



Corruption in the 20th Century Russia¹

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Corruption: Abstract norms and cultural meanings

Corruption is usually defined as use of public office for personal gain. That definition is based on the assumption that there is a delineation between public and private and that use and abuse of one by the other signifies a betrayal of the moral code and abuse of authority. It assumes that corrupt officials usually know that taking bribes is wrong and constitutes a violation of their professional code of behavior. Furthermore, corruption is usually understood as a deviation from the norm. If the norm is good governance, then corruption is the opposite of that what a country should strive for. In that sense corruption is an unfortunate reality contrary to the desired model.

In this classical understanding, corruption is used as a measurement of good governance. The less corrupt or deviant the public officials in a country are, the better is the governance and hence the more successful these countries could be in their performance.² Examples abound to the effect that corruption as bad governance is a major impediment to development (Henderson, 2000). Countries like Nigeria, Mexico and Thailand have long been viewed as classic examples of corruption becoming a major obstacle to development and economic progress.³ Yet, viewed from inside, use of public office for personal gain may not be a deviation from some abstract norm, but rather the norm. In this sense, corruption is culture specific, it is a reflection of the way things are done in a particular society or culture. Those who engage in corrupt practices may not feel themselves guilty of anything, least of all corruption. Exchanging favors, enforcing compliance, extracting dues from their subordinates are just as natural for them as a Weberian kind of bureaucracy may be to functionaries in some other countries. Moreover, they are convinced that there is no other way and that the only way to get things done is informally, through a network of subordinates, personal contacts, “telephone justice”⁴ or outright orders circumventing the law (Eisenstadt and Roninger, 1981; Adler-Lomnitz, 1988). They reject the notion that Western standards of what is and what is not corruption should apply to them, because their culture is different

and what they practice is not corruption but their traditional and efficient way to rule. From this point of view, debate on the nature of corruption reveals different cultural practices and different value judgments attached to those practices. It reveals the gap in the meaning among countries, or to use Samuel Huntington's (1992) phrase, a clash of civilizations.

No doubt in a country like Mexico before Vicente Fox or Russia under Boris Yeltsyn corruption was so widespread that it was impossible to function in any other way (Oppenheimer, 1996). People were conditioned to believe that bribing was a necessary way of getting things done. A hierarchy of double taxation spread so wide that one can think of a two tier parallel government, the official one, collecting for the state, and the unofficial one collecting for the boss, who could be a minister in charge of police, minister of justice or a prime minister himself.⁵ In such countries the private gain and public service are so interlinked that actors do not distinguish between public and private spheres. They treat the ministry under their command as their personal domain they can freely use for personal gain. Such a system can function quite smoothly at the domestic level. If all the major actors know the rules of the game and if all the citizens are conditioned to operate in this fashion such a system may indeed provide for an efficient operation of the state. If the populace tolerates a lower standard of living under the double taxation burden or if oil revenue or foreign aid foots the bill for double taxation then a country like this may muddle through for a considerable period of time.

The difficulty arises when foreign investors get involved. Not knowing all the intricacies of who pays whom and how much and proceeding from the assumption that they would act in accordance with the official laws of that country, foreigners usually get into trouble. They are cheated out of their assets, fall prey to swindlers and extortionists, get robbed by the police or invest in phony banks or companies. One American businessman in Moscow wrote about "insanity of doing business in Russia, of violence and intimidation" (Harper, 1999), the experience shared by many Western entrepreneurs.⁶ In such a scenario, legitimate foreign investors are likely to leave in disgust or fear, a country gets black listed and shamed at international fora, and its leaders get thrown out of office, as Yeltsyn and Salinas. But alas the real loser in such a scenario is the country's economic development. The examples of this sort of process abound notably in regard to Russia, Ukraine and Kazakhstan.

Without major foreign investment, corrupt countries are short circuiting their own future. They get stuck in a vicious circle of self-sufficiency. Their ever more desperate need for investment may lead to a painful attempt at reform or to the perpetuation of the old ways, which eventually would lead them to total collapse of public confidence, public finance and economy. Therefore in the age of globalization, corruption (or what is understood in the West as

corruption) turns from a factor of stability in national affairs to a destabilizing factor in transnational context. In a global economy one has to abide by the international standards or face ostracism. It is for these reasons that Vincent Fox, trying to change the reputation of the Mexican state, launched an anti-corruption campaign. It is for these reasons that Russia under President Putin has launched a banking reform and has passed laws against money laundering. Under the backlash of Western opinion, Putin has striven to change his country's reputation, attract foreign capital, and have Russia's name removed from the black lists of international organizations.

Corruption as cultural practice

Throughout the 20th century, corruption was a major part of social and political order in Russia. Scholars tended to examine the Communist rule from the point of view of its accomplishments or its horrors. Those who sought accomplishments, found plenty in the field of education, industrial development and women's rights.⁷ Those, on the other hand, who sought to find horrors found plenty as well during the civil war, the collectivization, the Great terror and beyond (for example, Graziosi, 1996). This focus on either accomplishments or horrors of the Soviet regime precluded us from seeing Soviet experience as a universe of cultural practices that were shaped by culture and understanding of how things should be done. Those understandings, in turn, were a product of religious belief, cultural context and dominant ideas of the time in a variety of subcultures in complex Russian society. It is impossible to understand the Russian post-communist corruption without having at least a basic grasp of cultural continuities and discontinuities relevant to these practices.

We can define dominant cultural practices as ways of doing things by social groups that are so natural to them that they do not think of them as anything but natural.⁸ For example, a set of cultural practices governs peasant life. They define peasants' relation to authority, land, state, church and women. It is natural for a Russian peasant to obey the master and the state on the one hand, and to cheat them on the other. That is his cultural heritage. That is, to use our term, his cultural practice.⁹

If one were to say to a Russian peasant in the year 1900 that to pay bribes to avoid taxes and to cheat on the state was a corrupt practice, he would not understand what was meant. Bribe-taking and giving, authoritarian patriarchal attitude to women, fear and cheating of authorities were a normal rather than deviant cultural practice in peasant milieu at the turn of the 20th century in Russia.

On the other hand, the major cultural practices of all those teachers, agronomists, and midwives, all those who considered themselves intelligentsia

– the stratum preoccupied with serving the great Russian people – were expressions of deeply patronizing attitude toward those they strove to serve. *Narod* (the people) was dark and unenlightened. It was primitive and crude. It needed to be shown the way to the bright future. Bolsheviks, Mensheviks (Democratic Marxists), Socialist Revolutionaries (a Peasant Party; hereafter SRs), Kadets (Constitutional Democrats, a liberal party of enlightened Westernized elite) and Tsarist ministers – all subscribed to that view. They differed on how to lead the Russian ignorant masses to the bright future. They differed on what this future should be like. They differed on what they should do to achieve their objectives, yet they all believed they had to teach, show, educate, or outright dictate to the people what they should do and how. When the revolution broke out, major social groups in Russian society simply acted out their cultural practices. The elites were teaching and punishing the backward masses; and the masses resisted in ways familiar to them.

The civil war: Corruption as arbitrary rule

In all the hundreds of books and articles on the Russian civil war, I have never encountered a discussion of corruption save for a few cases criticizing corruption under the Whites (Kenez, 1971). This is all the more surprising because bribe giving and taking, abuse of authority for personal gain, the blending of the private and public spheres and the privatization of the state by local dictators were not only commonplace during the civil war, these cultural practices were the very essence of the civil war (Pereira, 1997). As I have shown elsewhere (Brovkin, 1994), the civil war in Russia was in fact a period of multiple civil conflicts between a variety of forces engaged in a variety of wars, national and regional in character. Some actors claimed to act on behalf of the entire Russia, like the Reds, the Whites, and the SRs (Brovkin, 1994). Others claimed to speak for a particular area, such as peasant rebels Nestor Makhno and Antonov; still others acted in defense of their perceived interests, resisting state authority. These were the hundreds of thousands of the Greens – partisans hiding in the forests and resisting army draft.

Those who claimed to speak for the entire country or, indeed, for all oppressed proletarians of the world interacted with the local workers and peasants in terms of dictating to them what was best for them. Usually a Red or a White regiment would occupy a certain area and establish political order. Authority was not a product of free and fair elections monitored by international observers, it was established in the wake of conquest. Local people had no choice but to submit to the new authority and engage in interaction with it. In most cases it was an interaction of resistance. Peasants resisted the draft conducted by both the Reds and the Whites; they hid the grain from

the Reds or the Whites. They formed their own detachments and defended what they believed was their grain, their sons and daughters from an intruder. They also routinely bribed an established authority to reduce taxes and dues and to escape the draft. Cheating, bribing and even killing an intruder was a virtue during the civil war. In other words, the civil war enhanced rather than diminished the old cultural practices that under normal circumstances we would call criminal or corrupt – subverting the established law, cheating and bribing existing authority, and even resisting such an authority by any means available (Osipova, 1997).

