

It is hard to estimate the true effect corruption has on the economy, mainly due to the many forms corruption may take. However one can consider corruption as being a part of the hidden or unregulated economy. In Russia during the transition a large unregulated/black economy has emerged. One of the more obvious consequences of having a large unregulated economy or shadow economy is the large amount of uncollected taxes, which ultimately weaken the state’s ability to effectively provide services for the public. This translates into the state having less control over the management of the national economy. The already strained Russian budget thus had additional limits to its spending due to the large unregulated economy that exists in transitional Russia. The often already poorly funded government services are put under further pressure and as a result the service quality deteriorates. This also further promotes growth of corruption especially bribery among government officials whom
are often poorly paid and at times have not been paid at all for large periods of time. The failure to collect taxes from unregulated economy activity and the subsequent budget shortfalls further aggravate the many social problems transitional Russia is facing (Levin and Satarov, 2000). Corruption in transitional Russia is also likely to increase poverty and widen income distributions. This can be partly explained by the emergence of nomenklatura privatisation where by those with the right connections in government benefited enormously from the rapid privatisation programs (Kneen, 2000) while the majority simply got deteriorating public infrastructure and services. Levin and Satarov (2000) state:

‘Corruption distracts resources from the goals of public development and the authorities ability to solve social problems declines’ (Levin and Satarov, 2000, p116 in European Journal of Political Economy).

The presence of pervasive corruption in Russian government and business leads to higher costs in terms of production and distribution due to corruption overheads. This causes higher prices which are virtually passed on to the consumer. It has been estimated that the high levels of corruption in transitional Russia adds between five percent and fifteen percent to the cost of goods and services annually (Levin and Satarov, 2000). In essence corruption becomes a hidden tax of which none of the revenue is re-distributed back into public spending by the government.

Corruption reduces the level of investment in a country thus it reduces the level of growth also (Tanzi 2000). This reduction in investment can be attributed to the perceived higher risk in countries with high levels of corruption and the higher costs usually associated with doing business there. It creates doubts and a general lack of confidence among investors and potential investors in regulatory bodies being able to enforce laws ensuring fair competition. Ultimately those engaged in the market lose confidence in the authorities being able to establish and enforce fair practices involved with the move towards a free market economy. This translates into the level of investment to decline within Russia (Levin and Satarov, 2000).
In transitional Russia participation in the distribution and re-distribution of the national wealth (whether former state enterprises or resources etc) has been of greater economic benefit to business and entrepreneurs than any other form of activity. There is more profit to be gained through acquiring control of old state monopolies which is mainly facilitated through ‘personal contact with government’ than in ‘innovation or investing in new undertakings’ (Glinkina 1998, p596). Thus the incentive has moved to those activities such as rent seeking that can be viewed as being outside the real and are ultimately detrimental to Russia’s economic growth and productivity. During the early transitional period average profitability in the real economy was approximately five per cent, while some rent seeking operations had profit margins reaching some several hundred percent (Glinkina 1998, p596). The higher profit margins to be obtained through such practices as Rent seeking and obtaining control of former state enterprises and resource sectors causes those involved in business to spend vast amounts on gaining access to such lucrative areas. In Russia this translates to paying those in positions of power for their assistance and protection. Glinkina states:

The logic of market behaviour prompts economic players to withdraw their resources from the real economy and direct as much as possible of their efforts and resources into affecting the distribution process, thus “investing” in bonding relationships with officials responsible for crucial business decisions. By varying estimates, commercial structures direct from 30 percent to 50 percent of their profit in maintaining special relationships with corrupt officials and representatives of organised crime groups. (Glinkina 1998, p596).

