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This thesis is dedicated to my beloved parents, Sophia and Genady. For their endless love, support and encouragement

**THE POLITICAL ECONOMY OF ORGANISED CRIME  
IN RUSSIA:**

**THE STATE, MARKET AND CRIMINALITY IN THE  
USSR AND POST-SOVIET RUSSIA**

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A dissertation submitted for the degree of Doctor of Philosophy

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## **ABSTRACT**

This thesis investigates the origins, development and role of organised crime in Russia's political economy. The existing academic literature tends to regard the post-1991 era of transition as the hotbed for the emergence and development of organised crime in Russia. This thesis finds such readings problematic and incomplete. I identify and explore three salient periods of political-economic development during the history of the USSR and post-Soviet Russia, and find that each of them was distinct, yet crucial in enabling the growth and functions of organised crime. Moreover, throughout history, the state and organised crime in Russian functioned in close cooperation with each other. This study reveals that the Russian state and organised crime have always been interdependent, and that concentrating solely on the post-1991 era is profoundly misleading.

## INTRODUCTION

Is the Russian state run by a mafia? Is the Russian political system best described as a kleptocracy? A brief glance at the sections devoted to ‘Current Affairs’, or ‘International Politics’ in most bookstores in London, New York or Paris would give an unmistakable answer to these questions. Since 2000, the Russian President Vladimir Putin has presided over a mafia state, whose methods of operation include predation on private businesses, international espionage, and also various conspiracies, including conspiracy to murder on national and foreign soil. Existing academic consensus on this question also seems unequivocal: Russia is likened to a mafia state on Wikileaks and in academic literature (e.g. Dawisha 2015).

I find such arguments to be highly limiting. Corruption, the rule of hand-picked elites and a distinct lack of accountability are indeed the key structural problems of Russian political economy today. Yet the presence of criminality in the governance structures of the country long preceeded the reign of Vladimir Putin. In fact, it even predates the introduction of capitalism into the country.

This thesis analyses the political economy of Russian organised crime and aims to understand its relationship with the Russian state, throughout the Soviet era and the post-1991 history of Russia.

## **1. Organised Crime: a complicated issue**

Over the last 25 years, the academic community, law enforcement agencies and the public have become increasingly alarmed about the increase in organised crime throughout the world. Of particular concern has been the role of public officials in colluding with criminals, in numerous instances of financial fraud, political killings, trading in human organs, weapon and drugs, and the appropriation of state resources. The recent release of the Panama papers provides an insight into the use of offshore companies by the world's dictators, business tycoons and criminals, in order to conceal wealth, evade taxes and commit fraud. Although collaboration between state officials and criminals is hardly novel, its scope, impact and frequency seem to have increased over the last decade. Some commentators have suggested that global stability itself is threatened by the mounting interdependence between profit and power (Freeman 2009; Dobriansky, 2001).

The globalisation of markets and the spread of criminal networks have inspired academic attempts to study organised crime and its threats to the global order. Academic research has begun to shed some light on the nature and extent of organised crime. It has certainly exposed the inaccuracy of the public perception of the phenomenon<sup>1</sup> (see e.g. Adler 1985; Passas 1999a; Duyne et al. 2001). However, it has also added to the perplexity, by generating myriad contradictory conceptualisations and definitions, with regard to even basic research issues. This is because “a broad range of people, structures and events are in varying degrees and combinations subsumed under this umbrella concept” (Lampe, 2002, p.189), meaning that it is very difficult to even agree on the core terminology (see Williams, 1998).

Many prominent scholars in the field of organised crime critique the definitional ambiguity of the phenomena. Abadinsky (1981) claimed that all “12 articles published in the Annals of the American Academy of Political and Social Science (1976) do not propose a proper offered definition of organised crime” (p.52). This complaint is echoed by Frank Hagan (1983), who asserts that “[o]rganised crime has often been described

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<sup>1</sup> The generally held view is that organised crime is synonymous with mafia-style organizations.



and discussed, rather than defined” (p. 52) and criticises the failure of social scientists, legislatures, law enforcement agencies and the general public to adequately define organised crime. Finckennauer (2005) stresses the importance of defining organised crime as a prerequisite to “determining how laws are framed, how investigations and prosecutions are conducted, how research studies are done, and, increasingly, how mutual legal assistance across national borders is or is not rendered” (p.68). G. Robert Blakey, the Chief Counsel of the Subcommittee on Criminal Laws and Procedures, addressed the issue of legal definitions quite boldly: “[there are] no generally applicable definitions of concepts of ‘organised crime’, ‘corruption’, ‘racket’, ‘racketeering’” (President’s Commission, 1986, p. 511). In fact, although there are about 180 definitions<sup>2</sup> of organised crime, none of them are universally accepted.

The lack of definitional precision surrounding the concept of organised crime has led some to argue that “analytical sharpness is hard to find” in the academic investigation of organised crime<sup>3</sup>. This not only presents significant theoretical and empirical problems, but is also of practical concern; what van Duyune calls the “conceptual chaos” (Duyune, 2005) befuddles the attempts by policy makers to initiate programmes aimed at its eradication.

The vagueness and elusiveness of the concept of organised crime stem from the various explanatory approaches. They range from the criminological, biological and neurobiological to the psychological, political, and economic. From a criminological perspective, for example, the first and essential point of interest in researching organised crime is the determination of its nature and extent. This perspective draws on connections between rising crime and the rapid pace of change in social structures and values. This view aims to account for particular moral characteristics that are responsible for the emergence of organised crime (Gleason, 1990), and is expressed in the criminological theory of Durkheim (1951), Sutherland's theory of white collar crime

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<sup>2</sup> Klaus von Lampe collected 180 definitions of organized crime, <http://www.organized-crime.de/organizedcrimedefinitions.htm>

<sup>3</sup> Research Project ‘AOCRC’, 2007

(Sutherland, 1983), and in Hirsch's analysis of the role of social morality in regulating economic activity (Hirsch, 1976).

This view associates certain group traits with a predilection for criminal involvement, and suggests that the representatives of these groups are opportunistic individuals who actively solicit criminal collusion with public officials. These groups are often highly traditional; hierarchically structured, self-disciplined and closed to outsiders. Advocates of this view equate organised crime with the Mafia, and focus on the persistence of tradition in order to explain the origins of organised crime. Law enforcement agencies tend to be primarily concerned with an assessment of the threats posed by these criminal groups.

Psychologists centre their investigative efforts on obtaining answers to such questions as why some criminals engage in *organised* crime whereas others prefer to perpetrate crimes individually. Sociologists apply structural approaches, focusing on the structural aspects of an economic system, and the incentives they provide to engage in organised crime. They typically cite social injustice as a key factor in the emergence of organised crime. Transitologists tend to focus on political, cultural and economic changes as contributions to the emergence and development of organised crime, such as new business opportunities, ineffective regulatory policies, the disregard of laws and regulations, and periods of transition from autocratic to democratic regimes. Other key factors include periods of political and economic instability, and the impact of attempts by specific nations to dominate the international political arena.

### **Scholars and academics on the conceptualisation of organised crime**

In addition to those generated by legal agencies and state policy makers, there are a plethora of highly varied academic opinions on how to define organised crime. There is certainly no agreement amongst American academics that use different approaches, and apply different lenses and perspectives, to the problem of organised crime. These diverse perspectives are often indicative of different political leanings, and might even incorporate business strategies. Views on how to understand organised crime are therefore conceptually divergent. As Woodiwiss (2003) clearly put it “[d]epending on their political inclination, contemporaries could have applied [the concept of organised crime] to the schemes of the rich or the poor” (Woodiwiss, 2003, p. 4). This view is

reflected in the 'Report of the Society for the Prevention of Crime' by Parkhurst who was the Chair of the Commission "... the rich policy-men go on becoming richer and the poor men, whom they rob, go on becoming poorer" (Woodiwiss, 2003, p. 5)

One speculative view suggests that two attributes inform the nature of organised crime; criminal acts/activities, and criminal individuals/groups. The proponents of this approach use these two features interchangeably in defining organised crime. However, one way or another, this approach to organised crime is predominantly descriptive. It employs observation as a method to identify clearly discernible features that are claimed to be defining characteristics of the nature of organised crime.

This view of criminal acts and criminal activities was outlined, for instance, by Maltz (1976) in his early definitional debates on the nature of organised crime. He claimed that criminal acts best define the phenomenon of organised crime. He linked acts to typologies and suggested that defining the typologies would determine the nature of acts. This, according to Maltz, helps with the conceptualisation of organised crime. He proposed an interesting view on the construction of typologies, distinguishing means from objectives and manifestations, and speculated that the conclusive element in the typology of organised crime phenomena is not the means by which crimes are committed (violence, theft, corruption, economic power, deception, and victim collusion), but also the broader objective of the organised crime, including, for example, political and economic power. The manifestations of political and economic power become apparent through acts (Maltz, p.341). For example, the use of violence in order to obtain economic power (through illegal business) manifests itself in such acts as extortion and racketeering. Extortion and racketeering in this instance are conceptualised as organised crime. Or, to put it in a more focused manner, in this case organised crime is considered as a certain type of committed criminal act (extortion and racket) characterised by a definite level of violence, with the objective of gaining economic power. Maltz concluded that "...organised crime consists of acts, not groups" (Maltz, 1976, p. 342).

### Typology of organized crime based on Maltz's definition

MEANS	MANIFESTATION				
	ECONOMIC OBJECTIVE			POLITICAL OBJECTIVE	
	MANIFESTATION			MANIFESTATION	
	Through common crime (mala in se)	Through illegal business (mala prohibita)	Through legitimate business (white-collar crime)	Through the existing order	Against the existing order
<b>Violence</b>	Predatory juvenile gang. Hijacking gang	Gang wars for control of narcotics, etc. Extortion racket. Loan-shark enforcement.	Strike-busting. Enforcing strikes on non-strikers by force.	Threatening/killin g election opponents. Roughing up opposing voters.	Revolution. Kidnapping government officials.
<b>Theft</b>	Burglary ring. Stolen car ring	Theft of rival organization's goods (e.g. alcohol during Prohibition)	Burglary for insurance purposes. Stealing trade secrets; industrial espionage	Watergate burglary, FBI 'surreptitious entries' into political organizations' officers.	Theft of files from the Media, FBI office
<b>Corruption</b>	-	Gambling and narcotics payoffs to police, judges, etc	Paying kickbacks to purchasing agents, union officials, politicians.	Pardoning a convicted felon in return for political support	CIA actions in Chile
<b>Economic coercion</b>	-	Betting heavily on a fixed sports event to bankrupt a bookie.	Price-fixing. Restraint on trade. Closing down a factory with an illegal strike.	Obtaining political support by selective enforcement of the antitrust law.	U.S. embargo of Cuba. Arab oil embargo.
<b>Deception</b>	-	Fixing a sports event	Planned bankruptcy. Siphoning off corporate funds through a dummy corporation. Falsifying auto emission data to comply with EPA.	Watergate coverup.	Espionage
<b>Victim participation</b>	-	Prostitution. Narcotics. Gambling	Home improvement schemes. Polluting a town dependent on the polluter for its livelihood.	-	-

Source: Maltz, 1976, p. 343

The defining role of criminal acts and activities in conceptualising the essence of organised crime was also formulated by Fickenauer (2005). He narrowed down his definitional discussion to the “elusive modifying term *organized*” (Fickenauer, 2005, p. 64). Fickenauer connects the word ‘organised’ to committed crimes. He asserts that attributes like sophistication, structure, self-identification, and the authority of reputation, size, and continuity, render crimes organized, marking an essential difference from isolated criminal acts. Therefore, collective and ongoing criminal acts, according to Fickenauer, are the fundamental elements of the nature of organised crime. Additionally, “[w]hat is essential to the definition of organised crime is the ability to use, and the reputation for use of violence or the threat of violence to facilitate criminal activities...Also essential is that organised crime employs corruption...” (Fickenauer, 2005, p. 82).

This view that restricts the perception of organised crime to illegal activities was corroborated by Caiden and Alexander (1985). They described a configuration of illegal activities that might contribute to the core understanding of organised crime, namely “...arson, insurance fraud, credit card fraud, bankruptcy fraud, commercial kickbacks, embezzlement, tax violations, check-kiting, housing code violations, deceptive advertising, home improvement schemes, mortgage milking, diploma mills...” (Caiden and Alexander, 1985, p. 5). These and many other criminal activities constitute the defining characteristics for the phenomenon of organised crime.

Illegal activities have also been usefully employed to explain the nature of organised crime by those who advocate an entrepreneurial approach. Albin’s (1971) concept of organised crime, for instance, hinges upon the notion of the illicit enterprise. He defines ‘illicit enterprise’ broadly as ‘...professional, occupational, corporate, or even conventional criminal behavior’ (Albin, 1971, p.53). Albin equates organised crime with ‘syndicated’, entrepreneurial crime, where the motivating factor is the demand for illicit goods and services. He leans towards an analysis of the methods of organisation of crime: “...any criminal activity involving two or more individuals, specialised or not, encompassing some form of social structure, with some form of leadership, utilising certain modes of operation, in which the ultimate purpose of the organisation is found

in the enterprises of the particular group .... [A] continuum of different types of organised crime ... includes political-social, mercenary, in-group and syndicated organised crime” (Albini, 1971, p. 37).

The entrepreneurial approach regards illegal activities as business enterprises. It posits that, though illegal, these activities employ the same economic and business principles as legal businesses. Very often an illegal business enterprise is analysed in the light of two main perspectives. The first perspective examines the impact and nature of criminal activities from an economic perspective, such as money laundering (see Karchmer, 1985), racketeering (see Reuter, 1985), narcotics trading (see Kleiman, 1985) etc. This approach also extends its investigative boundaries to include the assessment of illegal markets and their specific characteristics, like monopolisation and exclusive influence (see Schelling, 1971). Another perspective that serves as a background for the fundamental analysis of illegal business enterprises is predominantly political. Political analyses focus on investigating criminal actions such as political corruption (see Alexander 1985; Bellis 1985).

Irrespective of the researcher’s political preferences, and regardless of the angle of examination taken to analyse organised crime, either from a political or an economic perspective, the “one unifying context” (Lampe, 2008, p. 8) presented by the entrepreneurial approach is that of criminal acts and criminal activities.

Another approach to studying organised crime focuses on the organisational context, or hierarchical patterns, within the **criminal organisations**. According to this ‘ad hominem’ approach, criminal groups, rather than criminal methods or activities, determine the nature of organised crime, with the sociological notion of the ‘organisation’ being applied to criminal individuals and groups. This analytical perspective categorises organised crime according to its constituent hierarchies, or structures. The foundational subject is the criminal group, which is characterised by a stable hierarchy and structure, a high degree of conscious organisation and, often, ethnic restrictions to membership. This approach is primarily concerned with the arrangements **within** a criminal organization. This has led many to argue that organised crime is actually a synonym of ‘La Cosa Nostra’, or ‘Mafia’ which is considered the ‘ideal type’

(Hagan, 1983) of organised crime phenomena. The pillars of Hagan's conceptual framework are organised hierarchy, restricted membership and secrecy. These dimensions morph into a continuous spectrum which is the mainstay of the Continuum Model. The Continuum Model enables the positioning of any particular group along each dimension, with Hagan suggesting that the degree of manifestation indicates whether or not a group exemplifies organised crime. Hagan distinguishes between generic and specific, or criminological, concepts of organised crime and attributes the identified key dimensions, such as violence, threat, means, illicit goods, to the specific, criminological nature of the phenomena. Holding this viewpoint, Hagan subscribes to the view that organized crime is analogous to a criminal group that exhibits certain organisational characteristics and commits crimes by dint of means and acts.

Such a multidisciplinary 'eclectic patchwork' (von Lampe, 2006) not only generates confusion and exacerbates the already existing ambiguity of the fundamental concept of organised crime, but it also ignores the significance of its historical aspect. Yet despite the prevalence of organised criminal activities in a variety of domestic economic and political domains, academic circles (and law enforcement agencies) keep focusing on the organisational, international and social aspects of the phenomena, having long failed to seriously engage with the contradictory historical aspects of organised crime. Academic inquiry on the part of political economists shows a similar bias<sup>4</sup>. Transitology, a subdiscipline of political economy, is heavily invested in the analysis of Russian organised crime as predominantly a product of the recent transition from a state centralised to a capitalist economy, but this perspective entirely ignores the role of political and economic events that took place throughout the history of the Russian state. This tendency to ignore the whole sweep of Russian history may stem from the fact that international political economy is a relatively young discipline, with its origins going back only to the collapse of the Bretton Woods System in 1971, which brought an end

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<sup>4</sup> Although most academics would concur that organized crime has a highly disruptive effect on societies, only a handful have pointed out the leading role played by organized crime in the historical accounts of state formation and the development of capitalism (see McIntosh, 1975; Block and Chambliss, 1981).

to the convertibility of the dollar into gold (Gowa, 1983), and the oil price shocks which followed (Goldstein, 1988).

The received narrative of the USSR's disintegration in the early 1990s perfectly epitomises the conceptual ambiguity and misinformation about the origins and nature of Russian organised crime. Certainly, most International Political Economy (IPE) accounts of the rise of Russian organised crime associate it with the start of the market reforms of the 1990s and the development of capitalism. Two specific strands of this conceptualisation can be identified.

The first, advocated by most transitologists and mainstream IPE scholars, stresses the institutional vacuum unleashed in the post-Soviet state by the 'retreat of the state' from regulating all areas of life and the economy (Solnick, 1996). Those scholars with this view tend to conceptualise organised crime as an institutional response to a variety of institutional deficiencies, created by the absence of state enforcement (e.g. Skapedras, 2001). They argue that this created a power vacuum, with two main aspects. The distinctive feature of the first aspect is that organised crime was substantially advantaged by the new opportunities afforded by globalisation. Terrorism, protection rackets, money-laundering, drug running, slavery, intellectual property theft and trading in human organs have developed and proliferated due to the new market, technology and mobility opportunities opened up by globalisation, with nation states struggling to contain these new threats. The second factor which contributed to the formation of organised crime resides in the considerable domestic political and economic difficulties of the era. These included the dissolution of the old Soviet political and economic system, nationalist wars, mass privatisation, hyper-inflation leading to the collapse of the financial system in 1998, and the roller-coaster of recovery and dynamic economic growth over the past ten years. Further difficulties were caused by the struggle over property and influence, including the substantial renationalisation of natural resource assets over the past several years, the growing social disparities, new and unregulated economic opportunities, ineffective regulatory policies, disregard of laws and regulations, and many other issues. These problems are archetypal during times of transition from autocratic to democratic regimes (REF), and it is unsurprising that



organised crime tends to play an important role in such eras, as a stabilising albeit ultimately destructive socio-economic institution. This two-faceted approach to organised crime that recognises the role played by both globalisation, and domestic political-economic instability, helps explain the emergence of close collaborative networks between the state, and criminal organisations.

The conventional narrative suggests that the pace of economic and political reform was too rapid to allow for a benign transition. The first steps towards privatisation, for example, were taken in the absence of any legal regulations or controls. With the political changes and economic reforms that abolished centralised control, state officials with privileged access to state resources acquired new forms of control, including the assignment of credits, privileges, and licences, the power to award privatisation tenders, the choice of authorised banks, and the choice of agents for implementation of major social projects. There was a general failure to implement new legislation to accompany the reformed economic activity, and to deal with the inevitable loopholes and unintended consequences of policy change. This failure of oversight resulted in the illegal selling of land and state property, and the ill-defined regulation of mixed state-private ownership. The legislative ambiguity allowed businessmen to assume the role of state officials, thereby allowing them to exploit newly implemented regulations in pursuit of their own interests, and to misappropriate state resources and assets. This combination of a variety of factors created an environment conducive to the emergence of new forms of corruption. The ambiguous laws and regulations effectively made it possible and easy for state bureaucrats to engage in extorting bribes and blackmailing citizens (Levin and Saratov, 1999).

The second (and related) reading of the emergence of Russian organised crime implies that criminality is a rational economic activity carried out by individuals balancing costs and benefits (Becker, 1968). This view point was recently reinstated by Williams (2014) who suggested that organised crime is not only an inevitable, but also a necessary element of transition to a market economy, and that criminal activities will generate the first proper ownership of capital. From this perspective criminal activities constitute what some mainstream economists euphemistically call “bumps on the road to a market

economy” (Holmstrom and Smith, 2000).

A less common account suggests that Russian organised crime is a crystallisation of older problems. These writers stress the continuity of malfunctioning institutions and long-running difficulties that had bedevilled the Soviet economy for decades. Two such problems stand out. The first is the USSR’s, and subsequently Russia’s, dependence on the export of raw materials such as oil. In this view of the origin of Russian organised crime, the abundance of natural resources had already produced organised crime in the Soviet era, but it became particularly salient between 1992 and 1995 when “oil smuggling and the laundering of profits brought corrupt managers of oil companies into contact with organised crime” (Pleines, 1999, p.107). According to Russia’s Minister of the Interior, Anatoly Kulikov, in 1996 the oil industry was managed by criminal organisations<sup>5</sup>.

The second longstanding problem for the Soviet economy was the centrality of the black market and the numerous informal networks in sustaining the socio-economic life in the USSR. These are considered to be the logical consequence of the incompetent and inflexible Soviet system, which was unable to react to the political discontent or economic needs of the population with sufficient alacrity. In such a system, all managers needed unofficial connections, not only with other managers and influential party officials, but also illegal entrepreneurs, in order to make deals and to feel secure in their performance (see Clark, 1993; Lampert, 1985; Nove, 1968; Simis, 1982). As with the analysis of criminal activity above, where organised crime is regarded as a rational act that helps promote a market economy, some even argue that Russian organised crime encouraged economic growth, as it helped correct inept government policies. This view echoes the claim that the lawless undertakings of the American "robber barons" of the 19th century produced economic growth through the investment of capital obtained through corruption.

One should not deny that the transitional period from the centralised state to a market economy creates a power vacuum that provides an opportunity for criminal activity.

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<sup>5</sup> Analytical Centre Izvesty, ‘Lukoil. Politika I biznes.’ *Izvestia*, 15 May, 1997.

However, this transitology literature is inadequate in that it fails to account for the close historical relationship between the state and organised crime, the roots of which go back to the very beginning of the USSR. I suggest that the existence of institutional deficiencies, and a power vacuum, offer only a partial expansion for the growth of organised crime in Russia today, and its role in the country's political economy.

I also suggest that the narrow application of the American school's conceptualisation of organised crime to Russia does not account for the complexity and depth of organised crime as an institution within Russian society, both historically and today.

The aim of this thesis is two-fold. First, it contributes to a fuller understanding of organised crime as an informal institution of political economy in Russia. It is widely accepted that institutions are a vital feature of any state system because they shape institutional and legal landscape of the state and its political outcomes. At the same time, academic approaches to understanding the role of institutions in society are starkly divided between older, historically informed schools of thought associated with old institutional economics (Commons, 1931; Veblen, 1899; Schumpeter, 1954) and newer, more quantitatively driven streams of research in new institutional economics, mainly associated with the work of Douglas North and his followers (Rodrik, 2008: 51; North, 1994: 360).

Academic scholarship on post-1991 Russia and other former socialist states depicts the gulf between these two approaches. While the dominant economic analyses of transition tend to be aligned with the methods of new institutionalism, a lot of sociological, anthropological and historical research stresses the vital role of practices of informality and informal institutions in shaping post-Soviet political and economic outcomes. This thesis draws on the latter approaches and contributes to this literature by focusing on an important, yet conventionally overlooked, element of the socio-economic system in the USSR and Russia: the network of organised crime.

While there are a variety of theoretical approaches to institutions (such as sociological, political, new, historical), the most relevant to the purpose of this thesis is historical

institutionalism that views institutions as a product of history, as a set of both, formal and informal norms, routines and believes in the organizational structure of the political economy and examines the particular conditions at the root of the formation of institutions.

Secondly, this thesis also addresses the gaps in IPE scholarship on the post-Soviet transition period, by investigating the relationship between organised crime and the state in the USSR and post-1991 Russia. To this aim, this thesis investigates the emergence, formation and evolution of Russian organised crime in the light of political and economic events that took place since the formation of the new Russian (Soviet) state in 1917. Thus, the main research question is: **What is the role of organised crime in the political economy of Russia?**

This thesis demonstrates that:

- Organised crime is an immanent feature of the Russian state's political economy, a situation that long preceded the anarchic 1990s;
- Russian organised crime has maintained a key role throughout all the political and economic periods of the Russian state;
- The nature of organised crime in Russia is highly adaptive: whilst under centralised control it takes the form of illegal trade and illegal production, and whilst under capitalism it mutates into the appropriation and theft of state assets.
- The changeable nature of Russian organised crime is derived from the nature of the relationship with the Russian state: 'emergency economic aid' in the period of NEP and industrialisation, 'outsourcing' in the period of stagnation, 'legalisation and institutionalisation' in the period of perestroika, and 'statization' after 2000.
- Russian organised crime is shaped as a network. Whilst for most of the Soviet period it evolved horizontally, providing various supportive functions to the state and the command economic system, post-2000, this network assumed a more hierarchal shape, reflecting the broader processes of centralisation and

statistation of Russian society under Putin.