The interaction of the local people with the Reds and with the Whites was similar at the level of cultural practices related to resistance. However, the way the Reds and the Whites engaged the local people was fundamentally different. The Whites did not really care about involving them. The new order they sought was little different from the good old days and from the natural state of the villages they occupied. They expected cheating and bribing as natural too (Heretz, 1997 and Pereira, 1997). Bribes and tributes from the population were a natural supplement to the income of the army. At certain points that was the only source of income for the advancing army. The Whites believed that the population had to be so grateful to them for the liberation from the Bolshevik rule that it should be willing to pay for the maintenance of the army and the new administration. This worldview generated immense corruption among the White civil service.

Since the White regime was an improvisation and had no money to pay to the civil servants and officers in the army, and since only very few did their duty out of conviction and dedication, most others helped themselves to the gains offered by abuse of the authority given to them. Tents, uniforms and warm clothes for the army supplied to the Whites by the British disappeared to the black market the next day it was unloaded in Novorossiysk port. Ammunition, rifles, uniforms, spare parts, anything and everything was up for sale. In the field, with the acting army, the situation was even worse: senseless robbery, requisitions, rape and murder for entertainment were common practice. Corruption as degradation, as deviant behavior and as abuse of authority for personal gain was the most important attribute of the White administration and went far beyond what was culturally considered normal. Eventually, General Denikin's failure to establish a functioning administration paralyzed his war effort. The arbitrary corruption under Denikin was indeed one, if not the most important, contributing factor to Denikin's defeat.

Under the Reds: Corruption as a method of government

The nature of the interaction of the Reds with the local population was fundamentally different from that practiced by the Whites. The Reds engaged the local population in establishing the new regime. They came with preconceived notions on who was who: who was a *kulak* (a rich peasant) and by definition suspect and who was a proletarian, that is a worker imbued with positive values. They recruited their personnel from those they defined as reliable and trustworthy. They came with a mission to reward some and punish others.

The Bolsheviks recruited administrators from the locals, which gave them an inexhaustible source of state servants for the building of their state apparatus. It would be naïve to think that a poor peasant who had accepted the job of a *soviet*¹⁰ chairman from the Bolsheviks acted so because he saw the light of the dawn of the new era. Most likely he made a rational choice that under the Bolsheviks he stood a better chance of making it through, surviving and advancing his interests than otherwise might have been the case. We know from numerous party reports on the quality of Soviet personnel in the provinces that they were autocratic, dictatorial drunkards for the most part abusing their office for personal gain.

The Bolsheviks divided the local community by promoting some over others, delegating administrative authority to them, knowing full well that they would use that authority to serve their own interests. The Bolsheviks did not seem to mind that, however, as long as the newly appointed fulfilled all the commands of the party. In other words, the Bolsheviks used corruption as a method of governance. They knew that the little despots they relied upon were requisitioning and robbing the population, abusing authority, damaging the local economy, antagonizing the population and generating resistance. And yet, they chose to rely on local despots and tolerate their abuse of authority (corruption) as the most effective way to control the countryside.

Abuse of authority, bribe taking, senseless robbery of the local population therefore was commonplace under both the Whites and the Reds. The crucial difference was that while this rendered the White regime ineffective in their war effort, under the Reds, any damage inflicted on the local economy was outweighed by the recruitment of countless volunteers for the Bolshevik cause.

The long term consequence of the civil war was that the Bolshevik leaders, their local recruits, and the peasants shaped their mutual relationships in terms of abuse and resistance. The Bolshevik leaders knew and expected that the local leaders abused authority and robbed the peasants and that the peasants, in turn, resisted, cheated and bribed them. The Bolshevik government feared peasant resistance and feared giving in to what it believed were peasants'

proprietary instincts. Peasants had to be held down by force and by concessions. If the price for that was arbitrary rule and the robbery of the population by local representatives of the center, the Bolsheviks were willing to pay that price. Abuse of authority was overlooked for the sake of maintaining Bolshevik control over the countryside.

The peasants on their part, exhausted by rebellions and famine were more than happy to settle for a compromise when trade was re-legalized in 1921. They had to tolerate Bolshevik control over the countryside yet they got what they wanted, a right to keep their land and sell the product of their labor. Requisitions and confiscations were over. Money was to be restored and economic improvement possible. Both sides, the Bolsheviks and the peasants, regarded the other side with suspicion and expected violations of the truce. The Bolsheviks feared that the peasants would not be content with economic concessions only and in the long run would demand political power sharing in the countryside. The peasants deeply resented “foreigners” in their midst, the big city outsiders who preached them some foreign and incomprehensible concepts of socialism, proletariat, and class struggle. The government and the governed perceived each other as enemies whose struggle may resume at a future date.

Under NEP: Corruption of the party

The New Economic Policy

The period of Soviet history of the 1920s, the so called, NEP or The New Economic Policy period, is rarely considered in terms of corruption. We have been conditioned to focus on the party debates, Stalin and Trotsky, educational opportunities, cultural vitality, anything but corruption. Yet corruption of the party was one of the most important shifts in that epoch. It was one of the most important causes of the demise of the NEP.

The NEP meant admission of private trade in Soviet Russia. Prior to 1921 all trade was banned and the most important commodity in the country – grain – was requisitioned by the Red requisition detachments. Workers were provided with coupons for food at their factories and those labeled bourgeoisie were allowed to emigrate or die in the cold cities. This was the system later called the War Communism with the word War serving as an excuse and suggesting its temporary and extraordinary nature. At that time, however, the extraordinary was the norm, as the Bolsheviks sought to establish “Communism” by which they meant a system free of exploitation, excluding private property, private enterprise and trade. Money itself was supposed to be phased out. Peasant resistance and famine of 1921 forced Lenin to sound a retreat, as

it was called then, from the construction of Communism and to adopt a new economic policy to be known in the West as NEP.

NEP was a period when money was reestablished, when taxes were collected and when private trade flourished. Under NEP, Russian economy revived and showed healthy growth. At the same time elements of the market economy provided countless opportunities to abuse authority and grant privileges for a fee.

The cultural heritage of the party cadres

The Communist party became corrupt at its core by the end of the decade. There were several reasons for this. New recruits into the party were barely literate upstarts poorly trained in *sov-party* schools in ABCs of Marxism, which they never learnt or understood. The sole reason why they joined the party was to elevate themselves over others, and to use this elevation for personal gain. The new recruits were turning the Bolshevik party from a party led by intellectuals and idealists, journalists and politicians, into a party of half literate peasant career climbers (see, for example, Easter, 2000).

In their behavior, the new appointed political elite began to imitate the lifestyles of the old elite. They moved into the manor houses, surrounded themselves with servants, maintained fancy horse drawn carriages, and caroused and drank freely. The ostentatious lifestyles of the Communist upstarts was so glaringly compromising that the Central Committee in a top secret memorandum addressed to all the Provincial Party Committees wrote:

There are at the disposal of the Central Control Commission a series of facts which indicate that both the central and the provincial party organizations maintain fleets of automobiles and horse drawn carriages without any work related need. . . . It has come to our attention that very often special rail cars have been dispatched to the southern resorts for the sole purpose of delivering one passenger to the resorts. At state expense, entire freight railcars were dispatched to the southern resorts transporting automobiles. (The RCP. . . , 1923: 2)

They did not think they violated any ethical norms as privilege came with the job. Their social status required and encouraged it. They surrounded themselves with material attributes of a superior social class, such as maids, cars, servants and drinking parties.

Moreover the upstarts brought into the party-state their heritage, that is their own cultural practices that were based on peasant notions of social and cultural hierarchy. These experience-based notions had little to do with respect for law or human rights or virtues of liberation of labor. The peasants' cultural practices were based on obedience, hierarchy, authority, punishment

and cheating the state. By far the most important was the notion of subservience to the master and oppression of the ones under one's command. "They Abuse me I abuse you" – that was the main principle of authority projection in civil service. In many party reports it is mentioned that the local party apparatchiks refer to themselves in front of peasants as "their Lord, to whom they should be obedient".

Structural problems of Soviet industry

The economic system of NEP generated its own type of corruption due to its incongruous nature. In the cities, most of the large scale industry was in the hands of the state. In industry there was no NEP. Production targets were set as during the rest of Soviet history, by a central plan. However, private ownership was allowed in the small scale manufacturing and retail trade. This set up generated incentives for the Red directors to channel some of the state produced commodities to the private retail outlets and siphon off revenue without declaring the profits to the authorities.

