

Doing Business Legally in Lands without Laws

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by

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Doing business in the lands of the former Soviet Union (FSU) is a daunting task. We have all read the news reports of the “Mafia” who dominate the FSU and the lack of rule of law. Operating in the FSU involves operating in countries where one is open to extortion. As well, one is faced with rapacious civil servants who demand bribes for performing the most basic services. This environment is very reminiscent of the world of Thomas Hobbes: one in which “...every man is enemy to every man; wherein men live without other security than what their own strength and their own invention shall furnish them with...”¹; in brief a world where the life of man is “...solitary, poor, nasty, brutish and short...”².

Faced with such a tough environment how is it possible to conduct business in a legal and ethical manner? How does one conduct oneself in such a place?

To do business in the FSU it is important to look at several factors that make corruption in this region different from those in other regions. One of TI’s core philosophies has been that it is essential each country define its own anti-corruption programmes and methodologies according to the local “realities”. Hence the reasoning behind establishing National Chapters and our adaptations of the TI Sourcebook. Within the former Soviet Union there are specific realities that make the region different from others, including Eastern Europe. It is this “face” of corruption in the FSU that I would like to address here today.

Within the countries of the FSU is a set of regional specifics that define the popular conception and causes of corruption. These specifics should be recognised if an effective strategy is to be created in assisting the fight against corruption in the region. Knowing these realities is especially useful to those members from of the private sector who are contemplating working in the region.

¹ Hobbes Thomas, *Leviathan*, Oxford, 1996, p.84

² Ibid.

1. The first reality is the **high level of corruption** in the region. This region is an incredibly corrupt “zone” which in the TI Corruption Perception Index (CPI) for 1999 the countries of the FSU³ were placed between places 75 (Moldova) and 96 (Azerbaijan) in the 99 countries listed. This places it as one of the most corrupt regions in the world. The degree of corruption within the FSU is the crucial factor that separates it from other regions i.e. Central and Eastern Europe. The relative level of corruption in the FSU is similar to those in regions in Africa. In TI’s 1999 CPI, Belarus was tied with Senegal, Moldova and Ukraine with Cote d’Ivoire, and the Kyrgyz Republic with Uganda. This is a unique paradox of the FSU being an industrialised and well-educated region that is, in certain aspects, in the same leagues as “Third World” countries.⁴ One of the adage in the Soviet times was to refer to the Soviet Union as an “Upper Volta (today’s Burkina Faso) with rockets which seems to be more of the current situation than it was then.

2. The absolute **Poverty and Economic Collapse** of the states in the FSU. In the last ten years the levels of poverty in the region have increased dramatically. As well as the GDP, the levels of growth have dropped drastically since the collapse of the Soviet Union. In real terms from 1988 to 1995 poverty increased in the Western CIS (Ukraine, Belarus and Russia) from 2% to 52% and in Central Asia from 15 to 66%.⁵ The countries of the FSU have seen real GDP drop to slightly above 50% of that of 1989. Following a long period of dropping GDP there has been in the last 4 years started to have limited growth albeit slowly. The destitution faced by those in the region especially that of civil servants leads naturally to rampant corruption. Poverty is a major cause of corruption and anti-corruption work should be seen in connection with poverty alleviation. To quote the Indian ambassador in Tajikistan: “If you talk to a hungry man about good governance, he will probably kick you in the teeth”.⁶

3. There are the **cultural and historical factors** that contribute to corruption. The cultural legacy of a long history of “bad” governance. These cultural and historical factors play a dominant role in preventing the creation of a National Integrity System. 70 years of communist mismanagement, placed upon 600 years of autocratic rule of the Czars, and several hundred years of the “Tartar yoke” have left very barren ground for the growth of good governance. The staggering weight of this cultural baggage has not made the Russians “inherently corrupt” as is often claimed.⁷ However, it has left a large gap between what former Soviets consider to be illicit acts and what North Americans view as being unacceptable behaviour.

³ The Baltic countries (which are arguably a part of eastern Europe) and Belarus (which is economically a part of the Russian Federation) are for the purposes of this paper excluded from the FSU.

⁴ Such comparisons greatly irritate most citizens of the FSU and yet are sadly true.

⁵ European Bank for Reconstruction and Development, *Transition Report 1999: Ten Years of Transition*. London, 1999, p. 58. Of course one should always take Soviet (and post-Soviet) figures with a grain of salt due to the unreliable nature of government figures. Even the vaunted CIA grossly overestimated Soviet economic figures.