The main theoretical economic impact of corruption is the weakening of market competition. In transitional Russia the main beneficiaries of economic change have been those whom pay bribes and have special connections. In this environment market competition is weakened, as success depends not on firms competitiveness but rather having the right connections and enough financial resources to pay the bribes. A direct result of this weakening of market competition through corruption is that market efficiency declines and doubt emerges in people’s minds in terms of seeing the
benefits of market competition. (Levin and Satarov, 2000). While one can speculate and draw conclusions about the possible economic impact it is ultimately very difficult to make an assessment as to how much corruption hinders Russia’s transition to a market economy. This notion is supported by James Roaf of the IMF European Department who states in relation to the persisting high levels of corruption in transitional Russia:

‘While we can catalogue the possible channels by which corruption could wreak economic damage, it is almost impossible to judge how detrimental it really is to the economy’ (Roaf, 2000, p6)

While the immediate effects of corruption in transitional Russia are hard to judge its effect of draining public resources, distorting market functions and undermining the relatively new democratic institutions are in no way beneficial to the transition towards a democratic free market economy. Vito Tanzi, a long time analyst of the economic impact of Corruption supports this contention:

‘It reduces the legitimacy of the market economy and perhaps of democracy…Thus corruption may slow down or even block the movement towards democracy and a market economy’ (Tanzi, 2000, p127).

5.6 Conclusion.
The reasons for the high levels of corruption in Russia are far reaching and in most instances quite complex. Factors such as an inefficient and weak legal system during a period of economic crisis, large-scale activity in the black economy, poorly paid public servants and the mentality of the Russian people during the time all have part of the answer. Glinkina in relation to the dramatic increase of corruption after the initial transition period of the early ninety’s state:

‘What are the reasons for this scourge upon the country? The factors making up the answer include: the ability of the Russian legal code to deal
with contemporary demands and inefficient judicial system; an economic
crisis dominated by uncertain property rights and monopolies; and most
notably, rent seeking, in which wealth is sought not through profits of
market competition with other firms but through access to government
subsidies and granting of monopoly status; and finally aspects of the
national mentality and the state of social morality’ (1998 p594).

In the system to arise out of the transitional process, corruption in government from
the highest to lowest levels is generally accepted by most scholars to be wide spread.
However it is not simply the opportunities for corruption and crime that arise during
the transitional process to a free market economy and the ‘inherent evils’ of
capitalism that have caused such high levels of corruption in transitional Russia. It is a
weak legal system, the soviet legacy of bureaucracy and central planning which have
been the main contributory factors to the high levels of Russian corruption.

With the re-election of Vladimir Putin in 2004 and international observers saying the
election process being less than democratic, many fear a slide back towards a more
authoritarian form of government. This fear has been based on Putin’s general
direction towards more state ownership, media control and prosecution of prominent
Russian businessmen such as Mikhail Khordovsky the president of Yukos Oil
Company. After the rapid mass privatisations during the nineties it seems that those to
benefit have done so primarily through less than honourable methods, which were
facilitated by corrupt officials. Such corrupt officials and oligarchic networks seem to
have been the prime beneficiaries of the privatisation process during the transitional
process. So while there is a tremendous opportunity in Russia for growth, the biggest
threats are the in-efficient legal system, poverty, unemployment, dramatic declines in
the standards of living and the collapse of the economy. These individual factors
when combined are all excellent breeding grounds for corruption and can partly
explain its wide spread nature and persistence in transitional Russia. In a country
where it is estimated that over ninety percent of people are living in poverty (Jackson
and McIver, 2002) it seems painfully obvious that organised crime and corruption will
most certainly thrive. Therefore the economic implications of these hidden areas of
the economy while hard to estimate accurately are of prime importance in terms of
Russia’s successful transition towards a market economy.
Chapter 6 – Conclusion

6.1 Conclusion and Projections

Under Tsarist rule just before the beginning of the 20th century Russia could be considered as being relatively backward in terms of industrialisation when compared to Western Europe. When the Bolsheviks came to power after the 1917 Revolution they inherited the challenge of creating an industrialised economy in a predominantly agricultural setting. After War Communism which was essentially a move towards greater centralisation and restrictive economic policy, Lenin introduced the New Economic Policy which re-introduced elements of the market economy. Lenin justified the temporary move towards capitalism by claiming that the war and ruin caused by it, made it imperative for a change in economic policy. The New Economic Policy was essentially a move away from centralisation, which had been the main feature of economic policy under War Communism during 1918. This was to be Soviet Russia’s only real deviation or change in direction of economic policy before Gorbachev came to power and initiated reforms under *perestroika* in the mid to late 1980’s.

