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### Change, continuity and power in the Russian political economy in comparative BRICs perspective

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## Chapter 4:

### **Digging their own graves: how small Russian companies contributed to the emergence of Russia's statist-patrimonial political economy<sup>31</sup>**

#### **Abstract**

The paper analyses in historical perspective the origins of Russia's statist-patrimonial political economy, marked by insecure property rights and particularistic state-business relations. Based on in-depth interviews, the paper argues that statist-patrimonial capitalism is not only a result of top-down activity of the state sovereign, its corrupt agents or cronies in big business but is also a system that rests on the bottom-up activity of the bulk of economic actors - small and medium-sized firms. They are not just passive victims of state threats to property rights but in many cases are also a contributor to their emergence. This contribution happened - often inadvertently - through informal practices that locked small firms in the long run in the 'informality trap'. Back in the 1990s some of those informal practices were not the only choice but were taken up by companies out of expediency. In the 2000s firms' informal behaviour backfired as the corrupt state took advantage of the informality of some companies and exploited it to violate property rights of virtually any business actor. Thus the advent of statist-patrimonial capitalism in the 2000s was facilitated, among other factors, by the informal choices and practices of business actors in the previous decade.

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<sup>31</sup> This chapter is in preparation for submission.

### ***Introduction***

When states are weak and do not provide a stable legal environment and an adequate protection of private property rights, firms often have to rely on informal ways to do business and secure their property. The seminal example is the Italian mafia (Gambetta 1993), but equally important for contemporary political developments are the examples found in many post-communist states during the 1990s following the dissolution of the Soviet Union. There and then, criminal racketeering and private contract enforcement proliferated, while most state institutions such as tax collection, judiciary and the police were underfinanced, largely dysfunctional and corrupt (Volkov 2002; Vinogradova 2006). In such a hostile and uncertain environment, many nascent private firms got involved in corruption, tax evasion and other informal practices. While such informal business behaviour may be rational or even unavoidable at the beginning of political-economic transformation, it is expected that after the transition period firms start demanding state accountability and stable, secure property rights (Markus 2015). This did not happen in Russia, however. There, the mafia was pushed back by the strengthened state, but informality and insecure property rights got entrenched, and since approximately the mid-2000s Russia developed a form of political-economic governance that I call statist-patrimonial capitalism. It is defined by the strong role of the state in the economy, both by way of its formal involvement and, notably, its informal interference through corrupt bureaucrats. These state agents deploy the power of their position for personal gain and, most notably, threaten private property rights through predatory practices such as bureaucratic extortion, legal harassment and illicit asset-grabbing (see, for example, Gans-Morse 2012).

I treat such state threats to property rights as a fundamental characteristic of Russia's statist-patrimonial capitalism. They have proliferated since about the mid-2000s and nowadays occur in all Russian regions without significant variation, as research by Markus (2015) shows. State threats to property are perceived as a serious constraint for doing business by a majority of Russian firms (ibid). The problem is acknowledged at the highest political level: President Putin has repeatedly lamented, most recently in his annual address to the federal assembly in 2016, that

'pressure on business from some people in the law enforcement agencies [leads to] successful businesses collapsing and people having their assets taken from them' (Putin 2016). The emergence of a quite predatory form of economic governance is, or should be, puzzling, and motivates this article's central question: Why did informality and insecure property rights get entrenched in Russia in the form of statist-patrimonial capitalism instead of remaining a mere transitional feature? By addressing this question the article seeks to explore the origins of Russia's statist-patrimonial capitalism.

The predominant scholarly discourse on the emergence of Russia's statist-patrimonial capitalism focuses on the role of the state and historical legacies. One strand of research treats the post-communist state as the 'main culprit' of Russia's 'wayward transformation' and its 'corrupted' capitalism (Easter 2013: 200). It emphasises the strength of the state and the lack of institutional constraints on sovereign predation (e.g., Yakovlev et al. 2014; Hanson 2007; Dawisha 2014), with some scholars focusing on the legacy of patrimonialism and the historical continuity of preponderance of state power resources (such as coercion and capital) in relation to society (e.g., Pipes 1999; Easter 2013). Conversely, another strand of research views the Russian capitalist form as a product of the weakness of the Russian state, unable to control its lower bureaucracies that prey on business (see, most notably, Markus 2015). Either way, the statist paradigm focuses on top-down factors<sup>32</sup> in the emergence of statist-patrimonial capitalism. Society, and business in particular, appears as a passive participant in the process. Accounts that acknowledge the active role of business, focus on large firms and their political leverage (Yakovlev 2006; Hellman 1998). Small companies, on the other hand, appear as passive victims of state predation, pushed to collude or hide.

In this article I want to complement the dominant accounts by providing a different perspective - one that reassesses the role of small business. My main argument is that patrimonial capitalism is not only a result of the top-down activity of the state sovereign, its corrupt agents or cronies in big business, but also a system that rests on the bottom-up activity of the bulk of economic actors - small and medium-sized enterprises (SMEs).

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<sup>32</sup> By the term 'top-down' I mean factors associated with the state, from the top political elite to low-level bureaucracies.

Viewed from this perspective, businesses are not merely passive victims of state threats to property rights, but may have also been in many cases an active, or at least inadvertent, contributor to their emergence. This contribution happened - often inadvertently - through some of the small firms' informal business practices in the 1990s, some of them targeted, ironically, at securing property. I make the case by providing evidence that small Russian business initiated some of the corrupt and predatory practices at the beginning of Russia's post-communist transition in the 1990s. I discuss the motives for such practices and scope for alternative behaviour, showing that the particular firms' choices played a role in the emergence of Russia's statist-patrimonial capitalism. Certainly, in the 'chaotic' first decade of Russia's capitalist transformation some of the informal business practices were virtually inevitable. However, a notable part of informal practices were not, and it is these practices that, as I will argue, helped lay the foundation of Russia's capitalist form as we know it today.

The main causal mechanism of this dynamic is dubbed 'the informality trap': having embarked on informal behaviour in the 1990s, which may have been expedient or in some cases inevitable back then given the uncertainty of transition, small Russian firms experienced difficulty in returning to the formal sphere because of their legal noncompliance and the prospect of a pending punishment. As a result, their property became a welcome target for predatory state agents in the 2000s. To use a metaphor, by embarking on informal strategies business dug its own grave: those practices backfired and undermined the security of property rights, notably not only for those particular firms but also for the business community at large, thus laying an important foundation of Russia's statist-patrimonial capitalism. In other words, the informality trap made the transitory behaviour of firms a persistent feature of the Russian political-economic system as we know it today and thus sheds new light on its origins.

