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## Mafia Capitalism or Red Legacy?\*

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Russia is experiencing an organized crime epidemic. Its interior ministry says there are now more than 9,000 criminal organizations operating inside the country, employing nearly 100,000 people, or about the same number as the U.S. Internal Revenue Service. The Analytical Center for Social and Economic Policies, a government sponsored think tank that reports directly to Russian President Boris Yeltsin, estimates that four of five Russian businesses pay protection money. They also report that more than eight thousand Russians have mysteriously vanished from their homes, which have become lucrative pieces of real estate since the collapse of communism.

American news accounts of Russia's organized crime epidemic, however, continue to erroneously suggest that criminal operations there are an "extreme form of capitalism." Journalist Adrian

Kreye, for example, says Russia is experiencing a "mafia capitalism" that is based on "the dollar and the law of the fist", and Reuters reports that "threats and murders have become commonplace in the wild atmosphere of post-Soviet capitalism." More subtly, the Washington Post blurs the distinction between legitimate business and organized crime with talk of criminal "conglomerates" and "mergers."

Other observers hold that organized crime in Russia is simply an "early stage" of capitalism.

"Today's corruption," writes Cornell University professor Michael Scammell, seems "characteristic of a period of profound change and upheaval, when Russian society is in the stage of the primitive accumulation of capital." And Stephen Handelman, author of *Comrade Criminal: The Theft of the Second Russian Revolution*, reports that many Russians believe "that a period of lawlessness is part of the price every society pays" for capitalist development.

But organized crime in Russia is neither a "form" nor a "stage" of capitalism. Instead, it is a direct legacy of years of all-pervasive bureaucratic control and an economy that was forced underground.

### All-Pervasive Government

It was the presence of government control everywhere in Soviet life that provided the original opportunity for the institutionalization of widespread bribery and extortion. Indeed, Soviet bureaucrats could, and did, demand payment or favors for everything from drivers' licenses and consumer goods to medical care and higher education.

Moreover, bureaucratic corruption and favor trading meant that there were no uniform laws to live by. Instead, Russians encountered rules and requirements that varied from bureaucrat to bureaucrat and government ministry to government ministry. The result was that the Soviet Union functioned, not under the rule of law, but under the arbitrary rule of bureaucrats.

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Today, Russia is paying its failure to establish the rule of law. Faced with rampant crime, many Russian businesses are forced to take matters into their own hands and hire private security agents and bodyguards. One security-service provider says Russian businesses have little choice but to recruit their own security forces. "They do not trust the state. If they relied on the state, then you wouldn't see them riding around Moscow in a convoy. I laugh when I see five businessmen; they usually have 25 bodyguards." Officially, there are now ten thousand private guard services registered in Russia, but experts say there may be as many as three times that number.

The lack of faith in the Russian government's ability to enforce the rule of law is not limited to the business world. In 1996, a jailed Russian mobster testified before a U.S. Senate subcommittee that Russian hockey players in the National Hockey League, including Alexei Zhitnick, were targeted by the Russian mob for extortion. The witness claimed that when Zhitnick was confronted with the mafia's demands he did not go to the Russian authorities. Instead, he "went to a more powerful criminal group to take care of the problem." According to Zhitnick: "The cops can't do any-thing. No rules. No laws." Many Russians share Zhitnick's bleak view of the Russian government's ability to enforce the rule of law.

### **Underground Markets**

The underground markets that communism created are another source of Russia's organized crime problem. Shortages of consumer and producer goods in the Soviet era provided the opportunity for additional income at all stages of commerce. Goods arriving at retail stores were often set aside for preferred customers who paid extra. Those who controlled the distribution of goods, housing, indeed almost everything, were often in a position to extract additional payments from consumers. "Illegal private economic activities;" reports economist Gregory Grossman of the University of California at Berkeley, were "a major and extremely widespread phenomenon," and for a large part of the Russian population, "a regular, almost daily, experience."

It is no accident, then, that many members of today's criminal class are current or former government officials. The 1960s saw crime networks forged in Russia based on the ability of the criminal underground to provide Soviet officials with

consumer goods and services unavailable under the communist regime. As Mikhail Gorbachev liberalized the economy in the early 1990s, Russian organized crime retained its links to government officials and many former police and intelligence agents joined the Russian mafia after the collapse of communism. Several recent books published inside Russia support this account. *Mafia: Unannounced Visit* by interior ministry official Vladimir Ovchinsky describes the intertwining of the corrupt state bureaucracy and the criminal under-world, especially during the last years of communist rule. In *Thieves in Law*, Georgy Podlesskikh and Andrei Tereshonok expose how organized crime and the Russian government are tied to each other. Based on internal KGB documents, they show that Soviet officials influenced and sometimes supervised organized criminal activities.

Today, no level of government is immune from criminal infiltration. Take the case of Gregori Miroshnik. Imprisoned four times, he was widely considered a dangerous criminal. But in 1991 he somehow became the economic adviser to Russia's vice president. When asked where he found his advisers, the vice president said that he was too busy and couldn't check everyone's resume-

As one frustrated former Moscow prosecutor summarizes Russia's organized-crime problem: "The main way the mafia penetrates into the economy is via the bureaucrats. They are our main enemy. The mafiosi are only the second enemy."