## **2. Methodology**

The analysis within the thesis is cross-disciplinary, emphasising the social, political and economic contexts that created a fertile environment for the formation of organised crime. This approach employs a historical analysis, drawing on archival material where it is available, and explaining the phenomena of Russian organised crime through the prism of the historical roots of the Russian state-organised crime relationship. It also explicates the role of organised crime in the political economy of the Russian state. Undertaking research on organised crime in Russia is challenging due to the paucity of information. This problem is further compounded by the fact that, until the late 1980s, Russian officials were reluctant to admit to the existence of organised crime. Moreover, with regard to the quality of statistical information, inconsistent reporting methods mean that reliability and availability vary widely depending on the source. In general there is a persistent tendency to understate actual activity. Considering the above difficulties, the qualitative element of this thesis was enabled by using an environmental approach as a foundation, and then carefully looking at a wide range of data and information, a great deal of which came from various secondary sources, such as newspapers, magazines, books, journals, reports and other literature covering the period between 1920s and 2000s.

Within this, this thesis develops a critical IPE account of organised crime in Russia. In itself, this is a methodological challenge. Generally, the literature on the intersection of international political economy (IPE) and organised crime is relatively underdeveloped, and has even been characterised as ‘deficient’ (Friman, 2009). This means that, generally, there is only sporadic coverage of the phenomenon within IPE, with important phases being overlooked or subsumed by analyses of other issues of state-market interaction. For example, it is said that, while organised criminal activities flourished during the chaotic years of WWII “with the incredible rise in general violence, the rampant instability of government, the various commodity shortages, the problems of identity papers and currency, the opportunities for stealing, smuggling,

counterfeiting, black marketing extortion, and so on...” (Block and Chambliss, 1981, p. 123), the [IPE] literature that analyses organised crime of this period barely exists, as if the booming underworld “...simply dried up during the cataclysm of World War II” (Block and Chambliss, 1981, p. 123). This particular criticism may be unfair. As a discipline, IPE started to evolve only in the late 1970s, spurred by the seminal work of Susan Strange. Ever since, it has been torn between its US and British schools (Cohen, 2007).

IPE scholars often overlook important or emergent economic and social phenomena, with the global financial crisis of 2007-09 being perhaps the most vivid example of predictive and analytical neglect (Palan, 2009). As lamented by Katzenstein and Nelson: “what are we to make of this curious silence about a crisis that is widely acknowledged to have been more profound than any other during the last 60 years?” (Katzenstein and Nelson, 2013, p. 1102).

Such neglect can be attributed to the relatively young age of IPE as a distinct academic discipline. As Andreas (2004) put it, “IPE scholars have arrived late to the study of Illicit International Political Economy (IIPE), largely ceding this research domain to criminologists, criminal justice specialists, economists, and investigative journalists” (Andreas, 2004, p.642). Indeed, despite the notable contributions to studies of the impact of globalisation on organised crime made by IPE scholars, namely Ethan Nadelmann (1990), H. Richard Friman and Peter Andreas (1999), Phil Williams (2003), and James Mittleman (2000), “the illicit dimensions of the global economy are largely overlooked in the international political economy (IPE) literature” (Andreas, 2004, p. 641). The lack of attention devoted to the phenomena of organised crime can also be explained by the tendency of studies “to remove the analysis of criminal organisations from its historical, [economic] and political context” (Block and Chambliss, 1981, p. 119). Nevertheless, the growing interest among scholars, academics and practitioners in the political and economic context of organised crime on one hand, and on the other, “the true inter-disciplinary” (Lake, 2008) nature of IPE as an academic field that offers different lenses to examine a studied phenomenon, has gradually yielded new insights, suggestions and conceptualizations of organised crime. Scholarship from the past

century (Hobsbawm, 1959; Hobsbawm, 1969; Braudel, 1973; Price 1973; McIntosh, 1975; Chevalier, 1973; Bernan, 1960) provides fertile ground for the investigation of urban underworlds during the 19<sup>th</sup> century, and their evolution, development and transformation, against the background of the political and economic changes that took place in this period, whilst other contemporary studies focus on understanding the economic implications of organised crime (Allum and Siebert, 2003; Pinotti, 2015; Schneider, 2010).

Some scholars argue that organised crime emerges in the global arena because of states' power to use their sovereignty to criminalise or to sanction activities, thereby challenging markets and facilitating criminal business. Palan (2009) argues that a state's legitimate power to sanction or to criminalise "divides the entire world into two realms: the realm of legal activities, and the realm of illegal or criminal activities" (Palan, 2009, p.38). According to Palan, legal activities reflect sovereignty, whereas illegal ones reflect its counterpart – anti-sovereignty. When a state's ability to enforce criminalisation is weak, and the state's protection is lacking, this state assumes a form of anti-sovereignty. In this context, the rise of organised crime is inevitable as it becomes a substitute for formal governance mechanisms. However, as Palan argues, it is not solely the weak state that facilitates the rise of organised crime; a strong, fully 'sovereign' state can also be a facilitator too. In pursuing foreign investment to strengthen the economy, a state may seek a competitive advantage, or use incentives to attract foreign capital. Palan argues that the existence of offshore zones that enable the selling of "residential rights to foreigners" is a vivid example of how the intersection of states and markets paves a way for organised crime to thrive in "the realm of sovereignty".

Here, it has been suggested that the enforcement of criminal activities depends on the structural patterns of the existing enforcement, and on the level of corruption (Fiorentini and Peltzman, 1995a; Serrano, 2002). Scholars argue that the conventional approach to crime and globalisation stresses organised crime's infiltration in the politics and economics of states (Mittelman, 2000; Strange, 1996), referred to as the "diffusion of state power to non-state actors" (Frieman, 2009, p. 13). Others, on the contrary, argue

that sometimes states deliberately create conditions for the emergence of organised crime, through the criminalisation of certain activities, simply to further their own objectives and interests. Thus Schwarts (2009) argues “the state has a qualified interest in the emergence of mafias” (Schwartz, 2009, p.137) in order to extract taxes from immigrants, to promote capital accumulation in immigrant communities, and to expedite the process of “homogenisation”. In the same vein, Monica Serrano’s (2009) historical research on drug control in Mexico illuminates the state of Political Authority vs Governance in Mexico, and demonstrates both the diffusion and selective delegation of state power to organised crime in the context of institutionalised corruption.

### **3. The Structure of the Thesis**

To address these issues, I have made use of historical literature, prioritising those studies that stress the general importance of informal institutions in shaping the political-economic context (e.g., Rosefield and Hedlund, 2009), and particularly those studies that specifically examine contemporary Russia (e.g., Reddaway and Glinski, 2001). The thesis divides into two parts. Part I discusses conceptual approaches to the phenomenon of organised crime in general, and specifically those that address criminality in the Russian context. Part II focuses on four historical cases, which depict the evolution in the relationship between the state and organised crime in Russia. Chapter 1 engages with two major academic approaches to the study of organised crime: the American school and the European school. It shows that, whilst in both the US and Europe, organised crime has always been understood in terms of its relationship with the formal institutions of the state, the interpretation of the nature of that relationship, as well as the definition of organised crime as such, do differ. While US-centric approaches tend to see organised crime in rather narrow, actor-centered ways, the European school emphasises the functions and functionality of the network itself.

Chapter 2 reviews the existing IPE scholarship on organised crime. By navigating through the (still scarce) political economic literature on crime, it draws out the key structural factors that enable the emergence or development of organised crime. It finds



that while it is too early to talk about an ‘IPE school of thought’ on organised crime, there appears to be a consensus in the literature on the fact that, depending on institutional context, organised crime can enable and reinforce official political authority; or it can operate in direct competition and contestation with it, emerging as a substitute for official political structures.

Chapter 3 reviews key debates in political economy that pertain to the role of organised crime in Russia today, and its relationship to the state. It critically analyses the main IPE approaches to the phenomenon of organised crime in Russia. Chapter 3 finds that whilst the IPE literature concurs that the phenomenon of organised crime in Russia, and elsewhere, is related to the processes of governance, the contours of the state-organised crime relationship remain poorly understood. Specifically, whilst the current literature suggests that organised crime thrives in niches where “the state is absent” (e.g. Shinar, 2016, p. 632), my analysis finds that in the USSR, and later in Russia, functional links, and cooperation with the state, and state officials, have been central to organised crime in Russia, and its evolution.

Chapter 4 focuses on the political economy of the post-revolutionary period in the young Soviet state, a period that tends to be overlooked by the available literature. The establishment of the Soviet state brought dramatic political and economic changes, including a devastating economic crisis, which necessitated the beginnings of widespread collusion between the state and organised crime, which would continue throughout the 20<sup>th</sup> and early 21<sup>st</sup> centuries.

Chapter 5 extends the examination of organised crime in Russia to the post-1935 period, which includes the period of Stalinism, the post-war economic revival of the 1950s-1960s, and the period of stagnation and economic decay of the 1970s-1980s. These five decades saw the development and spread of organised crime and its functions in the USSR, spatially and functionally. Embedded in the shadow economy and underground markets, organised crime groups spread across the vast geography of the USSR, and permeated most economic sectors, especially those involving consumer markets. Crucially, the spread of organised crime in Russia evolved in close cooperation

with corrupt state officials who were gradually absorbed into the criminal networks, in all but name.

Chapter 6 focuses on the short, but critical, period of perestroika under Gorbachev, and market reforms under Yelstin. It examines the beginnings of the transformation of Russian organized crime from a largely horizontal web of group and networks, into a hierarchy of power, part of which ultimately merged with the state, and identifies key nodes in the evolution of this process.

Chapter 7 extends the analysis of the close relationship between the state and organised crime in Russia to the era of Vladimir Putin's reign. In contrast to what most of the current literature suggests, this thesis finds that the foundations of the merger between the state and organised crime are not directly associated with the reign of Vladimir Putin. Chapter 7 shows that the foundations of that close relationship were laid down in the 1990s, a period that was regulated by vague laws and faltering institutions, and which saw many of the barriers between the state, business and criminal groups erode. The reconfiguration of the state-business relationship under Putin changed the historical reliance of the state on the governance methods of the criminal underworld, and explains the transformation of Russian organised crime from a horizontal network of shadow economy and illegal groups (1921-1985) to a hierarchal network of state-centred power structures (2000- ). As a result, major business functions of organised crime networks were absorbed into the state *vertikal* of corporate and political power. However, despite this significant transformation in the state-organised crime relationship, informal institutions continue to play a central role in the Russian political economy to this date.

**PART I**

**APPROACHES TO ORGANISED CRIME**

## CHAPTER 1

### ORGANISED CRIME: A COMPLEX PHENOMENON WITHIN CAPITALISM

Although crime exists in any society, and this has been the case throughout history, the existing social science scholarship on organised crime is dominated by research on the 20<sup>th</sup> century. On both sides of the Atlantic, organised crime is strongly associated with the rapid development of market economies and capitalism. This chapter identifies and reviews two major academic approaches to the study of organised crime: the American school and the European school. As the chapter shows below, whilst in both parts of the world organised crime has always been understood in terms of its relationship with the formal institutions of the state, the interpretation of the nature of that relationship, as well as the definition of organised crime as such, do differ. While US-centric approaches tend to see organised crime in rather narrow, actor-centered ways, the European school emphasises the functions and functionality of the network itself.

#### 1.1. The American school

As a distinct phenomenon, organised crime was first identified in the US. The first attempts to conceptualise organised crime date back to the late 19th and the beginning of the 20th century. This was a period of rapid economic development and political and social change, including democratic representation, improvement of educational institutions and health systems, and increased wages. It was also a time when corruption and injustice became a focal point of active journalistic investigations. With this reshaping and redefining of political, economic and social powers during what became known as the Progressive Era, the phenomenon of organised crime in America became a subject of official debates that subsequently resulted in the creation of a variety of investigative Commissions, to address this newly identified problem.

This was the era of laissez-faire capitalism. Certainly there was little in the way of labour or consumer protection. This casual approach to market regulation enabled business tycoons in all sectors, such as heavy industry, transportation, finance, communication and manufacturing, to become immensely powerful. In the literature of political economy these capitalists are characterised as ‘robber barons’ (Josephson, 1934), that is, “...a set of avaricious rascals who habitually cheated and robbed investors and consumers, corrupted government, fought ruthlessly among themselves, and in general carried on predatory activities comparable to those of the robber barons of medieval Europe” (Bridges, 1958, p. 1).

The rise of new wealth facilitated the imbrication of state and business, leading to political corruption and cronyism. Many of the politicians and state agents became subordinate to big business. As a result, economic historians consider the period from the late 19th to the early 20th century as a golden era of Big Business, where the interests of capitalist tycoons were predominantly protected by state legislations that favoured large corporations. State institutions acted overwhelmingly on behalf of the representatives of the dominant companies, and state officials often played a dual role as both public servants and capitalists. For example, “a vice-president of Bethlehem Steel Co. was the mayor of Bethlehem, Pennsylvania while a member of a company’s private police force in North Clairton was also mayor of the town” (Rees, 2003, p. 128). Or, “the three big insurance companies occupied key positions in financing the [New York State] Republican machine (and to some extent the Democratic one also) and guaranteed not only friendly legislators but cooperative [state] insurance departments as well” (North, 1952, p. 27). Laws were adopted based on corporate interests; elections were administered through campaign donations from interested corporations; state and business re-shaped each other. Such a reciprocal system of tight cooperation between the business elite and administrative state officials had its historical roots in the colonial economy of 1700s, where “the elites treasured [such] golden connections and closely superintended access to official positions in county- and province-wide government” (Weinberg, 2003, p. 9) and still dominated the political economy of America between 1865 and 1920. As a thriving young state, America attracted massive immigration from around the world, which brought high rates of unemployment and crime. This, coupled

with social injustice and widespread corruption, facilitated the formation of criminal organisations. One of the commonly encountered phenomena of this time was the emergence of criminal groups of teenagers, who later on become prominent criminals, such as Al Capone and Bugs Moran<sup>6</sup>.

The ensuing social and economic problems necessitated a series of political, economic and social reforms that were enacted in the Progressive Era, including the development and advancement of democratic representation; the improvement of both educational institutions and the health system; an increase in wages; and an attempt to address the problem of institutional corruption, institutional inefficiency, and social injustice.

### ***Understanding approaches towards organised crime***

The problem of institutional corruption and, therefore, institutional inefficiency became more prominent in the early 20<sup>th</sup> century. Political organisations, initially formed out of social movements that emerged in the early 19<sup>th</sup> century, played a dominant role in local and, later on, in state politics and in the state legislature, by providing patronage, serving as an instrument for political corruption and exercising control of policymaking in such prominent business centers as New York City, New York State, Manhattan. One of those societies that served as a political machine for the Democratic – Republican Party was the Society of St. Tammany, or Tammany Hall, that was founded in 1786 and exercised a substantial influence in politics until 1930, when from 1930 to 1945 its influence waned as a result of losing elections to Franklin D. Roosevelt. Political corruption, bribery and the system of patronage brought about public discontent, and the emergence of citizen-based crime fighting organizations, with the clear aim of investigating the widespread corruption. One of the earliest examples of one of those organisations was the New York Society for the Prevention of Crime that was “chartered by the State and empowered to concern itself with matters that in

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<sup>6</sup> Robert M Lombardo’s famous article “The Forty-Two Gang: The Unpublished Landesco Manuscripts” examines the impact of ‘The Forty-Two Gang’ on the emergence of organised crime group ‘Outfit’ in Chicago.

the first instance come under the purview of state and municipal authority”, namely the investigation of “...the hidden features of the situation” (Report of the Society for the Prevention of Crime, 1903, p. 4) or in other words, with the widespread corruption within law enforcement agencies. The 1903 Report clearly reveals a conspiratorial network of criminals, operating gambling and prostitution businesses, and supported by public officials, namely executives at the highest level of the police hierarchy. These illegal activities were facilitated with the help of bribery and corruption. The report focuses specifically on the network of distinguished people engaged in crime. It delineates the specific illegal associations and roles of each criminal individual within the criminal network. For instance, with regard to the gambling activity, the Report identifies ‘runners’, ‘writers’ and ‘watchers’ who are secured by the ‘backers’.

Thus, “[i]n each of these shops (gambling rooms) was kept what is known as a ‘book’; said book being the records of bets made by the players. Twice a day these books and the money bet were sent to one or other of the two principal runners, one of whom was stationed at 31st Street and 8th Avenue and the other at 31st Street and 9th Avenue, and by them forwarded to the headquarters (of the Police) in West 31st Street” (Report, 1903, p.5). The same organisational pattern was in use with prostitution rackets. The Report explicitly singles out the fundamental attribute that formed the essence of the criminal enterprise, that is, a close partnership between criminals and representatives of official agencies, where each of the parties assume a specific role: one carrying out illegal activities (gambling and prostitution), with the other ensuring that these activities proceed smoothly.

The Report of 1903 brought about the appointment of Theodore Roosevelt as the president of the New York City Board of Police Commissioners, bringing down Tammany Hall.

The next attempt to address the problem of, and thus to define, organised crime at the government level was made by the Chicago Commission of Inquiry in 1919 (CCI). The opportunity available in America in the late 1800s to populate a relatively ‘young’ nation brought a massive influx of impoverished Europeans, often displaced from their ancestral lands as surplus labour. These had settled mainly in New York, Chicago and

Philadelphia. Given the extremely high poverty rates, such large-scale immigration engendered the establishment and growth of intricate underworld activities with gambling syndicates, criminal gangs, corruption and eventually, corrupt executive agencies. As Demaris (1969) put it, ‘from the moment of its incorporation as a city in 1837, Chicago has been systematically seduced, looted, and pilloried by an aeonian horde of venal politicians, mercenary businessmen, and sadistic gangsters’ (Demaris, 1969, p. 3). A corrupt environment and inadequate civic order served to boost the already flourishing criminal organisations, and incrementally government officials were dragged into this criminal net. The Chicago of 1900s was depicted as the “easiest joint in the country in which to jump bond, as well as for staying out of jail altogether. The price commonly being whatever you have in your wallet. If the wallet is empty a fifty-cent cigar will usually do it” (Algren, 1951, p. 17). The need to do away with corruption and to root corrupt state agents out of the system necessitated the establishment of the Chicago Commission of Inquiry, in 1919. The main objective of this body was to investigate the ‘wholly inadequate’ (CCI, 1919), unprofessional and lacklustre approach to crime prevention by executive agencies. The ‘wholly inadequate’ treatment manifested as the successful evasion of the law by a significant number of professional criminals, unjustified heavy punishments of poor and petty criminals, the ineffectiveness of ‘the treatment of those sentenced to penal institutions’, and the inappropriate application of practical crime prevention methods. The ‘means’ of preventing the creation of criminals in Chicago (CCI, 1919) were “far below standards already in practical operation elsewhere” (CCI, 1919, p. 9).

The primary focus of the Detective Bureau of the City Police Department was the investigation of the nature and causes of crime, detentions and prosecutions, the efficiency of the judicial system, the long-standing corruption within the Detective Bureau of the Police Department of the City of Chicago, and the collusion of many socially prominent individuals with the criminal underworld. Investigators noted that certain criminal groups were clearly set apart from the general criminal offenders by their unique language, traditions and the organised structure of operations. “While this criminal group is not by any means completely organised, it has many of the characteristics of a system. It has its own language; it has its own laws; its own history;



its tradition and customs; its own method and techniques; its highly specialized machinery for attacks upon persons and property; its own highly specialized modes of defense. These professionals have interurban, interstate, and sometimes international connections” (The Report of the (Chicago) City Council Committee on Crime (RCCCC), 1919, p. 164).

The notion of ‘system’ here is the key that decodes the concept of organised crime, though this concept was not distinctly formulated in the report. The notion of ‘system’, in the report, has an organisational, or structural, implication. Here structure is not understood in its standard meaning that implies hierarchy, or as it is mentioned in the report, ‘centrally organized’, ‘completely organized’, or ‘under fairly close control’. Structure in this sense refers to the system of illegal collaboration, or cooperation, whereby the state officials allow their illegal business partners, or criminals, to escape from arrest, in return for a share in the illegal proceeds. Namely, “...in some cases, not only were the proceeds of crime divided, but criminals were forced to ply their occupations, that the corrupt officials might have the plunder” (RCCCC, 1919, p.161). This system of illegal cooperation, or illegal networking, of criminals and state officials is considered to be the key element that determines the essence of organized crime. In fact, the word ‘organised’ is employed here to illustrate the organisational structure of unlawful cooperation where the ‘corrupt state officials’ and ‘corrupt lawyers’ play their part in the criminal ‘business’. “...When we consider the opportunities for escape from detection, by collusion... of police, by the work of professional fixers; by the pressure of political influence; by the inactivity of prosecutors... we must admit that professional crime is better organised...” (RCCCC, 1919, p. 164).

For the next 14 years, the phenomenon of organised crime was ignored and overlooked by the policy makers. As noted by Maltz (1985), “after more than sixty years of combating organised crime, there is still no appropriate definition of it” (Maltz, 1985, p.23). One of the reasons for such neglect was that the CCCI was formed by businessmen and was composed of representatives of both administrative and security institutions. The impact of such a group on national public opinion was limited. Furthermore, citizens held little trust in law enforcement agencies, holding the view that

they “were little oriented toward legal norms” (Haller, 1976, p. 303). It is important to note that the Commission conceptualised organised crime as a largely social phenomenon derived from the “the old established Protestant middle class... ‘drowning’ in crime, corruption and moral decay” (Lampe, 2002, p. 190). It should be noted that the school of thought that considers the city as a “laboratory” for analysing social interactions<sup>7</sup> is called the Chicago School. The Chicago Crime Commission approached organised crime from a business perspective, and provided a definition for it in terms of the criminal enterprise, essentially being composed of the unlawful cooperation between profit-driven professional criminals, engaged in illegal activities, and law enforcement agents, shielding this “organised criminal enterprise”.

The introduction of Prohibition in the USA in 1929 resulted in a rapid increase in the incidence of criminal activities, and provoked the creation of the Wickersham Commission<sup>8</sup>, or officially The National Commission on Law Observance and Enforcement, 1929-1931. Although the Commission produced unequivocal evidence of the existence of organised crime and a clear recommendation for further in-depth study of the phenomena, this was not implemented. This was most probably due to the fact that the focus of the Commission was on the consequences of the ineffectiveness of Prohibition that had manifested itself in the Chicago gang war, official corruption, and other abuses of authority. In the final report of the findings in 1931 and 1932 the commission revealed the widespread use of corruption by criminal justice systems, instances of bribery, coercion, and violence. Only in 1951 did the Kefauver Committee<sup>9</sup> initiate the first nationwide investigation of organised crime. The Committee revealed national criminal conspiracies all over the country in the face of continued FBI denial of their existence. It was the first time that the reality of organized crime was officially

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<sup>7</sup> The Chicago School has developed an ‘ecological model’ that tests the analogy and correspondence between natural and social mechanisms as a means to explain urban and social relations.

<sup>8</sup> The Wickersham Commission was unofficially named after George W. Wickersham, a well-known lawyer and ex U.S general attorney during William Howard Taft’s presidency. George W. Wickersham was appointed a chairperson of the Commission.

<sup>9</sup> In 1950 Senator Estes Kefauver headed the Senate Special Committee to Investigate Crime in Interstate Commerce. This Committee was termed the Kefauver Committee, or the Kefauver hearings.

recognized by the Government and it “brought national attention to organised crime” (Albanese, 1988, p. 58).

Although no definition had been proposed, the Kefauver Commission publically equated organised crime with the Mafia. This confluence, a tenet of Alien Conspiracy Theory<sup>10</sup>, was inherited by later Presidential Commissions and had a significant impact on the general perception of organised crime held by public officials, law enforcement and scholars. The investigative efforts of the Commission were aimed at studying and understanding the nature and the extent of organised crime. The report went on to detail illegal narcotic drug activities and corruption. The Commission concluded that narcotics were the main focus of criminal activities that “exemplify organised crime at its devastating worst” and delineated organised crime as “organised gangster syndicates”. It can, therefore, be seen that the Commission placed a great deal of emphasis on organised criminal activity, Italian-American Mafia and corruption. Henceforth, organized crime was essentially seen as organised criminal activities operated by the Mafia by means of corruption.

Although the existence of organised crime had been commonly accepted, a specific definition of organised crime had not been discussed. Subsequent attempts to understand the organised crime phenomena were made by the President's Commission on Law Enforcement of 1967. The commission followed the same descriptive and quantitative pattern in defining the phenomena as previous commissions. The nature of organised crime, its methods of operation and the threats it poses remains crucial factors and are seen as the underlying element in determining the conceptual essence of organised crime. That is to say " the core of organised activity is the supplying of illegal goods and services ...(four types of organised criminal gambling, loan sharking, narcotics, and other goods in services) as well as involvement in legal business through illegitimate methods: monopolisation, terrorism, extortion, tax evasion, corruption; the purpose of organised crime is not competition with visible legal government but

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<sup>10</sup> The Alien Conspiracy Theory was underpinned by the belief that organized crime in the USA could be mainly attributed to the Sicilian immigrant population, comprised of 25 criminal families.

nullification of it" (President's Commission on Law Enforcement, 1967, p. 187). It is particularly important to note that these characteristics were attributed solely to the American-Italian groups, known generally as the Mafia, or Cosa Nostra, that at that time were believed to be solely representative of the phenomenon of organised crime.

