

Security and Rule-Enforcement in Russian Business: The Role of the "Mafia" and the State

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The inability of the Russian state to enforce property rights and protect private entrepreneurs has been a major obstacle to economic growth. As the state became weak and lost its grip on justice and enforcement, alternative agencies emerged and took over these functions. But the competition between various criminal, private, and quasi-state agencies that offer protection and enforcement services has proven economically inefficient. Nor has it improved internal security and stability. However, several important shifts that have occurred in this realm over the last three years or so have made it possible to achieve a major reconfiguration. Analyzing these shifts, this memo suggests that improvement of state law enforcement capacity should now become the main priority.

Institutional Failure

The transition from the state-controlled economy to the free market may be understood as involving two major "moves." "Move A" is the transfer of economic assets into private ownership and the removal of price controls; and "move B" is the creation of institutions for registration, transaction and protection of private property and the enforcement of rules defined by these institutions. While move A implies a withdrawal of the state from direct management of the economy, move B reintroduces the state in a different role: it sets the rules, arbitrates disputes and enforces property rights. This process of institution-building involves the adoption of new laws and rules of action, and the reform of the system of arbitration courts and of police and security organs. Although the accomplishment of move B takes a much longer time, it is essential that both moves proceed simultaneously.

From the beginning of Russian reforms in 1987 up until 1997, the dominant ideology and policy laid the major emphasis on move A, almost ignoring move B. The liberalization of prices and privatization of assets were accomplished quickly and without adequate effort to create efficient institutions for the protection of private property and its orderly transactions. As the speed of liberalization was greater than that of institution-building, the emerging markets spontaneously developed alternative mechanisms of protection and enforcement. These involved various private groups and agencies that managed organized force: criminal groups, private protection companies, informal groups of state security employees, and various semi-autonomous armed formations attached to the state

"power" ministries. In the mid-1990s up to 70% of all contracts were enforced without any participation from state organs.

Criminal Groups

Since 1987, when the first cooperative and private enterprises emerged, criminal groups started to exact tribute from private business. The state police organs were reluctant to offer protection, not least because of the initially negative attitude towards private entrepreneurship and the lack of relevant laws and procedures. The core of these new criminal groups consisted of former sportsmen whose physical skills and respect for discipline made them particularly suitable for violent entrepreneurship. As extortion became regular, it turned into a protection racket--the collection of tribute on behalf of a criminal group that, in exchange, claims to offer physical protection from other such groups. But as the private sector expanded and the intensity of business transactions grew, criminal groups became engaged in more sophisticated activities such as debt recovery, contract enforcement, dispute settlement, and negotiations with state authorities concerning registration, export licenses, tax exemptions and the like.

In the early 1990s the number of criminal groups grew proportionate to the growth of the private sector of the economy. According to official statistics, their number rose from 952 in 1991 to 4,300 in 1992 and to 5,691 in 1993. By comparison, this figure was only 50 in 1988. These groups became the source of danger and entrepreneurial risk, and proceeded to exact tribute for the selective removal of the danger. On the other hand, a set of factors generated independent demand for a variety of enforcement services. Insufficient business experience and the propensity on the part of many businessmen for dishonest conduct increased business risk and lowered the level of trust. Due to the poor definition of property rights, the inefficiency of the state courts of justice (gosarbitrazh), and their incapacity to enforce decisions, the official institutions were practically incapable of resolving disputes and tensions. Private enforcers proved more competitive.

In the beginning, criminal groups did not aspire to participate in economic activity. They simply received a fixed amount of tribute, mainly from small and medium-size companies in wholesale and the retail trade sector. Later, in the beginning of the 1990s, they changed tactics, interfering in the management of enterprises under their protection, or purchasing shares and introducing their representatives into the board of directors.

But as criminal groups attain close control or ownership of economic enterprises, they become constrained by certain rules of economic action and begin to adapt to the emerging business culture. In the late 1990s many criminal groups and their leaders acquired economic assets. This compelled them to adopt more rational and risk-adjusted ways of behavior. Now they are evolving toward becoming legal business enterprises that play by formal rules and engage in capital investment and charity. For example, the most powerful criminal group in the St. Petersburg region, Tambovskaya, invested in the oil business and created a large holding--Petersburg Fuel Company (PTK). The leader of the group became its vice president. Most of the notorious criminal leaders who have

managed to survive have turned into respectable capitalists with political aspirations--including the owner of Krasnoyarsk Aluminum Factory, former boxer A. Bykov, as well as Moscow entrepreneur S. Mikhailov (the founding leader of the Solntsevskaya criminal group).