The article proceeds as a historical study of the informality trap using a longitudinal narrative involving process tracing of decisions by groups of firms and political actors. I first describe the informal business practices of the Russian small firms in the 1990s, analyse the motives for informal behaviour beyond pure necessity and discuss options for alternative

action. Thereby I trace how small firms fell into the informality trap. I then show how in the 2000s the firms' informal behaviour backfired and ultimately undermined the overall security of property rights. Process tracing reveals patterns that question the causal, top-down mechanisms presumed by conventional accounts, and demonstrates a step-by-step mechanism linking bottom-up informal activity of small firms to the emergence of statist-patrimonial capitalism. For data I rely on two sets of in-depth interviews on day-to-day interactions between small firms and state bureaucrats: one that I conducted in Moscow and St Petersburg in spring 2014 (see appendix) and another conducted in several Russian regions the late 1990s and published in full transcript by Kliamkin and Timofeev (2000). I supplement this primary material with relevant newspaper articles and secondary literature.

The findings contribute both to the empirical studies of the evolution of Russia's political economy and to the theoretical debate about the relative role of the state and societal actors in the process of social change. The analysis offers a novel perspective on small Russian business as an active contributor to Russia's current political-economic form, rather than being simply a passive victim of state predation or a force trying to resist it. More broadly, the re-assessment of the relative role of state and business in the emergence of Russia's variety of capitalism underscores the importance of bottom-up forces of society as a complementary factor to the top-down forces of state. It suggests that a distinct bottom-up process may lead to entrenched informality and insecurity of property, and highlights the informality trap as an important but overlooked mechanism of this process.

The section that follows elaborates on the argument of the paper in the context of existing accounts. The following empirical part traces in historical perspective how Russian companies fell into the informality trap from the start, and thus co-created the foundation of insecure property rights and informal particularistic state-business relations that define patrimonial capitalism. The final section concludes and reflects on theoretical implications of the results.

***The argument: bottom-up forces of business versus top-down forces of the state***

The study of the origins of Russia's statist-patrimonial capitalism - and the origins of insecure property rights in particular - is typically approached from a structural, top-down perspective. The conventional approach emphasises the legacy of patrimonialism, patronage and clientelism (Hosking 2000; Robinson 2013), the lack of tradition of private property rights and the historical fusion of sovereign property ownership and power (e.g., Pipes 1999; Tambovtsev 2009; Hedlund 2001; Jensen 2001; Solomon 2008a). In this context a strong emphasis is put on the role of the state. Two major arguments within this scholarship stand out.

The first argument views the 'restoration of the state' in the 2000s under President Putin as a crucial factor in the emergence of Russia's variety of capitalism (e.g., Yakovlev 2006; Hellman et al 2000; Gelman 2012; Yakovlev et al. 2014). It assumes in line with the 'state commitment' paradigm (e.g., Acemoglu and Robinson 2012; North et al. 2009) that the key reason behind insecure property rights are abuses by the predatory state ruler for the purpose of self-enrichment. Underlying this is a highly centralised model of corruption: the political elite permits state officials to engage in corrupt activities in exchange for loyalty (cf. Stefes 2006: 2f.). Viewed from this perspective, the lack of constraints on sovereign predation - on law enforcement apparatus in particular (the so-called *siloviki*) - explains the origin of Russia's politico-economic form (e.g., Yakovlev et al. 2014; Dawisha 2014; Ledeneva 2013: 198; Easter 2013; see also Sharafutdinova 2010: 7). The second argument within the state-centred paradigm proceeds from a contrary assumption - the weakness of the Russian state, unable to control its predatory agents (i.e. lower bureaucracies). The activity of these predatory state 'piranhas' can be viewed as the cause of Russian patrimonialism (Markus 2015).

Another strand of scholarship sees the activity of large business actors as key to the emergence of Russia's statist-patrimonial capitalism. This scholarship is inspired by a seminal article by Joel Hellman (1998) on the reform process in post-communist countries (Sonin 2003, Aslund 2002).

Hellman calls such actors early winners<sup>33</sup> of market reforms and posits that they subverted property rights security by blocking further reform in order to preserve 'the special advantages and market distortions upon which their own early reform gains were based' (1998: 204). Such powerful economic actors no doubt had an important impact on the development of Russia's post-communist political economy, as detailed in subsequent studies of state capture (Hellman et al. 2000; Yakovlev 2006), virtual economy (Gaddy and Ickes 2002) and the tycoons known as the oligarchs (Guriev and Rachinsky 2005; Pappé 2000).

What is striking about all these accounts is that they miss the bottom-up dynamic of the evolution of Russia's capitalism by not granting attention to the role of small firms: they are considered to have a much smaller political leverage than firms studied by Hellman and followers, and are viewed for the most part as passive victims of state predation that merely adapted to imperfect institutions (Paneyakh 2007; Markus 2012; Gans-Morse 2012). The few studies that do consider the role of small firms focus primarily on business strategies employed to resist state predation. For example, Markus (2015) finds that some Russian firms successfully resist raiding attempts by mobilising relevant stakeholders, while Yakovlev et al. (2014) study how firms set up collective organisations aimed at restricting state violence against entrepreneurs. Similarly, in her research O'Neal (2014: 2016) emphasises firms' 'civic-ness', having found that Russian regions with higher small business activity score higher on democracy. However, what these accounts seem to underestimate is that

- a) informal ways of resisting state pressure, for instance through mobilising the so-called 'administrative resource' (i.e., bureaucratic connections), are far more widespread compared to the relatively rare cases of public resistance and formal defence of property rights (cf. Yakovlev et al. 2014: 177);
- b) historically small firms' activity was associated with the opposite to civic-ness, namely informal (and often illicit) practices that locked business in the informality trap - a

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<sup>33</sup> Among them are 'bankers..., [s]tate managers turned private owners... [r]ising financial-industrial conglomerates' (Hellman 1998: 232f) and the 'former communist elite' (ibid.: 229).



mechanism that I will argue is at the origins of Russia's patrimonial capitalism.

In summary, whether the abovementioned accounts treat small firms as victims of state predation or as fighters against it, they underestimate the firms' complicity in Russia's statist-patrimonial capitalism. Just as property rights *security* may depend on the bottom-up activity of firms, as Markus (2015) shows, property rights *insecurity* may also be affected by the firms' activity. In short, scholars overlook the fact that actions of business actors may be actually conducive to state predation.

In this paper I emphasise the bottom-up agency of small Russian firms and argue that they were, at least to some extent, active contributors to the emergence of Russia's politico-economic form. The reason lies in the extensive use of informal practices in the 1990s, such as tax evasion, bribery and predatory corporate takeovers. These practices later became entrenched through the mechanism of the informality trap, and ultimately backfired in the 2000s. The mechanism implies that having once embarked on the path of informal behaviour, for instance having evaded taxes or paid a bribe, firms experience difficulty in trying to get out of the informality sphere. The reason is informal behaviour itself, or the legal non-compliance: as a result of it the firm faces pending legal prosecution as a sword of Damocles hanging over it, but at the same time cannot readily defend itself in a legal fashion. Therefore the firm is bound to 'buy off' the threat and becomes all the more vulnerable - both to further formal legal charges and informal state pressure such as bureaucratic extortion. The unintended consequence of action is important here: business behaviour that may have seemed rational or even beneficial in the short run may have the opposite effect in the long run. To put it bluntly, by behaving informally many small Russian companies inadvertently dug their own graves - and, as we shall see, in many cases they also dug the graves of those firms that were in legal compliance.