Following Lenin’s death in 1924 Stalin slowly emerged to become leader of the Soviet Union. The period under Stalin came to be as one of the darkest periods in Russian/Soviet history. Stalin, once portrayed as the caring fatherly figure through Communist propaganda came to be viewed as one of history’s most brutal and repressive dictators as exemplified by Krushchev’s revelations in 1956. While this period under Stalin was a time of great sacrifice and suffering it was also a time of immense and rapid industrial development. By the late 1940’s Russia had transformed itself from essentially an agricultural economy and underdeveloped country into an industrial and military superpower. The immense scale of destruction left behind after the Nazi retreat from the Eastern front meant that re-construction was the prime focus of Stalin in the immediate period following World War II. During this period a significant political divide between Russia and its Western allies emerged. It resulted in a divided Europe with Central and Eastern Europe under Soviet control. By 1948 and the Berlin blockade it became increasingly obvious that this political divide between Russia and it’s former allies had reached the point of no return, and a hostile and tense relationship ensued for the next forty years. The increasing diplomatic gap
and atmosphere of the time resulted in tension escalating between the Soviet Union and the West especially after 1949, when Russia also came to possess nuclear weapons. The following forty years was to be the period of the Cold War between the USSR and the US. During the Cold War the Soviet Union became increasingly more isolationist. After Stalin’s death in 1953 Khrushchev emerged as leader of the Soviet Union. For the first ten years of his tenure he rode a wave of strong economic performance that lasted through the mid to late 1950’s. However by the 1960’s ineffectual reforms of the centrally planned system and declining economic performance of the Soviet Union all contributed to bring about the downfall of Khrushchev in 1964. Brezhnev took over and ended many of the reforms initiated under Khrushchev. The period marked a movement back towards a more rigid system of economic planning. There was a large resistance to fundamentally changing the centrally planned system and this attitude was to persist until the Soviet Union’s eventual collapse. During this time corruption, nepotism, apathy and pessimism became norms of Russian life right through until the final days of the Soviet Union. The promises made by Khrushchev some twenty years earlier of Soviet society overtaking the West were unfulfilled and if anything living standards had dropped significantly lower than those in the West. The 1970’s and early 80’s were a period of economic stagnation where the deficiencies of Russia’s centrally planned system became more and more evident as time passed.

By the time Gorbachev came to power in 1985, economic and political reform seemed certain, the question was how dramatic the changes would be and at what pace they would occur. The immense changes to take place in the Soviet Union under Gorbachev during the late 1980’s marked the first movement away from the centrally planned system since Lenin’s NEP. Gorbachev took the first steps of initiating political and economic reform, this combined with his efforts to end hostilities with the west essentially bringing about an end to the Cold War made his legacy more far reaching than any Soviet leader since Stalin. Under his policy of glasnost for the first time ever, Russian citizens were not only permitted but also encouraged to speak of and even criticise political and economic matters. In this new climate of openness the process of de-Stalinization began to gather momentum and the brutal often disturbing nature of his rule was revealed by the government along with other previously denied or withheld information. This process marked a movement away from the highly
repressive and once all-powerful USSR. This ultimately weakened the position of the USSR and was best exemplified by the 1989 ‘bloodless revolutions’, which swept through Central and Eastern Europe. Only some twenty years ago any signs of opposition or dissidence throughout the former republics of the USSR would have been met with brutal military intervention.