⁶ Bharat R. Shri- Indian Ambassador to the author in Dushanbe, March 2000 during the joint TI/UNDP Governance Assessment Mission.

⁷ For a more complete discussion on the cultural aspect of corruption in Russia see: Bowser, Donald. 1999. ‘Corruption in Post Soviet States: A question of cultural identity?’. unpublished paper given at the Fourth Annual ASN Conference, New York.

4. One element of this legacy that may be considered on its own a factor Russian/Soviet view of **private property**. The concept of private property had within the area of the Russian Empire always been poorly developed due to the limited rights of the peasants. The very “eastern” concept of the community having a place above the individual has led to a much weaker bond with property than in the West. This history is combined with 70 years of Soviet rule in which owning private property was forbidden. In Soviet times there existed only state property (as an extension of the people) and personal belongings and even the concept of private property was banned as being too bourgeois. With such a legacy it should not come as a surprise that property rights in the post-Soviet states are poorly protected. In addition, this legacy led to the inevitable mass theft of state assets that occurred during privatisation. This was a natural development to what had happened in Soviet times. As an apologetic thief stated after an attempted robbery in Odessa in 1990: “It’s the state’s fault of course; first they stole from us then we stole from the state and now we steal from each other.”⁸ The post-Soviet addition is “and then we stole the state.” Or better yet the Soviet justification for helping oneself to anything at hand (building materials, farm produce) “well these are the people’s things and we are the people”. One can see that respect for private property was low in the Soviet Union and a natural conclusion to this is mass theft.
5. Closely related is the complete **lack of a separation between the public and private sectors**. If *misuse of public office for private gain* is the accepted definition of corruption than almost the entirety of the public sector of the FSU can be considered to be corrupt. This is also a Soviet-era heritage and is closely connected with the lack of a clear concept of private property and the resulting lack of a private sector. In that there was only the public sector in the Soviet Union, entrepreneurs used the only means available to the state assets and public office. A common mistake of foreigners in the FSU is to assume they have anything to teach the people in the region about being entrepreneurial. The vibrant second economy (the famous black market) of late Soviet times was a clear indication of how commercially minded were the citizens of the USSR. This tradition has been carried over into post Soviet times and public office exists as a means of production. In fact this “spontaneous privatisation” of public office is the justification of the states of the FSU for withholding the wages of public servants’ salaries. There is an absolute absence of professionalism in the public sector across the FSU and the idea of public servants existing to serve the public is a foreign concept.
6. There is **little (or no) Civil Society (CS)** in the way that the West conceives Civil Society. A *broad range of institutions outside of government—including civic associations, nonprofits, churches, and neighbourhood clubs—that contributes to the public good*⁹ is a useful description of the “western concept of CS. However few Civil Society Organisations (CSOs) in Russia are active in pursuing the public good but instead are involved in the pursuit of private/individual good. If there is

⁸ The incident happened to the author on a bus in late 1990.

⁹ *Civil Society, the Public Sector, and Poor Communities*: G. Thomas Kingsley and James O. Gibson, Number 12 in Series, "The Future of the Public Sector" found on http://www.urban.org/PERIODCL/pubsect/pub_12.htm p.1

no barrier between the public and private sectors than logically the same should exist for the third sector. Most NGOs are simply commercial organisations whose “capital” exists as aid from donor organisations and whose “products” are mainly oriented towards the “market” of the international community. Those genuine members of CS that do exist are usually too oriented towards their own national problems and realities to be able to engage in the competitive world of the non-profit sector. Foreign grant givers usually reward those that look and talk like they do. The poor Russian speaking researcher who is trying to fight for the accountability of Soviet era crimes is unlikely to get grants¹⁰.

7. A lack of an independent and responsible **media**. The years of authoritarian government of the USSR left behind a press that was ill prepared to meet the challenges presented by a free market and more democratic system. Although eager to pursue corruption cases this is usually based on the principle of *kompromat* (compromising evidence) that is usually not substantiated and is used for ulterior purposes i.e. to incriminate a political or economic competitor instead of pursuing public good. The politicisation of the media in Soviet times has made it relatively easy to co-opt the post-Soviet era press using repressive measures or economic means. The lack of professionalism, dire economic straits and lack of protection of journalist has diminished the independence and power of the “fourth estate”.
8. The dominance of **social networks**. The system of *blat* and informal social networks, which allowed life under the planned economy to become liveable has facilitated the emergence of a kleptocracy. Although based on the morally correct idea of helping others in one’s “family” or social group, this entrenched system of influence peddling has led to low awareness as to what is a conflict of interest.