Although the Commission approached their analysis of organised crime in terms of methods of operations, along with the intrinsic nature and magnitude of the threat it posed, their research perspective is not entirely compatible with the Commission's comment on the limitations affecting investigations carried out by law enforcement agencies. The Commission criticised the law enforcement investigation for their emphasis on the types of crimes involved, rather than a focus on the organisations operating these crimes. In particular, "...when law enforcement officials focus exclusively on the crime instead of organisations, their target is likely to be the lowest-level criminals who commit the visible crimes. This has little effect on organisation." (President's Commission on Law Enforcement, 1967, p. 192).

Thus, for the first time, understanding organised crime involved a new angle, whereby the actors, or the organisers, were considered as the key element in the emergence of organised crime, rather than their activities alone. The Commission defined organised crime as a 'society'. Society is defined in a two-fold manner: 1) a large group of people who live together in an organisational way, making decisions about how to do things and sharing the work that needs to be done; 2) an organisation to which people who share similar interests can belong. Either way, irrespective of whether it is a group of people or an organisation, this definition of organised crime as a society determines its essential nature, which rests on structural relationships.

Indeed, the Commission marked out 24 groups that co-existed and operated their illegal activities under the vernacular name La Cosa Nostra, namely, "the highest ruling body of the 24 families... composed of the bosses of the Nation's most powerful families..." who were in frequent communication with each other. Their smooth cooperation was ensured by a national body of overseers. La Cosa Nostra was also identified as an organisation where the "key organisational principle-membership [was] based on ethnicity, Italian..." (President's Commission on Law Enforcement, 1967, p. 193).

The President's Commission on Law Enforcement of 1967 broadened the understanding of organised crime. It incorporated into the concept a new determinant, additional to the criminal activities; 'actors', referring to those who operate the crimes. The Commission followed the same quantitative and descriptive approach, as the previous Commission, to explain organised crime. That is, the investigative focus was on the hierarchical characteristics of criminal groups equated with organised crime. These characteristics are considered a yardstick of the mafia concept.

The next attempt to define 'organised crime' can be traced back to 1968. In the Omnibus Crime Control and Safe Streets Act, Public Law 90-351, 1968, organised crime was defined as: "unlawful activities of the members of a highly organised, disciplined association engaged in supplying illegal goods and services, including but not limited to gambling, prostitution, loan sharking, narcotics, labor racketeering, and other unlawful activities of members of such organization". Like the definition proposed by the President's Commission on Law Enforcement and Administration of Justice, 1967, the Omnibus Crime Control enumerates and focuses on the same illegal activities and considers them to be a core component of organised crime. The new definition does link organised crime to a certain level of organisation. It retains, however, a significant degree of non-specificity and lack of clarity. For example, defining the criminal organisation as a 'highly organised, disciplined association' is too vague. How would a prosecutor measure the degree of organisation and the degree of its discipline whilst pursuing criminal charges?

The Organised Crime Control Act of 1970 definition of organised crime not only failed to yield any definitional clarity<sup>11</sup>, but was implemented nearly ten years later<sup>12</sup>. In the statement of findings and purpose the US Congress referred solely to five dimensions in the characterization of organised crime. The main focus was the Racketeer Influenced and Corrupt Organisation (RICO) statute (section IX) that attempted to analyse and define, amongst other criminal activities, racketeering, illegal enterprises, prohibited activities, and corrupt organisations (p.20, chapter 36).

However, ten years later the law enforcement agencies faced the same problem again. U.S. President's Commission on Organised Crime report of 1986 addressed the unsolved problem of defining organised crime. The Commission however acknowledged that organised criminal activity had undergone significant changes, both in the range of the criminal activities and also in the characteristics of the players. First, the Commission rejected the common practice of focusing solely on Italian-American criminal groups, and acknowledged the significance of other ethnic criminal groups, stating that "to focus exclusively on the actual hierarchy and the membership of La Cosa Nostra is to lose sight of a complex tapestry that includes the other organised crime groups as well as the numerous protectors, specialists, and associates who are crucial to the success of organised crime" (Commission on Organised Crime, 1986, p. 34).

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<sup>11</sup> Organised crime in the United States is a highly sophisticated, diversified, and widespread activity that annually drains billions of dollars from America's economy by unlawful conduct and the illegal use of force, fraud, and corruption; (2) organised crime derives a major portion of its power through money obtained from such illegal endeavors as syndicated gambling, loan sharking, the theft and fencing of property, the importation and distribution of narcotics and other dangerous drugs, and other forms of social exploitation; (3) this money and power are increasingly used to infiltrate and corrupt legitimate businesses and labor unions and to subvert and corrupt democratic processes; (4) organized crime activities in the United States weaken the stability of the Nation's economic system, harm innocent investors and competing organisations. It interferes with free competition, seriously burdens Interstate and foreign commerce, threaten the domestic security, and undermine the general welfare of the Nation and its citizens; and (5) organised crime continues to grow because of defects in the evidence-gathering process of the law which inhibits the development of legally admissible evidence necessary to bring criminal and other sanctions or remedies to bear on the unlawful activities of those engaged in organized crime and because the sanctions and remedies available to the Government are unnecessarily limited in scope and impact.

<sup>12</sup> Detailed discussion about RICO and its implementation can be found in James D. Cadler's *RICO's "Troubled transition": Organised Crime, Strategic Institutional Factors, and Implementation Delay, 1971-1981*. Criminal Justice Review, Volume 25, Number 1, Spring 2000.

Second, it concluded that criminal activities such as trade in narcotics, money laundering and labour racketing were the three new largest sources of revenue for organised crime. In other words, “it is the generation and accumulation of income that lies at the heart of organised crime” (Albanese, 1988, p. 191).

Although the Commission explicitly recognised the changes in the scope of illegal activities and the existence of other criminal organisations distinct from the Mafia-type, the concept of organised crime remained largely unchanged; criminal activity conducted by a group that possesses the following characteristics - continuity, structure, membership, criminality, violence, power/profit goal<sup>13</sup>.

One significant change, however, could be identified in the Commission’s discourse. The Commission emphasized that the problem in defining organised crime stems not from the word crime, but from the word “organised” (mentioned by Maltz, 1976, p. 19).

It continued with a comparison of the ordinary criminal behavior of an individual acting solely alone, and that of organised criminal groups, accentuating the general recognition and acknowledgement of certain behavior and actions as criminal, but also highlighting a lack of standard acceptance as to when a criminal group is organised (President’s Commission on Organised Crime, 1986, p. 19). The report refers separately to organised crime and criminal groups. Organised crime, as it suggested, is the collective result of the commitment, knowledge and actions of three components; the criminal groups each of which has its core persons tied by racial, linguistic, ethnic or other bonds; the protectors, persons who protect the group’s interests; and specialist support, persons who knowingly render services on an ad hoc basis to enhance the group’s interests (p.25).

This view relies on a dynamic perspective of criminal cooperation that determines criminal actions, rather than focusing predominantly on the internal structure of criminal groups. Criminal organisations are not ascribed to the stereotypical image of the mafia

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<sup>13</sup> Detailed descriptions of each characteristic are found in the Report to the President and the Attorney General: ‘THE IMPACT: Organised Crime Today’, 1986, p.26-29.

with its high degree of structural organisation, but are seen as an integral part of the wider political economy wherein they operate their criminal businesses. The conceptual mainstay here is the continuous dynamic process of adapting criminal activities to the political economy environment.

The participants referred to as “the Protectors” are an important aspect of the conceptualisation of organised crime. Protectors are understood to be corrupt public officials, attorneys, and businessmen, who individually and collectively protect the criminal group through abuses of status and/or privilege, and violation of the law (p.29). They provide a twofold benefit to organised crime; protection for the criminal group, and the ‘edge’ (p.30), or advantage, over other criminal activities and legitimate business by “being close to the bosses of the union...” (James Fratiano’s testimony, 1984). Likewise, William Webster distinguishes organised crime from other forms of crime by the requirement that it is “seeking an edge”.<sup>14</sup>

The protectors shield the criminal group from apprehension and prosecution by leveraging the prestige of their office and their influential connections. By assuming a twofold role, as a member of a criminal group and also a state official, they play a significant part in the growth and success of organised crime. They provide criminal group bosses with inside information, assist with money laundering from criminal activities through financial institutions, and instigate other schemes including legitimate business ventures.

Organised Crime Support consists of specialist support that provides specialised contract services, to facilitate organised crime activity. Examples of such support would be: user support, which is aimed at “individuals who purchase illegal goods and services”; and social support involving individuals and organisations that “grant power and an air of legitimacy” (U.S. President’s Commission on Organised Crime report, 1986, p. 32) to illegitimate/criminal affairs.

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<sup>14</sup> *Ottawa Citizen*, Nov. 30, 1983. “Few Untouched by Organised Crime”. Available at: <https://news.google.com/newspapers?nid=2194&dat=19831130&id=SKQyAAAAIIBAJ&sjid=P-8FAAAAIBAJ&pg=1208,5210615&hl=enPROPER> [Accessed 14 June 2015].



Thus, for the first time since the Chicago Commission in 1915, the President's Commission on Organised Crime (1986), in its attempts to understand and define organised crime, offered a new conceptual perspective on organised crime. The phenomenon could now be understood through the lenses of organisational principles, or relationships between organisers.

Table 1.1.1 A content analysis of dimensions of selected definitions of organised crime

Dimension	Abadinsky (1981)	Albini (1971)	Barlow (1981)	Clinard & Quinney (1973)	Conklin (1981)	Gressey (1969)	Haskell & Yablonsky (1974)	Inciardi (1975)	Mack (1976)	Malz (1976)
Non-ideological	X									
Organized Hierarchy Continuing	X	X	X	X	X	X	X	X	X	
Violence (force or threat of force)	X	X		X	X		X	X	X	X
Restricted membership	X					X				
Rational profit through illegal activities	X	X	X	X	X	X			X	X
Public demand		X	X		X		X		X	
Corruption		X	X	X	X	X	X	X		X
Monopoly				X		X		X	X	
Specialization				X				X		
Code of secrecy			X		X					
Extensive Planning							X			

Source: Hagan, 1983.

Table 1.1.2 The organised crime continuum model

Dimensions	Non-organised crime	Organised crime
Highly organised	No -----	Yes
1. Hierarchy	Not Relevant -----	Relevant
2. Restricted Membership	Absent -----	Present
3. Secrecy (Codes)	Absent -----	Present
Violence or threats of violence	No -----	Yes
Provision of illicit goods in public demand	No -----	Yes
1. Profit Oriented	No -----	Yes
Immunity Through:		
1. Corruption	Unconnected -----	Connected
2. Enforcement	No -----	Yes

Source: Hagan, 1983.

The analogy between organised crime and the Mafia/La Cosa Nostra, was also proposed by Cressey (1970). He stressed the significance of a crucial role for formal and informal structure in defining organised crime. Cressey wrote: "...the hierarchical organisation... is almost a carbon copy of the organisation of Cosa Nostra" (Cressey, 1970, p. 17).

Many scholars are sceptical of this 'Mafia' approach towards explaining the organised crime paradigm. Finckenauer (2005), for example, describes the limitations embodied in the concept, and in particular its 'definite U.S. bias' (Finckenauer, 2005, p. 64), and paucity of historical perspective, given that La Cosa Nostra is a relatively new phenomenon within organised crime. These caveats had already been noted by Hagan more than 20 years earlier, when he warned of the inevitable limitations of restricting research to analysing 'La Cosa Nostra' (1983). In a similar vein, Ianni (1974) refuted the 'Alien Conspiracy', by claiming and demonstrating that organised crime in America had not been imported from Sicily during the Great Migration but existed before and had just been displaced by African-Americans. Ianni represents the school of thought that understands organised crime in the context of origins, and bases its arguments on the 'Ethnic Succession Theory'. A fellow supporter of this school, Robert M. Lombardo

(2002) corroborated Ianni's claims by empirically proving that African-American criminal syndicates operated independently of the Italian-American Mafia since 1860. Likewise Morris and Hawkins (1970) and Smith (1975) criticised followers who advocated alien conspiracy. Caiden and Alexander (1985) considered the myths and preconceptions harboured by the subject of organised crime, and Smith (1975) was the first to analyse the 'myth of the mafia'.

Another approach to understanding organised crime maintains the preference for organisational analysis, but narrows the focus to examine the structure of cooperation between organisers. The crux of this approach is the nature of the connections between organisers, irrespective of whether they are identified forces or separate groups. In this context, organised crime is seen as a network, or enterprise. Blakey's proposal (1967) of a definition for organised crime reflects this approach. For Blakey, the fulcrum for determining organised crime is the nature of criminal groups and their constituent members, with their key principles and relationships, rather than criminal activities per se. Blakey identifies three separate criminal groups with organisational features. The first group is designated as an organised crime 'enterprise', which comprises, according to Blakey, a criminal firm or a business organisation. The relationship between these 'enterprises' is regulated and maintained by a second group, the 'syndicate', which controls and organises criminal activity. This 'syndicate' "...fixes prices for goods and services, allocates markets and territories, acts as a legislature and court, sets policy, settles disputes, levies 'taxes', and offers protection from both rival groups and legal prosecution" (Blakey, 1967, p. 5). The third group is dubbed 'ventures' and is understood as a collection of ad hoc criminal acts with the main objective of profiting a specific group. What enables the success of this criminal 'venture' is its link to 'syndicates' "...that give access to superior criminal resources, including capital, skilled labor, outlets for stolen property etc" (Blakey, 1967, p. 5). Blakey's view on understanding organised crime bears strong resemblance to the 1986 President's Commission's conceptual perspective on organised crime, which was discussed earlier.

Studying the nature and structure of the relations between organisers as the pivot for understanding organised crime was also favoured by those scholars who had earlier

subscribed to an alternative explanation of organised crime, namely unlawful activities. Maltz (1985), for example, admitted that his typology of crimes “was useful but limited” (p. 23). The unlawful activities that he claimed constituted organised crime centre on the organisational level of perpetrated incidents, but this approach ignores the further organisation that is essential to facilitate crime, such as the distribution of stolen goods through retail outlets. There are also networks of associates and colleagues who provide help in special circumstances, for example, financial and psychological support systems (p.24). Essentially, we find that the prevailing conservative view on organised crime, that served as a synonym to the ‘familiar vernacular’ (Albanese, 1988) of the ‘Mafia’, was challenged by the new conceptual model, namely “...the nature of criminal enterprises...to be part of organised crime” (Maltz, 1985, p. 24). The essence of this model lies in the analysis of the organisational level, rather than a descriptive treatment, and investigates organised crime phenomena in terms of who the organisers are and what the key organisational principles are. Maltz (1985), in particular, shifted his focus on the “post-organisation” activity of committed crimes by raising the question whether organised crime is an act or a group. He identified nine characteristics as the potential indicators of ‘organised crime’: corruption, violence, sophistication, continuity, structure, discipline, multiple enterprises, involvement in legitimate enterprises, and bonding. Importantly, he acknowledged that he ignored the menace that binds the acts and the group together, a key organisational principle. Maltz’s new approach suggested that organised crime cannot be defined and understood as acts and objectives alone; it must also refer to the people who work together as a group to commit them (p.33), “a network of associates and colleagues” (p.24).

Within this conceptual framework of viewing organised crime as determined by the nature of the relationship between organisers, it can be further delineated in terms of ‘identified forces’. Block and Chambliss (1981), for instance, represent the school of thought that regards organized crime as the confederacies or alliances of actors, identified forces, that are restricted to national scope and ...‘ are part of the social and political fabric of this nation (p.210). Their focus is not so much on the nature of the crime, the criminal activities, etc., but on the interaction between organisers that manifests itself in illegal activities.

Sometimes the concept of organised crime extends its limits beyond the framework of traditional views. For example, following Petra's (1977) focus on the nature of the relationship among criminals, William Chambliss (1989) took a step further, examining 'State-Organised Crime' as a manifestation of general causes of organised crime. He defined State-Organised Crime as "acts defined by law as criminal and committed by state officials in the pursuit of their jobs as representatives of the state". During his historical study of piracy and smuggling, Petra noticed that the piracy and smuggling of the 16<sup>th</sup> and 17<sup>th</sup> centuries were "sociologically the same as some of the organised criminal relations of today – both are examples of state-organised crime" (Chambliss, 1989, p. 59)

William Chambliss was not alone in his view that a wider focus is required. Philip Bean (2003) remarks that European nations "created a legal fiction with attempts to rationalize the fundamental contradiction between the law and the interests of the state" (Bean, 2003, p. 63). He argues that as the accumulation of capital turned out to become the "essential determinant" to shield national borders, states resorted to piracy, which at that time was outlawed.

Sutherland (1949) takes yet a different angle in his attempts to understand organised crime. He claims that the lack of a proper unified definition limits the effectiveness of policy makers and enforcement agencies in their attempts to evaluate and combat organised crime, which inevitably imparts a higher social and economic burden. There is therefore a social imperative for a more sophisticated understanding of organised crime. Sutherland's conceptual understanding of organised crime considers the degree of 'social harm' inflicted and the extent to which criminal activities are punishable by law. The author takes a step further and presents the concept of harm as one maintained by the control of harms. By demonstrating and discussing the examples of drug dealers and terrorists, who induce social harm, he outlines and justifies the necessity for the control of such harm. He regards terrorists as networks. Accordingly, organised crime too, in this sense, is perceived as a network. Understanding the potential vulnerabilities of organised crime is therefore paramount in its elimination.

From this broad examination, and literature review, of both the academic and official perspectives, two main disciplinary approaches to understanding organised crime emerge. The separate approaches do not contradict or argue with one another, but contribute substantially to our understanding of organised crime phenomena. Organised crime as an overarching phenomenon itself is, therefore, very complex.

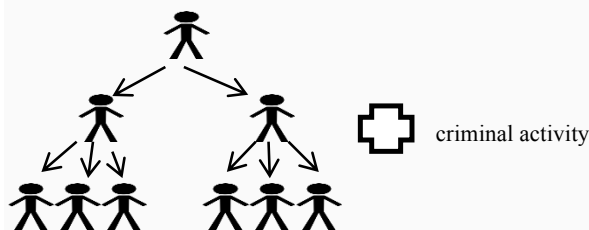
Figure 1.1.1. American disciplinary approaches

**Hierarchical structure approach**

**Horizontal structure approach**

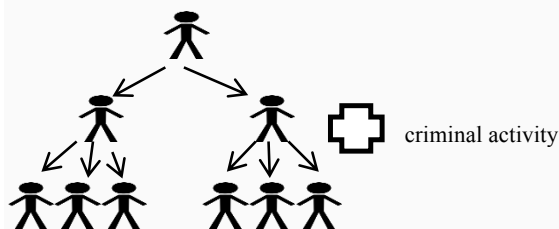
**Kefauver Committee Final Report  
Aug. 31, 1951**

Mafia as criminal entity, unit, family: hierarchical structure, ongoing illegal activities, strict code of conduct



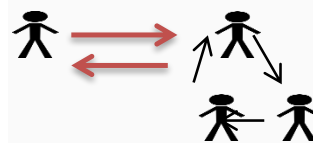
**Omnibus Crime Control and Safe Streets Act, Public Law 90-351**

Highly organised, disciplined association that provides illegal goods and services such as gambling, prostitution, loan sharking, drugs, labour racketeering



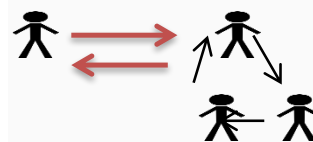
**Report on the Society for Prevention of Crime, 1903**

Conspiratorial network of criminals and public officials, collaboration of organisers, illegal ties interactions through specific roles



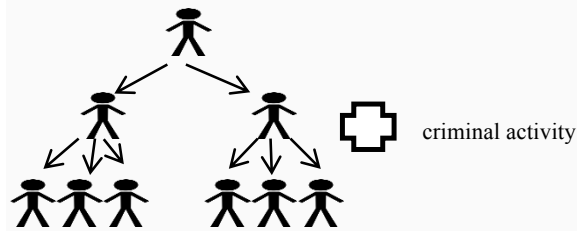
**Chicago Commission in Inquiry, 1915**

Conspiratorial network



**President's Commission on Law Enforcement and Administration of Justice, 1967**

Criminal organisations, namely mafia, that supply illegal goods and services

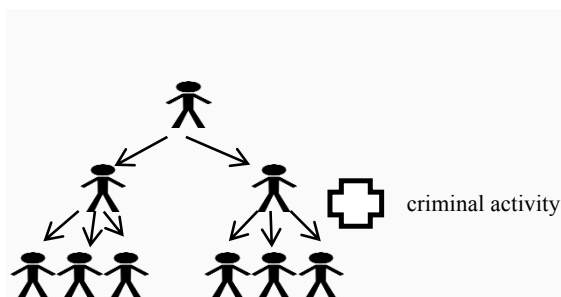


**The Organised Crime Control Act, 1970; The Racketeer Influenced and Corrupt Organisation (RICO)**

Activity (racket), illegal enterprise, corrupt organisations

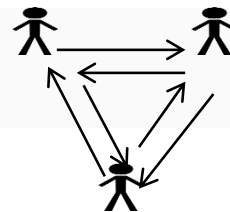
**The 1986 President's Commission on Organised Crime**

Unlawful activities, mafia



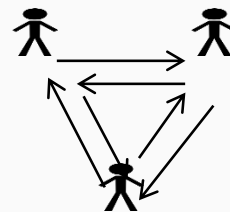
**Blakey R. (1967)**

Key organisational principles and relationship between organisers



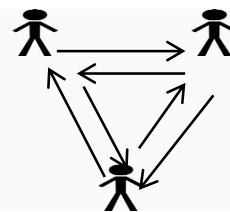
**Maltz, M., 1985**

Criminal network, collaboration between criminal organizers and the key organisational principles



**The 1986 President's Commission on Organised Crime**

Network of associates, Interrelations between criminal group + Protectors + OC Support



## 1.2 The European School

The origins of organised crime in Europe “go back to the preindustrial times and even all the way back to the Roman Empire” (Lampe, 2005, p. 404). Piracy and banditry are clear examples of ancient criminality. However, the historical and political importance of their emergence has always been ignored by scholars. This can be explained by the focus on the “colourful and romantic aspects of pirate life” (Ritchie, 1986), or the heroic deeds of the “peasant bandits” who “take from the rich to give to the poor” (Hobsbawm 1965), that obscured the more political and economic explanations for the rise of pirates and bandits. Just like in the US therefore, serious academic attempts to conceptualise and theorise organised crime in Europe did not generally predate the 20<sup>th</sup> century.

More specifically, European scholars first began to examine the origins of contemporary organised crime in Europe in the 1960s-1970s. The vigorous activity of the so-called underground criminals can be traced back to the late 18<sup>th</sup> to the early 20<sup>th</sup> century, periods of bourgeois revolutions and state formations in new nations with the subsequent evolution of capitalism in Western and Southern Europe. *The Victorian Underworld* (Chesney, 1970), *Laboring Classes and Dangerous Classes in Paris During the First Half of the Nineteenth Century* (Chevalier, 1973), *The Berlin Police Force in the Weimar Republic* (Liang, 1970), *The Spanish Labyrinth: An Account of the Social and Political Background of the Spanish Civil War* (Brenan, 1960) are just a few reflections on the existence and flourishing of the underworlds in Europe in the given period.

Yet, the term “organised crime” gained a foothold in Europe only after the early 1980s (Paoli and Fijnat, 2004, p. 23). Hobsbawm (1959) explains this absence of academic interest in the following manner: “Older historians have often tended to write off [organised crime] as marginal and unimportant phenomena, partly out of rationalist and ‘modernist’ bias, partly because... the political allegiance and character of such movements is often undetermined, ambiguous or even ostensibly ‘conservative’, partly because historians, being mainly educated and townsmen, have until recently simply not made sufficient effort to understand people who are unlike themselves”



(Hobsbawm, 1959, p. 2). With the same underlying theme, Block and Chambliss (1981) criticise scholars for ignoring the phenomena of organised crime in the nineteenth century, namely “[i]t is a strange fact that the scholarship dealing with Europe’s urban underworlds, scant as it is, is far stronger on certain nineteenth century cities than it is on any contemporary ones. It is as if the very notion of the urban underworld has been bequeathed to either historical study or to that branch of criminology that is solely concerned with juvenile crime. Undoubtedly, the latter point is one of the effects of the continuing influence of the Chicago school of social ecology on European academics” (Block and Chambliss, 1981, p. 122).