The declining economic performance, which started in the 1960’s, had continued through the 1970’s and early 1980’s and for almost a decade the Soviet economy virtually stood still. This period of prolonged stagnation created the atmosphere in which Gorbachev was to introduce economic and political reform under *perestroika*. Gorbachev’s reforms were gradual and he was often criticised later that the reforms were not fast enough to cause real change in the Soviet Union’s economic situation. His reforms were to be more of a political nature however; there was significant economic reform when one considers that it had been the biggest deviation from central planning since the NEP some sixty years before. This process of reform under Gorbachev and its gradualist approach was only to last for a relatively short time as the calls for greater reforms and the direction of further reforms were to far surpass what Gorbachev originally had intended. Gorbachev had wanted to create a socialist market economy opposed to making a rapid transition to a purely free market without accompanying political and legal reforms. While Gorbachev’s reforms were well intentioned it seemed as though it was to be a case of too little too late. The initial optimism of the Soviet Union’s citizens regarding the reform process under Gorbachev had diminished severely. Gorbachev had not wanted to completely dismantle the Soviet centrally planned system but rather re-invigorate the old system with elements of the market economy which would hopefully in turn increase levels of production and initiative amongst state firms.

After the failed 1991 coup by hard line Communists to regain control of the Soviet Union a period of dramatic political and economic uncertainty ensued. The coup was met by popular resistance from the Russian people. They were determined not to return towards the centrally planned system, rigidity and repressiveness that had been life under Communism in the past. After the coup and Gorbachev’s resignation Yeltsin emerged to lead Russia and the Soviet Union was officially dissolved. Yeltsin's approach to reform was to be of a much more rapid nature with the prime
focus on economic reform often neglecting legal and political reform. The economic reforms under Yeltsin particularly the 1992 reforms were significantly more drastic than Gorbachev's efforts at reforms. Yeltsin's economic reforms involved the largest privatisation program in the world, near complete financial liberalisation and various attempts at stabilising the emerging financial crisis. However few Russians really benefited under the reforms particularly the privatisation process, which had primarily benefited those with contacts in government. This created a greater wealth disparity in post Soviet Russia and living standards and incomes fell dramatically in the immediate aftermath of the dissolution of the USSR. The legacy of the Soviet central planning system and communist ideology was to make the transition to the market a less smooth operation than many in the West had expected or hoped for. The loss of social safety nets such as free health care and education and guaranteed employment were some of the consequences of Russia’s transition to a market economy. During the early 1990’s not only did living standards and incomes decline but the quality of state services also declined dramatically. One of the major criticism’s levelled at Gorbachev was that the pace of economic reform had not matched the pace of his political reforms. However under Yeltsin the opposite was true and under his rapid and often chaotic economic reforms, legal and political reform was ultimately neglected. Without the necessary legal framework and political reforms an atmosphere of wild privatisation of state assets took place. Those to benefit were primarily the old Communist elite and their networks emerged. In this environment of the early stages of transition and privatisation of a huge amount of state resources and assets corruption was to become a common feature of Russian transitional society and politics.

The reasons or factors contributing to the high levels of corruption affecting all levels of transitional Russian politics and society are far reaching and in most instances quite complex. Contributing factors such as a weak legal system during a period of economic instability, large-scale black economy activity, poorly paid public servants and networks of clans or groups controlling vast amounts of the economy have all contributed to the high levels of corruption in transitional Russia. These high levels of corruption in transitional Russia have created a situation in which the process of moving towards a market economy has been somewhat deviated. As Frye and Shleifer (1997) contend Russia has not developed to be a free market economy in which the
invisible hand or market forces allocates resources. They argue that Russia has developed to become a grabbing hand economy. This grabbing hand model is described as being when the government consists of a large number of substantially independent bureaucrats pursuing their own agendas, including taking bribes. In this grabbing hand scenario contracts are not always enforced and private property rights are not always enforced by the state (Frye and Shleifer 1997).