My argument echoes Hellman's in that I argue that at the beginning of transition period some Russian firms chose informal ways of doing business and exploited the loopholes and deficiencies in the 'murky water' of partial reform. An important difference, however, is the mechanism of the firms' agency. Hellman examines conscious efforts to 'impose policies that bring them [the winners] private benefits at a high social cost' (1998:

231) through the exercise of political power (especially in elections). In contrast, I focus on the unanticipated consequences of the firms' informal actions for the development of Russia's political economy. It is the implications of day-to-day business strategies rather than conscious political efforts that interest me.

Examining the reasons for informal behaviour is crucial for understanding how small firms fell into the informality trap. Undoubtedly many of the informal practices at the beginning of Russia's transformation were an adaptation to the adverse and unpredictable Russian business environment, as I will discuss in the next section. However, I want to complement this widespread view and suggest that it is no less important to consider cases of informal business practices that were initiated by the firms themselves out of expediency. Such cases show the firms' agency - understood as a conscious choice between potential alternatives - particularly clearly. I trace how certain choices made by the companies locked them in the trap of informality and backfired in the long run, allowing state actors to turn the tables and exploit the informality to undermine property rights. In a nutshell, the informal bottom-up activity of the firms at the beginning of Russia's transformation undermined the security of their property in the long run and thus can be considered one important origin of Russia's statist-patrimonial capitalism. At the same time, I do not advance the untenable claim that this factor alone can explain the advent of Russia's statist-patrimonial capitalism. Moreover, it is difficult to draw a line between informal behaviour that serves an expedient goal of the company and one that is a reluctant reaction to pressure, which in turn may be only *perceived* as inevitable and inescapable. Finally, the role of the state and historical legacies is important too, and will be discussed in the concluding section.

My argument draws on the seminal studies of Russian informality by Kliamkin and Timofeev (2000) and Alena Ledeneva (2006). Their rich ethnographies each detail the working of informal practices that are portrayed as being at the core of the Russian political economy and society more broadly. Kliamkin and Timofeev apply a transactional approach to informality (and corrupt behaviour in particular): bureaucrats, who act as sellers, and entrepreneurs, who act as buyers,

trade legal rights (for instance, the right to open a business) or the privileged opportunity to break laws in exchange for bribes. One of Ledeneva's main arguments is the ambiguity of informal practices: they compensate for some institutional weaknesses but at the same time may undermine those very institutions in the long run. I build on these arguments and extend them from the functioning to the origins of Russia's current political-economic form, trying to explicitly address why firms behave informally.

The empirical backbone of the study is formed by two sets of in-depth interviews. The first set comprises 22 interviews with Russian businessmen and bureaucrats from various regions regarding informality and corruption, carried out in the late 1990s and published in full transcript by Kliamkin and Timofeev (2000)<sup>34</sup>. Secondly, I use material from my own 34 interviews with Russian small and medium-sized entrepreneurs (SMEs) and business association executives, lawyers and experts conducted in Moscow, St Petersburg and a few regions in 2014 (see appendix). While the first set of interviews gives a detailed first-hand account of informal practices and choices made by firms in the 1990s, the second set allows us to trace how some of those practices endured and backfired. This data is complemented by the results of surveys and in-depth interviews in the 1990s by the Russian scholars Radaev (1998; 1999), Paneyakh (2007) and Dolgopyatova (1999). I supplement these sources further with relevant newspaper articles, policy documents and secondary literature.

### ***How small firms fell into the informality trap in the 1990s***

In the early years of the Russian post-communist transformation the extent of informal business practices and the shadow economy was considerable: 27% of GDP in 1993 and 50% by the mid-1990s, according to the official estimates (Kosals and Rybkina 2002: 20). In the case of

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<sup>34</sup> My work hugely profited from research on the Russian shadow economy by Kliamkin and Timofeev, who made their interview material available as transcripts at the back of their book (2000). This allowed me to profit not only from the authors' interpretation of the material but also from the original statements by the interviewees, which is a big asset for replication and future social scientific inquiry.

small and medium-sized firms, at least 30% of business activity was in the shadows, with tax evasion, double bookkeeping, cash operations and bribery being widespread (Dolgopyatova 1999: 51). Why was informality so widespread in Russia in the 1990s and why did it later get entrenched in the form of statist-patrimonial capitalism? To answer this question we need to understand why firms started behaving informally in the first place and how they got trapped in informality.

The causes of small firms' informal practices can be divided into two groups of causal logic: necessity and expediency. Many small companies were pushed to conduct part of their operations in the shadows by necessity, given the specificity of the Russian political-economic environment in the early 1990s, as we shall briefly discuss in the next section. I will not try to answer the question as to whether in the 1990s it was possible to do business in full legal compliance as it is beyond the aim of this article. However, we can and need to take the widespread popular belief that it was impossible to do honest business in Russia with a grain of salt: a considerable part of the informal practices was not inevitable and constituted a conscious entrepreneurial choice. This possibility implies a different cause of firms' informal practices: expediency.

### **Informal behaviour by necessity**

At least five aspects of the Russian political-economic environment of the 1990s compelled many companies to break the law and pushed them into informality. The first aspect concerns the specificity of the regulatory environment of the 1990s, which was marked by excessive, contradictory and changing regulations (Frye 2002: 574; Frye and Zhuravskaya 2000; Paneyakh 2007; Ledeneva 2006). Consider the following case, exemplary for many of the incoherent SME regulations in the 1990s: for security reasons Russian jewellery shops were required to have barred windows, but at the same time those very bars contradicted fire safety rules. There was no way to satisfy both regulations. Very high taxes were also a

problem: some firms reported the tax burden approaching or even exceeding 100% of profit (Polonsky 1998: 525).<sup>35</sup>

The second factor that pushed firms into informality was the weakness of the law enforcement institutions, the lack of coordination between various agencies authorised to inspect business and the ineffectiveness of courts. Additionally, bureaucratic discretion in law enforcement allowed arbitrary interpretation of particular business regulations and bureaucratic extortion. Firms often succumbed to these pressures and resorted to paying bribes.

Thirdly, criminal extortion rackets pushed firms to 'buy off' threats or to give away substantial parts of their profits. In the absence of a predictable and effective legal environment, criminal groups (so-called 'roofs') supplanted dysfunctional state institutions and under a threat of violence offered their clients 'protection services'. Calling the police in the case of a criminal racket was an 'utterly hopeless enterprise' (Radaev 1999: 50). Criminal 'roofs' also performed some of the indispensable functions that the state failed to deliver, such as debt collection and the enforcement of contracts (Vinogradova 2006; Gans-Morse 2012: 266; Radaev 1999).