The real causes of the inefficiency of Soviet enterprises were structural. In practice, socialist industry meant state industry. This meant that the state-appointed managers operated on the assumption that the state would not let them fail. The priority of the management was not improving performance but concealing bad performance and extracting as much as possible from the state budget for their plant, on the one hand, and from their plant for themselves, on the other. The relationship between the state and managers was one of who could extract more from the other for less. The state wanted more production for less cost. The management wanted to reduce required targets of production, increase state allocation and siphon off extra surplus. The very structure of Soviet industry precluded its efficiency, discouraged it and encouraged double accounting duplicity and corruption.

Even though officially all major enterprises were organized as industrial trusts with all the attributes of economic independence, in fact, they were all state property. Generating losses did not lead to bankruptcy, but instead to replacing bad comrades with the good ones and allocating subsidies from the budget to correct any deficits. At no time did the Soviet industry operate in market conditions. All enterprises in the final analysis relied on budget allocation, regardless of their profitability. In 1927, the chronic unpredictability of state metal industry was incorporated into Soviet legislation that tried to spread the burden of inefficient enterprises onto the entire economy. A special decree on trusts excluded profitability as a necessary requirement of performance; the emphasis was put on fulfilling output targets set by the state (Neretina, 1994: 96). In these conditions, trusts had no interest in decreasing the cost of production because their targets would be raised. Moreover any

profits they showed would be automatically diverted into the state budget (Isaev, 1994: 98). There was no incentive to show profits; and if there were some, one had to hide them from the state. Loss making, inefficient enterprises engaged in double accounting and milking the budget – this socialist industry existed well before the Stalinist revolution from above. According to Litvinov, a graduate of the Institute of Red Professors, in the early 1920s, corruption was already pervasive in the party and state regulatory agencies:

In the economic departments, in the military and supply agencies, as well as in the diplomatic service thieves control everything. I am sure that the percentage of thieves among the Communists employed at the Supreme Council of People's Economy, Tsentsosoiuz [Central Cooperatives' Administration] and People's Commissariat of Foreign Trade is higher than 99 per cent. In those agencies everyone is a thief, beginning with the People's Commissar and ending with the simplest courier.

(Litvinov, 1922: 96)

This side of economic activity under NEP has been by and large overlooked.

NEP's self-destructing course

In contrast to the heavy industry sector, which was excluded from the NEP, small but well run private establishments did remarkably well under the new policy. This was true particularly in food processing and consumer manufacturing as well as in such industries as leather, timber, fishing and textiles, where enormous fortunes were made. Not only did they show profits and paid taxes designed to discriminate against private sector, but in many cases they paid higher wages than state enterprises. In some provinces, such as Samara, private companies offered wages “several times higher” than at state enterprises (Samara Gubkom, 1925). The Bolsheviks faced an embarrassing situation. The, so called, “socialist” industry paid lower wages at the enterprises nationalized in 1917 than their private owners (“the capitalists”) used to pay before the war. According to the GPU (Secret Political Police): “In the majority of provinces, the average wage for workers reached barely fifty per cent of the pre-war level.” (Unshlicht to Stalin, 1923: 2).

The urban Communist party elite was closely intertwined with the private entrepreneur stratum and the two elites were thriving in the conditions of NEP. Problems arose when private companies had to deal with competing bureaucracies that demanded their share of the pie. In such situations *soviets* rivaled Gubkoms (regional party committees), and financial scandals occasionally flared up. As one example one can cite a scandal in Kaluga (Kaluga Gubkom, 1928: 16–17). A local trust and a Gubkom got along very well. Someone got jealous of this cordial relationship, however, and sent a

“signal” to Moscow that the trust was actually a nest of counterrevolutionary specialists and former capitalists. This was the most effective way to destroy competitors or punish those who had not delivered what was promised. The desired result was achieved. Once one started digging, one could always find irregularities, kick-backs and corruption. Moscow party committee admitted in 1928:

We have cases of moral degeneration of party members, cases of their “bourgeois” degeneration. We have cases of bribery. Party members working in the state apparatus and in distribution departments accept bribes. We have cases of linkages between Communists and the kulaks, and cases of systematic drinking parties of Communists with the NEPmen and bourgeois elements (Moskovskii Komitet, 1928: 1–24)

By 1928 most of large enterprises were loss making, unemployment was mounting and corruption thriving. The course chosen after 1928, when the private sector was smashed, was to pursue industrialization without any regard to profitability of the enterprises. From then on, it would be a barrack style production (Ivanova, 2000). Under NEP, the wealth was in private hands and it was transferred in the form of bribes to the political elite, – the Communist administrators. This meant in practice that the semiliterate and appointed Communist apparatchiks developed dependency on the prosperous and smart businessmen who were building networks of connections, corrupting the apparatchiks with their money and weakening Moscow’s grasp over the economy and the administration. What was worse from Moscow’s point of view was that private enterprises were generating profits and state enterprises generated losses. State enterprises were inefficient, state subsidized and unable to compete. That which was supposedly superior and “socialist” in economy did not perform and that which was supposedly inferior and “capitalist” performed well. From this point of view, smashing private enterprise was an act of covering up Socialist inefficiency. In a system where everybody would work for a food ration and no private competition would exist, it would no longer be possible to see or prove that Socialist enterprise was inherently inefficient.

The withdrawal from NEP and the transition to barrack style socialism was a tacit admission by the party that the private sector was more profitable than the state one. It had to be smashed precisely because it was generating wealth into private hands uncontrolled by the state and corrupting the party state officials. It was preferable to have everyone dependent on a state food ration than tolerate independent wealth (see, for example, Los, 1990).

Rural corruption

In the countryside, the NEP system created even more misbalance. Taxes were assessed on the basis of class and income. Rural soviets determined who was listed as a *kulak* and who was not. Income was assessed on the basis of property listed in the property surveys. The surveys were conducted by local soviet functionaries. The amount of taxation, social identity, status and later survival depended on those surveys. In Novosibirsk province, for example, of 26,994 taxable households, or 22.5% of the total number, were freed from paying any agricultural tax as poor peasants. Investigation later showed that the recipients were not poor peasants but drinking pals and relatives of those in power (“Sostoyanie. . .”, 1927: 18). Bribery was rampant in the countryside in connection with taxation. The levels of taxation on well to do peasants were high, at first, and then simply ruinous. What prosperous peasants were trying to do was to parcel out their holdings among friends and relatives and to bribe local officials so that they would be listed as middle income peasants. This system generated enormous hidden wealth shared by the corrupt party and state officials and well to do peasants.

By the mid 1920s, the accumulation of wealth through private agricultural production led to political consequences in rural elections. The well to do peasants bribed local officials, co-opted poor peasants and tried to place their people in rural soviets. The Bolsheviks responded by waves of disenfranchisement of the, so-called, *kulaks* in order to stem the tide of political influence of private wealth. In November 1926 a new electoral law expanded the category of *kulaks* and traders who were deprived of voting rights (Levichev, 1928: 99–101). As a result the number of disenfranchised doubled. In some areas the increase was several fold. In Siberia, for example, 14, 564 persons were disenfranchised in 1926, but their number grew to 76,958 in 1927 (ZamPred OGPU, 1927: 6). According to official statistics, in 1927 a total of 1,338,158 persons in Soviet rural areas were deprived of electoral rights (Vserossiiskii. . ., 1927). Local cliques and clans used the disenfranchisement to preserve control over rural *soviets*, and that meant control over taxation and revenue.

The local party held political control and the well to do peasants held economic power and money. The two elites were beginning to blend into one. Rich peasants married their daughters to poor but influential party and GPU officials and the two groups were pooling their political and economic resources. The majority of province party committees all over Russia owed money to peasant cooperatives. Peasants gladly loaned money to the party as a way of securing political influence. It was a form of bribery (Otchet, 1925: 47). According to the Party Control Commission that investigated dozens of cases of rural corruption of the party, virtually all provincial rural cells owed

money to the private sector (Central Committee Info. Dept., 1926, doc. 366). Peasant cooperatives typically granted loans to the party cells, which were seldom collected. By 1928, the extent of the party's indebtedness in rural areas was extraordinary. Rural officials regarded their position as a source of revenue for themselves. They delivered what they thought a fair share to Moscow and kept the rest for themselves. The GPU wrote with alarm: "Lower standing rural soviet officials actively cooperated with the kulaks in underreporting taxable property" (OGPU, 1926: doc. 200a, pp. 1–24).

According to a special party report on Siberia, embezzlement rates in the tax collection apparatus were high throughout the province and "the embezzlers were the administrators and the administrators were the party members" (Sibirskii Kraikom, 1926: 149). In the Kuban region the process was described as "capitalist regeneration." The Communists there appropriated the best parcels of land. Since they had no time or skill to till it, they rented it out to Cossacks. By Soviet official standards they received what was called "unearned income," qualifying them for a *kulak* tax status. Yet the practice went on for years without any effect on the tax rates. The most serious problem was related to: "pervasive drunkenness, scandals, fights, . . . Embezzlement of public funds and waste of public resources is often connected with drinking" (Kubansko-Chernomorskaya, 1926: 202).