Most scholars within the area generally accept corruption in Russian government and society to be an everyday and extremely common feature since the transition. However one must take care when arguing that the dramatic rise in corruption is completely due to the transitional process. As Kneen (2000) contends the Soviet coping practices developed under central planning and their legacy continue to be a large contributing factor to the high levels of transitional corruption. The rapid privatisations of the early 1990’s saw those with the right connections prosper while most of Russia’s citizens did not have the money or connections to make use of the opportunities offered by the move towards a free market economy. The prime beneficiaries of Russia’s rapid privatisation in its transition to a market economy have been the oligarchic networks and criminal affiliates whose roots can be found before the transition even began. However when the transition did begin and there was essentially a power vacuum left in the wake of the dissolution of the USSR these networks where in the best position to benefit from the transition process and subsequent privatisation of former state enterprises.

6.2 Recommendations for future study.
Not only is the area of corruption difficult to research due to its hidden and illusive nature, multiple definitions and differing understandings across cultures. When put in the context of a transitional economy the issues that arise and the background information necessary to understand the high incidence of corruption draws from a wide range of disciplines and periods of Russian history. In short the topic of corruption in transitional Russia has numerous often complex and speculative facets which when combined can describe some of the various reasons or contributory factors for the high incidence of corruption in transitional Russia.
Further detailed analysis is required in any of the major contributing factors to the high levels of corruption in transitional Russia outlined in the report. Analysis of the Russian legal system before and after Communism is an area that warrants further analysis in terms of explaining the high levels of corruption present in transitional Russia. A more in-depth look at the relationships forged between organised crime and politicians/bureaucrats during the years of the Soviet Union would also be a recommendation in terms of further understanding the nature of these relationships in modern day Russia.

An area, which most certainly warrants further analysis, is the economic effects and implications of corruption in transitional Russia. While one can speculate numerous possibilities regarding economic outcomes from high levels of corruption, it is hard to gather real data and from more solid conclusions. This raises the issue of collecting accurate information on public and business perceptions and incidence of corruption in Russia and then forming new economic estimates of its impact on the economy. Due to the illusive nature of obtaining data on corruption in Russia, and some of the inherent dangers of probing perhaps too deep for answers, it is an area which will always warrant further analysis. This is especially the case as Russia emerges to be more and more influential on the world market and continues to make its transition to a democratic free market economy.

6.3 Conclusion
Russia is still in the early stages of developing its democratic free market economy. When one considers how long the democratic free markets of Western Europe and America have been in operation and the amount of changes made to these economies over the past two hundred or so years, it becomes clear that it is unrealistic to expect a perfectly functioning democratic to emerge after the dissolution of the USSR. However, the problems to arise out of the transition from a centrally planned economy seems to have been a more painful and acute in Russia than almost all other countries in the former Soviet Union. Transparency International in their corruption perceptions index 2005 ranked Russia 126th out of 158. With 1 being the country with the lowest rates of corruption and 158 indicating very high levels of corruption (Transparency International 2005 corruption perceptions index, 2005). The issue to arise out of this
transitional period for Russia is: why such high levels of corruption have accompanied the transitional process?