Private Protection Companies

After the adoption in March 1992 of the Law On Private Protection and Detective Activity in the Russian Federation, legal private protection companies--set up by former state security and enforcement employees--entered into direct competition with criminal groups in the market of private protection and enforcement. The law defined the forms of activity and basic rules of the new business. It is private protection companies rather than criminal groups that are now key players in the domain of security and enforcement.

This new development followed the reform of the KGB, the Committee for State Security, in 1991-92 (now known as FSB, the Federal Security Service). In the course of reform the KGB was fragmented and reduced. Over 20,000 officers left or were discharged between September 1991 and June 1992. More security officers left after the crisis of October 1993, including members of the special elite units Alpha and Vypmel. In 1992 President Yeltsin ordered that the 137,000-strong central apparatus of the former KGB be reduced in the process of restructuring. Consequently, 11,000 had to leave state security permanently. Comparable reductions occurred in the Interior Ministry (MVD).

The majority of those who left the state security and enforcement organs found new employment in the growing private security sector. In 1998, of the 156,169 licensed private security employees in Russia 35,351 (22.6%) came from the MVD, 12,414 (7.9%) from the KGB/FSB, and 1,223 (0.8%) from other security and law enforcement organizations. They occupy key managerial and analytical positions in the business. As a whole, the existing 10,800 private security agencies have absorbed nearly 50,000 former officers of the state security and law enforcement organs.

The Growth of Russia's Private Security Industry, 1992-1998

	1992	1993	1994	1995	1996	1997	1998
Private Protection Companies	0	1,237	1,586	3,247	4,434	4,705	5,650
Private Security Services	0	2,356	2,931	4,591	5,247	4,973	4,720
Private Detective Agencies	0	947	2,088	149	182	809	434
Total Number of Agencies	0	4,540	6,605	7,987	9,863	10,487	10,804

Professional training, active use of business information analysis, and ties with state security and police organs are the main competitive advantages of private protection companies. They have formed a number of professional associations and adopted sophisticated marketing methods in order to establish a business reputation and attract clients. The state supervising authorities, in turn, have tightened their control, applying sanctions to companies that break the rules or are known to cooperate with criminal groups. The bulk of large banks and enterprises are now using the services of private protection companies or their own security divisions. This has narrowed the operational field of criminal groups, forcing them back into traditional spheres of activity. Private protection companies are gradually becoming the major security option for Russian and foreign businessmen operating in the legal sector of the economy. On the whole, the state policy of legalization of private protection agencies has led to the emergence of a market for security and enforcement services. It has also had an unintended anti-criminal effect.

General Trends

The evolution of the private security and enforcement sector over the last decade involves the following developments:

- The main business of Russian organized crime has been illegal enforcement of contracts and property rights for its own gain, taking advantage of the incapacity of the state to maintain order in Russia's emerging market.
- The crisis of the state and the concomitant downsizing of the state security and law enforcement organs was followed by the rapid growth of the legal business of private security and enforcement. Private agencies, set up by former security and police officers, gradually took over large segments of the market of private protection and enforcement and weakened the positions of crime syndicates.
- The elite of the formerly powerful criminal groups has accumulated substantial capital and now seeks compromise with official authorities badly in need of investments. The formula is: "we respect the law and invest money in the legal economy; you let us be."
- Members of the lower strata of criminal groups are becoming obsolete and losing their jobs. Criminal leadership turns out to have been a means of rapid social advancement within the span of one generation. As a result, the formerly powerful Russian mafia is failing to reproduce itself as an autonomous system and is bound to fragment.
- All this has created momentum for the state to step in and intensify the enforcement of law and order. The probability of success for such a policy today is higher than before because powerful groups in the economy and the state are beginning to see the benefits of stable rules. Given its double dependence upon the rules of the economic market and state regulations, the private security sector is also likely to support rather than oppose such a policy.

Policy Recommendation

If Western aid to Russian reforms still has even a slight chance of remaining on the current policy agenda, then supporting law enforcement in Russia should become priority number one. Efficient law enforcement has long been the missing element of Russian reforms. Today it has a greater chance of being introduced by state authorities and accepted by society--due to the growing determination of the former and demand of the latter. A comprehensive program of support should have as its goal the increase of efficiency of central and especially local organs of justice and enforcement. This could involve personnel training and legal consulting, as well as direct financial support. In the context of the sweeping accusations against Russia's leadership of involvement in massive corruption, who, if not the law enforcement organs, are to ensure that Western aid is not appropriated for private needs?

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