A survey of the rural party in Saratov province showed that embezzlement of state funds was epidemic. The Committees to Aid the Poor were "dispensing funds to friends and drinking companions" (Grachev, 1927: 37). The Central Committee report on the lower Volga area described:

Links between party officials and anti-soviet and kulak elements, misuse of authority for personal gain, drunkenness, patronage of alien social elements, . . . drinking ties between party officials and alien elements. . . They were getting money from wherever they could.

(Central Committee Info. Dept., 1925, doc. 451: 54)

In Vologda province, the Control Commission discovered the "blending of the entire blocs of the soviet and party apparatus with the capitalist elite in the countryside" (op. cit.: doc. 371: 143). The *kulaks* were taxed at a lower rate in exchange for a bribe, a phenomenon called "systematic undertaxation of kulaks." The ever tougher measures against the *kulaks* adopted in 1928 led to ever more ingenious ways of adaptation to the situation (Steltsov, 1929: 194).

The overwhelming number of party officials were comfortably set up in their provinces, and most of them learned to live well under NEP. Most party organizations in most provinces had countless financial ties with the well to do peasantry. They held shares in partnerships, rented out land, took

bribes and kickbacks, loaned and invested money and received payments for favorable rulings in disputes over taxation and property rights.

The rural party identified with local economic interests and covered up the missing revenue. A blending of economic and political elites was going on in NEP Russia. From Moscow's point of view, rural party cells were becoming an adjunct of *kulak* networks. As I argued in my book *Russia After Lenin* (Brovkin, 1998), Stalin's decision to halt NEP may be seen as an attempt to stop and reverse the process in motion, the process of withering away of the Communist party in the countryside. The demise of NEP was a blow not only against prosperous peasants but also against the local party which prospered from peasant bribes. The most important long term consequence of the 1920s was that the habits were formed of cheating the new state, bribing one's superiors, channeling profit making activity underground and sharing the surpluses with the bureaucrats. These features of the Soviet system became stronger as years went on and in the 1960s and 1970s became the dominant ones, leading ultimately to the collapse of the entire system.

Under Stalin: Corruption incorporated

Mechanisms of corruption

Much of the scholarship on the Stalin period is devoted to the problem of the purges, their nature, scope, causes and effects. The school of thought that views communism in terms of totalitarianism has traditionally interpreted the purges as the essence of the communist system, its disregard of the human beings, its handling of classes, reshaping society and coercing everyone to comply (see, for example, Schapiro, 1965; Malia, 1980 and Pipes, 1993). The revisionist school of thought has done much to conceptualize new ways of looking at the purges: such as the war of elites, the game theory, various models of power struggle (Fitspatrick, 1994).

What both schools of thought have overlooked is that Stalin was fighting against insubordination. The key to understanding the purges is not Stalinist destruction of the Leninist Bolsheviks, and not only the war of party cliques for power, it was first and foremost Stalin's fight against disloyalty to him personally. Stalin needed an obedient party, loyal to his apparatus and not to those who would pay more, not to local lords and not to former party equals. The purges were a fight against corruption in the party, which is not to suggest that Stalin fought for transparent law abiding party. The early 1930s' campaign aiming at expulsion of unreliable elements from the party and the exchange of party cards campaign of 1933 can be interpreted as Stalin's attempts to subordinate the party to the center by eliminating cliques and

clans in the provinces. It still mattered, of course, if an official held Trotskyite views or had worked under one of the overthrown high ranking Bolsheviks, but it also mattered whether the person in question belonged to a retinue of a party boss who retained his own fiefdom, collected kickbacks for himself and misled Moscow about the state of affairs in his province.

The relationship between Moscow and the province party boss was that of a constant pressure from Moscow to obey, to deliver, and to comply, while the province party boss was trying to retain loyalty of his people, conceal poor economic performance and preserve some of the resources for his province. Stalin in his speeches constantly referred to double dealers, liars, and comrades who surrounded themselves with personal friends. Knowing that heads rolled and commissions could come and purge the province party leadership, province bosses tried even harder to surround themselves with people who would not betray them. If purges came, they tried as they saw it to sacrifice unimportant people and preserve the lives of important ones, and to survive by displaying outbursts of praise for comrade Stalin. However, Stalin was looking through the lists of those expelled and the economic performance data collected by the NKVD and compared those data with the party reports. Clearly, he had to have noticed that the party bosses were lying and, consequently, many of them would have to be removed.¹¹

The relationship between the center and the provincial party bosses fits the model of game theory. While the center expected from the provinces disinformation, inflated figures on successes and declarations of loyalty, it suspected poor performance, cover-up, duplicity and cheating. Hence the double-dealers had to be unmasked. The province leaders had to anticipate the next salvo directed at them and show initiative in unmasking enemies, since their performance was measured by their ardor. Both sides tried to out-smart each other in the game of hiding and extracting, based on each other's perceptions. The province had to excel in convincing the center that they were fulfilling the orders of Moscow. For that the reward was life and a whole lot of privileges, perks, country estates, food supply, medical care and servants on one condition, obedience.

Unlike in the NEP period, now all the perks were centralized, everything came from Moscow through centralized distribution. Stalin turned the party into a personal network of subordinates who owed everything to him. A civil war cohort Bolshevik Martimyan Riutin who served in the 1920s as a district party committee chair in Moscow authored a famous dissident Bolshevik critique of the Stalinist regime. For that he was arrested imprisoned and executed in 1937. In his critique, Riutin wrote:

The Politbureau, the Presidium of the Central Control Commission and the province Committee chairmen have turned into a gang of political

crooks without any principles. They regard the party as their patrimony. . . People's Commissars, their deputies, prominent apparatchiks, editors of major newspapers and union chairmen. . . are all ensnared by the process of degeneration. All of them including the former workers do not have any connection to the working people any more. They are provided for with high salaries, resorts, country houses, luxurious apartments, special overt and covert food supply, free theatres, excellent medical care and so on. And all this is taking place at a time when people are being pauperized and a semi-starvation existence is reigning over the entire country. To a certain extent, they are bribed by Stalin.

(Riutin, 1992: 243)

The relationship between the party boss and his subordinates had also undergone a significant change. These people in the second tier of leadership had to prove their loyalty to the boss, yet they knew that they could be sacrificed at the next purge. One needed a protector both at the province and at the higher levels. So, provincial apparatchiks were delivering their subservience to the highest bidder in terms of protection and security. They likewise dispensed patronage to those below them by bestowing favors, apartments, good jobs and other perks to those who were the core of their support infrastructure.

A position of authority in Stalin's times turned into, on the one hand, a source of peddling influence, a source of perks and material benefits controlled by the state and, on the other hand, a source of danger, a source of constant threat of punishment if disloyalty was discovered or imputed. From this point of view, the authority structure Stalin created was very similar to that of Sicilian Mafia. The key to it all was loyalty to the boss. Any disloyalty was punishable by death. On the other hand, within his own jurisdiction the local boss was free to exercise vast powers over life and death of others, as well as over material goods and privileges.

In contrast to NEP, Stalin removed money from the system of distribution of wealth. A loyal party boss could have all the houses and movies and fine things in life from the center and from the center only. Stalin made party bosses dependent on the party rather than on client networks of independent entrepreneurs. A job in party hierarchy meant privilege, it meant responsibility and it meant an ability to convince Moscow that orders were fulfilled. This type of a relationship had nothing to do with law or with any written set of rules. It was based on a silent understanding of the deal with the center.

The terms of the deal can be summarized as follows:

To succeed in the Stalinist apparatus one had to:

- Excel in expression of loyalty devotion and praise to the boss
- Guess correctly what was expected of him without oral or written instructions

- Always follow the party line with ardor, whatever it may be
- Obey direct orders regardless of their legal content
- Have no loyalty to family or friends stronger than to supreme ruler
- Have no opinion of one's own.

Stalin succeeded in creating an obedient apparatus. If he had decided to proclaim himself Emperor there would not have been opposition in the Communist party on ideological grounds. The party congress would have hailed the Emperor. The party claimed to have been Marxist-Leninist. In fact most of its members knew virtually nothing of Karl Marx's teachings and had no interest in them. The idea of building socialism degenerated into a widely held understanding that it meant fulfilling orders from above in terms of taxes, targets, plans, and construction sites.