Fourthly, an important driver of informal business practices was unfair competition with businesses affiliated with the bureaucrats. Consider a typical case from the late 1990s, reported by a Rostov entrepreneur who recalls a state tender for laying tiles on the sidewalks of the city:

The contract was won by the company "Tandem", unknown to anybody in the construction business, because it was created by Rostov bureaucrats and is now controlled by them. This company not only lays tiles but also produces them. They are produced in Rostov's prisons, of course illegally. The bureaucrats enjoy super-profits because no tax inspector will ever check this company.' (Kliamkin and Timofeev 2000: 483).

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<sup>35</sup> In the 1990s, tax on profit was 35%. However, businesses had to meet more than 40 additional taxes and payments, which made the overall tax burden very high. However, it bears notice that in some cases profits were stellar, too. Consider the case of Mikhail, a Volgograd entrepreneur who started importing Finnish ice cream in the early 1990s and sold it at a whopping 100% profit margin in his popular café chain (Polonsky 1998: 529).

In addition, affiliated companies enjoyed privileged access to credit and other financial privileges. Competing with such companies often required paying kickbacks or cutting costs through shifting part of the operations into the shadows.

Finally, monetary constraints such as high inflation, difficulties in accessing credit, non-payments between business partners and barter often pushed companies in the 1990s to step out of the legal sphere, for example by cooking the books or evading taxes.

Serious as they were, these external pressures were neither universal nor totally unavoidable. Let us consider the example of extortion - both criminal and bureaucratic. Even though it is hard to estimate the exact scope of the criminal protection rackets, there are good reasons to believe that the range of the mafia may have been exaggerated in the popular view. For example, a 1997 survey by Radaev (1999: 39f) reveals that only about 45% of businesses were paying protection money, amounting to about 10-20%, occasionally 30% of their profit. The majority of surveyed firms did not perceive criminal rackets as a serious problem. Similarly, a survey by Frye and Zhuravskaya (2000) found that in 1996 about 40% of small Russian retail shops had contact with criminal protection rackets. Two years later, it was just 25% (Frye 2002).

Available data on bureaucratic extortion reveal a similar picture: the widespread view that nothing gets done in Russia without bribing the officials may be an exaggeration. For instance, a 1993 poll showed that while 62% of entrepreneurs experienced extortion (16% of them experienced it often), 38% did not experience any (Radaev 1998: 64). A 1997 poll showed almost identical results<sup>36</sup> (Radaev 1998: 64; Radaev 2002: 64). Moreover, apparently not all Russian businessmen who faced extortion by the bureaucrats succumbed to it: in Radaev's 1997 survey, 20% of businessmen reported not having paid the requested bribes despite bureaucratic extortion (1998: 65). A survey by Kliamkin and Timofeev (2000: 216) in the late 1990s came up with a similar finding: 22% of the surveyed entrepreneurs reported they had not faced corrupt activities or extortion by the bureaucrats in recent years (compared to

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<sup>36</sup> 65% of enterprises experienced extortion (20% of them frequent extortion), while 35% did not.

58% of respondents among the general population). Even though these figures are aggregated and the actual experience of extortion and the ability to resist it may vary depending on the size of the firm and business sector, these figures put the widespread belief about the occurrence of bureaucratic extortion in perspective.

### **Informal behaviour by expediency**

While informal practices were very widespread in Russia in the 1990s, given the various constraints and pressures, we need to bear in mind that those factors were not wholly external and that there was a certain demand for such practices in the business community (Radaev 1999). In this section we discuss the situations and circumstances in which small firms hid their revenues, bribed officials and used shadow business schemes not as a method to survive or cut through red tape, but rather as a business opportunity, exploiting the legal uncertainty to their advantage and colluding with corrupt state officials to beat the system. I argue that a considerable part of small firms' informal activity in the 1990s occurred not in response to crude pressure or objective circumstances, but as a matter of a conscious choice made by the entrepreneurs. The main reason for such choice was expediency: an attempt to cut costs, to secure a competitive advantage or a lucrative business opportunity. I will focus on three prominent practices:

- 1) Tax evasion and other illicit operations with the goal to hide revenue;
- 2) Bribery as a way of buying the privilege to break the law (or make the bureaucrat turn a blind eye to a violation);
- 3) Prepaid business attacks (*naezdy*) and illicit corporate takeovers (*raids*) by means of exploiting legal loopholes and making use of corrupt judiciary and law enforcement.

In the following we will discuss these practices using anecdotal evidence and available statistics.

#### ***Tax evasion***

Tax evasion was very widespread in Russia in the 1990s: firms hid on average between 42% and 70% of their revenue. For example, in Vinogradova's sample of 45 shops in St Petersburg, only six shops

reported not concealing revenue (2006: 457). Many tricks were used to minimise profits for the purpose of tax evasion such as black cash transactions, partial payment of salaries in cash, the use of shell and offshore companies as well as various, sometimes very complicated, financial schemes (for details, see Ledeneva 2006: 156-159).

An account by the co-owner of a financial company gives an impression of the aim and scope of such schemes in the 1990s:

'The specialisation of our holding is devising and deploying accounting schemes, transferring our clients' money offshore. Thereby we do it in a way that no-one else can do. For each scheme we prepare a large pile of documents, which an outsider cannot sort out. Our schemes boil down to diminishing the size of necessary taxes to 2-3% of turnover. ... [Or take] another example: a manufacturer produces a good, which has a cost price of 50 rubles and sells it for 100 rubles. So she pays taxes on 50 rubles. We can prepare the documents in a way that the cost price becomes 90 rubles.' (Kliamkin and Timofeev 2000: 415).

On the one hand it is not always easy to tell whether the goal of tax evasion is expediency or sheer survival in terms of maintaining a profitable enterprise, as most entrepreneurs seemed to lament in the interviews of the 1990s made available to me. On the other hand, there are good reasons to believe that, as Ledeneva (2006: 159) notes, '[g]iven the skills and the determination to invent such schemes, it is unlikely that the reduction of the profit tax will be a sufficient stimulus for companies to give up these practices'.

One classic example of tax evasion for the sake of increasing profit is found in the manipulation of customs clearance. In the 1990s it offered handsome profits to the Russian SMEs, many of whom were engaged in selling goods imported from abroad. A manager of a retail firm recalls his experience with customs:

'When importing goods into Russia you can register them in various ways and pay different customs duties. ... Expensive goods - medicine, cigarettes, computers, video technology etc. - are registered as if they are food, cotton pads or some



other crap. Customs officers are being paid substantial sums of money [bribes] so that they do not inspect the freight according to all rules, but let the goods pass through customs with forged documents. As a result, the duty for crap is ten times lower than for medicine. The same happens with imported cars. There are a huge amount of fake documents for importing expensive foreign cars duty free... The customs officers turn a blind eye to forged documents and for a bribe let the cars pass and later levy a tiny duty on these cars.' (Kliamkin and Timofeev 2000: 482f).