Organised crime in Europe during the late 18th and early 20th centuries was conceptualised in terms of “social banditry”, “urban underworlds” (Hobsbawm, 1959), “professional crime”, “criminal underworld” (McIntosh, 1975), or “dangerous classes” (Chesney, 1970). In all cases the political and economic circumstances play an irrefutable role in the emergence of organised crime and in the formation, shaping and cementing of a tight cooperation between the state and organised criminal entities. Hobsbawm (1959) alludes to the economic and political effects that brought about the emergence of ‘first-generation immigrants’, or Italian *Mafia*, that is, “they come into it as first-generation immigrants, or what is even more catastrophic, it comes to them from outside, insidiously by the operation of economic forces which they do not understand and over which they have no control, or brazenly by conquest, revolutions and fundamental changes of law whose consequences they may not understand, even when they have helped to bring them about... they break into it” (Hobsbawm, 1959, p. 3). Struggling for control over political power and resources, both within the nation and between states, is part and parcel of the bigger process of state formation and of the formation of international order. The conflicts of this type very often involve collaboration between legitimate institutions and organised crime. McIntosh (1975) emphasises the importance of political conditions, such as revolutions, that shape organised crime with “the changed situation of the state in late capitalism” (McIntosh, 1975, p. 153). Chambliss (2006) demonstrates how the competition between nation-states for control over territories and resources blurs the distinction between legal and illegal, and endorses states’ cooperation with organised crime.

Notwithstanding the fact that the scholarship dealing with organised crime in Europe in the 19th and 20th century is scant, there are a number of academic books and articles that explore the political, economic, and social systems of European states in the period of the late 18th to the early 20th century, that suggest, in one way or another, tight links between state institutions and organised crime. The next section briefly explores the evolution of the political and economic order of Italy and Spain in the late 19th and early 20th century, and that of France and England in the 16th and 17th century, and their interplay, through cooperation, with organised crime. Italy and Spain represent a vivid example of the exceptionally complex history of political and economic evolution, where organised crime was employed by the state to resolve internal political struggles, whereas France and England exemplify explicit collaboration between the state and organised crime in order to enable control over territories and international resources.

### *Italy*

The Mafia as a phenomenon emerged first in Sicily, at the end of the 18th and beginning of the 19th century. This historical period witnessed social and economic turmoil, as a result of political changes that brought about the redistribution of political power. The most significant change took place during the Bourbon era, was the abolition of the feudal system in 1812. In Sicily, with the absence of any reciprocity between social forces and political institutions in this period, which is so vital for political and economic stability in times of modernisation or transition, new actors had emerged to fill the vacuum. These newly emerged forces were mainly comprised of peasant bandits, referred to in the literature of organized crime as a “social banditry” phenomenon<sup>15</sup>. They played a two-fold role in the political economy of Sicily in this period.

First, through the use of violence, these illegal forces, also known in the literature of organised crime as “violent entrepreneurs”, enriched themselves by stealing, kidnapping and robbing people. Concomitantly, they created a network of collusion with

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<sup>15</sup> For more discussion on social banditry see Hobsbawm’s chapter ‘The Social Bandit’ in *Primitive Rebels*, 1959.

representatives of higher social ranks, both official authorities and bourgeoisie, in order to penetrate the highest echelons of society. This created a broad network of illegal collusive relationships between official agents, violent entrepreneurs and the upper classes, which was eventually cemented into a structural framework, with horizontally reciprocal relationships. Each entity performed a definite role in this network, thereby re-defining and re-shaping political and economic forces in Sicily. For instance, the bandits originated, organised and supervised operations, whereas the official authority supported and protected these illegal activities and guaranteed impunity to the bandits (Fulvetti, 2004, p. 55-56). There was even a reference to a “common fund” in the report of Cala Ulloa, the Bourbon official, to the Minister of Justice (Pezzino, 1995, p. 6-7, quoted in Fulvetti, 2004, p. 57).

Secondly, the bandits played a key role in resolving internal political conflicts between the ruling elites, local ruling classes, and the government, who cultivated illegal ties with bandits, in order to defeat their enemies and to gain political and economic power. Instances of such connivance are numerous; the collaboration between the Provisional Committee and criminal gangs during the revolution of 1848 (Fulvetti, 2004, p. 57); “...the alliance of the ruling-classes... [imposing] the socially more reliable National Guard and eventually the combination of policemen and Mafiosi... after 1848” (Hobsbawm, 1959, p. 36); the collusion between Camorra and the Bourbons “...who [the Bourbons] – after 1799 – regarded the *lumpenproletariat* of Naples [Camorra] ... as their safest allies against Liberalism” (Hobsbawm, 1959, p. 54).

From the outset of its formation, organised crime during the 19<sup>th</sup> century in Italy played a crucial role in the evolution of Sicily. It shaped its economic and political structure, by creating alliances with the ruling elites that helped to preserve their political power. In turn, the ruling classes turned a blind eye to the parallel system of law that the Mafia provided in the territories under its influence. Such symbiotic relations between the ruling elite and the Mafia, the state and organised crime, eventually established organisational and structural patterns. These patterns became a social reality which were transmitted and adopted in the later stages of state building.

In other words, the symbiotic interaction between state institutions and organised crime was institutionalised.

### *Spain*

In the period 1916-1923, Spain witnessed great political and economic turmoil, which culminated in the struggle between the conjoined forces of industrialists, socialists and a number of leftwing parties, and the ruling elite. The institutional landscape of Spain was highly corrupt. The army was demoralised. Brennan (1950) writes: “just as Governments took bribes, so peculation was rife in certain departments of the Spanish Army. In 1922, it was discovered that 77 million pesetas had been spent by the Ordnance Depot, without any record appearing on the books.” (Brenan, 1950, p. 61-62). Such an unstable political and economic order precipitated the growth of new forces that similarly pursued their own self-interest. There was a general struggle between the industrialists of the north and the landowners of Castile and Andalusia, and a bitter rivalry between the civil and military authorities, in which the military sided with the industrialists. The significance of these political battles lies in the fact that criminal organisations became leading actors in these internecine struggles, employed by the various contesting forces, as “...terrorist gangs, who worked at different times under the orders of the civil and military authorities” (Brenan, 195, p. 68). The ‘professional’ criminals were hired by the army, namely “the *pistoleros* [who] were organised from the Captain-General’s headquarters” (Brenan, 1950, p. 68). They served manufacturers’ interests and were also employed by the Government. The striking example of tight cooperation between the government and criminals in this period of political struggle was the appointment of the Civil Governor of Barcelona, General Martinez Anido, who chose three related methods to bring order to the city. He reorganised and armed a small *company* trade union, the *Sindicato Libre*, which already had a high proportion of professional criminals, and provided them with a list of syndicalist leaders to assassinate. In less than two days they murdered 21 CNT leaders. Secondly, he commissioned the Barcelona police to arrest and shoot labour leaders. Thirdly, workers were arrested and would be met from prison by a gang of ‘pistoleros’ who would shoot

them before they could return to the workers' district. This extensive network of cooperation between state institutions and criminal world in Spain was also recorded in the 1890s, a period of social chaos and terrorist attacks, when the political police of Spain, *Brigada Social*, was too incompetent to fight crime with the inadequate technical support provided. As Bernan put it, “[criminal gangs] grew up in close association with the police” (Block and Chambliss, 1981, p. 122).

### ***England and France***

By the mid-16th century Spain and Portugal were overtaking France, England and Netherlands in the competition for conquering new territories and amassing wealth. This was mainly due to the quick colonisation of America, and newly established trade with India, following Christopher Columbus and Vasco de Gama's discovery of the New World.

The political system of England in the 1600s was extremely corrupt. The authority of central governmental institutions was undermined by the local elites, enriched by the gains from piracy, who controlled local authorities. Typical of his class was William Kidd, whose famous voyage to Madagascar in 1696 was financed by England's most powerful politicians. Their support granted him immunity, and unique privileges, in return for embellishing his patrons' wealth (Ritche, 1986).

International relations also represented an ill-established institutional system (Ritchie, 1986, p. 11) with international conflicts fuelled by behavior that lacked the slightest patina of legality, that is, “through state sponsorship, by licensing of entrepreneurs, or simply by turning a blind eye to pillage” (Ritche, 1986, p. vi). Piracy was commonly legitimised by the issuance of a privateering commission, or “orders of the Crown”, that in wartime sanctioned attacks on enemy ships, and in peacetime endorsed piracy as a means of minimising losses. The Crown might also provide piracy with a “silent blessing”. As Chambliss (2004) writes:

*The state's complicity in piracy was more successful, one suspects, than even the most avaricious monarchs expected. On one voyage (between 1572 and 1573), Drake returned to England with enough gold and silver to support the government and all its expenses for a period of 7 years (Corbett, 1898a; 1898b). Most of this wealth came from Drake's attack on the town of Nombre de Dios, which was a storage depot for Spanish gold and silver. In this venture Drake joined forces with some French pirates and ambushed a treasure train. Drake was knighted for his efforts, but the Spanish were not silent. They formally challenged Britain's policies, but the Queen of England denied that Drake was operating with her blessing (after, of course, taking the gold and silver that he brought home) and Drake was tried as a criminal. He was publicly exiled, but privately he was sent to Ireland, where he reemerged several years later (in 1575) serving under the first Earl of Essex in Ireland (p. 186-187).*

Under the French law engaging in piracy meant a death sentence. Yet, the French government was the first to not only turn a blind eye to pirates, but also to join forces with them, in order to balance the center of power, and to neutralise the wealth of Spain and Portugal (Chambliss, 2004). The pirate ships found a safe haven in French ports, offered by the French authorities in exchange for a share of the stolen goods. With the clear aim of gaining international political and economic power, France employed the most violent criminals whose savagery toward their victims was notorious. One of the most prominent pirates of these times was a French pirate Borgnefesse whose cruelty and violence were “well protected by French ships and French colonies” (Chambliss, 2004, p. 186).

There are other solid studies of Germany's organised crime during the 18th and early 19th century (Lange, 2004), Corsican banditry (Wilson, 2004) and the Ottoman Empire's criminals (Yesilgoz and Bovenkerk, 2004) that detail the links between organised crime and state institutions.

To sum up, the period of 1800s-1900s in Europe evidenced political, social and economic changes, both nationally and internationally: civil wars, internecine strife, political struggles, revolutions, industrialisation and the establishment of capitalism.

The common denominator to the occurrence of all of these changes was the struggle for power, and control over resources, within the state and between nations.

Nationally, the same pattern of cooperation between state institutions and organised crime is observed in European states in the periods of political turmoil, revolutions and insurrections. State institutions and ruling elites formed alliances and employed organised crime in order to crush political opponents, restore political order within the state, or to seize control over state resources. In return, organised crime was given permission to perform a certain function of control in the territories, where state institutions were feeble.

From an international aspect, a nation's ability to protect its borders and to increase its territories was to a certain extent a question of its military strength. This depended on the amount of wealth a nation possessed. Wealth, for its part, was measured by natural resources. The more natural resources a nation possessed the more it invested in military equipment. A nation's prosperity also posed a threat to the sovereignty of other neighbouring states. Consequently, in order to prevent the monopolisation of wealth accumulation and political and economic advantage, states whose military was not strong enough to go to war and whose institutions were malfunctioning, resorted to making common cause with criminals. Pirates could help to balance the center of political and economic power. States formed illegal alliances with criminals to secretly engage in a variety of criminal activities and giving precise instructions to chosen state representatives to protect and support them. Such criminal activities as murder, stealing and rape took place with the connivance of state officials in exchange for a share in plundered proceeds.

To summarise, both sets of scholarship revised above suggest that the fundamental platform that enables and nourishes the existence of organised crime is the historical context of the political and economic evolution of a society, with a variety of national and international aspects. Therefore, the phenomenon of organised crime needs to be understood broadly as concomitant to the evolution of capitalism and state institutions.

Both in Europe and America, it frequently relied upon state support, performing certain functions of control that other institutions could not provide. However, in America the cooperation with the state was through corruption, whereas in Europe organized crime cooperated with the state openly, upon invitation. It is important to observe that America as a state was stronger, politically and economically, and with progressively larger ambitions, therefore the cooperation took the form of corruption. The study of European organised crime has been more challenging, as Europe is more heterogeneous, and its development was punctuated by wars. Unlike in the US, however, the organised crime phenomena took a form of a network rather than a strong hierarchy. Organised crime in Europe evolved in the context of economic and political instability, and due to certain factors, such as constant conflicts between neighboring states, the institutional weakness of states and the lack of wealth, it was openly invited to take part in resolving internal power conflicts by the ruling elites.

Therefore, organised crime in Europe evolved in a network relationship to the state compared to the US, where the links with the state took the form of corruption, reflecting institutional weaknesses of the time. In Europe organised crime, like in America, performed the functions of state institutions in certain respects. However, unlike in the USA, organised crime in Europe was commissioned, authorised and invited by the ruling elites to perform many functions that the state struggled to provide. This can help explain the distinctiveness of the European approach towards organised crime from American conceptualisation of the phenomena.



## **CHAPTER 2**

### **ORGANISED CRIME AND INTERNATIONAL POLITICAL ECONOMY**

IPE approaches to organised crime are focused on the relationship between crime, governance and political authority (Frieman, 2009). While it is perhaps too early to talk about an ‘IPE school of thought’ on organised crime, it is fair to say that there is a consensus in the literature on the fact that, depending on institutional context, organised crime can enable and reinforce official political authority, or it can operate in direct competition and contestation with it, emerging as a substitute for official political structures.

In general, IPE perceives organised crime as a phenomenon of capitalism and the specifics – often seen as deficiencies - of state-market relationships. Methodologically, there is a split in the IPE literature on organised crime. Firstly, there are those who examine the impact of markets on states. The advocates of this approach are largely concerned with the issues of production and distribution, demand and supply. They argue that the powerful effects of demand and supply create illicit markets and weaken states’ ability to exert influence. Secondly, the more conventional approach is to posit that organised crime is a product of the influence of states on markets. This cluster of scholars concentrates on power, centralised decision making and the resolution of conflicts. They argue that it is the state, with its ability to criminalise or enforce certain behaviours, which shapes the rise of organised crime<sup>16</sup>, which then in turn erodes state power. There are also arguments that crime becomes a means to expand state power.

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<sup>16</sup> For more detailed discussion on organised crime, states and markets see Fiman, H.R., 2009 “Crime and the Global Political Economy.”

Andreas and Nadelman (2009), for example, contend that the other side of criminalisation, de-criminalisation, usually “masks the enduring importance of power and conflict” (p.27) and assists in consolidating power and control. They emphasise the role of the state in encouraging “violations of other states’ legal control” by “refusing to criminalise tax evasion, money laundering...etc” and in “sponsoring and engaging in activities that their own laws criminalise” (p.29).

What unites the two groups of IPE scholarship is their understanding of organised crime as a response to the power vacuum created by the absence of state enforcement (e.g. Skapedras, 2001). In the era of globalising markets, this in turn, has two facets: on the one hand, contemporary organised crime has been enabled by the new opportunities opened up by globalisation. Terrorism, mafia activity, money-laundering, the drug trade, modern slavery, intellectual property theft, trade in human organs etc. have developed and grown in scale due to new markets and technology, communication and mobility afforded by globalisation, against the background of the limited powers of nation-states. On the other hand, and consistent with these trends, domestic contextual factors play a key role in the formation of organised crime. These include failing or weak states, institutional decay, economic and political instability, foreign aid and interventions in the process of state building.

The aim of this chapter is, by navigating through the still scarce political economic literature on crime, to draw out the key structural factors that enable the emergence or development of organised crime.

### **2.1. Institutional Failures in State-Market Interaction**

The interrelationship between state institutions, political stability and economic performance is at the heart of the IPE literature on organised crime. The fundamental platform in the analysis of the origins of organised crime is the institutional framework and its key role in the emergence, formation and development of the phenomena of organised crime (Gambetta, 1993; Bandiera, 2003; Buonanno et al., 2015). The degree of political and economic stability is defined by the political, economic and social environmental structure, which, in turn, is determined by institutions. IPE presents

institutions in a twofold way: on the one hand, they are the formal, restrictive organisations that define and shape patterns of behavior, limiting them to the existing social norms, rules and constraints (Rodrik, 2008); on the other, they are informal organisational entities shaped by habits of thought, principles, historical traditions and legacies (Rodrik, 2008).

Formal institutions enable individuals to engage in different activities by “structuring incentives in human exchange, whether political, social, or economic” (North, 1990, p.3) and have a twofold regulative role: they maintain the normal performance of the economy and free market on one hand, whilst seeking to encumber any informal institutions that infringe regulations or laws on the other hand. As such, the quality of state institutions determines the viability of informal institutions, both legal and illegal. While informal legal institutions such as the constitution and the electoral system shape, “enable and constrain political behavior” (Helmke & Levitsky, 2004, p. 726), informal illegal institutions, such as the black market, corruption or organised crime, hinder political and economic outcomes. In another words, institutions determine the structure of social order. Because social order “exists *only* as a product of human activity” (Berger and Luckman, 1967, p. 70), and human activities are determined by institutions that both define and are shaped by the structure of political, economic and social environments, the phenomenon of organised crime, that is clearly delimited by illegal (and therefore criminal) activities, is thus also a product of these aforementioned structures.

Institutional structures vary from state to state. This “incipient differentiation” (Berger and Luckman, 1967, p. 84) manifests itself in deficiencies, such as a lack of specific goals, ineffective regulatory policies and the disregard of laws and regulations, as well as in new and unregulated economic opportunities. These deficiencies determine many areas of conduct that are relevant to certain types of individuals and are recognised by scholars of IPE as characteristic of institutional weakness/failure, which, in turn, engenders the emergence of organised crime.

The roots of an institutional structure lie in historical legacies and patterns of behaviour which are a product of “reciprocal typifications of actions built up in the

course of a shared history” (Berger and Luckman, 1967, p. 72). Institutions, therefore, are the products of history. As Berger and Luckman (1967) wrote, “it is impossible to understand an institution adequately without an understanding of the historical process in which it was produced” (p.72). And though the effectiveness and ineffectiveness of state institutions and the causes thereof are understudied (Bares, 2008), IPE literature has identified a number of historical factors that undermined the strength of state institutions. These include colonialism, with its arbitrary borders and post-colonial struggles to establish viable political institutions and a centralised administrative system (Alao, 1999; Gross, 1996; Ignatieff, 2002; Esty et al., 1998; Prah, 2004).

Another contributory factor is the “economic inequity”, or the negative impact of the globalised international economic system that manifested itself in the “unfair terms of trade [that] make it impossible for states in the developing world to build up the revenues they need to build strong institutions” (Ezrow and Frantz, 2013, p. 68). The effects of the Cold War have also proved significant (Rosh, 1989; Zartman, 1995; Dorff, 1996) given that the majority of developing states, such as African nations, “became pawns in the hands of the superpowers [who provided] economic assistance without a clear strategy” (Ezrow and Frantz, 2013, p.71), which, in turn, facilitated the growth of widespread corruption. Lastly, the effectiveness of state institutions has also been hindered by the policies associated with the neoliberal agenda, namely its policy of state nonintervention in market forces (Fritz and Menocal, 2007), imposed upon nations as a by-product of international aid they may be in receipt of from international financial institutions (the World Bank, World Trade Organization and International Monetary Fund).

All these factors, according to scholars of IPE, are directly responsible for the failures or weaknesses of state institutions, and have negative consequences by prompting the emergence and formation of informal institutions and non-state actors. In essence, they make it easier for criminal practices and behaviours to become embedded within the weakened, and thus easily corrupted, formal framework. In other words, profit-driven crime becomes ‘institutionalised’, albeit not in a formal sense.

In line with this, this section will explore the different nuances to institutional failures, breaking them down into four focal aspects: regulatory inadequacy within states; the incompetency of states to effectively regulate newly emerging economic opportunities; the disregard of rules and regulations; and finally, institutional corruption.

### ***Regulatory Inadequacy***

Inefficient and inappropriate regulatory policies within both the public and private sectors create and encourage illegal markets, the dynamics of which engender and feed organised crime. Citing an article in *Foreign Affairs*, Tamanaha (2004) stressed that “...several decades and hundreds of millions of dollars have been expended on developing the rule of law around the world with minimal positive results” (p.4). As the organisational structure of organised crime, and the mode of its illegal operations, such as production, distribution and chain-supply, is claimed to strictly depend on the effectiveness and adequacy of regulatory policies and relevant laws, the degree of regulation is a significant element in shaping the legality, or its antithesis, illegality, of the provision of goods and services, particularly on the transnational level (Bersten, 1990).

There are a myriad of instances that can be traced throughout history that show how ineffective legislative measures facilitated the creation and moulding of illegal markets that foster organised crime. The US National Prohibition Act of 28 October 1919, Ch.85, a nationwide constitutional ban on the production, importation, transportation and sale of alcoholic beverages in America that remained in place from 1920 to 1933, is an early example of poorly conceived legislation that led to the creation of an illegal market in which organised crime flourished on an unprecedented scale. The ban on liquor by Federal law brought into existence an economic opportunity for criminal organisations to produce, distribute and sell alcohol illegally, since the public’s demand for alcohol was not significantly affected by the introduction of prohibition (Schloenhardt, 1999).

The trade in antiquities is another example where ill-defined legislation facilitates, and even encourages organised crime. The Dealing in Cultural Objects (Offences) Act 2003 in the UK created the offence of illegal trading in stolen, illegally excavated, and illegally exported artefacts. However, the design and implementation of the 2003 Act encountered a variety of problems, with the most salient being the international regulation of the trade in illicit antiquities, that is, “proving the origin and transit history of a clandestinely excavated and probably illegally exported artefact” (Mackenzie, 2011, p. 73). According to the 2003 Act, the definition of “tainted” does not include illegal exports. This, as Mackenzie notices, “is problematic since stolen objects are also often illegally exported, and it tends to be easier to prove their illegal export than it does the original theft – or at least a court would be more likely to find fault in a buyer if “taint” were to include unlawful export, the source country had a prohibition on unlicensed exports of that type of artefact, and the object had no export documentation” (p.73).

In similar vein, what is called the ‘provision of non-retroactivity’ requires UK prosecutors to prove the illegality of an object. This implies that “...a failure by the accused to carry out adequate checks on the provenance of an object will not constitute knowledge or belief” (Department for Culture Media and Sport, 2004, p. 8). This suggests that dealers would prefer not to ask questions about provenance, but carry on with their deals, thereby contributing to the growth of illegal markets, which create opportunities for the entry of organised crime groups or networks into the market chain of supply.

Consider this comment, from one prominent London dealer: “The people in Hong Kong don’t tell you [about provenance] because the people who smuggle the goods out of China are not the sort of people you want to talk about. When I’ve asked about odd pieces, you know, ‘Are there any excavation notes? Can you find where something like this came from? It would be fascinating to know.’ They just say, ‘You don’t ask those questions; you don’t want to get a reputation for asking questions.’ It wasn’t me saying that; that’s what they say. That’s the way presumably, if you’re a Hong Kong dealer, to

end up in the harbour” (London dealer quoted in 2007 study, cited in Mackenzie, 2011, p. 74).

The drug trade is another example of how regulations and prohibitions can impact and facilitate the growth of organised crime by generating fertile ground for increased criminal activities. Drug policies are regulated by the global legal framework that was defined by the UN Convention on Drugs 1961. In the UK, for example, the supply of drugs is regulated by the Misuse of Drugs Act 1971. The report ‘A Comparison of the Cost-effectiveness of Prohibition and Regulation of Drugs’, published by the Drug Policy Foundation, ‘Transform’, in April 2009, provides empirical evidence that demonstrates the negative effect of “this modern prohibitionist framework [that] was established with the clear aim of reducing drug supply and use, but has achieved the exact opposite on a consistent basis” (p.10). Yet, some comparative studies that examined the correlation between the level of consumption and public policies in “tolerant” and restrictive countries have found no significant differences in the consumption level (Reuband, 1995).

The strong correlation between the effectiveness of regulatory policies and the scope of organised crime is found in the effect of anti-money laundering regulations, which can be seen as an accelerant of criminal financial activities. Money laundering is a set of operations aimed at concealing proceeds from illegal activities by means of transfers involving legal business and foreign banks. It has a prejudicial impact on social, political, economic and security fields, both nationally and internationally. The inadequacy of regulatory policies concerning money laundering tremendously benefits organised crime in enabling the easy transformation of illegitimate and illegal assets into legitimate and legal property. Masciandaro’s (1999) analysis has shown that there is an inverse relationship between the increase in the volume of money laundering within a given economy and the effectiveness of anti-money laundering regulations, which is supposed to raise the costs of money laundering. The more effective the anti-money laundering regulations that are in place, the lower the frequency of crime. Through transforming potential into effective purchasing power, money laundering allows the reinvestment of laundered illegal funds, thus playing a crucial role in

strengthening the ties between the real and the financial side of a criminal economy (Masciandaro, 1999, p. 238).

The importance of legislative policies and laws in prompting, creating and facilitating organised crime can also be observed from the situations where formerly illegal goods become legalised. The legalisation of once illegal goods discourages organised crime from continuing to engage in the criminal activity related to the legalised goods. It has been found that after the prohibition of liquor was repealed in the US in 1993, criminal organisations suspended their alcohol producing and retailing activities (Schloenhardt, 1999, p. 208).