The rewards for a successful apparatchik were: upward mobility, power over others, privilege, special food rations, separate medical service, privileged entertainment, servants and relative immunity from claims of abuse originating from those below him. The higher one climbed the ladder of hierarchy the more one could feel above the law and get away with things normal mortals could not even dare to try. Promotion or demotion was totally at the discretion of the center. One never knew what was going to happen next week. One could be promoted to almost unlimited heights or get a bullet in the neck without any warning or explanation.

The in-built weaknesses of the Stalinist system of rule

This system had a number of weaknesses. It could only function well if party officials at all levels feared the center, and if there was an efficient enforcer of the center's will, like the NKVD (secret police). A skill of the party boss to convince the center that things were fine was built into the Stalinist system. That meant either total obedience to the center or skillful cheating of the state. If and when the pressure of the center were to weaken, if and when the threat of sanctions including death were to be eliminated, cheating the state would replace total obedience as a way of dealing with Moscow.

Corruption under the Stalinist system, in the sense of abusing public office for private gain, did not cease to exist, it simply changed. Using and abusing public office for private gain was institutionalized. It was incorporated into the system. One could use and abuse the office for personal gain on one condition: if one were to show total obedience to the center and fulfill all the orders. Power over the life and property of others was a reward for obedience. The supreme ruler dispensed rewards and punishments to his servants. No written law, and no moral code guided their relationship. It was based on fear of the ruler by the local chieftains. Once the supreme ruler was gone, they were bound to usurp as much arbitrary power to themselves as they could handle.

Another weakness of the Stalinist system was that it generated the party officials' desire to hold on to their privileges in perpetuity and, therefore, a desire to weaken, if not to get rid of, the capacity of the center to remove them from their positions and deprive them of their wealth. They had a natural inclination to stash away some wealth for themselves and their families precisely because they knew that one day they might lose their privileged status. Cheating the state remained key to survival and key to passing the wealth along to off-springs.

Stalinist system's greatest handicap was that it was unsustainable in a long run. As newcomers settled into their comfortable positions of authority, they of course went through the usual expressions of loyalty and praise. They knew what was expected of them, but it was increasingly difficult to command their true loyalty. They became masters of deception. They showed excellent performance results, they fulfilled and over-fulfilled the plan on paper, and at the same time they were busy building their own support networks, connections, trading favors and personal insurance funds, to ensure that if they fell, they would have something to rely upon.¹²

Therefore the Stalinist system contained within itself the structural deficiencies that led to its decline and a few decades later to the collapse of the entire edifice. The Stalinist system incorporated cheating the state into the normal arsenal of tools available to a normal apparatchik. Every new generation of local rulers were ever more proficient in showing great results and getting away with cheating on Moscow. The old peasant skill of cheating the state got perfected to a point of incorporated duplicity. Everyone knew that official reports were based on lies but everyone pretended that it was true. Everyone knew that at every level managers and directors skimmed off revenue and falsified official books, yet everyone pretended that Socialist construction was achieving new heights in performance. Everyone pretended that things were getting better all the time, whereas in fact abuse of public office for personal gain was reaching enormous proportions under Stalin's successors.¹³

After Stalin: Patronage networks unbound

The structural deficiency of the Stalin system, as we have seen, was that the privileged elite had an inbuilt desire to weaken the control of the state, to eliminate fear of death as ultimate punishment for disobedience and to preserve the privilege in perpetuity. In a historical perspective, the post Stalinist elite was in a similar situation as the post-Petrine Russian nobility in the middle of the 18th century. Then, the new nobility wanted to preserve the privilege and the property without obligation to serve the sovereign and without paying

taxes. They craved for independence and for their rights guaranteed to them as nobles.

In the middle of the 20th century, the party elite craved for security, inviolability of the person and freedom from arbitrary death. At the same time, they wanted to preserve their privileges and their superior position in society. They increasingly regarded themselves as a ruling class that had deserved the leadership role and had paid for it with its own blood. This worldview fostered exclusivity vis-à-vis the masses. The classless society in theory was turning increasingly into a class society whereby the privileged elite wanted to solidify, codify and preserve its privilege (Djilas, 1957; Voslensky, 1980; Jowitt, 1983). The difference with the 18th century was that then the nobility if it chose to serve the state did that voluntarily and developed a sense of honor, duty and patriotic élan. Service became not bondage but a source of fulfillment, career building and attainment of personal esteem.

In post-Stalin Russia, corruption was built into the system. A job, any job was perceived as a source of influence. A job was a link in patronage networks and a source of trading favors. At the top of the social hierarchy, a party secretary in a province was a demi-god. He was the most powerful man in that province. He could distribute dozens of *nomenklatura* jobs, he was serviced by a retinue of servants and had garages, and cooks and sanatoria, all free of charge. His children were guaranteed entries to the best universities and promising careers (Simis, 1979, 1982). At the other end of the social hierarchy, if we consider the role of a simple clerk in a city administration, he or she could, for example, have access to *propiska* (residence permits) or to licenses or to leasing of state real estate. Everything theoretically belonged to the state, but the people who managed it on the state's behalf were free to extract benefits for themselves. Anything one had access to was a potential source of income. The entire system was permeated with influence peddling, favors trading, projection of authority, and exchange of goods and services under the counter.

The spread of corruption in retail trade was particularly conspicuous. By the mid 1960s, it amounted to a gigantic underground conglomerate of kickbacks, double accounting, siphoning off revenue and illicit accumulation of wealth. Directors of department stores and restaurants made a lot of money over and above official cash register sales. They shared that surplus revenue with controlling agencies, directors of hotels and city officials and ultimately with the party officials. Little by little bribery spread to law enforcement and the courts.¹⁴ At each level of a trade hierarchy a designated person delivered "gifts" to the boss above. This system of kickbacks or "gifts" permeated the entire society. Doctors increasingly expected "gifts" after an unscheduled visit. Teachers increasingly expected a "gift" for good teaching and preparing a

student for college exams or for good grades. Policemen expected a “gift” if they overlooked a traffic violation. In all walks of life, a job was increasingly perceived as a source of supplemental income.

In short, corruption was becoming a norm in Soviet society and no one thought that cheating the state was reprehensible. If one was smart and managed to extract something from his job by cheating the state, that was an obvious thing to do. The notions of what was honest and what was dishonest got increasingly blurred. As entrepreneurship was driven underground, wealth building was and could only be of illicit origin and acting outside the parameters of the law became normal and expected practice. This fostered disrespect for the law, any law. Beating the system, acting outside the law, and getting away with it was the virtue. Black marketers, underground manufacturers, party bosses, factory managers and restaurant directors all of them were a part of the system by working outside the system, milking the system, and privatizing the benefits of state property years before privatizing became official. The notion of property became blurred. The state property was nobody’s property to be exploited by those who administered it on the state’s behalf.

If we define the Soviet system in terms of centralized state and supervised production and distribution, its demise occurred years before 1991. The Soviet state was being gradually privatized by corrupt elites and patronage networks unbounded due to the lack of sanctions. The Soviet state was splintering into autonomous chunks without one law for all. It was glued together by the party. Once the Communist party collapsed, chunks of the old state in the form of monopolies or republics grabbed as much of state property as they could handle.

Similar to the 1920s, in the last decades of its rule the party was corrupted by the stream of illicit deals, kickbacks and wealth. Power and wealth were increasingly linked not to favors from Moscow as under Stalin, but to underground illicit commercial activity as under NEP.¹⁵ The undoing of the Soviet system came from criminal linkage to entrepreneurship. Private enterprise emerged devoid of honesty and a code of honor. Profound cynicism permeated Soviet society in the years of its decline, in the 1970s and early 1980s. The elites openly discussed their doubts in the Soviet system and in its official ideology and claims. Yet they were very savvy about exploiting opportunities under that particular system. In a sense the Soviet elites were trapped between stagnation and a desire for change. They could play it safe and operate in the system they knew, but they did not like it and aspired to move on to open private ownership and entrepreneurship. Just as the Stalinist elite wanted to preserve life and privilege as its key objective, the Soviet elite under Brezhnev developed a desire to pass on its wealth to their off-springs.

Little by little the idea that private entrepreneurship and market relations had to be legalized became acceptable.

From this perspective, Gorbachev's perestroika was only a transition period – a period when market relations, private property and entrepreneurship became legal and acceptable in the national consciousness. However, these new notions appeared in a society that was damaged by decades of illicit deals, kickbacks and underground economy. The result was a peculiar mutation of capitalism, empowerment of the criminals, rise of powerful cliques and oligarchs, corrupt privatization, unfair division of wealth and many other ills of the Yeltsyn era.