Another very widespread practice concerned cooking the books: official records did not correspond to the actual revenue. For example, a retail trader from Moscow keeps a record of her operations, as required by law, but grossly understates the profit:

'For example, I bought the shampoo for 15 rubles, and sold it for 23 rubles, but [in the books] I write down only 18. ... It is impossible to catch us. About 80% is in the shadow. This is the only possible way. Everybody works this way. Every day I sell goods for 2000 [rubles], but show [only] 300 rubles.' (ibid: 436f.).

The system of tax evasion became further entrenched by the prevalence of undocumented cash payments: in the 1990s many Russian customers were ready to pay in cash without receipts for a wide range of purchased goods and services including repairs, construction and renovation. In fact it was considered absolutely normal (ibid.: 207).

### ***Bribery***

Bribery unsurprisingly is a two-sided story involving bribe-takers (state officials) and bribe-givers (entrepreneurs). However, there is an important difference between offering a bribe and a bribe being extorted. By bribing officials, entrepreneurs bought the right to shadow entrepreneurship, or the privilege to break the law by making the bureaucrat turn a blind eye to the legal violation. For a bribe entrepreneurs might also try to secure individual privileges or lucrative state contracts.

Available evidence in the 1990s suggests that cases where companies 'extend the envelope' i.e. gave a bribe are not rare. In a 1997 survey of Russian firms, about half of the firms conceded that entrepreneurs played an active role in corrupt relations with state officials (Radaev 1998: 71). Anecdotal evidence from interviews with entrepreneurs admitting bribery abound. Testimonies of bureaucrats further illustrate the fact that entrepreneurs initiated some of the corrupt deals. A high-ranking official from the cabinet of ministers of the Bashkortostan region of Russia recalls in a surprisingly open interview in late 1990s:

'Today a person came to me and offered 30,000 rubles for certain services. I sent him away, because I could not do what he was asking for - this is impossible today, nobody will be able to do what he wanted. Of course I did not take his money. However, if something depended on me [if I could have done something], then we would have had a different conversation. This is a normal practice. The reason is that by offering me 30,000 he counts on making 300,000. ... You see, I am on the other side of the barricades: I do not deal with corruption - it is the other people who have to deal with me. ... Nowadays, if a mayor or a head of the administration is not tied with shadow business and criminal structures, he will not be able to work within the given legal and economic space. Basically he is being forced to have such connections.' (Kliamkin and Timofeev 2000: 572f).

Evidence from in-depth interviews suggests that entrepreneurs tend to view bribes as yet another cost associated with doing business. Some of the entrepreneurs seem to compare the price of breaking the law, which is the bribe, with the cost of adhering to it: 'In the end every bribe is justified from the economic point of view' (owner of a clothing factory quoted in Radaev 1998: 71). Thus for instance many entrepreneurs preferred to 'buy off' threats instead of paying fines or fulfilling the regulations. The case of handling the utilities payment is one example of such cost-benefit analysis. The deputy Director of a brick factory in Rostov explains that instead of paying for electricity the enterprise routinely bribes officials after they cut off the electricity:

'You are wondering why our director does not simply pay for the electricity? Every entrepreneur strives to do business at the lowest cost possible. Nowadays it is cheaper to "buy off" [pay a bribe] than to pay in full for the electricity supply.' (Kliamkin and Timofeev 2000: 420).

The management of the same brick factory uses various tricks to fool the gas counter in order to reduce the bill:

'We have a silent contract with the lower officials: they turn a blind eye to the leakage of energy, and we regularly pay them before they come for an official check-up.' (ibid.: 421).

Another goal of actively offering bribes to state officials is to speed things up in the case of something that would otherwise have taken longer or involved a complicated formal procedure. A Rostov entrepreneur recalls:

'...bribing helps. For instance, if you urgently need some official document, for instance within a day, but it is normally issued within about a week. I could lose a client because of this delay. I have to "grease the palm", and the issue is solved.' (ibid: 450).

Similarly, an owner of a manufacturing enterprise recalls certifying his industrial equipment:

'Take the certification agency. I received the certificate of conformity for a bribe. Not because my equipment does not conform to standards. I just invited the official of this agency (to visit), paid for his journey, offered him a meal and so on.' (ibid: 406).

What is conspicuous about these examples is that the entrepreneurs choose to offer bribe without an obvious necessity and without extortion, but rather out of sheer expediency.

### ***Naezdy and raids***

While at the beginning of the 1990s firms waged their competitive battles with the help of their criminal roofs, from approximately the mid-1990s they switched to using corrupt officials, including officials from law

enforcement and fire inspection agencies and the tax police in order to carry out the so-called *naezdy*, or prepaid business attacks. Through *naezdy*, companies typically attempted to secure a business advantage or to harm their competitors. For example, *naezdy* could be used to recover a debt, to prevent certain transactions, to interfere with shareholder meetings, to promote desirable results or to simply harass competitors (Ledeneva 2006: 173ff). A manager of a computer firm interviewed by Radaev (1999: 48) concludes: 'A better means of competitive struggle is to send the law enforcement bodies after you'. Another businessman agrees:

'In the past, if someone refused to pay they could damage the shop or just burn it down. Now they've understood that it is cheaper and safer to get a fire inspection to close it down for a week or two. And the effect is the same.' (Volkov 2002: 51; cited in Gans-Morse 2012: 281).

While *naezdy* made the life of competitors difficult, a much graver interference with property rights that proliferated at the end of the 1990s was *raiding*. Raiding is an extreme form of hostile acquisition, or a forced change of ownership and management of a company undertaken by another business actor. Raiding attacks of industrial plants, profitable export-oriented enterprises and other companies became common practice at the end of the 1990s, recorded cases reaching thousands annually. This led to the largest redistribution of assets in the Russian economy after the privatisation of the early 1990s (Volkov 2004).

The spread of raiding was triggered by the introduction of a new liberal bankruptcy law in 1998 that made bankruptcy procedures relatively simple. The law permitted courts to initiate bankruptcy cases against companies whose external debt was as low as 1,500 USD if it was not repaid within three months after the due date. Typically raiders manipulated the law by buying the debt of a company, claiming it back and using it to initiate a bankruptcy procedure and thus obtain the right to appoint a temporary manager. The change of management at the discretion of the raider allowed them to poach the assets of the company or de facto to take it over (Volkov 2004: 533f.; Firestone 2008: 1210f.; Ledeneva 2006: 156). The practice involved bribing a variety of state officials in order to give an illicit hostile takeover a semblance of legality.

Central to the strategy was a prearranged court ruling and access to coercive resources such as special police forces in order to execute the change of ownership by means of physical coercion. To suppress resistance, raiders often initiated criminal investigations against the owners of the target company. The final step in a raiding attack often involved a quick money laundering action, achieved through the sale of the company to a good-faith purchaser. Even if the criminal charges against the initial owners were dropped, recovering property from a good-faith purchaser was rarely possible (Volkov 2004).