Some scholars point to the links between ill-defined regulations and corruption. This reciprocity is explored in the literature in a two-fold way. On one hand, economists argue that inadequate and ambiguous regulations engender corruption. A weak institutional system is a 'homeland' that offers indecent incentives for corrupt policy-makers, bureaucrats, and the public in general. The studies that have taken up the topic of corruption as an outcome of ineffective regulations have primarily used these instances which demonstrate the close links between the two concepts. For example, the research on transition economies in Europe and Central Asia has shown that restrictions to market entry result in high levels of corruption (Broadman and Recanatini, 1999; Djankov et al., 2002); studying the correlation between the period (in days) it takes to obtain legal permissions to conduct business, and the extent of corruption has found a positive correlation (Svensson, 2005). Another positive correlation between corruption and regulatory quality has shown that the more effective the regulations the lower the level of corruption (Gerring and Thacker, 2005). Finally, positive reciprocity is also observed in the financial domain between government regulation and corruption (Goel and Nelson, 2005).

On the other hand, IPE scholars claim that corruption hinders the development of adequate regulations and policies, and therefore poor regulation and corruption are often two sides of the same coin. When local firms are given preferential treatment in public tenders, this may induce corruption, but it may also be the outright result of strong private interests that have captured public funds (Lambsdorff, 2007).



Some scholars apply the concept of state failure to illustrate how the ineffectiveness of regulations prompts the appropriation of control over state institutions (Dobovsek, 2012). The seizure of state institutions is frequently a product of a weak institutional framework, which allows private gains to be distributed to state bureaucrats via loose, obscure, and discriminatory channels, or through a blurred distinction between the political and business agendas of public officials. Organised crime, as a rule, influences state officials in the conceptualisation and preparation of regulations, policies and laws, by means of corruption (Philip, 2001). In the same vein, Dobovsek (2012) suggests that in defining and analysing the state capture concept, we examine how different corruptive activities affect the creation and formulation of laws and regulations (p.171). By employing corruption as an effective method in subordinating public officials and thereby passing the laws that benefit organised crime's political and economic agendas, organised crime "...endangers political and social stability and security, undermines the values of democracy and the rule of law, jeopardises social, economic and political development" (Borlini, 2008, p. 73).

It is argued that the importance of the failure to provide effective laws and regulations tends to be magnified in times of transition from autocratic to democratic regimes. The manipulation of policy formation dramatically increases, which in turn leads to state capture. Hellman and Kaufmann (2000) from the World Bank Group, in their article "Confronting the Challenge of State Capture in Transition Economies", stress the significance of specific mechanisms, or specific types of corruption, through which non-state groups and individuals seek to shape decisions taken by the state to gain certain advantages, often through the imposition of anticompetitive barriers that generate highly concentrated gains to selected powerful firms at a significant social cost. Hellman and Kaufmann link the concept of state capture to the rule of law and describe peculiar types of corruption, such as bribes to "buy votes" on important pieces of legislation, to influence court decision, and shape the formation of laws, rules and regulations.

Overall, the bulk of IPE literature on organised crime focuses on the links between the ineffectiveness of regulatory policies and legislations, and organised crime. This ineffectiveness is generally recognised as a result of a weak institutional framework

imbued with widespread corruption through the system of illegal cooperation. It is argued that one of the essential fundamental principles upon which a strong institutional system rests is the rule of law, “a truly democratic rule” (O’Donnell, 2004, p. 32) which carries two facets. Firstly, the strength of state institutions lies in their responsiveness to the interests and needs of the citizens, such as those related to administration and security, which are defended by the vigorous rule of law. Effective rules and law, therefore, form the very cornerstone that determines the extent to which organised crime can thrive. Amongst the variety of features that underpin the effectiveness of regulations, laws and policies, some scholars suggest three fundamental qualities: equality, clarity, and publicity (O’Donnell, 2004). Others argue that accessibility, predictability, liability, legal rights, and compliance (Huntington, 1968; Bingham, 2007) determine this effectiveness. In addition to this, there is a plethora of scholars who conceptualise effectiveness in a different fashion. Tamanaha (2004), for example, describes three conceptually distinguished features that define the quality of laws and regulations: 1) government is limited by the law in that government and state officials must operate within a currently valid, positive law, with restraints on their law-making power; 2) formal legitimacy stems from the qualities of generality, equality of application, and certainty; 3) legitimacy is ensured when individuals are ruled by law, not by men.

Nonetheless, irrespective of the differences of opinion on which characteristics determine the effectiveness of the regulations and laws, all scholars agree that ineffective laws and regulations, and weak or failed institutions, are two sides of the same coin. The inadequacy and ineffectiveness of the rule of law implies weakened or even failed state institutions that struggle to provide basic public services and goods. These failings tend to get magnified in transition periods, when organised crime tends to play a role as an important socio-economic institution.

Secondly, the ineffective and ambiguous “rule of law” can play a seminal role in undermining citizens’ trust in the state. When regulatory policies and legislations are applied unequally, i.e. benefiting the powerful and disadvantaging the powerless,

rendering “the rule of law” unclear and arbitrary, the population’s faith in state institutions becomes corroded.

### ***Incompetent Regulation of Innovative Economic Opportunities***

Crime tends to thrive in new, untested markets, and unregulated area of activity. Many scholars apply an entrepreneurial or business perspective in explaining the phenomena of organised crime. They argue that organised crime emerges in areas with newly created industries or new methods of generating money, and apply a market opportunity structure approach in discussing the nature of the emergence of organised crime. Albanese (2008), for example, argues that organised crime is attracted by the availability of high-risk products and markets and suggests four features that generate market opportunities that define the level of attractiveness for organised crime. He posits that supply (defined by availability and ease of movement of goods and services), demand (characterised by the extent of elasticity), regulators (limited in their effectiveness by the ease of entry into the illicit market or product), and competition (described by profitability, the history of organised crime in the market, and the impact of any consequent harm) play a key role in the creation of new illicit markets and new illegal methods of generating money, where organised crime is the first to seize these opportunities (Albanese, 2008). Edwards and Gill (2002), Reuter (1985), and Smith (1980) also suggest that it is the interaction of these four variables that constitutes any particular market’s opportunities and structure, and thus contributes to the emergence of organised crime and its involvement in illegal trade or market. Organised crime, therefore, is understood as a phenomenon that responds to newly created opportunities, thereby spiraling into increased criminal activities and transnational networks, which eventually threaten nations and the world order.

Some scholars suggest that it is the vulnerability of markets that attracts organised crime. Mackenzie (2011), for instance, applies a “sector vulnerability” versus a market-oriented model, and argues that the market of antiquities in the UK is to a considerable extent vulnerable to organised crime, as it largely relies on the looting of artefacts. Yet

the looting is considered by the dealers as beneficial as it potentially saves artefacts from destruction by infrastructure projects like road building (p. 82). This benign act of “saving” clearly represents an opportunity offered by the market, and organised criminals promptly react, deploying a new method of generating profit.

Political and economic reforms that are followed by power vacuums and instability create and alter market structures. As a result of these reforms, newly emerged market structures very often serve as breeding grounds for the emergence of organised criminals, who are able to benefit from free entry, and seize control by exerting enforcement powers. The provision of protection is an example of how a market structure creates new opportunities to generate illegal money. In Sicily, for example, the demise of feudalism in 1812, and the collapse of the Bourbon’s regime in 1861, contributed to the disruption of law enforcement institutions and the weakening of property rights that created new opportunities where the market structure became “... a curious sort of monopolistic competition, whereby each gang has the local monopoly of protection within a certain area and this local monopoly is maintained by the gang’s capability of mobilizing and using force against other gangs” (Skaperdas, 2001, p. 186-187). The absence of state protection created a new criminal opportunity to use violence to illegally extract money, thereby increasing and intensifying criminal activities.

Another explanation presented by some scholars for the emergence of new criminal opportunities lies in the application of economic modelling to the deformational effects imposed by market restrictions. They argue that market limitations create opportunities for criminal behaviour such as systematic corruption. Lambsdorff (2007) gives an example of one of the biggest cases of systematic corruption as an outcome of market distortion. The Iraqi Oil-for-Food programme between 1995 and 2003 was created in order to help provide the public with basic necessities. As such, the sale of oil was restricted to the exchange for humanitarian goods. This limitation not only created ample opportunities to increase prices, but also provided opportunities for massive corruption. Lambsdorff (2007) writes:

*“Of the 4,500 private firms involved in the program, close to half were involved in the payment of bribes. One paradigmatic case relates to a truck being sold by Daimler*

*Chrysler. While the regular price would have been US\$130,000, the company charged US\$143,000 and passed on US\$13,000 to a Swiss bank account of an Iraqi official. Likewise, oil left the country too cheaply, and kickbacks were paid in exchange” (p.3).*

It is argued that the larger the markets in which transactions are proscribed by the government, the greater are the economic opportunities that engender organised crime (Andreas, 1999). New and unregulated economic opportunities that emerge as the result of a lack of regulations, or ill-defined laws and policies, political changes and economic reforms, social and technological changes, geopolitical changes, failing states and globalisation have a significant impact on the type of criminal activity, and the mode of criminal operations. If new regulations, for example, are lacking the administrative corroboration that should be provided with operational ‘infrastructure’, the mode of the provision of goods and services will be altered by organised crime.

### ***The disregard of laws and regulations***

A problem that often overlaps with institution deficiency and the emergence of new economic niches is the disregard of laws and regulations. Individuals who “fail to adhere to established institutional rules, or are denied their protection” (Feige, 1990, p. 990) play a significant role in shaping the informal economy,<sup>17</sup> a breeding ground for organized crime. Conducting business without a formal license, or trading in goods that violate intellectual property rights, for instance, are manifestations of the informal economy created by the disregard of laws and regulations.

It ought to be noted, however, that it is not only the violation and neglect of legal constraints and regulations that fosters an informal economy. The disregard of regulatory stipulations in the production and distribution of goods and services also contributes to the emergence of the informal economy. A non-exhaustive list of examples includes tax evasion in the cigarette trade, the employment of illicit labour, the violation of safety and environmental compliance standards in the production or

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<sup>17</sup> A concept of informal economy was presented first in economic anthropology (Hart, 1988)

distribution of otherwise legal goods, illegally harvested timber, trafficking in protected species without an export license, and arms trading with forged end user certificates (Beckert and Wehinger, 2012). A key point of distinction between informal economies and illegal markets is that informal economies involve legal goods, whereas “illegal enterprise involves the production and commercialisation of goods that are defined in a particular place and time as illicit” (Portes and Haller, 2005, p. 4). Schneider (2008), for example, maintains that evasion of taxes, disregard of policies aimed at social security, ignorance of labour market standards, and non-compliance with certain administrative procedures comprise forms of the underground economy that pertain to legal goods and services.

Illegal markets are created by organised crime. The nature of the illegality of products and services that are defined as prohibited, such as drugs, weapons and trade in human organs, constitutes the essence of organised crime. Yet, criminal activities perpetrated by organised crime are not solely limited to illegal goods, with numerous legal goods also being traded. Naturally, the trade of legal goods and services is regulated by the state and requires legal stipulations, allowing this element of ‘condition’ to serve as an incentive for organised crime. Thus, scholars claim that the violation and disregard of regulations, laws and in some instances, norms, contributes to the creation of the informal economy which, in turn, facilitates organised crime. This comes at the cost of third parties like the state (Beckert and Wehinger, 2012). For example, Sakwa (2000) posits that if laws and policies are ignored and unenforced, power and authority is at the mercy of non-state individuals or organisations, that is, “[p]ower and authority are formalised with the force of law and ultimately with the sanction of coercion, and no longer open to permanent contestation and redefinition” (p.195). Other scholars argue that in some instances, violations of laws, regulations and restrictions are almost welcomed because they create an informal economy, the mainspring of which is “the inalienable right to life and property, which comprises the right to sustain both life and property through honest work” (Sennholz, 1984, p. 9). Sennholz (1984), for example, argues that the underground economy, created by the circumvention of laws and regulations, “promises new hope and opportunity” (p.9). This view can be supported by the claim that in the time of economic stagnation and decline, in the former USSR in

the 1980s, the underground economy that emerged as an outcome of flagrant violations of extant laws and regulations served a useful economic and social function. Given the great scarcity of basic products, and the habitual difficulty of obtaining them through official channels, the underground economy offered vitally important commodities in abundance. However, irrespective of the “quality” of laws and regulations, whether they are designed to favour the entire population or merely to serve specific parties, there is a consensus amongst all scholars that the disregard of laws and regulations directly paves a way to the emergence of the underground economy, and, thus, fosters organised crime.

In one way or another, all these factors challenge the strength and effectiveness of state institutions. This, in turn, affords a widespread system of corruption, bribes, inappropriate patronage, and a lack of clear separation between the ‘private’ and the ‘official’. In some extreme cases, states eventually lose control over political and economic facets of the country, rendering the jurisdictions failed states.

The role of organised crime in the process of state failure is illuminated by newer scholarship. Scholars address this interrelationship through the lens of political economy, and argue that organised crime can both cause, and emerge out of, state failure. Political aspects of organised crime reflect opportunities afforded by disturbances in the functioning of the state (Schelling, 2002). These opportunities undermine the power of the state, and prevent it from providing basic public needs such as security and economic opportunities, eroding its legitimacy and functionality. Ultimately, the end result of this is institutionalised corruption (Williams and Godson, 2002; Makarenko, 2002), organised crime exerting control over territories (Mylonaki, 2002), and the provision of public goods being shifted from the state to organised crime, thereby securing the loyalty of citizens towards organised crime (Rotberg, 2002). Given these patterns, it becomes evident why some scholars suggest that administrative corruption in institutions, and organised crime, are intrinsically linked (Hehir, 2007, p. 321).

The prevalence of organised criminal activity in weakened or decayed administrative institutional systems also implies a high level of politicisation of these institutions, with

political interference with appointments, few guarantees of occupational stability or promotions, and a patrimonial approach becoming embedded into the system (Buscaglia, 2003). As with administrative institutions, weakened judicial systems can also suffer from a high level of organised crime intervention (Bibes, 2001). Biased judicial rulings, the abuse of judicial discretion, procedural complexity, judicial corruption, a lack of predictability in judicial rulings, and a lack of transparency and high rates of impunity are all factors that contribute to the formation and success of organised crime (Ezrow and Frantz, 2013). Weak security institutions are considered easy prey for organised crime “because there is more opportunity for them to exercise control” (Ezrow and Frantz, 2013, p. 214). It therefore comes as no surprise that scholars have argued that countries with the lowest level of police training tend to exhibit the highest level of organised crime (Buscaglia, 2003). Consequently, weakening/decaying state institutions represent a fertile ground for the formation of organised crime, mainly due to the widespread experience of high levels of bribery and corruption, a phenomenon that will be explored in further depth in the subsequent section. Some of the studies of IPE literature on organised crime have been devoted to “state capture”. This involves the “use of political power and insider knowledge to achieve (criminal) aims in a subtler way to weaken the administrative, judicial, and security institutions from within” (Cornel, 2006, p. 40). Analysis shows that corrupt practices, such as the “de facto takeover of public institutions for private business or criminal activity; forming collusive networks to limit political competition; undermining free elections through slush funds, hidden advertising, etc; misuse of legislative power; corruption of the judicial process; misuse of auditing, investigatory, and oversight powers; using kompromat for political blackmail and coercion; corruption of and in the media”, in other words the network of corrupt agents, or organised crime, are a clear manifestation of a “state capture”(Karklins, 2002, p. 24).

The primary goal of all these studies is to derive insights into how organised crime, through weakening or demolishing the institutional landscape within states, affects political stability and economic performance, and can eventually cause state failure. Some studies have focused on the political aspects of organised crime. Although the analyses of political consequences of organised crime are relatively few in number,



recent years have brought an increased examination of the political effects of organised crime (see Sberna, 2011; Acemoglu et al., 2013; Pinotti, 2013). For instance, using data on over 1,500 municipalities in Southern Italy in the period between 1985 and 2011, Daniele and Geys (2015) have empirically demonstrated the negative correlation in the relationship between organised crime and politicians as a result of the improvement in the institutional framework.

## **2.2. Globalisation and the Development of Transnational Organised Crime**

In recent years, scholars and policymakers have expressed growing concerns about significant new forms of international crime, such as terrorism and money laundering, and a surge in the illicit trade in stolen ideas, human organs, weapons, drugs and even humans themselves. Scholars of IPE argue that the common denominator to all these crimes is that they are enabled by the power vacuum created by market-driven globalisation.

The conventional explanation for organised crime suggests that it is a side effect of globalisation. This claim depends on a certain perspective on the neoliberal policies that underpin the mechanism of globalisation - a global market free from any external interventions and regulations, increased mobility and the decline in international restrictions on movement of goods, services and money. Studies have argued that such “freedom” weakens institutional frameworks and thus facilitates criminal activities. In Latin America, for instance, neoliberal policies have weakened state administrative institutions and provided a fertile ground for the unprecedented rise of organised crime (Boege et al., 2009).

It is argued that globalisation, whilst encouraging the growth of legitimate trade through its mechanism of loosening, and even abolishing, border controls, created innumerable market incentives (Naim, 2005). This, in turn, contributed to the spread of illicit commerce that benefited from a variety of competitive advantages. One of these advantages is the difference in the jurisdictional system of different states which enabled the smooth movement of illicit goods from one jurisdiction to another.

Arguments that globalisation has facilitated the spread of transnational organised crime through encouraging market forces echo earlier explanations of the outbreak of two World Wars. In his classic *The Great Transformation*, Polanyi (1957) argues that the aftermath of the Industrial Revolution, and the introduction of ‘self-regulating’ markets, eliminated social and cultural identities, thereby creating sharp divisions within society. This, in turn, changed the relationship between society and the economy and brought about a social crisis. The formation of trade unions, the emergence of nationalism, and the Darwinian concept of natural selection of nations all propelled the outbreak of two World Wars, according to Polanyi. Thus IPE literature suggests that in the periods of transition “market incentives, [that emerge] outside the structures of legitimate authority and power” (Mittelman and Johnston, 1999) contribute to widening social disparities, enable the emergence of non-state actors, and eventually bring about conflicts that threaten national and world order. Yet, while some scholars argue that transnational organised crime is the direct product of globalisation, others strongly refute this claim. Andreas (2004), to name but one example, argues that ‘transnational organised crime’ is simply an old “long-established clandestine transnational economic practice” of “some form of profit-driven smuggling across borders” where “smuggling is as old as efforts to control borders” (p.643).

The perception of organised crime as a side-effect of globalisation stems from studies of the technological, political and financial changes that have empowered criminals, as well as transformed economies and re-shaped governments. Many aspects of globalisation benefit organised crime, such as the weakening of government border controls, an increase in trade volumes, the emergence of multiple cross-border informal networks, and the growth of new forms of terrorism (Naim, 2005). IPE scholars argue that globalization, and its accompanying neoliberal policies that promote governmental non- intervention, weaken state institutions, thereby aiding crime. Several studies have empirically demonstrated the causal relationship between organised criminal activities and political instability, coups, and assassinations, also known in the IPE literature as “greed wars”. One example is the drug trade in Guinea-Bissau, which is deeply integrated into the political framework; or the control of profits from illegal activities,

such as diamonds in Sierra Leone, or human trafficking in Ghana, Togo and Mali (Prah, 2004).

The intersection of globalisation and organised crime in IPE also investigates the collaborative nature of the relationship between organised crime and other non-state actors, such as terrorists and other violent groups. The struggle to control resources, to take advantage of existing global logistical arrangements, and the need to join forces to achieve goals, such as the defeat of a mutual enemy, are major determinants of these collaborations (Forest, 2010; Makarenko, 2004; Shelley and Picarelli, 2005). These links may only last until the desired goal is achieved, but may also prove more durable, as when a terrorist group controls a certain territory and the illicit trade within it, and begins to be envisaged as the only feasible provider of protection to the resident population. In this case, the relationship between organised crime and a terrorist group is adversarial, as can be observed with organised crime in West Africa<sup>18</sup>, and the Taliban in Afghanistan<sup>19</sup>.

Nevertheless, while some studies of IPE explain transnational organised crime as a side effect of globalisation - enabled by rapid technological innovations, free markets and deregulations, easy trafficking in people and narcotics, money laundering, computer fraud, stealing nuclear material, cross-border terrorism, piracy, and corruption - others argue that transnational organised crime is a more complex phenomenon, and itself an integral part of globalisation, where "the political, economic, and normative agendas of state and non-state actors led to selective criminalisation and diverse patterns of compliance with prohibition regimes" (Friman, 2009, p. 1).

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<sup>18</sup> For a more detailed discussion on transactional relationships between organised crime and terrorist in West Africa see Vanda Felbab-Brown & James J. F. Forest, 2012. 'Political Violence and the Illicit Economies of West Africa.' In: *Terrorism and Political Violence*, Vol. 24, pp. 787–806,

<sup>19</sup> For a more detailed discussion on the links between terrorist groups and drug trafficking, see Jonathan Goodhand's article *Corrupting or Consolidating the Peace? The Drugs Economy and Post-conflict Peacebuilding in Afghanistan*. *International Peacekeeping* Volume 15, Issue 3, 2008 Special Issue: Post-conflict Peacebuilding and Corruption

Scholars who adopt this viewpoint examine the intersection of organised crime and globalisation through the prism of the “changing nature of states and markets” (Frieman, 2009), contesting that markets, in fact, do challenge states. The demand for illicit goods, cheap labour, services and capital inevitably drives markets to provide illicit supplies, which are facilitated by the mechanism of globalisation, through policies of economic liberalisation, such as lax control of national borders. This, in turn, challenges states.

There are accounts, for instance, that examine organised crime and globalisation through the links of power, global economy and global crime. For example, the concept of “otherness” reflects this power-market-global crime nexus. Drawing on Carl Schmitt’s concept of power, scholars of political economy apply the concept of “otherness” to analyse organised crime (Mittelman, 2009). According to Schmitt, there is a clear-cut distinction between insiders and outsiders in political life, where outsiders are considered political enemies who represent a threat. As such, the enemy is to be criminalised and exiled from the society, moreover all constitutional protections towards the enemy are to be suspended. Employing this model in examining organised crime as an integral part of globalisation, some scholars argue that this “state of exception” determines “the fate of trafficked, transnational workers who have become disposable, subtracted from the system of sovereign nation-states” (Mittelman, 2009, p. 164). In other words, globalisation opens borders and provides influxes of cheap labour, thereby enriching national and global markets and economies. Simultaneously, it satisfies the needs and interests of global organised crime by enabling them to control this labour force. Inherently, organised crime then proceeds to use the lack of constitutional protections to criminally exploit a labour force that are considered outsiders within the host country.

The interconnections between transnational actors and networks provide yet another perspective on the role of organised crime in the context of globalisation. Studies that examine transnational organised crime in the light of a link between transnational actors and networks apply different approaches. Some scholars use a conventional approach that assumes lowered barriers to entry and new communication technologies “allow such tasks as warehouse management and shipment tracking to be done remotely” (Naim, 2005, p. 19), thus facilitating the emergence of a new breed of criminal players

and activities. It also enables the expansion of existing national criminal organisations internationally, through new ventures and structures.

Others argue that “these arguments are less helpful in capturing the ways in which transnational actors and networks have been instrumental in the political contestation of global prohibition regimes” (Friman, 2009, p. 11). Palan (2009) argues that the globalisation of crime is enabled by the change in shifting patterns of capital accumulation, from traditional trade to capitalisation of “anticipated future earnings”. The latter requires approachability of legal financial markets which are enabled by so-called tax havens, or offshore zones, where certain states and transnational actors sell residential rights to foreign citizens for money. This, in turn, enables organised crime to utilise legal methods of capital accumulation, thereby expanding transnationally by leveraging the seemingly unmissable opportunities in foreign, financially enticing jurisdictions. There are also studies that have examined the political impact of transnational actors on transnational organised crime (Andreas and Nadelmann, 2005), furthermore depicted criminal groups as “transnational moral entrepreneurs” (Picarelli, 2005).

Nevertheless, irrespective of the explanations that organised crime exploits “technological innovations, deregulation, and free markets to triumph over state sovereignty”, or that it results from “political, economic, and normative agendas of state and non-state actors [that] lead to selective criminalisation” (Friman, 2009, p. 1), scholars of IPE unanimously acknowledge that it is globalisation that both helps and transforms crime. Globalisation generates unfair terms of trade, opens new lucrative opportunities and offers “a high degree of flexibility, the ability to adjust to market changes and the use of socially weak segments of society” (Hofmann, 2009), thereby creating power vacuums. Organised crime, therefore, is to be understood as an organised response to these power vacuums, seeking to plug the gaps left behind by the frailties and cross-state inconsistencies fashioned along the trail of an increasingly globalised world.

In sum, IPE tends to conceptualise organised crime as an outcome of institutional weakness or institutional failure. It is generally argued that whilst a high quality

institutional system will endure any economic and political instability, the latter will have an adverse impact on weak institutions with a high probability of failure. Weak or failed institutions create a variety of institutional deficiencies, such as social disparities, new and unregulated economic opportunities, ineffective regulatory policies, and a disregard of laws and regulations. All these failings tend to get magnified during periods of transition from autocratic to democratic regimes (REF). It is here where organised crime plays an important role as a socio-economic institution.