The 1990s: A disastrous decade

The collapse of the Soviet Union and of the Communist regime in 1991 is usually understood as a dawn of the new era of democracy and market reforms in Russia.¹⁶ That may be so in the long term perspective but in the period immediately following the collapse the most important process was not of democratic reforms but of the disintegration of the Soviet state, fragmentation of authority and a free for all re-division of wealth comparable only to that under the Bolsheviks. The former custodians of people's property, the party apparatchiks, *soviet* executives, officials and the KGB officers went on a rampage of undisguised theft of natural resources, abuse of authority and corruption as a chosen model of government.

Corrupt privatization

Much has been written about the process of privatization in the early 1990s. It was a three stage process, with voucher privatization followed by the auctions of enterprises and leading up to the wholesale transfer of the biggest enterprises to chosen elite groups. At every stage of the process, the main and most important component was corruption. People who orchestrated the procedure derived benefits for themselves and their clients using the process for personal gain.

Vouchers were supposed to be redeemable for stock in enterprises to be privatized. All citizens got a share of vouchers as their share in national wealth. Those in the city administration who knew the value of enterprises or the managers of the enterprises bought up the vouchers from the rank and file for pennies and then redistributed them to their friends and relatives to claim ownership of the enterprise when those would go up for sale.¹⁷

The problem with the transition to private property in Russia was that a clear distinction has never emerged between that which is private and that

which is public. Soviet enterprise directors exploited enterprises under their control for their own benefit; they did not care about the long term economic performance of the enterprise. Their priority was to extract as much out of the enterprise as possible regardless of what happens afterwards. This attitude affected the manner in which the state economy was privatised. For example, the state railroads, notorious for their corruption, created all kinds of service companies ostensibly independent but in fact owned by the friends and relatives of the management. These companies passed on to them for pennies the valuable assets and lucrative contracts, leaving on the books of the state that which required maintenance and expenditure. As a result, all the profits went to the managers and their relatives and the state-owned roads and tracks were falling into decay.¹⁸

The same happened with airports and car manufacturing and many other branches of Russian industry. Airports were divided up among scores of private companies whereas the state wound up with everything demanding expenditure: runways, traffic control and maintenance. Much the same happened to one of the most lucrative service industries – hotels. They were privatized for bargain basement prices, usually thanks to kickbacks to city officials, and then divided up into small enterprises. Their struggles for survival were accompanied by shootouts among rival gangsters. The situation was not different in the military sector. As one scholar noted, “military industrial complex was an easy prey for various predators: bureaucrats, directors of enterprises, nomenklatura and criminals” (Schwartz, p. 42). Retail kiosk trade, at first neighborhood bound, was from the very beginning taken over by street gangs who usually forced kiosk owners to pay for protection. With this initial capital, the Solntsevo mafia grew to buy legitimate businesses, casinos and restaurants and night clubs. Following a similar pattern, Izmailovo mafia is known to have gotten into drug business, and the Chechen mafia in Moscow got heavily involved in auto-market linked to one of the wealthiest and most powerful Russian “oligarchs,” Berezovsky (Klebnikov, 2000). The word “mafia” in this usage usually refers to an organization of criminals linked to each other by bonds of kinship or neighborhood or nationality who pursue enrichment by violent and criminal means.¹⁹

Mr Berezovsky’s Logovaz concern was a private dealership owned jointly by the very same people who served as CEOs of VAZ automobile plant. Logovaz dealership bought from the manufacturer newly made cars at artificially low wholesale prices and sold them to retail outlets for a normal price, thus pocketing all the profits and leaving the manufacturer without profits. Why would the owners strip their own manufacturing plant of the profits? The answer is that they did not believe that they would indeed remain “owners” of the plants. The managers in post-Soviet enterprises were acting exactly as

they did under the Soviet regime: they ripped off their own enterprises. The key difference is that now they could do so openly and they could move their money offshore, to Cyprus or elsewhere.

In the early 1990s the structure of Russian industry acquired a very peculiar shape. In the aluminum industry, in oil, timber, fishing, automobile and anything that could be exported and sold for foreign currency, the Russian state manufacturer sold his commodity at a very low domestic price to some obscure offshore company or a Russian intermediary who would then sell the commodity to an offshore intermediary that, in turn, would sell the commodity at Western markets at world prices and pocket all the profits. The giant oil enterprise Gasprom, for example, was notorious for this sort of schemes. It funneled lots of gas to friendly companies, like Itera whose owners are still unknown, and they, in turn, sold it to foreign customers at world prices keeping the profits and presumably sharing them with Gasprom managers.²⁰

It was demonstrated in several court cases that the intermediaries were owned by the managers of the very enterprises that had produced the commodity. For example, a British registered company Base Metals Limited belonged to the same people who were the CEOs of the Novokuznetsk aluminum. Base Metals bought aluminum from Novokuznetsk at Russian domestic prices and then resold it in the West for world prices. Novokuznetsk showed no profit for 1996 and Base Metals would make 90 million profit in 1996 alone.²¹ This was a way of siphoning off state profits, stripping assets and moving the wealth overseas. By some estimates Russia was losing 12 billion dollars a year in the form of capital flight from the mid 1990s onward. Some of that money was mixed in with the criminal proceeds but most of it was stolen national resources by the unscrupulous managers of the state-owned and/or newly privatized enterprises.²²

The process of privatization at the so-called auctions in 1995–1996 was particularly corrupt. It is known in history as the “loans for shares scandal.” Outwardly the scheme looked rather innocent. The government needed money for the budget of 1996. So, in the fall of 1995, it took loans from some banks and secured the loans with a collateral in the forms of shares of the soon to be privatized enterprises. The loan providers were to hold those shares until the privatization auctions would take place and then they would be able to buy those shares and the government would repay the loans it had taken with the proceeds of the privatization sales. In other words, the government got the money from privatization before it privatized the enterprises. In reality, as one analyst put it, the resources were “centralized, diverted and privatized.” (Tikhomirov, 2000).

When the privatization auctions commenced in 1996 those companies that provided the loans to the government would act as the organizers of

the auctions and as the sole bidders for the enterprises to be privatized. In what was later established as rigged auctions with no real competition several privileged banks acquired control over the largest enterprises in nonferrous metals, aluminum and oil industries. For bargain basement prices these privileged groups obtained control over the largest enterprises in the world. Norilsk Nickel, the largest nickel producing enterprise in the world went for 135 million dollars, a price which was a fraction of the annual profits.

There is no doubt that this was all orchestrated from the very top with the consent and knowledge of the government, the Prime Minister and the President. In case of Siboil, a special *ukaz* (ordinance) was made making possible creation of that company. In numerous instances those managers who resisted the hostile take-over wound up dead. In aluminum industry the fight for control, was particularly bloody, and was nicknamed the great aluminum war.²³

Gigantic aluminum plants produced hundreds of thousands of tons of aluminum, which was sold at a price slightly higher than at cost of production to obscure companies who were shareholders of these enterprises. Those companies were usually registered offshore and their real owners were never known to the public. Obtaining aluminum at incredibly low domestic price they shipped it to Western consumers for a world price and kept the proceeds in offshore banks. The Russian enterprises sought ever more loans to finance their production and service outstanding loans, thus never getting out of debt. This was a convenient method of shifting the proceeds overseas.

Did the government know about this? And if they did, why did not they do anything about it? Apparently, Yeltsyn was trying to make sure that if he lost power, either by losing elections or in some other way, he would have enough wealth distributed to his friends and allies that he would be in the position to continue political struggle or at the very least have a secure financial and political base. Wealth was distributed by Yeltsyn's regime from above in return for political support, election campaign financing and personal kickbacks from the oligarchs for the top leaders who stashed it away in personal bank accounts overseas.

If we were to look for historical parallels to this process, what comes to mind first is not the Soviet experience but the autocratic influence peddling under the last Tsar. Under the influence of a crazy monk Grishka Rasputin, the imperial family, particularly the Empress distributed profitable contracts, appointed and dismissed Prime ministers, made and ruined fortunes and formulated policies behind closed doors among the few trusted oligarchs.

Corruption as a bribe to nomenklatura

Mid 1990s were a period of great instability in Russia. No one knew for sure what would happen next. Those who had privatised the state wealth among themselves were uncertain whether they would be able to hold to their gains. No one could guarantee that the hardline Communists would not come back and reverse the gains of the past years. The President like everyone else was far from sure that he would continue to hold on to power. He had to create some insurance for the rainy day.