The described manipulation of the bankruptcy law was very widespread at the end of the 1990s and up until 2002: it is estimated that up to a third of bankruptcy cases dealt with by the state arbitration courts in 2000-2001 were contract bankruptcies, initiated with the goal of raiding in mind (Volkov 2004: 528). After the adoption of a new bankruptcy law in 2002, instances of raiding gradually receded. Raiding provides an example of predatory manipulation of existing legislation by companies, and undoubtedly constituted the most outright form of informal business behaviour undertaken out of expediency in the 1990s. The contribution of firms to undermining property rights through the practice of raiding is beyond dispute.

### **The informality trap and ways to escape it**

The informal corrupt practices described above opened companies up to state predation and ultimately locked them in the informality trap - a vicious circle in which initial informal behaviour entails its perpetuation. Here is the mechanism of this negative dynamic. To the extent that the informal practice entails a legal violation, the company crosses the legal boundary. If the violation is uncovered, for instance during a check-up, the state has legal grounds to punish the company (e.g., through fines, by halting its operation, through demands for back tax or, in more serious cases, criminal prosecution). The firm cannot readily defend its rights in a formal fashion because its legal non-compliance can be uncovered during a court procedure. Instead, the company is bound to resolve the problem informally - often through 'buying off' the threat. In turn, the bureaucrat may use the fact that bribery has taken place as a means of extorting further money under the threat of legal prosecution. The director of a

wholesale trade company pointedly sums up this dynamic: 'If you start paying [bribes], you will never be able to break free from this [vicious] circle.' (Radaev 1998: 75). As a result, the company falls into the informality trap and at least part of its operation becomes firmly rooted in the corrupt sphere.

It is important to note that the informality trap was not unavoidable in the 1990s: there was room for choice on the part of the firms. Consider the choice between paying fines and bribes. If a company commits an infringement and faces fines (rather than criminal charges), it can choose either to pay an official fine or to negotiate a lower penalty for a bribe. Tellingly, evidence from interviews in the 1990s suggests that companies tended to view both payments as comparable business expenses and often opted for the latter one because it was 'cheaper'. However, there is a big difference between the two transactions: if a company opts for a fine, it remains in the legal realm and escapes the informality trap; a bribe may get a company into a vicious circle of 'buying off'. A Moscow entrepreneur underscores the increased vulnerability of companies that bribe to state attacks because they represent 'easy prey':

'As soon as you open this feeder [i.e., bribe], you become something like a "free cashier" at McDonalds... Everybody will come to you.' (Gans-Morse 2012a: 11).

Business practices that did not constitute bribery or outright evasion allowed companies to avoid the informality trap in the 1990s. One of the widespread practices involved the cultivation of personal relations with state officials. Such relations involved not bribes, but rather non-monetary favours and allowed companies to get around cumbersome regulatory procedures, to avoid bureaucratic extortion and to receive preferential treatment such as access to credit. Some companies employed a 'right person' (e.g., the relative of a bureaucrat) or made contracts with a 'right company' (Radaev 1998: 75). Other firms employed a 'specialist for the work with state organs', as an owner of a manufacturing enterprise explains:

'This is a person who can make friends with any official from the state agencies. We employ a woman. She regularly visits the respective state agencies, brings something for tea and

consults with them, talks heart to heart. ... And this is sufficient- there is no need to bribe. In this way we deal not with bribe-takers ... but with friends, with whom it is nice to talk and drink a cup of tea.' (Kliamkin and Timofeev 2000: 407).

Good personal relations with state officials - often referred to as 'administrative resource' or 'political capital' - allows for a kind of a patronage that may help to avoid bureaucratic pressure and bribe extortion. The head of a firm dealing with the supply of fuel recalls: 'If everyone knows that some firm ... indirectly is connected with the interests of a high-level official . . . naturally there will be no check-ups, no police, no sanitary control.' (Radaev 2002: 67). Similarly, the owner of a Moscow manufacturing enterprise recalls that he could avoid extortion from law enforcement agencies, which was very widespread in Moscow in the second half of the 1990s, thanks to his friendship with one of the employees of a law enforcement agency. The entrepreneur never had to 'buy off' but rather he told them that he 'came to them from "Ivan Ivanovich" [read: a good friend in the agency], so my security was granted special attention.' (Kliamkin and Timofeev 2000: 413).

Another way to avoid the informality trap was by making legal payments to service companies instead of paying bribes. This strategy sometimes allowed companies to square the circle: fulfil cumbersome regulations, stay profitable and remain in the legal realm. For example, specialised commercial firms helped resolve problems of registration, licensing and other business requirements. Thereby potential bribe expenses were included in the fees (Radaev 2002: 63). Sometimes such commercial firms were affiliated with the bureaucrats. An entrepreneur recalls negotiating with the fire safety officials:

'I invite him to visit me and say: "I was wondering who could help us draw up a plan of fire evacuation? I will pay for the work, of course." He readily replies: "My wife is a specialist in this." Then I say: "And could you perhaps buy the fire extinguishers for us? Here is the money and your per diem allowance." That's it, everybody is content and everything is clean. The money is paid for the work, no bribes.' (Kliamkin and Timofeev 2000: 408).

Another alternative informal practice concerned the diversion of attention from actual violations by intentionally leaving or making small mistakes in the bookkeeping (the so-called *oshibochki*). In the 1990s, when tax evasion was pervasive, the tax inspectors' main goal was to boost tax collection. To this end inspectors would routinely look for mistakes in the bookkeeping in order to file back tax claims and fines. By making small obvious mistakes in the bookkeeping entrepreneurs allowed tax inspectors to fulfil their duty and at the same time discouraged them from digging further and discovering a graver violation. Some entrepreneurs, like a St Petersburg businesswoman even openly colluded with the tax inspector, citing good personal relations:

'When I come to the tax inspection, she [the inspector] tells me: "Please leave some mistakes [in the bookkeeping]. I am obliged to file some back tax claims". When I do the paperwork, the balance sheets, I always write down the mistakes that I made [on purpose] on a separate piece of paper. Recently I brought the documents to the tax inspection. They asked me: "Did you bring the mistakes?" - "I did". They are obliged to file back tax claims, to find some mistakes in the bookkeeping. I make the mistakes for them. ... [Interviewer question:] "Did you bring any presents, or at least some chocolate?" - "No, no. Just good personal relations".' (Paneyakh 2007: 77).

At first sight such a scenario represents a classic route into the informality trap - after all, the company, by falsifying its bookkeeping, commits a violation that the inspector is aware of. However, what is important is the fact the entrepreneur pays an official fine rather than a bribe. On top of that, the entrepreneur maintained good relations with the inspector by allowing her to fulfil her tax collection plan.

In the 1990s Russian firms often deployed informal practices, sometimes struggling to survive, sometimes using the deficiencies of the regulatory system and legal enforcement as fantastic business opportunities and opportunities for predatory behaviour. By behaving informally, firms opened the door for bureaucratic predation and fell into the informality trap. In any case, the informal activity of firms compromised property rights security and undermined formal state institutions. In the long run,



in the 2000s, this contributed to the emergence of statist-patrimonial capitalism characterised by state threats to property rights, as will be discussed in the following section.