### **2.3. Structural Factors in the Political Economy of Organised Crime**

Numerous studies have indicated that structural factors, such as major societal events, environmental conditions, resource availability and demography, to name but a few, play a significant role in hindering institutional effectiveness, and thereby facilitating organised crime. Scholars and researchers emphasise that environmental factors, such as poor agriculture or geographic location, play a sabotaging role in weakening state institutions (Sachs and Warner, 1997; 1999), moreover they stress the impact a country with high levels of criminal activity exerts on its respective neighboring countries, often leading to increases in organised crime within other countries of close proximity.

In light of these deeply ingrained structural causes, this section will be anchored around two of the most prominent factors that facilitate organised crime; the notion of the struggle for resources, and how this struggle contributes to the establishment of organised crime, and the impact of crises and transitions, and how these relate to the onset of organised crime.

#### ***Resource Competition and Organised Crime: Regulatory and Policy Framework***

The role of the regulatory and policy framework in resource-rich countries in facilitating organised crime is frequently discussed in the IPE literature. In line with this argument, many scholars have pointed to the historical function of resources in the quality of

institutional development - one of the key motivations for the establishment of organised crime around the world.

It is argued that national resource abundance affects the quality of state institutions. Gylfason and Zoega (2002), for example, argue that resource wealth gives a false sense of stability and security, thereby undermining institutional efficiencies, qualities and development. States that over-rely on primary resources are often referred to as rentier states<sup>20</sup>. The institutional landscape of these states is arguably dominated by patron-client networks (Smith, 2004).

The juncture of natural resources and weak institutional system as a facilitator of organised crime in IPE also investigates the correlation between natural resources and investment in education and other industries, such as manufacturing<sup>21</sup> (Gylfason et al., 1999), and also with kleptocracy (Acemoglu et al., 2004), opportunities for rent seeking (Gylfason and Zoega, 2002; Brinkerhoff and Goldsmith, 2002), conflicts (Reno, 2000a), and civil wars (Collier and Hoeffler, 1998). All these side effects of resource abundance clearly weaken political and legal institutions. In such a dysfunctional institutional environment, where struggles over access to resources are likely to accelerate, corruption, rent-seeking and violence increase (Collier and Hoeffler, 2002; Skaperdas, 2002) and mafia-type organisations emerge (Gambetta, 1993; Konrad and Skaperdas, 2012).

The role of resources as geographic preconditions contributes to the creation of economic opportunities for criminal behaviour. For example, both the lack and abundance of resources, such as labour and food, translate into negative impacts on the institutional development of states (Engerman and Sokoloff, 2002; Rodrik, 1999; Isham, 2005). A prime instance of this would be the correlation between an abundance of natural resources, and an increase in corruption, particularly through the creation of rent-seeking opportunities (Ades and Di Tella, 1999; Leite and Weidman, 1999; Montinola and Jackman, 2002; Gylfason, 2001; Sandholtz and Gray 2003; Ades and Di Tella 1996; Wei 2000a). These internal political and economic conditions constitute the micro-level

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<sup>20</sup> Rentier states predominantly rely on rents, external revenues that usually derived from the exploitation of natural resources.

<sup>21</sup> This phenomenon is known as Dutch Disease and referred to the decline in the manufacturing sector in the Netherlands after it discovered natural gas in 1959.

factors that foster challenges to state institutions, which, in turn, facilitate the rise of a more dangerous and, thus, challenging phenomenon - organised crime. Thus, countries that are rich in natural resources, such as rare metals and oil, or indeed other resources, including arms and agricultural prosperity, tend to present an auspicious opportunity for criminal networks to leverage this abundance for their financial gain (Sachs and Warner, 1997; 1999). In other words, if a certain state possesses natural resources, organised crime will endeavour to maximise their share of the pie.

In Sicily, for example, the discovery of sulphur in 1883 occurred in the context of weak law-enforcement. This favoured the emergence of a mafia-type criminal organisation, the Brotherhood of Favara (Dickie, 2004). Buonanno et al. (2015) argues that "...this reflects a broader phenomenon, namely the fact that under weak institutions an increase in the value of lootable natural resources may foster mafia-type organisations" (p. 175).

The strong correlation between violent crime and the struggle for resources is one that has continuously been noted by scholars (Gates et al., 2012; Collier and Hoeffler, 2002; Cooper, 2002; West, 2006). Nations which have only recently emerged from periods of war tend to be highly vulnerable. This is due to the fact that states that are already governed by unstable regimes have more difficulty in attempting to transition from a phase of widespread violence, to a state of peacefulness. Furthermore, with an abundance of military resources and supplies still circulating within the state, criminals have unparalleled opportunities to capitalise on these unsteady periods, rendering organised crime a common occurrence in the aftermath of warfare (Paris, 2004).

Another point of discussion that has taken place in the political arena with relation to resources and crime surrounds the question of what exactly constitutes a volatile resource – i.e. a resource which puts a country at risk of contracting waves of organised crime. Ross (2004) posits that resources can, in fact, be split into two distinct categories; those which are easy to loot, and those which are not possible to loot. An example of an easy-to-loot resource would be gold, for instance, which can be mined, carried and exported with minimum fuss, mainly due to being compact in size and high in value. Alternatively, an example of a resource which is not possible to loot (or at the very least, presents great difficulty in looting) is oil, whereby mining via an oil-rig would pose



significant stumbling blocks; it is not discreet and is bound to attract unwarranted attention, it is extremely expensive and consumes vast amounts of effort and time, and its value only becomes interesting to criminals when harvested in massive quantities, which, in turn, would pose new issues altogether with regards to transportation and exporting (Ross, 2004).

Other scholars, such as Le Billon (2001), suggest that another possible way to interpret and categorise volatile resources is through a geographical lens. This stance posits that a resource which is situated in a rural region would tend to be far more volatile than its counterpart situated in the inner-city. The reasoning behind this proposal is as follows: the closer a resource is to a city or state capital, the higher the likelihood of that resource being safeguarded well and difficult to access, and, henceforth, the higher the barriers to entry for organised crime (Le Billon, 2001).

As such, upon studying the various interpretations within the literature on resources, it becomes viable for us to apply the political economy of resources and crime to global cases of criminal activity and conflict, allowing us to understand these examples through innovative angles that have seldom been considered beforehand, like the case of Columbia, to name but one instance.

As a hotbed for illegal drug cartels, it has often been the case that most academically-grounded literature on Columbia's crime and violent conflict problem becomes sidetracked, with the drug trade regularly featuring as the root cause of all the issues (Angrist and Kugler, 2008; Bagley, 2001; Holmes et al., 2006; IEPRI, 2006; Mejta et al., 2014; Pardo, 2000). However, with that having been said, some writers in recent years have taken the initiative to break this mold, choosing to focus instead on the ties between resources and organised crime beyond the drug trade, and thus delving into the realm of the political economy of resources. Amongst the most suggestive of these contributions comes from Massé and Camargo (2012), who highlighted criminal groups' efforts to capitalise on the revenues which the Colombian mining industry creates (Massé and Camargo, 2012), hence fostering a breeding ground for Colombian illicit market trends in the wake of the country's boom in the mining sector.

### ***Crises, Transitions and Organised Crime***

Much of the discussion on organised crime in the IPE literature and amongst policymakers has focused on social disparity. The literature demonstrates the clear links between poverty and inequality, and crime and violence. Neoclassical theory maintains that free international trade has an impact on national income, social stability, political power and economic growth - the four basic interests upon which a state-power theory is based (Krasner, 1976, p. 317) <sup>22</sup>. Social inequality thus becomes a function of the openness of international trade. IPE literature demonstrates the negative impact of openness on social stability. Krasner (1976), for example, claims that “greater openness exposes the domestic economy to the exigencies of the world market” (p.319). These “exigencies” take the form of social instability that results in the increased unemployment of mainly, but not only, unskilled labor.

Social inequality can also emerge out of turbulence in the domestic economy. It is commonly recognised that economic and financial crises have far-reaching negative effects on social development. Inequality in the distribution of income and growth in unemployment rates, as a result of the financial crisis, for instance, have a paramount effect on the well-being of a society, which inevitably leads to social disparities. Social disparity, as a concept, measures poverty, and, in particular, assesses the level of community poverty and determines the level of local needs. Scholars suggest that the higher the rate of inequality in a given society, the larger the group of people in the lowest category of privilege (Yusuf et al., 2001). These groups comprise a variety of individuals who are poor, socially unprotected and therefore vulnerable, and include the victims of trafficking and smuggling, poor producers of illicit crops who lack sustainable alternatives, and lowly state officials who are no longer able to support their families. These individuals in the lowest groups represent “a state of exception” (Agamben, 1998, p. 169-175), where quite often they are not only deprived of basic

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<sup>22</sup> For a more detailed analysis of state power and international trade see Krasner’s 1976 paper “*State Power and the Structure of International Trade*”.

public services, but are also “outside the usual juridical order” (Mittelman, 2009, p. 164).

This social disparity, as is suggested, serves as a foundation upon which organised crime thrives, exploiting the most vulnerable in society behind the façade of “lending a hand”. An apt illustration of this “state of exclusion” was provided by the Asian financial crisis of 1997-1998, where immigrants were criminalised by being blamed for the financial crisis (Mittelman, 2009, p. 164-165), and therefore socially excluded. The reaction of organised crime was instant. The report “Exploring Policy Linkage between Poverty, Crime and Violence”, produced in 2008 by the United Nations, demonstrates the links between inequality, states of exclusion and organised crime, by pointing out that social exclusion which reinforces inequalities helps forge strong bonds between the excluded community and organised crime. Accordingly, inequality and exclusion may therefore result in negative social and political consequences which threaten public safety, undermine the democratic process and restrict growth (p.20).

Block and Chambliss (1981) argue that in order to minimise the number of the unemployed labour-force that is set to embark upon the path of crime, it is vital that stable state institutions and an adequate welfare system are in place. They believe that punitive laws and underpowered welfare provisions are the main reason for “a surfeit of crime” (Block and Chambliss, 1981, p. 130). They highlight the interconnection between crime and state institutions, demonstrating the importance of the ruling class, or the bourgeoisie, in establishing and transforming organised crime by offering new opportunities and power to criminals. One of the ways this is done is through the formation of new state institutions, which predominantly promote the interests of ruling elites. To reinforce this claim they cite Landes (1969, p. 9):

*“Mass production and urbanization stimulated, indeed required, wider facilities for distribution, a larger credit structure, and expansion of the educational system, the assumption of new functions by government. At the same time, the increase in the standard of living due to higher productivity created new wants and made possible new satisfactions, which led to a*

*spectacular flowering of those businesses that cater to human pleasure and leisure: entertainment, travel, restaurants, and so on”.*

In other words, economic changes that took the form of an industrial revolution, and that reflected the transition into a mercantile economy, had a significant transformational impact on the formation of organised crime.

Nevertheless, it is not only economic and financial crises that are responsible for social disparity. Corruption that has an adverse impact on economic development (Mauro 1995) also undermines the quality of a state’s institutions, thereby feeding poverty and inequality. The misuse of a state’s resources by diverting them from vitally important sectors, such as health, education and development, prevents the general public from benefitting from a nation’s economic growth and development, and therefore generates social disparities. This creates the growth of socio-economic inequality that inevitably brings about a mistrust of state institutions.

Altogether poor legal economic opportunities, an unequal distribution of wealth, inadequate public goods and security, and insufficient access to legal services and to financial markets all engender and reinforce poverty. This, in turn, creates a vacuum - whilst it increases the demand for basic services and public goods, state institutions are unable to provide them. Scholars argue that this “opportunity-vacuum”, “a stepping stone in gaining control of the community”, is instantly filled by organised crime, which provides an institutional response to the deficiency created by “effectively exploiting the economics of poverty” (Kinnes, 2000, p. 13).

Some scholars assert that the institutional inability to provide basic services is at the nucleus of the nexus between illegality, crime, and human security. By patronising illegal economies in areas where the state’s ability to provide legal economic opportunities and public goods is sub-par, organised crime can frequently improve some aspects of marginalised populations’ lives, rendering these populations dependent on illicit economies to satisfy their basic needs, despite the obvious drawbacks. At the same time, simplistic law enforcement measures can, and frequently do, further degrade human security (Felbab-Brown, 2011a).

The exploitation very often takes the form of seemingly innocent charitable donations and the provision of public services, which can reconcile large segments of the community to the organised crime that surrounds it. Many studies have illustrated the tactics employed by organised crime in response to institutional deficiencies. Rashaad Staggie, for example, who was the leader of the Hard Livings gang in Cape Town, South Africa, used to provide food, money and basic necessities to people in need, and was famous for his habit of throwing money out of his car when out driving. He did this to ensure that people would continue to stand by him (Kinnes, 2013). In similar fashion, Du Yuesheng, leader of the Shanghai Green Gang, gained the trust of his community, becoming both its leader and primary philanthropist. In Jamaica, some communities support their local gang because it “returns the spoils” of crime to them. Some larger gangs in the United States have assisted residents with accommodation and bills, protected them from physical attack and exploitation, organised recreational activities and otherwise contributed to community well-being (Ayling, 2009). In Colombia the presence of organised crime is felt in many aspects of social life. Drug traffickers provide both regional employment and recreational facilities, by financially supporting people to help them set up coca plantations.

The most striking example of how organised crime was able to gain local dominance is that of Pablo Escobar. A “modern-day Robin Hood”, Escobar supported the weak and poor of the population whilst engaging in criminal activity. In the USA and Colombia, he was outlawed as a criminal, mob and a drug dealer, whereas in Medellin, the second largest city in Colombia, Escobar was warmly welcomed by inhabitants as a philanthropist.

Due to his knack for self-promotion, he acquired a huge following amongst the poorest strata of Colombian society. He frequently doled out money to impoverished families, built churches, schools and houses, sponsored many lower-league soccer clubs and constructed some eighty illuminated sports arenas in Medellin. As such, people revered him and mourned his death when he was killed. At one point during the height of his power and popularity, locals in Medellín would release celebratory fireworks whenever a drug shipment made it across the border. For Escobar to have cultivated this kind of

following in his home city, where he was responsible for the killing of hundreds of innocent civilians, politicians and police, as well as for the city becoming known as the murder capital of the world, is not only extremely ironic, but is a direct testament to his exceptional approach to public engagement. Escobar worked hard to cultivate a Robin Hood image amongst what he perceived as his people, and somehow, rather intriguingly, it proved to be successful (Castells, 2010).

Political life is also dominated by organised criminals who assume the duties of the state, and fills the gap created by its failure to provide welfare. Consequently, the established multilayered relationships between organised criminals, and their communities, allows organised crime to maintain a certain degree of social control in their regions.

Organised crime establishes a network of beneficial relations with local politicians, through monetary donations to local political parties and lobbyists. By getting involved in politics through providing financial support, donations and funding, organised crime benefits from the ineffectiveness of laws and regulations, created by the corrupt officials, who support proposals serving the interests of organised crime. Ineffective regulations and policies, corruption, and the venality within the higher echelons of power, all weaken the state institutional framework, which in turn hinders state institutions' ability to provide vitally important services. This consequently affords opportunities for organised crime to gain local dominance within existing states. Organised crime in this instance plays a key role in providing an institutional response to the population, thereby supplementing the state (Sullivan and Bunker, 2003).

The casual relationship between organised crime and the state also has a reciprocal character. On the one hand, the political and economic inadequacy of state institutions contributes to the emergence of illegal networks that "...may arise from the bowels of the state apparatus" (Berdal and Serrano, 2002, p. 20). On the other, a variety of factors, such as widespread corruption within the state apparatus, a mistrust in, and sometimes even hostility towards the formal government machinery, and instrumentalism, also significantly adds to the weakening of state institutions, making them ineffective, and

thereby “bolstering the existence of “sovereign free” areas” (Kotkin and Sajo, 2002, p. 21).

Interestingly, the predecessors of organised crime, including social banditry, secret societies and urban underworlds, evolved from the need to protect weak segments of the population, or persecuted groups. The need to protect members of the community, to provide help and assistance through tough times, and “to shield them against turmoil, anarchy, and arbitrary government” spurred the formation of resistance movements. Many existing criminal organisations, such as the Sicilian Mafia or the Chinese Triads, evolved as protective-benevolent societies (Godson and Olson, 1995, p. 20-21). However, as time passed by, their actions have shifted from being ‘philanthropically-driven’ towards often illegal profit-driven activities.

To summarise, IPE scholarship, centred on questions around the relationship between criminality and authority, sheds light on many of the structural and institutional factors enabling the development of organised crime. Working at the nexus between economics, political science and sociology, IPE scholars have provided compelling analyses of the political economy of organised crime, its effects on the economy, and links to the state. IPE thus explains, not only the nature and different dimensions of organised crime, but also who benefits or loses from the process of this interaction; how actors acquire and use their political power and economic resources, and what are the patterns of relations between different groups, both legal and illegal, formal and informal, in different societies and political contexts.

Yet, there are a number of limitations. Alongside a diversity of factors discussed earlier, which are claimed to play a role in the emergence of organised crime, and in particular the role of economic crises or political reform, IPE literature often overlooks the historical factor in the emergence and formation of the phenomena of organised crime. For example, states such as USA, Italy, Israel, Colombia and many others are renowned for the central role of criminal networks in their economies and societies. IPE literature also often lacks the insight of criminology and sociology in depicting the inner dynamics of criminal clans and networks, and the evolution of organised crime.

The major premise of this thesis is that organised crime is a complex social and political-economic institution, and as such, it is embedded in a broader set of historical experiences. The historical aspect, which is largely overlooked by scholars of IPE, is a gap in the literature of IPE on organised crime. The historical analysis of political and economic changes in Russia, developed further in this thesis, aims to help close this gap in IPE approaches to the phenomenon of organised crime in Russia, by examining the key stages of its evolution throughout Soviet and post-Soviet political economy.



## CHAPTER 3

### RUSSIAN POLITICAL ECONOMY AND ORGANISED CRIME

The role and nature of institutions remains perhaps the most divisive issue in the study of the political economy of Russia's capitalism. Indeed, many of the earlier contentions of the country's post-Soviet transformation appear to be settled today, almost 30 years afterwards. Namely, it proved to be a mistake for Yeltsin governments to rush with shock therapy measures, hoping to build capitalism 'from scratch'; it proved to be a mistake to dismiss any alternative to Washington Consensus in 1991/92, when most of the reforms were conceived; the experience of other countries suggests that a gradual approach to economic reforms may have yielded different results politically.

Against these (now uncontroversial) lessons, it remains an open question for many about how best to think about formal and informal institutions within Russia, and perhaps more crucially, what role informal institutions both do and should play in Russian capitalism today. On the right wing of the political spectrum, there are ultra-liberal scholars and policymakers who believe that institutions are products of law and the legal system, and informal activities fall into the realm of the illegal (e.g. Dawisha, 2016). At the other end, there are those who stress that throughout history, informal institutions such as kin and family networks, communities, and even the grey economy have played a central role in first Russian, and then Soviet political economy, and ignoring their influence has been a crucial mistake in Western foreign policy towards post-1991 Russia (Reddaway and Glinski, 2001; Silvius, 2015). The place of the criminal underworld and organised crime in Russia is an example of such divisions. Whilst most US-centred approaches adopt a strictly legalistic understanding of organised crime and corruption in Russia, and suggest that it has no place in the political system, studies inspired by the European school suggest that organised crime has been a central, albeit rarely discussed, institution in the USSR and remains so in post-1991 Russia.

This chapter reviews key debates in political economy that pertain to the understanding of the role of organised crime in Russia today, and its relationship to the state. For most IPE scholars, the development of capitalism, or the transition from socialism to market capitalism, is one major change that is instrumental in explaining the emergence and development of organised crime in general, and in Russia in particular. Indeed, approaches to both the post-Communist transition and organised crime, overlap, with most academic literature on criminality in Russia emerging only from the mid-1990 onwards and accelerating during the 2000s.

The aim of this chapter is to critically analyse the main IPE approaches to the phenomenon of organized crime in Russia, and identify gaps in existing understandings. To anticipate, the chapter finds that while IPE literature concurs that the phenomenon of organised crime in Russia, just like elsewhere, is related to the processes of governance, the contours of the state-organised crime relationship remain poorly understood. More specifically, while current literature suggests that organised crime thrives in niches where the state is absent (e.g. Shinar, 2016), my analysis finds that in the USSR, and later in Russia, functional links, and cooperation with the state and state officials have been central to organised crime in Russia and its evolution.

### **3.1. Approaches to organised crime in Russia**

#### ***Organised crime as a Transitory Phenomenon of Early Capitalism.***

Typical of other formerly state-dominated economies, Soviet Russia was commonly considered to have a crime-free economy. As late as the late 1980s, there was an ongoing discussion over whether Russia suffered from organised crime at all. There was some solid ground for such debate as, during the Soviet period, daily life was closely supervised and deviant activities such as gambling, prostitution or trafficking in narcotics were strictly limited or at least, appeared controlled (Shelley, 1999, p. 341). Soviet propaganda strongly denied the existence of crime in Russia, with any crime being regarded as a vestige of capitalism. It was the decade of the 1990s – the traumatic period of post-Soviet history of the country - that witnessed a growth in studies of

Russian organised crime (for example Varese, 1994; Volkov, 2002; Volkov, 2006; Stephenson, 2015).

Most IPE accounts of the rise of organised crime in Russia do associate it with the beginning of market reforms during the 1990s, and the development of capitalism. Most such conceptualisations stem from the view that criminal activity, including organised crime, emerged in post-1985 Russia, along with other post-command institutions. These included new lines of business, the very notion of (legal) private ownership, access to international markets and trade, including new financial institutions and practices. In this view, organised crime is an organic element of the genesis of capitalism in a country which had never experienced the same scale of market relationships. Having been spurred by the first pro-market reforms of Gorbachev in the late 1980s, the spread of organised crime in Russia and beyond was greatly accelerated after the collapse of the USSR in 1991. “Former closed and state-dominated economies exhibited a powerful contribution to the rise of criminal activities”, argued Naim (2007, p. 30). Policy makers and law enforcement agencies endorse this view by claiming that “unexpectedly fast Russian organised crime emerged and developed new features by significantly advancing in size, sophistication, and the degree of transnational activity and cooperation, thereby presenting a far-reaching and complex threat to social, political and economic norms” (Guymon, 2000, p. 53).

Within this broad theory of organised crime as a product of transition, two further, more nuanced lines of interpretations can be found. The first – advocated by most transitologists and mainstream IPE scholars – stresses the institutional vacuum unleashed in the new post-Soviet state by the retreat of the state and its institutions from regulating nearly all areas of life and the economy (Solnick, 1996). The weak, fractured Russian state, staffed by unmotivated bureaucrats, was not able to control the spread of criminality across the country (Voronin, 1998; Kim and Pridemore, 2005). As a result, criminal networks grew and expanded in their presence and power, in the process exploiting new market opportunities afforded by the emergent capitalist system (Varese, 2001; Williams and Godson, 2002). From small scale smugglers who expanded into larger-scale import-export goods businesses or by exploiting the differences between

low domestic and high world market prices, to larger scale networks of criminals spanning several industries, criminality in Russia has become a synonym of the anarchic 1990s. As Gilinsky (2006) writes “[c]ontemporary organised crime began in Russia during the 1970–1990 period when some kind of contact was established and collaboration initiated between traditional white-collar criminals embedded in business organisations, corrupt party and state functionaries, and various types of criminals, including old ‘thieves-in-law’ (criminal organisations having their own ‘laws’) and the new generation of ‘bandits’ or ‘sportsmen’ (members of gangs, many of whom were previously involved in sports)” (Gilinsky, 2006, p.279). This approach towards Russian organised crime suggests that the emergence of a new "market" in Russia in the 1990s “introduced some new features into the nature of crime: embezzlement, corruption and smuggling caused by the contradictions of the poorly implemented transition to a market economy” (Kuznetsova, 1994, p. 443).

The second (and related) reading of the emergence of OC in Russia implies that criminality is not only an inevitable but also a necessary element of transition to the new system (Williams 2014). Commonly referring to ‘gangster capitalism’ in the USA in the beginning of the twentieth century, such views welcomed the spread of criminals and criminal behaviour as healthy indications that a new market based and profit-oriented mentality has taken hold of the new Russia. Eventually, they suggested, these criminal activities, which mainstream economists call “bumps on the road to a market economy” (Holmstrom and Smith, 2000), will generate the first proper ownership of capital, motivated by property interests and keen to preserve the new system of market economy.<sup>23</sup>

Organised crime is also seen as a product of fragile institutional transitions from strictly centralized economies to market economies, and from autocracy to democracy. Scholars argue that failing “to make any structural changes to [institutional] policies” (Webster, 2000, p. 32), such as transparency, accountability, and property rights,

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<sup>23</sup> The most prominent advocates of this view were David Lipton and Jeffrey Sachs from the Harvard Institute for International Development (H.I.I.D), the key representative of the Clinton Administration for economic assistance in Moscow.

contributes to the malfunction and/or the collapse of state institutions, widens the institutional gap and eventually leads to the emergence of organised crime.