It seems the most critical moment in Yeltsyn's political career was the rebellion against him by the pro-Communist parliament in October 1993. What shook Yeltsyn up was the fact that his Presidency and his life depended upon the decision of a few top Generals. If they had decided to side with his opponents, he would have been removed from office, tried and possibly killed (through death penalty or assassination). Some of them (and he knew that) hesitated for a day or two not knowing whose side to take. After some hesitation, the generals took the President's side and obeyed the orders to storm the parliament. Images of tanks shooting on the burning parliament will always remain associated with Yeltsyn's Presidency. Some openly declared that in the conflict between the President and the Parliament the army should stay neutral and not be dragged into a political fight. From this experience, Yeltsyn drew a lesson that the army could not be trusted and that everything possible should be done to avert a repetition of this situation later. The first thing to be done was to weaken the army by sharply reducing financing, the second was to shift some power to the Police. That is exactly what was going on in the 1995–96 period. The Ministry of Internal Affairs (MVD) developed its own military capacity, with tanks and special units rivaling those of the army. But by far the most cunning method Yeltsyn chose in his dealing with the army was corruption as a method of keeping the army under control.

In 1994, in the aftermath of the October 1993 rebellion and shootout in Moscow, the army engaged in the biggest theft and sale of its own resources in world history. Particularly notorious was the Russian army of the so-called Western Group of forces, in Germany and the Baltic states. These units were to be withdrawn from a very comfortable environment into poor Russia. The officers were known to oppose the withdrawal and resent their return to Russia calling it a sellout of national victory in the World War II.

It was most likely a conscious decision by President Yeltsyn to allow them to steal as a way of keeping them busy and happy rather than angry, venting their frustration in scheming and plotting. Millions of dollars worth of hardware went for sale to obscure offshore companies through intermediaries with proceeds divided up among the army top brass including the Minister of Defense.²⁴ The President decided to corrupt the army to prevent a possible

coup d'état and as a convenient way to keep it under control. Shady deals could always be brought up as charges against any specific individual who would be disloyal to the President. Corruption in the Western group of forces was accompanied by a murder of a famous journalist who tried to investigate the shadowy deals, a murder that was never solved.²⁵

The rot went further. In the Far East military district, illicit deals involved admirals of the fleet selling sophisticated hardware to North and South Koreans. Military bases in Georgia had extraterritorial status and therefore were controlled by no one. Neither the Georgian nor the Russian authorities could check what was coming in or out of these bases. They quickly became notorious for shipment of illegal alcohol and drugs in and out of Russia.²⁶ Russian units in Tajikistan likewise very quickly became engaged in a booming drug trade.²⁷

The war in Chechnya in 1995–96 offered new opportunities for enrichment conveniently disguised as war losses. Ammunition was sold and written off. Any loss of property could easily be laid at the Chechen door. Women were raped and then declared to have been suspects in terrorism. Hostages were taken by the suspicious groups claiming to be Chechen and deals were arranged through Russian intermediaries like Berezovsky for their release for a ransom (Khlebnikov, 2000). A lot of people made a lot of money on the Chechen war and among them many top brass Russian officers and politicians.

The problem with Russian transition to market economy was that the entrepreneurial class evolved out of the Soviet apparatchiks.²⁸ These people knew best how to fulfill the plan and to report successes to the superiors. They were unsurpassed in cheating the state and milking their own enterprises out of their assets. They were not good in adapting to new conditions, developing new markets and acting in compliance with the law. Their aim was to grab and run.

Those officials who were less fortunate than the managers and who had no state assets under their custody to grab and privatize, felt cheated out of their fair share. If for example a factory manager could get control over the factory or a hotel manager could privatize the hotel with a little bribe, the general in the army could not as easily privatize his division. Ostensibly it still remained state property. However such generals still tried to extract as much revenue for themselves personally from their divisions. A common practice was to use the soldiers for construction projects, such as building houses for officers and country estates for corrupt generals.

What happened was that the nominally state-owned property was de facto privatized by the servants of the state. We call this process a privatization of the state.²⁹ Generals nominally were public servants yet they used their

soldiers as their slaves for their own benefit. Policemen at a street corner were nominally serving the city yet in fact they privatized their street corner and turned it into money making enterprise ripping off motorists by “fines” payable to themselves. On a much larger scale, police units began privatizing law enforcement by providing protection for favored customers. Police “protection” units were selling justice to the highest bidder. They became indistinguishable from the mafia protection providers. The country was rapidly turning into a criminal corporatist state.³⁰

After Yeltsyn’s election for the second term in 1996, fear that the hard-line Communists would stage a comeback receded. Many hoped that now an era of stability and real reform would commence. In fact what followed was a period of even more aggressive and unrestrained grabbing of national resources by the ever more powerful oligarchs.³¹ Several large conglomerates emerged controlling millions and billions of dollars worth of national resources. The heads of these conglomerates were known as oligarchs, meaning that they “owned” the President, and that he had to go along with the decisions they made. The President owed them a favor for their support during the election campaign. Yeltsyn was more and more becoming a hostage of the oligarchs he had created. They began to act like they really owned the plants and factories and mineral resources they had privatized. As time went on, they amassed immense fortunes, mostly stashed overseas, and began to flex their muscle in national politics. Boris Berezovsky and Vladimir Gusinsky, for example, acquired ownership of TV networks and newspapers.³²

In the summer of 1997, the oligarchs found themselves locked into a battle for the purchase of the largest company yet to be privatized in Russia, Svyazinvest, a telecommunications company. Two clans clashed in a bid to win the auction and the side that lost began to fight back against perceived favoritism to the other side. The second half of 1997 was known as the “war of the oligarchs”. Newspapers published all kinds of revelations about corruption, rigged auctions and pre-arranged privatization schemes.³³

Privileged banks and the crash of 1998

As Russia entered 1998, it would not be an exaggeration to say that the country was facing a serious crisis: instead of market reforms and democracy, instead of transition to market economy and rule of law, Russia was in the grip of criminal political networks worse than under the Soviet regime. These people were gangsters, thieves and outright mafia bosses. They made their money either by protection rackets or milking national resources or stripping assets of state enterprises. The President was mostly sick or drunk or willfully blind to the disintegration of his own state, demoralization of civil service,

decomposition of the army, degeneration of the police and criminalization of the entrepreneurial class (Bivens and Bernstein, 1998 and Jensen, 1999).

Factories were mostly idle, production was falling down with every passing month, wages and pensions remained unpaid for months and destitute population, as usual, was grumbling against the President's inner circle, the "family clan" and the favorites at the imperial court. With a little more astute policy the regime could have perhaps muddled through a little longer, but Yeltsyn had very little understanding about economy and banking (Glinski and Reddaway, 1998 and Ruble, 1998). He relied heavily on the advice of macroeconomists with their friends in Washington, the so-called, Chubais clan (Wedel, 1998, 1999). This, as it turned out, speeded up the collapse of the corrupt regime.

The key idea of the American macroeconomists was that in order for Russia to be able to receive Western loans, it had to show a stable currency. That would, so they maintained, stimulate production, investment and normalization of economic life. To keep the ruble exchange rate stable was only possible by offering ruble holders a better return than they would earn by holding foreign currency. And so, in 1995 and especially 1996, the government issued the, so-called, GKO's (Government short term bonds) at very attractive rates. Very quickly those were selling briskly at the world markets. The government was raising money, keeping the ruble stable and assuring more loans from the International Monetary Fund (IMF). All this was handled by a very special form of corruption – the privileged banks.

Those banks were privileged – and were called so – because they had the privilege of handling accounts of the Russian government. A particular bank handled the accounts of the Customs Office, another bank of the Ministry of Defense, and so on. Needless to say, these comfortable arrangements did not come free. The privileged banks had to pay for the privilege to those who had dispensed it for them. The key to understanding this arrangement is that the privileged banks had some extra cash which they invested in GKO's. The returns were phenomenal. By the summer of 1998 the return on the GKO's was sixty percent going to over a hundred percent. The only way the government could afford to pay such interests for its GKO's is by borrowing more money from the IMF.³⁴ With a new loan, the money would be spent on what was called the "stabilization package" i.e. financing the high yield GKO's.

IMF would later claim that its loans were never stolen. Yet, what actually happened amounted to a transfer of IMF funds to favored banks as well as to Western investors who made a lot of money on Russian GKO's. The loans were spent on supporting the ruble and/or the high interest rates. Theft was disguised as "supporting the ruble" policy. The government was borrowing money from IMF, and the Central bank along with favored banks were spend-

ing these funds on paying high interests for the bonds the government printed. This was a pyramid scheme that was bound to collapse before long.³⁵ The GKO money making enterprise got so profitable for the favored banks that the government itself in the form of its Central Bank was playing on the GKO market via a Paris based subsidiary of the Central bank, the infamous Fimaco (Financial Management Company).³⁶

To any economist, especially to those of the IMF, it should have been perfectly clear that a country where production, productivity of labor and standard of living were falling and capital investment was frozen could not possibly pay a hundred twenty percent interest on its bonds. And yet, in July 1998, Anatolii Chubais in his capacity as Russia's representative to the IMF went to Washington and, as a result, Russia received four billion dollars new credit from the IMF, as a part of the huge 22 billion package. The money disappeared and has not been traced to this very day. The Chamber of Accounts claimed later that the money was stolen. The IMF insisted that it was not. Chubais himself said in an interview that the IMF was screwed out of four billion dollars. Most likely the money went to the privileged banks in the form of interest payments for their GKO's.