### ***How state agents exploited the informality and started an assault on property rights in the 2000s***

The proliferation of informal business practices in the 1990s had serious repercussions in the following decade for Russia's political-economic development. In the 1990s firms often manipulated weak state institutions as just another player in the market for protection or as a means of competitive struggle. As the state regained its monopoly on violence in the 2000s the situation reversed to the firms' collective disadvantage. The strengthened state seized the opportunity to exploit the informality of businesses through its corrupt officials and started a systematic assault on the firms' property rights through legal harassment, bureaucratic extortion and even raiding (Gans-Morse 2012). Remarkably, it was not only companies who had previously fallen into the informality trap who were facing these state-sponsored threats to property. Virtually any company could become vulnerable to state harassment as the room for manoeuvre and alternative behaviour became considerably smaller for all firms compared to the 1990s. Under these circumstances escaping the informality trap became difficult. A statist-patrimonial variety of capitalism consolidated in Russia.

Even though at first sight this development may appear as a clear top-down dynamic of state oppression, it is important to view it against the backdrop of its historic development. I argue that the massive state-sponsored assault on property rights in the 2000s was made possible by the informal behaviour of companies in the previous decade, among other factors. State agents exploited the informality of the firms and also adopted some of the predatory techniques that the firms were using in their own competitive battles in the 1990s.

### **Proliferation of state threats to property**

When President Putin took office in 2000, he set out to increase state capacity, curb the political influence of big business, push back the shadow economy and make companies pay their taxes. His administration

succeeded in strengthening institutions by re-centralising them and improving their funding. The scope for conducting business in legal compliance considerably increased in the course of the economic reforms of the 2000s, which included a radical tax reform, a simplified customs procedure and a reduction of administrative barriers (see, for example, Aslund 2002). Interviews show that unlike in the 1990s, after 2002 small entrepreneurs deemed it possible to do business in legal compliance and to pay all necessary taxes (Paneyakh 2007: 122). As we shall discuss, this 'coming out of the shadow' did not necessarily safeguard companies against state predation.

At the same time, Putin's 'restoration of the state' happened at the expense of the quality of institutions. Institutions that were formerly assured at least some degree of accountability and control have gradually been dismantled; examples include the critical media, independent parliament and the elections of regional governors. The Federal centre's interference with legal cases undermined the independence of the judiciary (Mendras 2012: 175-181). Corruption did not decrease, but rather became centralised and institutionalised (Satarov 2013).

In this context it was the increased state capacity to collect taxes and fight economic crimes, backed up by toughened laws, that gave corrupt state officials a potent weapon to exploit the informality of firms for their private gain. Criminal prosecution by different law enforcement agencies became one of the most common extortion and harassment tools. For example, Nazrullaeva et al. (2013: 4) found an upward trend in the dynamics of economic criminal cases in 2004–2009, driven by the 'rent-seeking' of law enforcement officers and the system of assessment of police departments' performance (the so-called 'stick system'). The police also increasingly resorted to arrests of entrepreneurs on minor charges, thus weakening their ability to defend themselves against attacks (Rochlitz 2013: 14). About 150,000 cases are filed annually for so-called economic crimes such as fraud or embezzlement. As only a minority of cases (10-15%) resulted in sentencing, while other cases were dropped or not brought before court, Volkov et al. (2010) concluded that criminal prosecution indicates rent-seeking behaviour by law enforcement officials.

While in the 1990s corrupt state officials were for hire, in the 2000s they started acting on their own initiative. The proliferation of state-induced raiding is a case in point. The 2003 Yukos affair may have been a turning point - after that raiding increasingly became a state-initiated practice. While in the late 1990s and early 2000s private raiders 'hired' corrupt state officials to facilitate an illicit takeover, during the course of the 2000s state agents became the beneficiaries: they started conducting raids in the interest of higher placed officials or attacked companies for their own benefit (Rochlitz 2013: 12). Thereby the new state raiders were well-informed about the raiding techniques as the result of facilitating attacks and providing logistical support in the 1990s. State officials either started using the same techniques themselves or pushed raiders to carry out takeovers on their behalf.

Having examined 312 cases of raiding based on the analysis of 1,500 newspaper articles, Rochlitz finds evidence that the role of state agencies in raiding throughout the 2000s has been rising: between 1999 and 2002 illegal state involvement was mentioned in 37% of all cases, but between 2003 and 2010 state agencies were involved in 61% of the cases (Rochlitz 2013: 13). While companies are frequently mentioned as hiring raiding agencies to initiate attacks during the early years of the decade, from the mid-2000s onward newspaper articles increasingly reported that members of state agencies themselves ordered, initiated, and benefited from attacks (ibid.: 15). Among the victims in the second half of the 2000s were restaurants, hotels, car dealers, smaller supermarkets, other shops, local housing service providers, transport companies, and scientific research institutes. One of the victims was my respondent Vadim<sup>37</sup>, the owner of a small Moscow dental clinic.

Vadim describes how his clinic was raided in the autumn of 2013 on behalf of his landlord, who turned out to be a highly-placed state official from Tver Oblast (the property was formally registered on the name of his wife). The conflict started when the landlord suddenly demanded a sharp rent increase. Vadim disagreed as he had an unlimited lease and expected to receive at least the legally guaranteed three-month notification. The landlord insisted. Shortly afterwards Vadim witnessed his clinic being raided by a group of masked people. The lock was

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<sup>37</sup> Name changed.

removed, the dentists were 'kicked out' and their equipment was carried out. Having contacted the police, Vadim was not permitted to file a lawsuit and was told: 'They are the owners of the premises. They can do as they please.' As a result, Vadim lost his business, his medical equipment and the rent deposit of 260,000 rubles (about 8,000 USD). Vadim considers such raid a 'form of business': 'To get this money back is all but impossible, to put it mildly. Even going to court is pointless.' (interview with B6).

### **Limited room to escape the informality trap**

Was there room for manoeuvre to resist state attacks and avoid falling into the informality trap in the 2000s? Certainly legally compliant companies had an option to defend their rights in court. Indeed, litigation was the most widespread means to resist the attack by the corrupt officials in the 2000s: the number of firms' lawsuits against state agencies soared (from 13,000 in 2000 to 50,000 in 2008) and win rates were relatively high, between 60% and 70% (Gans-Morse 2012: 274). However, suing the state was not always desirable because it could provoke retaliatory measures from inspection authorities, such as legal harassment. Moreover, litigation was feasible only for bigger companies that could bear the cost and mostly in case of smaller violations of property rights, such as unfair fines or penalties. Defence against criminal charges was much less promising - in fact most businessman preferred to avoid opening a criminal investigation in the first place because once a case is filed bank accounts are frozen and the owner is detained. As this implied the destruction of business, many firms facing criminal charges were bound to 'buy off' the threat and were drawn into the vicious circle of informality.