Transitology literature suggests that periods of reform generate political and economic instability. The latter manifests itself through a variety of economic and institutional outcomes, such as lack of employment and hyperinflation (Williams, 1997, p. 9), thereby creating environmental conditions conducive to the emergence, formation and development of organised crime. Economic and technological changes, for instance, appear to take the form of declines in the prices of produced products, whilst the prices of imported machinery and tools remain high. This inevitably leads to increased unemployment rates, whereby it is very probable that a proportion of the unemployed will become involved in organised crime in response to their economic grievances. These groups, as a rule of thumb, tend to exhibit a distinct lack of trust, faith, confidence and interest in the institutional system when the economy is defunct.

Thus, as it is widely accepted that the functionality of state institutions determines the social well-being of a society, it follows that during these periods of a defunct state system, new non-state actors (or so-called outside institutions) emerge to fill the void and to carry out the administration of the policies that the state has failed to uphold. These outside institutions have a profound impact on the development of a society (Warren et al., 2001), effectively becoming substitutes to state institutions, assuming a protective role (Narayan, 1999) and acquiring independence - independence which, it might be added, only further strengthens organised crime networks (Hess, 1970).

Yet another group of scholars in the sphere of IPE argue that the periods of transition also lend a transformational aspect to OC. While some scholars recognize the fact that organised crime existed in pre-industrial Europe in the form of “social banditry”, “mobs”, “mafia” and “peasant bandits” (Hobsbawm, 1959; Keep, 1956; Maxwell, 1956), other academics stress the importance of transformations of this existing criminal world in the light of recent political and economic shifts. This intersection between political economy and crime is the focal point of the framework suggested by Block and Chambliss (1981). They claim that “organised crime is not a modern, urban, or lower

class phenomenon: it is a historical one whose changes mirror changes in civil society – the political economy” (Block and Chambliss, 1981, p.128).

Some scholars have focused on the industrial revolution and its impact on the material conditions of life (Feurer, 1959), and in turn its effect on pre-existing organised crime. Block and Chambliss (1981) argue that the industrial revolution did not only bring about great political, economic and technological changes in Europe, but also created favourable preconditions for a considerable increase in the incidence of urban underworlds. Changes in technological innovations, for example, brought about new machinery, new energy supplies and advances in waterpower systems, all of which compressed the demand for labour at various times, thus leading to a growth in poverty figures. This is illustrated by Frieden (2006, p. 7-8) in the following way:

*“New factory techniques made craftsmen obsolete, and advances in agricultural productivity made farmers redundant. Technological change allowed remarkable increases in the productivity of just about everything, but the benefits of these advances were not evenly distributed. When a machine and five men could do the work of a hundred, the social good was plain to see, but even if a few of the other ninety-five were employed making machines, most would have to abandon their accustomed lives and find other ways to support themselves. The trade and technologies that increased aggregated income could also ruin millions of farmers and workers”.*

From the 1990s, there was a “failure of the state to meet many of its obligations to society”, argued Galeotti (1998, p. 418), such as security, basic administrative, social and judicial services, and employment. A situation in which “28% of law students at Moscow State University felt “that surviving in the current situation in the country without breaking the law is virtually impossible” (Grib, 2001, p. 152), spurred many to embrace organised crime, it is argued. As Handelman (1995) observed, “every third crime was committed by an unemployed person during the first half of 1993” (Handelman, 1995, p. 334). Institutional weakness, as most transitologists and mainstream IPE scholars would contend, resulted from institutional and structural deficiencies, and reflected a power vacuum. This, in turn, produced the “economy of

collapse”, a product of the dissolution of the Soviet system, that created suitable conditions for criminal activity to flourish (Ledeneva and Kurkchiyan, 2000, p. 90).

This line of argument suggests that one of the causes of the large-scale spread of Russian organised crime is an entrenched social conflict, created by the governance vacuum, which in turn is linked to several facets of organised crime that have thrived and expanded during that period. The fundamental conflict of political economy – the distribution of resources in the post-command system – was not resolved by the political structures in the context of the anarchic 1990s. Instead, the market reforms of 1991/92 led to the disintegration of the economy, a massive loss of output, widespread corruption in the ruling elites and state institutions, the inability of the state to provide health, education and other social services, and abuses of human rights. The collapse of the previous political economy balance also opened a stark new divide between the newly impoverished population and the “New Russians”. Whilst “New Russians” constituted “oligarchs” as well as part of the old communist nomenklatura and their children, the socially vulnerable strata of society is described as “the lot of the class of the excluded (Kanfler, 1965; Lenoir, 1974; Paugam, 1996; Young, 1999; Finer and Nellis, 1998) [that] constitutes the social basis for various forms of deviance including crime and organised crime” (Gilinsky, 2006, p. 262).

Pilkington (1994), for example, alludes to the socio-cultural aspects that, as he argues, played a key role in the emergence of Kazan-type gangs. The phenomenon of juvenile criminals, who were often subsequently recruited by organised criminals, is also claimed to be a product of neoliberal policies that resulted in an institutional vacuum. As Russian criminologists Dolgova (1997) points out, “every year some 500,000 children and teenagers lose a parent. Nearly 40 percent of all juvenile crimes are committed in these families” (p.10-11). Many scholars argue that institutional vacuum contributed to a weakening border controls, thereby making any illicit trade much easier (McCartny, 2011, p. 61).

The institutional vacuum, or “institutional bottleneck” was aggravated by ineffective regulatory policies that “weaken the integrity and efficiency of legal regulation” (Letyaev and Letyaeva, 2015, p. 35), thereby creating preconditions for the spread of

organised crime. In terms of legislative agenda, the new economic reforms had a disorderly legal character that often manifested itself in overlapping and contradictory regulations, laws and decrees that were often a product of different jurisdictions. Quoting Frydman, Rapaczynsky and Earle (1993), Charap and Webster (1993) write that “the same subjects are often covered by many different and mutually contradictory normative pronouncements, and it is difficult to ascertain their ultimate validity” (p.315). Sharing similar views, Naishul (1993) claimed that the collapse of state authority resulted in “a system of autonomous administrative offices with overlapping jurisdictions, each pursuing its own rather than the general state interests” (p.36). Passas (2000) mentioned that the “deputy minister of Internal Affairs admitted at a 1992 press conference that “even our specialists find it difficult to determine the legal from the illegal to determine, for instance, what is profiteering and what is honest trade” (p. 37).

The ineffectiveness of regulatory policies, in turn, facilitated the emergence of opportunistic, or rent-seeking entrepreneurs who took advantage of the absence of effective regulation and institutions (Ledeneva and Kurkchiyan, 2000; Ledeneva, 2001; Ledeneva, 2002; Volkov, 2002) and transformed economic opportunities into criminal businesses (Felson and Clarke, 1998). In this “opportunity structure”<sup>24</sup> social, political, and economic changes construct new opportunities, and restructure existing opportunities, both of which contribute to the emergence of organised crime.

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<sup>24</sup> Opportunity structure amalgamates three concepts: Opportunity Theory that argues that new economic opportunities prompt the emergence of crime; Social Network Theory that centres on social relationships (Morselli, 2005); and Strain Theory that argues that crimes are committed by citizens due to pressure from societal structures (Cloward and Ohlin, 1960).

It is argued that the emergence of Russian organised crime can be at least partly explained by the economic opportunities that arose out of the turbulent economic policies of the 1990s, during which the nation was bereft of effective institutions and legal infrastructure, that is, “the chaos and opportunism of the immediate post-Soviet period was fed by the need for the population to adjust from an environment in which entrepreneurial activity was essentially illegal, to one in which almost any profit making activity was de facto permissible, and where more unscrupulous elements took advantage of the absence of effective regulation and a proper institutional framework for market activity” (Hamilton and Deakin, 2015, p. 19).



Opportunities indeed arose everywhere, from smuggling scarce goods, such as imported cars, electronics and drugs, to trading in strategic commodities, such as arms and nuclear material (Lee, 1994). The black markets for these products facilitated the formation of new illegal enterprises and created new criminal networks (Passas, 2000). Scholars who conducted research on illegal trade in commodities concluded that rent-seeking entrepreneurs turned the opportunities that emerged out of the ensuing economic and political chaos to their advantage and deliberately created shortages of coveted goods, thereby creating new criminal opportunities, such as demand-supply imbalances (Duyne et al., 2000; Vagg, 1992). Passas (2000), for example, claims that the opportunities provided by these supply-demand imbalances were exploited by the “thieves in law”, the major criminals of the Soviet times. However, the newly emerged opportunities were not limited to exploitation by only the “thieves in law”. Structural changes and the implementation of neoliberal policies also attracted other rent seeking groups, for example, ethnic based criminal groups, such as Osetians, Armenians, Azeris, Chechens and Georgians, whose main criminal activities were the illegal trades in drugs and arms trafficking. They seized the opportunities that sprang from the financial crisis which left many people jobless and despairing, and focused on the development of the drug business by employing jobless people (Lee, 1994).

Institutional dissolution, and chaotic disorder in law enforcement, created another opportunity, which played into the hand of criminals. The absence of clear legislation and enforcement allowed criminals to blackmail and racket legitimate businesses with impunity, while law enforcement agencies were unable to provide any assistance and protection. Accordingly, businesses preferred to “befriend” criminal groups, hire them as protectors (Skaperdas, 2001), and, very often, turn them into business partners (Lee, 1994). According to Afanasyef (1994), Russian experts claim that Russian organised crime gained its strength during the market reforms of 1992.

The privatisation that took place in Russia in the 1990s is considered among IPE scholars as one of the facilitating factors that created an opportunity for newly emerged capitalists, existing professional criminals, the nomenklatura and knowledgeable and skilled managers to engage in corporate crimes and abuses of power (Glinkina, 1994;

Kuznetsova, 1994; Shelley, 1994). Acquiring state assets and enterprises at extremely low prices (sometimes secured by threats) was a common practice among criminals. Naylor (1999b) maintains that the lack of experience in conducting business in the free market economy forced “old school”, or ex-Communist bureaucrats to privatise state enterprises, thereby creating another opportunity grabbed by criminals. Handelman (1995) writes that not surprisingly the process of privatisation, “*privatizatsiya*” in Russia, was renamed by Russians as “*prikhvatizatsiya*”, or “grabbing” (p.104).

In a parallel stream of scholarship, Russian organised crime is also argued to be a product of criminal opportunities afforded by globalisation (Burbach et al., 1997). Globalisation introduced borderless trade, the omnipresence of transnational corporations, and eliminated preferential treatment for domestic industries, in order to generate competitiveness. As many scholars argue, many private enterprises struggled to survive in the newly-competitive opened economy (Cheloukhine and Haberfeld, 2011). The most drastic consequence was bankruptcy. As a result, newly emerged challenges required state protection, for example subsidisation. As Passas (2000) put it, “enterprises that do not enjoy state intervention are at a disadvantage and may be forced into bankruptcy or crime as a last resort” (p.33). Such “dependence” on state protection triggered the emergence of new criminal opportunities. Accordingly, the extent of the widespread corruption and the frequency of banking crimes dramatically increased alongside the formation of a variety of criminal networks throughout Eurasia that constituted entrepreneurs, criminals, financiers and high-rank officials (Beare, 2000). Passas (2000) writes: “The ongoing investigations into billions of dollars (possibly IMF-provided funds) laundered through the Bank of New York have expanded to include British, Swiss, and Italian entities and actors. Moreover, Ponzi pyramid schemes and other frauds have devastated gullible investors, as is the case with other post-Communist countries. Independent Oil, Lenin Trade and Financial Corporation, Aldzher (a security corporation), and other companies defrauded more than a million depositors and investors. Just as the Savings and Loan frauds that resulted from obsessive deregulation in the U.S. were committed against “the weak, the meek, and the old,” Russian pensioners were the main victims of fraud (Glinkina, 1994, p. 33).

Geopolitical tensions and specifically, new armed conflicts across the former USSR that began during that period, also added to the vast array of new opportunities for criminality. Crimea, Transdnier, the Caucasus and Chechnya are areas well known for their political turbulence, instability and armed conflicts, where “rebellion and illegal markets become interconnected, as armed conflicts necessitate training, weapons, intelligence, and financing” (Passas, 2000, p. 33). Many scholars attribute the emergence of Russian organised crime to the opportunities that emerged out of the political revolts that facilitated such crimes as money laundering, and the trade in arms, drugs, and nuclear weapons (Kuznetsova, 1994; Lee, 1994; Naylor, 1999b; OGD, 1996).

While Chechnya, for instance, has become a host for Russian criminal organizations, whose criminal activities are delineated as "a crusade against a 'mafia republic'" or "a conflict between opposing criminal elites for the control of oil and the financial resources held by the government in Grozny" (Politi, 1998, p. 44), Transdnier<sup>25</sup> emerged as a centre for the illicit arm trade.

One of the outcomes of these reforms was a dramatic increase in the extent of property ownership, although clear property rights legislation, enforcement of rules and administrative or financial codes of practice were weak or absent. The ensuing legal vacuum made law enforcement very difficult due to the confusion over which laws to prioritise and apply (Afanasyef, 1994). Scholars claim that such uncertainty meant that “the power of the Russian mafia started to grow exponentially, as hundreds of organised criminal groups emerged to capture benefits in the changing economic environment” (Volkov, 2006, p. 161). Extortion rackets, criminal protection, so-called *kryshas*, or *roof*, and contract killings, for example, evolved out of the absence of an effective court system to enforce property rights (Modestov, 1996; Volkov, 2002). Volkov (2002) emphasised that “in Russia, the activity of private protection agencies extended beyond mere physical or informational security and into the sphere of business transactions and civil property relations” (Volkov, 2002, p. 141). Within this line of interpretation,

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<sup>25</sup> Transdnier is a rebellious enclave of Moldova, and one of the areas where arm smuggling particularly flourishes.

Russia is consistently depicted in terms of its criminal activities (Satter, 2003; Lukes, 2016), and as a captured state (Slinko et al., 2009; Yakovlev, 2009), or mafia state (Harding, 2011) and representing “a reflection of the absence of credible and legitimate mechanisms to control social interaction and create some sense of common order” (Galiotti, 1998, p. 418).

The suggestion that Russian organised crime is a necessary element of a transition to a new and better economic system is underpinned by the historical origins of capitalism in the United States and Europe. It suggests that organised crime is a predictable, and an inevitable, phenomenon of the development of capitalism, and that Russian organised crime reached its pinnacle in the early 1990s (Kosals, 1998). They equate it to “a system of tycoon capitalism” (Wedel, 1998) and “gangster capitalism” that “began in the early 1990s when Russian market reformers attempted to introduce capitalism” (Holmstorm, 2000).

This thread of literature associates organised crime in Russia with Marx’s account of “primitive accumulation”. It finds strong links between the market reforms of the 1990s, which they call the “modern version of primitive accumulation”, with the emergence of two classes. One class of capitalists is called the “rich capitalists”. These embrace “management, underworld gangsters and the like”. Another class is a proletariat, or “unemployed and starving”. In this view, “Russia’s descent into gangster capitalism began in the early 1990s when Russian market reformers attempted to introduce capitalism in one fell swoop” (Holmstrom, 2000).

Some advocates of this understanding of the emergence of organised crime in Russia take a step further and suggest that criminal activities, afforded by the transition to the capitalist system, are nothing but “transition costs” that provide adequate ground for the establishment of the market economy system, namely, “In the short run that may hurt [them] somewhat... [b]ut the increased rationality of resource use will easily justify the transition costs” (Sachs, 1990). As Holmstrom (2000) put it, “...the architects of the transition insist that a certain degree of pain was unavoidable, at least in the short run, in order to give... “New Russian” entrepreneurs the freedom to remake the economy, thereby opening the way to greater prosperity for all”.

### 3.2. Russian Organised Crime as the Crystallisation of Older Problems

The second thread of literature pertinent to the understanding of organised crime in Russia comes from political economy, history, sociology, human geography and other social sciences. These writers stress the continuity of institutions and long-running problems that had confronted the Soviet economy for decades. Two such problems stand out. The first is the USSR's and subsequently Russia's dependence on resource exports as a key mode of economic integration. The second is the central place of the underground economy, and informal institutional networks, in sustaining the socio-economic life in the USSR and Russia. Let us consider them in order.

The problem of over-dependence on oil and other resource exports has long been seen as a key obstacle to modernisation across emerging and developing economies (Corden 1984; Krugman 1987). The USSR's production of oil and gas accounted for approximately 95% of total exports, hitting a peak in 1988 of 4.1 million barrels per day, albeit behind the world's largest exporter, Saudi Arabia, which exported 4.7 million barrels per day<sup>26</sup>. These figures progressively increased after the collapse of the USSR in 1991 (Table 3.2.1 and Figure 3.2.1 show that the Soviet Union and the Russian Republic were major producers, exporters, and consumers of primary energy products).

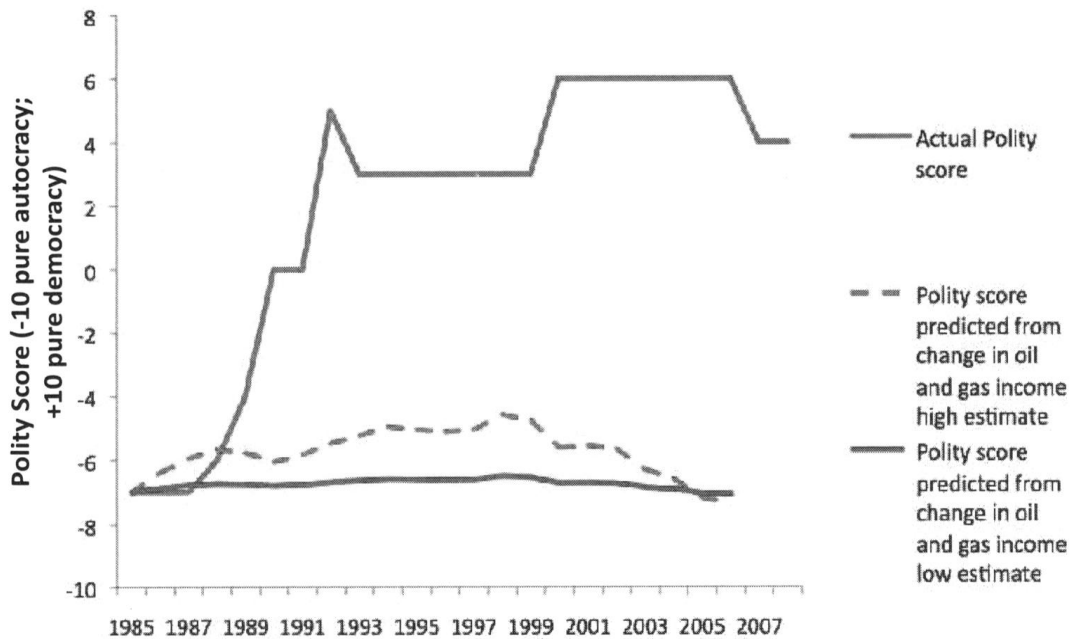
Table 3.2.1. Fossil Fuel Reserves, Production and Consumption in Russia (2001)

	<b>Proved Reserves</b>	<b>Production</b>	<b>Consumption</b>
Oil	6.6 billion tons (48.6 billion barrels)	380 MT/yr (7.5 mb/d)	118 MT/yr (2.38 mb/d)
Natural Gas	47.6 tcm (1,700 tcf)	598 bcm/yr (57.2 bcf/d)	386.2 bcm/yr (37.8 bcf/d)
Coal	173 billion short tons	281 million short tons	249 million short tons

Source: Energy Information Administration, BP World Energy (referenced in *The Soviet Legacy on Russian Industry*, CEE; [http://www.beg.utexas.edu/energyecon/new-era/case\\_studies/Soviet\\_Legacy\\_on\\_Russian\\_Petroleum\\_Industry.pdf](http://www.beg.utexas.edu/energyecon/new-era/case_studies/Soviet_Legacy_on_Russian_Petroleum_Industry.pdf))

<sup>26</sup> According to Centre for Energy Economics (CEE). [http://www.beg.utexas.edu/energyecon/new-era/case\\_studies/Soviet\\_Legacy\\_on\\_Russian\\_Petroleum\\_Industry.pdf](http://www.beg.utexas.edu/energyecon/new-era/case_studies/Soviet_Legacy_on_Russian_Petroleum_Industry.pdf)

Figure 3.2.1. Oil and Gas Income and Russia's Political Regime, 1985



Source: Triesman, D., 2005

Political scientists and political economists find a strong link between primary resource production and criminality (Le Billion, 2001; Welsch, 2008). In Russia, this problem is most commonly analysed as a problem of pervasive and institutionalised corruption. Resource wealth, also known in IPE as the “resource curse” or “the paradox of plenty”<sup>27</sup>, for example, is considered to be a contributing role in fostering corruption which, in turn, hinders democracy (Naim, 2004; Friedman, 2006; Fish, 2005). As Naim (2004) writes, “A lot of oil combined with weak public institutions produces poverty, inequality, and corruption. It also undermines democracy” (Naim, 2004, p. 94-95).

<sup>27</sup> The resource curse, also known as the paradox of plenty, refers to the paradox that countries with an abundance of natural resources, tend to have less economic growth, less democracy, and worse development outcomes than countries with fewer natural resources.

Various scholars have found a correlation between perceived corruption and natural resource wealth (Leite and Wedmann, 1999; Okonota and Douglas, 2003)<sup>28</sup>. Russia is frequently depicted by political scientists and scholars as a classic case of the resource curse. According to Russia's leading think tank devoted to studying corruption, INDEM, the Center for Applied Political Studies, every year bribes and kickbacks amount to some \$37 billion. Bransten (2003) suggests that it is equivalent to the \$40 billion of legal revenue. The political elite of the 1990s, it is argued, drew support from oligarchs, or "robber tycoons", who amassed their wealth from "rigged privatisations" of oil, gas and metals companies, and subsequently channeled the profits from these resources abroad (Holmes, 1997). Some of these oligarchs are claimed to be "former criminals...[that] worked with organised crime, either because they had to conduct business or because crime was their business strategy" (Stratfor Global Intelligence, 2008).

Despite the fact that corruption in Russia is an old phenomenon and is traced back to the 12<sup>th</sup> century<sup>29</sup>, the research and literature on corruption in Russia has flourished only in the late 1990s and early 2000s (Williams, 1997a; Webster et al., 2000; Galeotti, 2002; Varese, 2001; Frisby, 1998; Holmes, 1997). For instance, "in 1995–1996, national and regional newspapers and magazines published more than 3000 articles on corruption, and there were more than 150 television programs concerned with the subject. More than 60% of respondents in opinion polls reported that they believe corruption is a factor threatening Russia's national security. More than 70% agreed with the statement that Russia may be considered a corrupt state" (Levin and Satarov, 2000, p. 114). The mainstream account of IPE literature suggests that the political, economic and social instability that accompanied the transition in Russia in the 1990s had a significant

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<sup>28</sup> The first study to find this was Alberto Ales and Rafael Di Tella, 'Rents, Competition, and Corruption.' In: *American Economic Review*, 89, no.4, pp. 982-993

<sup>29</sup> In the 12<sup>th</sup> century the ruler of Novgorod, including his relatives and entourage, was banned from owning any landed estates in the region. This is to prevent Novgorod traders, who already owed such estates, from ruling the region and using that position to entrench themselves and their allies as an oligarchy (Kalinina, 2013).

impact on the magnitude of corruption in Russia. According to one Russian analyst of police criminality, corruption contributed to a “legal nihilism in the country” (Altukhov, 2001, p. 9). It comes as no surprise, therefore, that corruption, like organised crime, is also claimed to have emerged as a product of capitalism, with some scholars equating the widespread increase in corruption in Russia to the period of the robber barons in the US. As Levin and Satarov (2002) concluded, “historically, corruption has begun when a country enters in a period of modernisation and change. The stories of the robber barons of the US are well known. It is understandable in a historical context that negative features of radical change should be present in Russia. Russia in the transition underwent a radical renovation of its public, state and economic foundations” (p. 116). Passas (2000) claimed that “global neoliberalism and serious crime go hand in hand” (p.39) and argued that “...globalisation and neoliberalism spread analytically similar criminogenic processes that were once unique to the U.S. culture of the American Dream in a context of structural inequalities” (Passas, 2000, p.38).

Yet, “the literature is less abundant in recent years that it was in the 1990s and at the start of the Putin era” (Holmes, 2008, p. 1012). This decline can be explained by the fact that scholars and practitioners argue that corruption in Russia is the phenomenon of the transition.

The tradition of absolute power, despotism and totalitarianism (the other side of the rule of law) which was characteristic of both Tsarist rule and the Soviet regime, alongside the economic policies and reforms during the chaotic 1990s, and the intolerance and other cultural and cognitive factors that were created throughout Russian history (Tsysarev and Gilinskiy, 2004), are also considered as contributing factors to the emergence of Russian organised crime.