As it turned out, this was the last scheme the oligarchs were able to pull off. In mid August a meeting of oligarchs with the Prime Minister – later called the “blue jeans meeting” – took place. The then Prime Minister Sergei Kirienko, Chubais, a powerful magnate Vladimir Potanin, and a few other people were said to have been present. It was clear that the government had no money. Default was inevitable. Russia could no longer maintain the exchange rate or pay the high interest on the GKO's.

The prospect for most Russian privileged banks were indeed grim. They had borrowed from Western banks in hard currency in order to buy GKO's in anticipation of enormous returns on their investment. Now that it was certain that no GKO profits were forthcoming, they had to repay Western creditors. Moreover the Central bank had to pay to the foreign holders of the GKO's. It is important to keep in mind that it was not the President or the Prime Minister who made the decisions. It was the oligarchs who dictated policy to the government. But the government had no money and could not save the banks. All it could do is to declare a moratorium for 90 days and smooth over the transition to bankruptcy. During the moratorium the privileged banks got a favor from the government one more time at the expense of the treasury. While being in fact bankrupt, favored banks took new loans from the Central bank backing these loans with worthless GKO's as a collateral. Foreign holders of GKO's were excluded from this operation. They were allowed to just lose their money invested in worthless GKO's (Hedlund, 2001). The privileged

banks used that time very well and stashed away whatever funds they had, ruining their depositors.

As a result of the 17 August 1998 debacle, prices went up 100 percent. Most Russian banks were bankrupt, economy went into a free fall, the ruble rate of 5,000 to a dollar went to 30,000 to a dollar, devaluing six times over. The cause of that calamity was of course the Russian crony pseudo-capitalism with its corruption and speculation rackets. Privileged banks, speculators posing as reformers in government, a habitually drunk, sick and incompetent president, crooks running financial pyramids in privileged banks – all these parties had their share of responsibility. The West and especially the IMF was complicit in this as well. Western leaders kept pumping more money into non-performing unreformed and utterly corrupt Yeltsyn regime, misleading Western private investors and helping the Russian thieves in ruining the Russian economy.

Already at that stage it was clear that Yeltsyn's tenure as President would not last long. He realized that and panicked by appointing Evgenii Primakov as Prime Minister, a person with solid Soviet credentials and a reputation of being patriotic and uncorrupt. In a matter of months investigations started into the misdeeds of the oligarchs, especially of Berezovsky and those known to be the closest associates of the "imperial" family. The family clan fought back vigorously by unleashing a sex scandal against the Prosecutor General Yurii Skuratov and by forcing the President to sack Primakov in May of 1999.

As soon as the new Prime Minister Sergei Stepashin showed a slight sign of independent judgment, he was sacked too, in the summer of 1999. The next prime minister was a young man unknown to the public, a director of the FSB, known to be loyal to the President – a forty something Vladimir Putin. Before the year was out Yeltsyn was forced to resign and unscheduled presidential elections were held in the spring of 2000.

Putin takes over

Putin stepped into Yeltsyn's shoes as a loyal servant, as a master spy who was supposed to defend the family and its holdings and protégées. Nothing was supposed to change and nothing did change in the year 2000. Putin marked his presidency by a brutal assault on Chechnya, thus establishing for himself credentials of a tough and resolute nationalist.

Yet in 2001 little by little Putin's agenda was slowly being unveiled. Within a year, a money laundering law was passed, a land bill was adopted, the labor code was passed, the criminal procedure code was accepted by the Duma, the jury-based court system was established, and a steady and mounting pressure on the oligarchs was launched. They were made to understand that they would

no longer dictate to the President. If they wanted to survive, the theft of national resources had to stop. Some oligarchs were simply banished and their possessions taken over by companies loyal to the Kremlin. Others quickly realized that they better start cooperating and restructure their patterns of skimming off the state.

Putin was deliberately slow and avoiding to produce an impression that something was going to change. He repeatedly assured the oligarchs that no reconsideration of the privatization was going to take place. And yet, in fact, that was exactly that was going on. Notorious cases of privatization were given close scrutiny and the biggest exporters of national resources, such as Gasprom and the oil companies, were forced to replace their management and to establish more transparent procedures of their accounting and business operations.

Skeptics still maintain that Putin is simply establishing a strong Russian state after a decade of disintegration and corruption. Skeptics still doubt that real gains would be made for human rights and democracy-building in Russia. Putin supporters, on the other hand, point out that the real reforms have finally commenced and that more have been done in two years of Putin's rule than in the preceding ten. Whether the glass is half empty or half full, first steps in the fight against corruption have clearly been made. Nevertheless, in view of the past record, established habits and behavior patterns of the Russian elite the transition to law based society would be long and difficult at best.

Notes

1. This article is based on my extensive archival research and the relevant literature.
2. For a discussion of corruption and good governance, see Henderson, 1998 and Hanson, 1998.
3. On corruption in Nigeria, see Okonta, Duglas and Okanta, 2001.
4. "Telephone justice" is an expression defining the practice in Communist countries when justice was dispensed by a telephone call from party officials to the police and court functionaries.
5. On allegations of corruption of Defense Minister Pavel Grachev, see Fedarko, 1994.
6. For the latest examples, see several American court cases launched by US companies claiming to have been defrauded by Russian partners and cheated out of their assets or investments. See Harper, 1999.
7. Of the vast literature outlining accomplishments of Socialist construction in Russia, see Rosenberg, 1984 and Stites, 1989.
8. For the definition of cultural practices, see Chartier, 1995. On culture and values, see Harrison and Huntington, 2000.
9. On peasant attitudes and cultural practices see Frierson, 1993.
10. A local communist council.
11. The GPU (Secret Police) reports to Stalin came out monthly under a general title *Political Situation in the USSR*. Only 32 copies were made, each numbered and intended for a

- specific individual in the top party state leadership. Stalin compared these reports with the reports from the chiefs of the province party organizations. For a detailed discussion of the procedure, see section “Who Knew What,” in Brovkin, 1994: 58–59.
12. For a discussion of continuity of Soviet corruption, including under Stalin, see Loskutov, 2000.
 13. See Los, 1988 and her numerous articles and book chapters and articles, e.g., Los, 1987.
 14. shadow economy Glinkina
 15. second economy literature – Coulloudon, 1998.
 16. For a positive assessment of the creation of the market economy in Russia, see Aslund, Shleifer and Treisman, 2000. For a critical assessment, see Gatty, 1998.
 17. On vouchers, see Supyan, 2001.
 18. On allegations of corruption of Rail Minister Aksenenko, see *Pravda. Ru* (30 October 2001).
 19. For a discussion of organized crime formation, see Shelley, 1998.
 20. On allegations of corruption in Gasprom and Itega, see Levyveld, 2001.
 21. All this came up only thanks to litigation in British and Swiss courts over a breach of a contract to a third party. See details in *Mealey's International Arbitration Report*, 1998.
 22. For a discussion of the composition of 12 billion dollar capital flight estimate, see Brovkin, 2001. For a discussion of various estimates, see Gvozdeva, Kashturov, Oleinik and Patrushev, 2000. See also Brzezinski, 2001.
 23. For a discussion of aluminum war, see Sergeyev, 1997.
 24. On the ills of Russian army, see Busza, 1999 and Herspring, 1999.
 25. On murders for hire, see Nomokonov and Shulga, 1998.
 26. On corruption in Georgia, see: www.nobribes.org.default.htm
 27. On corruption in Tajikistan, see: www.reliefweb.int
 28. There is a substantial body of literature documenting this, including Nelson and Kuzes, 1998.
 29. For a detailed discussion of this concept, see my earlier article, Brovkin, 1998, and Shelley, 1997.
 30. The term criminal corporatist state appeared in the Center for Strategic and International Studies (CSIS) report, see: *Russian Organized Crime and Corruption. Putin's Challenge*. (CSIS: Washington, DC, 2000).
 31. For a detailed discussion of this period, see Brovkin, 1997.
 32. For a discussion of the career of Berezovsky and other oligarchs, see Coulloudon, 1998 and Graham, 1999.
 33. On the war of clans, see Coulloudon, 1998.
 34. For a relationship of Russia and the IMF, see a critical assessment by Hedlund, 2001.
 35. One of the first to expose the scheme before the August 1998 crash was the auditor of the Chamber of Accounts, Veniamin Sokolov, see Sokolov, 1998.
 36. On the Fimaco scandal, see Cohen, 1999.

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