Room for other strategies that could help resist a state attack or escape the informality trap, like the ones used in the 1990s, became much narrower in the 2000s. Firstly, even conducting a legally compliant business was no guarantee against conflicts with the state. In fact, it was sometimes an invitation to trouble, because state inspectors took tax evasion for granted and could inspect a company with 'clean books' particularly thoroughly and perhaps impose arbitrary fines. In this sense, the informal behaviour of companies back in the 1990s made almost every company look

suspicious later on in the 2000s. Moreover, few legal barriers held if forces in the state bureaucracy were determined to harass, take away or destroy a business. For example, over 100 small trade pavilions were demolished overnight in the centre of Moscow in 2016 on behalf of the city authorities. A new law declared that the buildings had been built illegally, although the owners had valid construction permits (Gessen 2016). The co-owner of a Moscow chemical company, Anna<sup>38</sup>, was imprisoned for over a year on trumped-up charges of involvement in the production of illicit chemical substances, even though the company was in full legal compliance. Anna assumes that the firm was attacked because it had refused to pay kickbacks to one of its clients - the state gas giant Gazprom (interview with B10).

Secondly, the toughening of regulations often left companies without the option of paying a fine instead of a bribe, a practice which had previously helped them avoid the informality trap. For example, the 2016 amendments to the Code of Administrative Offences tightened penalties for firms and increased fines by several orders of magnitude: instances where penalties were imposed included violations concerning security standards, sanitary norms and consumer rights. Penalties imposed could also force the liquidation of the business. Similarly, the period during which back taxes could be demanded was extended from one to three years, expanding the authority of law enforcers to probe firms (Vinokurov 2015). Facing exorbitant fines or criminal prosecution, firms had no choice but to 'buy off' the threat and thus fall into the trap.

Thirdly, informal connections to state officials or payments to affiliated structures, though still prominent, ceased to be a fully reliable strategy for preventing conflicts in the 2000s. This became all the more true after the onset of the economic slump in 2014, which was propelled by low oil prices and economic sanctions in the wake of Russia's annexation of Crimea. In the context of declining oil rents and intensified competition for resources among the bureaucratic elite, business was exposed to increasing informal bureaucratic pressure and bribe extortion. While before the crisis bureaucrats had expected to draw 'dividends' from their informal control over cash flow from private property over many years, after the advent of the crisis they seem to have been trying to extract

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<sup>38</sup> Name changed.

maximum resources as quickly as possible, to 'fleece entrepreneurs as if it was their last chance'. Under these circumstances the well-established informal arrangements ceased to work as reciprocally as previously. Anecdotal evidence suggests that law enforcement agents were extorting increasing sums of money from businesses without providing protection or services in return, but rather they threatened companies with a criminal investigation (author's private correspondence; cf. Yakovlev 2014). For many Russian companies, the scope of choice was de facto reduced to two options: losing their business or being drawn into the informality trap.

To sum up, in the 2000s the corrupt state took advantage of the informality of some companies and exploited it to violate the property rights of virtually any business actor. From the perspective of the 'good citizen' firms, the proliferation of state threats to property may look like a top-down 'statist' story, where institutional constraints on sovereign predation are lacking and corrupt lower-level bureaucrats are out of control. However, I argue that the advent of statist-patrimonial capitalism, marked by state threats to property rights, was also made possible and in fact facilitated by the choices and practices of business actors back in the 1990s. These practices created a massive temptation for the state and made the state-sponsored assault on property rights in the 2000s possible. By having embarked on expedient, predatory informal practices in the 1990s companies dug their own graves. Ironically, they also dug the potential graves of everybody else. Being pushed into these graves by corrupt state officials became only a matter of time.

### ***Conclusion***

A significant part of developments in Russia's political economy may be described a 'statist' story: bad rules and their poor enforcement; lack of commitment by the state sovereign to protect property rights; a swarm of bureaucrats-piranhas uncoordinatedly persecuting businesses for their private gain; and finally, a communist legacy of command economy and a looming authoritarian state. This interpretation seems all the more plausible if we look at Russia's political-economic form as it has evolved since about the mid-2000s. In this article I suggested viewing the

emergence of Russia's statist-patrimonial capitalism from a different angle: first, by going further back in time, namely to the beginning of Russia's capitalist transformation, and, second, by reassessing the contribution of business.

I found that what may seem like a statist top-down story (and may be experienced as such by the entrepreneurs) - namely the proliferation of predatory bureaucratic pressure on business in the 2000s - was in fact to some extent made possible, among other factors, by the business community proper. I illustrated the argument using the example of the informal behaviour of small- and medium-sized enterprises (SMEs) in the 1990s with regard to tax evasion, bribery and prepaid business attacks. Russian firms behaved informally for a variety of reasons, some of which, as I showed, pertained to expediency rather than necessity and were meant to exploit the loopholes and business opportunities of the nascent Russian capitalist order. One particularly predatory informal business practice in the 1990s was raiding, or the illicit seizure of the property of a target firm or a competitor by means of the manipulation of law enforcement and the judiciary. This practice vividly illustrates the active contribution of companies to undermining the security of property rights.

Most importantly, I found that by embarking on informal business practices firms often fell into the informality trap - a vicious circle of informality and pending punishment that puts property rights in jeopardy. I made the case that the informality trap was not inescapable in the 1990s because there were alternatives to many informal business practices that did not entail a legal violation. However, in the 2000s the situation changed with the advent of Putin's 'strong state'. As the punishments became imminent and the penalties tougher, companies had less room for manoeuvre. The firms' agency closed and their informality backfired, as the state exploited the firms' informality through its corrupt agents. Vulnerable as they were under the circumstances of Russia's chaotic transition in the 1990s, by deliberately choosing to evade taxes, to bribe officials or harass competitors, the firms contributed to the insecurity of property rights and ultimately made themselves *and everybody else* vulnerable to later attacks by predatory state officials. Again, the case of raiding is exemplary: corrupt state agents adopted a predatory practice

once 'invented' by ruthless parts of the business community. Instead of being hired by the businessmen, they began engaging in asset-grabbing themselves.

Notably, state threats to property rights affected not only firms directly implicated in informal behaviour, but the whole business community, irrespective of its legal compliance. Even though 'white' companies had a slightly higher chance of defending their rights in court, overall the scope for the firms' agency and choice diminished drastically. Potentially every business could become target of a state attack, succumb to pressure and fall into the informality trap.

Viewed from the perspective of the informality trap, the origins of statist-patrimonial capitalism lie not only with the state, a corrupt bureaucracy and Soviet legacies. Parts of the business community made an important contribution to the advent of a predatory state offensive against property rights that defines today's Russian statist-patrimonial capitalism. This reassessment of the role of business – as an accomplice rather than a victim - is important if we want to gain a better understanding of the origins of Russia's contemporary political-economic form and perhaps that of other emerging economies too.