So what are the results of this region specific “face of corruption”? What all these elements bring about is:

- **the complete lack of trust between the people and government** and
- **the failure of the transitions to democracy and a market economy**
- **weakening of the state.**

The erosion of trust between the people of the FSU and the governments may not seem to be a major issue of importance but it is in actuality. What this lack of trust by the citizens for their governments has led to mass tax evasion and capital flight. The recent spate of scandals concerning misuse of the IMF and World Bank funds should come as no surprise to those who know Russia. The fact that the Central Bank of Russia keeps large amounts of its funds in offshore accounts is not a promising sign of faith in the government!

This could be considered one of the unique aspects of corruption in Russia. The mass theft of state assets that occurred during privatisation is not an unprecedented event. It has been often compared to the early days of North American capitalism, the robber baron period. However, the difference lies in that the “oligarchs” of the Former

¹⁰ A good example of this is Sergei Grigorinats of the Glasnost Foundation who has had a long and hard struggle as the founder of an anti-KGB NGO.

Soviet Union are not the Rockfellers or J. Paul Getty. They do not invest in their countries but instead transfer their assets to offshore or Swiss bank accounts.

The other ominous sign of the mistrust of the peoples of the FSU and their respective governments, is the massive evasion of taxes. The majority of Russians don't pay taxes nor would they know how if they were so inclined.¹¹ Nine tenths of the citizens of Russia view their public officials as being corrupt¹² and a result of this is that few feel the need to fulfil their part of the social contract. As civil servants are engaged in rent seeking for public services, the public doesn't feel the need to pay for services that must be "bought" anyway. The old Soviet adage "they pretend to pay us, we pretend to work" it has become "we pretend to pay them and they pretend to deliver services". This downward cycle of decreasing tax bases hampers the state from providing the most basic services that a state should provide, including additional tax collection and policing its own laws¹³! What has emerged alongside the second or "black" economy is the non-taxed business of personal protection and contract enforcement using non-legal methods through the *mafya*¹⁴ which provides those services that the state is incapable of providing.

What this means for the foreign investor is that they provide the easy "target" when the government needs to increase tax revenues. A case in point is following the crash of the Ruble in August 1998, when Russian tax collectors went to foreign business with baseball bats in hand to try and increase tax collection¹⁵! This of course is something that wouldn't occur to Russia businesses that possess the right *krysha* or protector within the state apparatus. The end result is a downward spiral leading towards a collapsing state that can not protect the interests of its citizens or the state itself. Ukraine and Kyrgyzstan provide two examples of states in name only. These "virtual" states slip deeper into economic collapse.

Additionally the transition to a democratic system is undermined. The lack of trust in elected officials breeds cynicism and mistrust in democracy. Authoritarian regimes in the region are perceived to be less corrupt than the more liberal regimes.¹⁶ This distrust erodes the faith in the comparative advantage of a democratic system, to quote a citizen of Odessa, Ukraine "democracy shemocracy, they stole from us in the past and they steal now, only difference with democracy is they are more open about it."¹⁷ The recent election of Vladimir Putin in Russia is a clear demonstration that the citizens of the FSU are willing to support more authoritarian governments if they can increase the strength of the state and set limits on the behaviour of public servants.

¹¹ Can't Pay, Don't Need to Pay: How Russians View Taxation. Found at:

<http://www.cspp.strath.ac.uk/nrb7pr.html>

¹² *ibid.*

¹³ Lovell, David: Nationalism and Democratism in Postcommunist Russia. Unpublished paper University of Melbourne 2000. p.3

¹⁴ Post-soviet organised crime is much talked about but the name *mafya* is very much a misnomer. Since few businesses in the FSU pay their full taxes all business has a degree of illegal activities. The emergence of the "Comrade Criminal" (a state official engaged in illegal business activities) implies that there is no line in the FSU between the private and public sector.

¹⁵ Anecdotes of this sort are widely circulated among the expatriate community in Moscow and appeared at the time in many Western publications.

¹⁶ Good indication of this is TI's Corruption Perception Index in which relatively liberal regimes such as Georgia and Kyrgyzstan scored lower than their more authoritarian neighbours.

¹⁷ Maria Scheglov in conversation with the author June 1999. Stating that one works for an organisation fighting corruption usually produces such comments.

The face of corruption in the Former Soviet Union is a unique one. This incredibly high level of corruption occurs in a region that is developed, industrialised, highly educated, and possessing a wealth of natural resources. It is a region that geographically and economically can not be marginalised and therefore these realities must be confronted.