Some of the contributory factors or reasons for transitional Russia’s high levels of corruption are quite complex and ultimately relatively hard to research. This is largely due to the fact that there is little incentive for either party involved in a corrupt exchange to come forward and reveal information about the exchange, thus most of the corruption in transitional Russia is hidden and consequently difficult to research. However one can look through Russian history and the beginning of the transition process in the early 1990’s to identify primary reasons for such high levels of pervasive corruption. Many of these reasons for such high levels of corruption in transitional Russia can be attributed to the Soviet legacy. Government officials falsifying unrealistic quotas for the ambitious five year plans is one of the largest contributing factors to the overall culture of corruption throughout the Russian bureaucracy. While this dishonesty among government officials is understandable in terms of the unrealistic totals set by the central planning bureau and the often severe repercussions of those totals being unmet, these coping measures often manifested itself via falsifying documents and statistics for personal benefit. This was particularly evident towards the end of the 1970’s and into the 1980’s as the USSR’s economy deteriorated even more substantially than in the past. During this time many government officials formed collusive networks among businessmen operating illegally (manufacturing and selling goods in shortage) and organised crime. Thus when the significant power vacuum emerged after the dissolution of the USSR and the wild privatisation of 1992 ensued before the implementation of adequate legal infrastructure, these networks emerged to control large segments of the economy. The rapid and chaotic ‘shock therapy’ reforms of 1992 began the largest privatisation in history in an environment of inadequate legal infrastructure. This lack of clarification of the law particularly property rights and contract enforcement led to a power vacuum which was subsequently filled by private protection which often took the form of organised crime. The levels of high corruption in transitional Russia can find its origins in Soviet times however it was the opportunities to arise out of the transition and the connections to government necessary for success that made corruption sky rocket in the following years of transition.
The impact of corruption on transitional Russia is far-reaching and ultimately hard to assess, particularly the economic impact. The social impact is more observable as it is reflected through the high incidence of reports in the Russian media and anonymous public perception studies. The negative aspects of Russia’s transition, namely; the mass unemployment, economic crisis, falls in the standard of living and the loss of many of the social safety nets that existed under Socialism have created an environment where by the majority of the Russian population have not benefited from the transition. Those with the connections and access to funds at the beginning of the transition have created a great number of clans or groupings usually along regional lines whom control vast amounts of former state property and indeed sections of the shadow economy also. This situation is largely facilitated by the pervasive corruption throughout Russian politics and government services. The public distrust of government officials among the Russian people is widespread. In numerous surveys and questionnaires conducted by various institutes and organizations, they persistently reflect that government and civil servants especially the police are perceived as being the most corrupt members of Russian society. This result shows that Russian people are beginning to lose faith in the democratic and reform process as they themselves benefit little out of the process. Rather through the high incidence of pervasive corruption, black market activity and uncollected taxes the functioning of a free market economy is severely undermined. Social services suffer dramatically due to the corruption and loss of government revenue which results in lower efficiency and poorly paid civil servants among other negative aspects. The civil servants being underpaid creates an environment where bribes are almost expected and necessary to supplement low incomes and are paid basically without question by members of the Russian public. It is through such instances of grassroots corruption where one can begin to gauge how common corruption across transitional Russia truly is. Most political and business corruption is hidden for the most part unless one of the parties has an underlying motivation for bringing the corrupt act to light. This means that corruption in transitional Russia has become a political and legal tool for discrediting or undermining competition and rivals.

The immediate effects of corruption are indeed hard to judge or assess. However from the study conducted one can conclude that the high levels of corruption to accompany Russia’s transition to a free market economy has been ultimately detrimental to the
process of transition. The effect or impact of high levels of pervasive corruption in transitional Russia can be summarised as follows. Corruption has the effect of draining public resources resulting in poor services and protections. It creates distrust of the government at large, which undermines the democratic process and reduces foreign investment. Increases wealth disparity as those with the right connections and access to funds prosper while the majority’s standard of living remains largely unchanged. And lastly it distorts the overall functioning of a market economy through monopolistic conditions and the presence of a huge unregulated black economy which in turn severely affects government revenue and social services. Ultimately corruption hinders the transition to a market economy, however it must be stressed that Russia is still in the early stages of transition and to expect a perfect transition to the market is unrealistic. The power vacuum left in the wake of the dissolution of the USSR provided the perfect opportunity and atmosphere for corruption to thrive. There is a huge opportunity in Russia today for investment as it has vast resources, an educated work force and many other conditions and attributes working in its favour. However as long as there is an environment with an under developed legal system, poverty, huge wealth disparity, established criminal/business networks and mass unemployment in a period of political and economic crisis, corruption will almost certainly continue to thrive.
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