### **Criminal Catalyst**

The Russian government's reluctance to give up further economic control is the single greatest catalyst to organized crime. Indeed, many Russian businesses turn to mafia groups to evade excessively high taxes and overly restrictive regulations. The growing scope and power of Russian organized crime is thus partly attributable to the continued existence of heavy government burdens on private economic activity. Reforming the tax regime and reducing the regulatory burden would be two of the most important steps the Russian government could take to bring its organized-crime epidemic under control.

The types of crime being committed in Russia also illustrate the need for further privatization and red-tape cutting. Indeed, most serious organized crime in Russia is not based on "traditional"

forms of illegal activity, such as prostitution or stolen-car rings; it is instead intertwined with state-owned enterprises and resources. "It's [a] serious economic operation," writes Igor Baranovski, a reporter for Moscow News, "playing games on the exchange rate. Half-legal operations selling oil." Large-scale crime in Russia often means selling government resources that nobody really owns. Billions of dollars of government-controlled resources -everything from aluminum to gold to fishing rights- has been sold for illicit private gain.

Government ownership is not the only factor that leads to corruption: excessive bureaucratic interference with commercial activities turns otherwise legitimate businessmen into criminals. At both the federal and the local level, the Russian government levies a daunting array of license, permit, and fee requirements on normal business activity. Rather than dealing with those government-created obstacles, businesses often choose to avoid official red tape by paying less costly and more expeditious bribes. According to the director of a large Moscow bank, government officials who issue licenses and permits "practically have a price list hanging on the office wall." A recent study of neighboring Ukraine, a former Soviet-run state, found that small businesses in Kiev spent an average of \$2,000 a year on such under-the-table payments, whereas official fees amounted to about \$12,000. The mafia often plays the role of middleman in these situations, facilitating transactions between businessmen and corrupt government officials.

Burdensome customs procedures have also made Russia into a nation of smugglers. The Washington Post reported that smalltime importers who travel by every means imaginable now carry out a quarter to a third of Russia's foreign trade. Those "shuttle traders" must routinely engage in extensive illegal activities. Quasilegitimate Shipping companies charge a fee for handling paperwork, customs negotiations, and dispensing bribes. Attempts by the federal government to stiffen customs requirements have only resulted in a greater demand for illegal facilitation services.

During the summer of 1995, such activity was observed firsthand as one of us traveled from Turkey to Russia on a mafia-owned passenger bus. Except for his party, the only "passengers" on the bus were color televisions, car batteries, and friendly gun toting mobsters. The actual border crossing consisted of a quick payoff to a uniformed official followed by a bumpy ride through a dry creek bed. On boarding the bus, the customs official cheerily announced, "Good morning, mafia! Passports please mafia!" Without high tariffs and labyrinthine customs procedures, such border crossings would not be necessary.

## What Is to Be Done?

Far from being a "form" or a "stage" of capitalism, organized crime in Russia is a direct threat to capitalist reforms.

Widespread violence and crime in Russia have begun to generate nostalgia for authoritarian rule. Flagrant lawlessness has resulted in a resurgence of politicians who promise to reestablish order and fairness by using the brute force of government. Increased criminal activity fueled the backlash that contributed to ultranationalist Vladimir Zhirinovskiy's electoral success in 1993. Zhirinovskiy's platform included on-the-spot execution of criminal gang leaders by firing squad and the wholesale seizure of assets thought to belong to criminals.

Moreover, rampant theft, fraud, and extortion have rendered property rights meaningless to many Russians, and without credible property rights, ownership will not facilitate investment and economic efficiency. Adam Smith made that point more than two hundred years ago. Owners, he said, have strong incentives to eliminate waste and maximize the value of their property, naturally seeking "the most advantageous application of every inch of ground upon [their] estate." Insecure property rights not only remove the incentives to improve one's property but also discourage the purchase of new property. Indeed, as political scientist David Weimer clearly explains in his new book, *The Political Economy of Property Rights*, "the greater the perceived risk of losing existing property rights, the less likely the holders of those rights will be to forgo current consumption to accumulate property."

As Russia shows, excessive taxes, regulations, and state ownership of property, coupled with a legacy of all-pervasive government control and an economy that was forced underground, lead to rampant corruption and crime. The role of the Russian state is vital to bringing that crime under control, but it must be limited in scope. Continued privatization and liberalization will render most

criminal activity unprofitable, but such reform must be accompanied by changes in the police and legal system. Russia's private businesses are plagued by the inability to legally enforce contracts. Laws are often conflicting, and police departments cannot be relied on to provide protection from physical harm. Russian lawmakers must clarify contract laws. In addition, police salaries should be increased to limit incentives for corruption.

In short, what Russia needs is not "more government" or "less capitalism" but a greater commitment to fulfilling the core tasks of liberal governance: the prevention of harm and the protection of property rights. Just as important, privatization, tax relief, and deregulation must be more vigorously pursued. Continuing failure in those areas will jeopardize the long-term viability of Russia's capitalist reforms and expose it to financial crisis.