What is to be Done?

So we are therefore confronted with the problem of how to conduct business in these countries without a functioning laws. There is ample material on how the private sector should conduct itself on the bribery issue¹⁸ so to prevent a repetition only the region specifics will be mentioned in this paper.

One relatively effective tool is to be cautious and invest in finding reliable **local partners** that one can trust not to engage in such practices. Although many in the region have a different view on what is considered corruption than Westerners, a clear policy will be followed. It should be clear that the system of “gifts” was considered normal practice in Soviet times and the practice has only been exclusively “monetarised” in the last ten years. Petty corruption for example payments to traffic police are not considered to be a criminal offence.¹⁹ One must bear in mind that the actions of local agents can be used against any firm if the government so chooses. There is a good chance that one enters into negotiations with the government or with firms connected with the state²⁰ there is a good chance your counterpart possess a thick file of *kompromat*. One way (although not always reliable) to find good partners is through the locally based Chambers of Commerce. Given that there are few resources available to you if your partners decide not to oblige by their contracts the time invested in finding good partners is perhaps the best investment you can make.

Another practice that works is to **play “dumb”**. It is common practice in the region to consider Westerners - to put it kindly – naïve. A common mistake of western business people in the region is to assume that they are cleverer than the locals. In terms of conducting business in the FSU this has in large part to been proven not be true. The people of the FSU are some of the best educated in the world and are much more aware of our “world” than we are of theirs. So if one pretends that you don’t understand the rules of the game it won’t come as a surprise to your counterparts. In fact they expect Westerners to be in a word - “stupid”.

Make friends in the administration. The system of having a *krysha* or roof is not only connected with illegal activities. One of the governing principles of Soviet life was the consideration of the “human factor”. Given the highly personalised manner in which transactions occur in the FSU, it is very important to have personal relations with local decision-makers. This does not imply that one has to be involved in any shady business but the occasional trip to the *banya* (Russian sauna) can do wonders in helping clinch a deal or avoiding a bribe. The social networks that are prevalent in the

¹⁸ Perhaps one of the best guides is the International Chambers of Commerce’s

¹⁹ This has been shown by some surveys and seminars conducted in the region by TI and its Chapters.

²⁰ This includes not only state owned enterprises, which given the absence of a line between public and private sector is the majority.

Soviet Union can also act as assistance in avoiding bribes. One's friends are usually not extorted from. In addition such a *krysha* can save you from organised crime types who assume you are paying protection money to these officials.

Be informed about the actual situation and the "rules of the game". One of the most common mistakes made by foreign business people is paying bribes even though nothing has been directly asked from them. This has been a factor in perception of foreigners as the perpetrators in the region. The mantra "that's the way things are done here" isn't necessarily true. A good case in point is the "entry fee" supposedly demanded by Kazakh border guards at the Almaty airport to allow Westerners to enter. Many western business types were putting \$50 dollars into their passports in the false assumption that this was the only way to gain entry into the country²¹. This wasn't the case and no extra money was necessary but it was a practice that made many a border guard a happy man. As TI's Bribe Payers Index (BPI) shows, there is plenty work to be done on stopping the supply side of bribery.

Finally, another possible suggestion is to **join TI** or other organisations in the fight against corruption²². Many times in the Former Soviet Union I have been able to avoid bribes by announcing what it is I am doing in the country. Nothing deflates a rent-seeking official than telling him you are in the country to promote anti-corruption reforms and perhaps it should start in their department. Anti-corruption activists are usually considered best to be avoided. Collective refusal to bribery helps all private sector actors working in the country. Shutting down the supply side is one of the easiest parts of the problem and is in all of our interests.

In conclusion, one can see that corruption in the Former Soviet Union is a daunting problem for development of the country and for those working there. There are actions that can be taken and through TI's Chapters work is being accomplished. However, there needs to be a genuine private sector response to the problem. Realising the dimension of the problem and its causes is a big step towards finding solutions. Anti-corruption activities should not be approached as a strictly moral duty. It is in all of our own selfish interests to stop bribery. As I was told by an employee of a North American mining company in Kazakhstan: "we don't pay bribes any more, not because of morality but we don't get anything for our bribes nowadays"²³.

²¹ This anecdote was related by TI Kazakhstan's Chairman, Vitaly Voronov, in conversation with the author March 1999.

²² The foreign Chambers of Commerce are very good methods of protecting common interests and promoting joint action.

²³ In conversation with the author in Astana, Kazakhstan June 1999.