### ***Institutional Corruption***

Whilst the disregard of laws and regulations by informal networks has been widely studied, and interpreted to be a key contributor to the distortion of the economic system, fostering the formation of informal economies and non-state actors, the disregard of



legal norms by state management itself, otherwise known as state corruption, is also a subject of study that provides another vital piece of the jigsaw. The Norwegian Bureau for the Investigation of Police Affairs, for example, observed that, “corruption not only distorts the economic system of a country, but also has a negative impact on its political system. Informal networks become a problem when members of such networks choose to ignore rules and legislations and focus on those actions that only benefit themselves and/or fellow members” (Ackerman, 1999, p. 3). The former USSR is a vivid example of the state officials’ contribution to the formation of the underground economy. The centralised planned economy imposed strict quotas on production and delivery deadlines, leaving no choice but to circumvent them. The constant disregard and violation of laws and regulations resulted in the formation of an underground economy which at a certain stage served as a platform for advancing organised crime.

As a phenomenon, corruption has received considerable attention and has been a subject of studies by many scholars from different disciplines, and for much longer periods of time than organised crime. As a result there is a large literature that researches, studies and explains corruption. However, the use of this literature in this thesis is limited because the main focus of this study is organised crime, a phenomenon that is much bigger and more complex. However, as “corruption and organised crime go hand in hand” (Ezrow and Frantz, 2013, p. 25) and this thesis engages in some discussion on corruption as a means of organised crime, it is necessary to devote a place to some discussion on the phenomena of corruption.

While some scholars mention that “corruption can in one sense be interpreted as evidence of state power: criminal groups have to bribe and pay off the state because they cannot entirely bully and bypass it to stay in business” (Andreas, 2004, p. 647), the effect of corruption on the quality of institutions can be exceedingly harmful. There are studies that show the links between institutions and corruption. Buascaglia (2003; 2008), for example, examined how widespread corruption in administrative institutions contributes to illicit activities, for example, tax evasion. This type of illegal activity is common among organised crime. Corruption also weakens judicial administrative systems, thereby increasing organised crime. Biased judicial rulings and the abuse of

judicial discretion (Buscaglia and van Dijk, 2003), a lack of predictability in judicial rulings (Buscaglia et al., 1995), high rates of impunity (Fajnzylber et al., 1998), and a low frequency of punishment (Davis, 1988) are all manifestations of corruption in judicial institutions, which play into criminals' hands and contribute to the capturing of the court system.

Corruption also permeates security institutions where law enforcement agencies use their positions to extract bribes. Citizens who live in countries where the police are highly corrupt avoid seeking help within the legitimate institutional framework, and prefer to hire criminals. Moreover, corrupt police are themselves engaged in crime. As Ezrow (2013) put it, "it is not uncommon for the police to serve as fronts for criminal groups or also extort criminal groups, in exchange for not arresting them" (p.261). Police in African nations, and in Mexico and Russia, are renowned for their corrupt practices and links with organised crime.

The military system is also not immune to corruption. One of the most common corrupt practices of the military involves illegitimate procurement practices (Ezrow, 2013). The level of transparency within military industries is usually low, therefore "the nature of the arms being procured, how much is being spent, the size of the kickbacks, and where the money from the kickbacks is being laundered" (Willett, 2009, p. 343) is frequently obscured. The political and economic instability very often boosts the illegal trade. In Russia, for example, in the 1990s, organised crime groups turned the economic turmoil that threatened the survival of many military producers to their advantage, and purchased submarines with missiles for the transportation of drugs in exchange for bribes.

Arguably amongst the most prominent of phenomena pertaining to the political economy of corruption is the "elite bargain". This phrase refers to the relationship that arises between the formal elite, or the state, and more informal elites, represented by economic magnates in clandestine sectors, such as organised crime (Hesselbein, 2010). During periods of instability, or out of necessity, formal elites have a propensity to forge bonds with even highly unsavoury groups, in order to preserve their status and wealth. Such co-operation can take various forms, and is not always voluntary.

This phenomenon, which brings together various concepts from international political economy, will be revisited in subsequent chapters with respect to Russia, where, during periods of economic stagnation, the illicit capital controlled by organised criminals endowed the latter with superior economic power, ultimately allowing them to become an informal economic elite. Furthermore, because the state - the formal political elite - was dependent on the informal sector that was operated by organised crime, this dependence took form of a 'co-existence', where the state turned a blind eye to the spread of illegal networks, in return for economic stability.

This analysis of political and economic conditions of the period of stagnation will show that it was a type of unwritten, and unspoken, elite bargain, struck by default. This process also can be attributed to the earlier institutionalisation of an organised criminal network, with the state being amongst its key supporters. It will come to be seen that this, in fact, set a precedent for the rapid growth of Soviet organised crime.

Some studies have also endeavoured to explore the topic of corruption in the process of the creation, building or reformation of state institutions (state building) and the connection to organised crime. In general, "though state building can be taken on by a state's government, it is usually spearheaded by outsiders, typically members of the policy and development [international] communities" (Ezrow and Frantz, 2013, p. 285). The process of state building can be influenced by foreign aid or foreign intervention, where international actors become involved in the process via the distribution of financial resources, or physical involvement in ensuring the security of a state. Even though many scholars are staunch proponents of foreign aid (for example, Sachs, 2005), there are scholars who argue that financial aid potentially strengthens organised crime.

In line with these reservations, one of the potential disadvantages of the financial aid given by International Financial Institutions to developing countries is its possible dissemination into the pockets of ruling elites, dictatorships, and feckless government officials (Fritz and Menocal, 2007), who constitute an organised criminal network and who prefer to strengthen the already existing system of patronage rather than to allocate the financial aid in order to improve state performance (Brett, 2006). Some scholars have highlighted the fact that organised crime "...dedicate(s) efforts toward trying to

control the government and get their hands on a piece of the ‘aid pie’” (Ezrow and Frantz, 2013, p. 295)

Overall, the effect of corruption is pernicious. It inflicts a profoundly harmful impact on political development and economic stability, undermines the development of state institutions and democracy, criminalises regimes, creates disenchantment with leadership (Eigen, 2002), creates social unrest and disorder, and, according to the World Bank, is a cause of military coups (Rose-Ackerman, 1997).

### *Shadow Economy*

The second legacy of the USSR that is often linked to the problem of crime and its longevity is the persistence of the underground, or informal economy and social networks in Russia, that is, “the liberalization of the economy created a favourable environment for the extensive reproduction and expansion of the traditions of the Soviet "shadow economy"” (Ryvkina, 1998, p. 37). McCartney (2011), for example, views Russian organised crime through the lens of Soviet practices that were handed down from the past by traditions, such as “the use of bribery, black markets, and other schemes to survive in Soviet society” (p.3). These “other schemes” took the form of corruption, thievery, the illicit cooperation of state officials with criminals and illegal entrepreneurs, and informal practices of manipulating the system, such as bartering.

This thread of literature suggests that Russian organised crime existed in its present form since the 1970s, exploiting weaknesses within the official economy. It argues that informal relations, corruption and the informal economy in the USSR (Feldbrugge, 1984; Grossman, 1977; Katsenelinboigen, 1977; Simis, 1982) that included significant involvement in the production of both consumer goods and heavy industrial products, were the principal source of organized crime.

Within this view, the hidden mechanisms of governance formation that emerged out of the system of double standards in the Russian State “as a result of political coercion, economic mismanagement, commodity scarcity and grossly unequal distribution of social advantages” (Frisby, 1998, p. 28), contributed to the emergence and formation of

the system of informality<sup>30</sup>, or a "mechanism of mutual understanding" (Naishul, 1998). This system of interpersonal interactions, that was "very useful in the first stages of market reform" (Ryvkina, 1998, p. 37), provided the core platform of the underground economy. Managers had no choice, but to engage in illegal deals, to ensure the smooth running of their enterprises, as defects in the Soviet economic system prevented not only enterprises, but whole branches of industry, from fulfilling economic tasks. This implied illegal cooperation with the representative of the "black market" (Ryvkina 1998).

Rampant double standards, it is argued, also engendered a great distrust amongst the population of official regulations and laws. There is therefore an argument that "any official reforms in Russia, after the collapse of the USSR, were already at a disadvantage, due to the seventy-year-old 'habit' of the population of searching for ulterior motives in government policy" (Orlova, 2005, p. 32). For instance, the reforms that aimed to fight organised crime were perceived as a 'façade for the ruthless plunder of Russia by those who achieved political and economic influence under the pretense of fighting organised crime" (Plekhanov, 2003, cited in Orlova, 2005, p. 28). The ineffectiveness of new reforms and regulations impaired trust in state institutions and encouraged people to resort to private means of dealing with crime, for example the payment of protection, or so-called "krysha".

The underground economy, which constituted the illegal production of commodities, enabled by the appropriation of state resources, and the 'black market', was governed by organised crime. As Frisby (1998) writes, "these leaders of the underground economy, nicknamed 'sharks' (*akuly*) by the thieves' fraternity, in their turn constituted a close criminal community and by the end of the 1970s most of them belonged to diversified criminal organisations with quite extensive regional connections" (Frisby, 1998, p. 33). It is argued that this tradition of shady economic activity in the USSR, as well as outright

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<sup>30</sup> Ledeneva (2013), for example, provides a comprehensive analysis of the role of informality in Russian society, from the provision of public goods to the distribution of wealth.

economic crime, has been inherited by post-Soviet Russia. Underground enterprises are another example of the legacy of criminal structures inherited from the USSR.

Yet, the system of informality and crime that was transferred to post-communist Russia also served a definite purpose in the USSR, where it was used to favour specific elite groups (Favarel-Garrigues, 2011). Ryvkina (1998) links this argument to the widespread corruption of the power apparatus of the Brezhnev era, and the major scandals of this epoch. As she writes,

*“It is striking that these deals are similar in their structure (for example, the Brezhnev years of the eighties saw the "fish affair" involving the Okean shops and the "cotton affair" in Uzbekistan). Just as happened then, present-day Russian business people export their output directly, open accounts in foreign banks, engage in financial operations using cash, and appropriate huge sums. Just as in those days, all this takes place with the help of Western firms, and fictitious organisations are created in Russia to launder the money. Just as in those days, top political figures participate in such businesses, and hence the deals are concealed” (p.37).*

### **3.3. Organised Crime in Russia: Beyond Corruption and ‘Russian Mafia’**

It is true that most of the socio-economic problems that came to the surface in the 1990s have long roots in Russian and Soviet history. It is precisely in the disregard of, or abstraction from, the role of historical institutions, including informal ones, that the assumption of the possibility of a smooth transition from a command economy to capitalism was always so deeply flawed (Reddaway and Glinski, 2001). Important institutions that were overlooked included the organised criminal networks. New markets and open borders did facilitate the inflow of new wealth into the country in the late 1980s-early 1990s; weak, inadequate or non-existent regulations did enable the growth of areas where criminality thrived, yet organised crime in Russia does have a

long history and predates even the 1917 revolution<sup>31</sup>. As was shown above in this chapter, accounts of Russian criminality tend to be polarised between those who see Russian organised crime as a uniquely dangerous transnational net, originating in the 1990s, and analyses of Russian political economy that tend to conflate corruption, crime, underground networks and the informal economy. In reality, concepts such as the ‘Russia mafia’ are of limited value: most Russian organised crime tends to resemble a clear-cut organisation, with a strong structural hierarchy, division of labour, code of conduct, and membership and is equated with the Mafia, hierarchical associations, mafia groups, gangs etc. (Abadinsky, 1981; Abadinsky, 1994; Albanese, 1989; Block, 1983; Cressey, 1972; Hagan, 2010; Gilinsky, 2002). This approach towards the conceptualisation of Russian organised crime is underpinned by the concept of the Mafia, namely, the “[Russian] Mafia emerged after 1985” (Varese, 1994, p. 233). It is, therefore, understandable that Russian organised crime is very often equated with the Italian Mafia,<sup>32</sup> as it reflects the American literature on organised crime, which views organised crime as a problem that parallels the development of capitalism. Others depict Russian organised crime as constituted by loose criminal groups, like gangs (Burton and Burges, 2007). Some scholars define the Russian mafia as an umbrella terms that covers “a number of mafias or mafia-like groups with identities that derive in part from their having a physical location within the Russian Federation” (McCartny, 2011, p. 55)<sup>33</sup>. Russian organised crime is also equated with the “Vory v zakone”, or “thieves in law”, criminal fraternity, the hallmark of which is a code of behaviour governed by a network of strict regulations, a peculiar criminal argot called *fenya*, rules of conduct among members, a dress code and tattoos<sup>34</sup>.

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<sup>31</sup> A vast body of academic literature on the nature of economic crimes in the USSR links these illegal practices to corruption in both the nineteenth and twentieth centuries, from Tsarist to Soviet and post-Soviet Russia. See Chwalba, 2001; Heinzen, 2009; Holmes, 2012; Satter, 2004; Wedel, 2005

<sup>32</sup> For a more detailed account of the Italian Mafia, see Gambetta, 1993

<sup>33</sup> See, for example, Serio (2008)

<sup>34</sup> The opinion among scholars about the origins of the Vory-V-Zakone is divided. While some argue that the society existed in Tsarist Russia (Rossi, 1989, p. 23) and “the Vory existed in Russia long before the revolution” (Santerre, 1960, p. 60), many historians and scholars believe that it was formed in the 1930s,

Notwithstanding, the problem with the existing conceptions of Russian organised crime is their disregard for the history of the Russian state, their inability to understand the socio-economic and political roots of organised crime in Russia, and their exaggeration of the correlation with US history. They do not provide a full account of the emergence and development of organised crime in Russia and its role in the Russian economy today, and overlook the ancestry of state-mafia relationships. My research illustrates that Russian organised crime is not an identifiable hierarchical clear-cut group, or organisation, as there is no such ‘mafia’ or criminal organisation in Russia with a given name, unlike Italian Cosa Nostra or Ngradetta. In 2012 the Obama Administration named one of the Russian organised group “the Brothers’ Circle” as a criminal group that posed a threat to American security, along with other criminal groups like Camorra, the Naples, and the Mexican Zetas cartel. This claim, however, was refuted by some specialists in Russian organised crime. Mark Galeotti (2012) for example, an expert on Russian and Eurasian security affairs and transnational crime, and Academic Chair of the Centre for Global Affairs at New York University, said in an interview with a journalist from OCCRP that “I have not found anyone in Russian law enforcement or elsewhere who actually says ‘yes, the Brother’s Circle is an organisation and it exists. In the context of that particular ordinance, given that you’re associating them alongside more structured organisations like the Yakuza and the Camorra and so on, it was just a handy synecdoche, an overarching term rather than just saying “and these miscellaneous Russian and Eurasian gangsters” ”. He says that the Treasury Department’s grouping of gangsters in this way is “either complete myth, or 99 % myth”<sup>35</sup>. According to Galeotti, the term the US government is using dates from the 1950s and 60s, which even then described a not very centralised group. “Even at the height of the “vory v zakone” [“thieves in law”] era, there wasn’t a formal organisation, but there was this sense that the aristocracy of *vory* would represent an authority structure, but even then, this is not on the level of organised crime. It was

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the period of captivity by the Soviet State of the entire social stratum of the population. They suggest that the society of the Vory-V-Zakone was “firmly set up by the beginning of the 1930s” (Gurov, 1990, p.108).

<sup>35</sup> A full interview with Mark Galeotti can be found at <https://www.occrp.org/en/investigations/1393-what-is-the-brothers-circle>



more managing disputes and managing behaviours and cultural codes within the prison population” (Organised Crime and Corruption Reporting Project, 2012).

My argument is that, while a narrow and legalistic approach towards organised crime focuses solely on the dynamic within a definite group or organisation, it ignores the external structural aspects as a defining feature of organised crime. Therefore, the conceptualisation of Russian organised crime should draw on a more inclusive approach, which embodies historical, political and economic aspects, the deployment of which in the analysis of organised crime helps to conceptualise Russian organised crime from a different angle and allows an improved understanding of the nature of the relationship between the Russian state and organised crime. Corruption, while often being a constitutive element of the evolution of organised crime in Russia, does not fully accommodate the specific functions that organised crime networks performed throughout Soviet and post-Soviet history, and, most importantly, the relationship between organised crime and the state during this period.

The second part of this thesis will analyse the role of these long-standing institutional roots and structural factors in the evolution of organised crime in Russia. It will demonstrate that unlawful means and activities such as embezzlement and corruption, are not new to the Russian system, as they have always been an integral part of the political and economic structure in Russia. This thesis also shows that institutional deficiencies and power vacuums offer only a partial expansion for the growth of organised crime in Russia today, and its role in the country’s political economy. Drawing on the long history of organised crime in Russia that preceded the post-Soviet state, even before the 1917 revolution, the analysis demonstrates that organised crime has maintained tight links with the state in Russia, often fulfilling many functions of the state and even enabling it to carry out its functions.

## **PART II**

### **CHAPTER 4**

#### **NEW ECONOMIC POLICY (NEP): THE GENESIS OF ORGANISED CRIME IN SOVIET RUSSIA**

Russian organised crime cannot be fully understood without a thorough analysis of a historical dimension of the political economy of the USSR which “...provides an insight into the breadth and the depth as well as into the inconsistencies and contradictions...of the social and political factors that may play a role in shaping perceptions on organised crime” (Lampe 2001: 100).

Part II of the thesis reviews key periods of Soviet and post-Soviet history, aiming to inquire into the nature of the relationship between the state and organised crime in Russia, and the role of organised crime in the country.

Chapter 4 focuses on the political economy of the post-revolutionary period in the young Soviet state, a period that tends to be overlooked by the available literature. However, as is shown below, there were dramatic political and economic changes that followed the establishment of the Soviet Russia, including a devastating economic crisis, the political economy of which enabled the beginnings of collusion between the state and organised crime that would continue throughout the 20<sup>th</sup> and early 21<sup>st</sup> centuries.

#### **4.1. War Communism, 1918 – 1921**

The Bolshevik Revolution of 1917 brought about a new political and economic order. This order was underpinned by socialist ideology, the key aspect of which was an intense communisation, or nationalisation, which in turn, required drastic transformational changes, both political and economic. This period was given the name ‘War Communism’<sup>36</sup>. In the first four years after the Revolution these changes were accompanied by political and economic turmoil. There were two major contributory factors to this turmoil that helped produce a "black economy." Together, they not only triggered the development of the more serious phenomenon of organised crime, but also determined the relationship between the Russian state, and Russian organised crime.

The first factor was the political turmoil in the young Soviet state. Multiple causes were behind the power crisis, including WWI (1914-1918) which was devastating for Russia, the civil war that followed soon after (1918-1921), and the terror and counter-terror which brought about destruction, depletion of supplies, the paralysis of transport links, and the degradation of important industrial and agricultural zones (Nove, 1990; Bettelheim, 1977; Davies, 1980; Erlich, 1960; Spulber, 1964). This was exacerbated by the weakness of the emergent Russian administrative system, whose newly appointed staff "had only a nodding acquaintance with the discipline of economics and none whatsoever with business management", and whose "knowledge of the subject derived exclusively from the reading of social literature" (Pipes, 1996, p. 194). This resulted in orders that "were in any case all too often confused and contradictory, through sheer inexperience or because the civil service machine was all too effectively smashed" (Nove, 1990, p. 38). Lenin himself admitted that "such is the sad state of our decrees; they are signed and then we ourselves forget about them and fail to carry them out"

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<sup>36</sup> Even though War Communism, the period of extreme communization, was introduced by Lenin and his Bolshevik supporters, such as N. Bukharin, Y. Preobrazhensky and L. Trotsky, Lenin's early plans called for "State Capitalism", system where the capitalist sector would be subordinated to the state. War Communism was a combination of socialist dogma and emergency measures. While the political rationale behind it was to secure central control of economic development through the abolition of private trade, the nationalisation of all large-scale industry, and the replacement of money by introducing rationing, the reasoning for the economic policies was to combat the economic problems brought on by the civil war in Russia. For more about War Communism see A. Nove (1990), R. Pipes (1996), M. McCauley (1999) and O. Figes (2014).

(Lenin, Vol. 32, p. 22). All this contributed to the general sense of chaos. Lenin's economic advisor Yuri Larin, the most prominent and influential figure in designing War Communism, whom Suhanov, the Executive Committee of the Petrograd Soviet, called "a poor cavalryman who knew no obstacles to the leaps of his fantasy, a cruel experimenter, a specialist in all branches of state administration, a dilettante in all his specialities" (Pipe, 1996, p. 194), himself admitted "the strength of [our] inability to carry out [this] trade in the market forms" (Larin, 1927, p. 5).

The second factor leading to the emergence of organised crime as a political-economic force in Russia was the severe economic crisis. In many ways, the economic devastation was a product of the transition to the new power structure. Not only were the newly proclaimed decrees frequently contradictory in themselves, but they were implemented by weak institutions that were incapable of providing adequate supervision. For example, whilst the Decree of 8<sup>th</sup> October 1917, regarding the nationalisation and redistribution of land, prescribed an orderly distribution according to land fertility, many villages lacked the necessary administration to enact this. Instead the process was marred by plunder and the violent settling of scores (Wade, 2017; Hoffmann, 1994).

The economic crisis threatened a structural collapse of the Bolshevik state. With the earlier system of production and agriculture based on private property no longer deemed legitimate, with the land redistribution<sup>37</sup> that had a destructive effect on Russian agriculture (the following data illustrates its devastating consequences), and with the new redistributive system not yet functioning, the country faced famine and economic devastation (Table 4.1.1).

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<sup>37</sup> Pursuing the policy of nationalisation, the Congress of Soviets adopted the land decree of 8 November 1917, embodied in a law promulgated in February 1918

Table 4.1.1 The decline in the size of sown areas, harvests, and numbers of livestock

	<u>1913</u>	<u>1922</u>
Sown area (million hectares)	105.0	77.7
Grain harvest (million tons)	80.1	50.3
Horses (million head)	35.5	24.1
Cattle (million head)	58.9	45.8
Pigs (million head)	20.3	12.0

Source: Statistical Year-book, 1934, p.4

By 1921, Russia was facing “...harsh and terrible realities [where] the great monarchy which was here in 1914, the administrative, social, financial and commercial systems connected with it have... fallen down and been smashed utterly” (Wells, 1921, p. 137).

Table 4.1.2 demonstrates this collapse numerically:

Table 4.1.2. The economic collapse

	<u>1913</u>	<u>1921</u>
Coal (million tons)	29	9
Oil (million tons)	9.2	3.8
Electricity (million Kwhs)	2,039	520
Pig iron (million tons)	4.2	0.1
Steel (million tons)	4.3	0.2
Bricks (millions)	2.1	0.01
Exports (roubles)	1,520	20

Source: Nove, 1990

The flow of new economic decrees and policies aimed at the centralisation of economic control, such as the ban on private trade, nationalisation, the partial elimination of money, control over the distribution of food, and many other measures, exacerbated economic collapse. The lack of basic knowledge of economics and business management, coupled with the fact that “economic activity was focused on distribution and not on productivity” (Szamuely, 1971, p. 144), contributed to acute food shortages.

Table 4.1.3 demonstrates the decline in industrial output after the proclamation of nationalisation.

Table 4.1.3 The decline in industrial production between 1917 and 1919

Industrial sector	1917	1918	1919
Salt	16434	13369	5896
Chemical and pharmaceutical, soap and perfumery	11819	8838	7374
Rubber	27963	7059	5995
Starch	7140	3042	2308
Paper	40385	39464	31633

*Source:* Central Statistical Office of USSR, pp. 239-241.

Numerous cases illustrate how institutional weaknesses, administrative inconsistencies and the lack of basic economic competence contributed to the economic decay in the aftermath of the Bolshevik revolution. While, for instance, under the new economic measures, the allocation of foodstuff and prices was coordinated solely by the state, control over the production of vital foodstuffs such as grain remained in the hands of peasants. This, in turn, created a conflict.

On the one hand, state control over the allocation of foodstuff compelled peasants to sell foodstuff to the state. On the other, existing economic and political chaos prevented the state from paying peasants market prices, meaning that the state's price was usually far below the market price. As a result, peasants not only refused to sell their products to the state, but also reduced their productivity. This resulted in the emergence of food shortages that eventually contributed to the massive famine that broke out in 1921, and claimed the lives of around 10 million people (Pipes, 1995). Table 4.1.4 illustrates the sharp drop in the crop capacity in 7 provinces in Russia between the years 1917 and 1920, in comparison to the period 1905-1909.

Table 4.1.4. Change in crop capacity between 1917 and 1920

Province	Years 1917-20	
	Average crop capacity	Change in %
Kursk	41,1	- 30,8
Orlov	38,7	- 26,9
Tula	38,3	- 29,7
Tambov	40,6	- 34,1
Riazan'	41,7	- 25,1
Penza	31,4	- 37,0
Siberia	44,3	- 9,2
Kazan'	38,3	- 18,0
Saratov	28,5	- 30,0
Samara	26,8	- 32,2
Ufa	38,4	- 23,6
Voronezh	38,1	- 30,0
Don	30,0	- 26,6

*Source:* Cherevanin, 1927.

As a consequence, not only did the food industry collapse, but the whole Russian economy broke down. The following tables and charts show the sharp decline in industrial production in the period of the aftermath of the Russian revolution.

Table 4.1.5. Production of cast iron, steel, rolling and steel pipes between the years 1913 and 1922 (thousands of tons)

Years	Cast iron	Steel	Rolling	Steel pipes
1913	4216	4231	3509	77,7
1914	4137	4466	3648	87,3
1915	3764	4120	3266	68,2
1916	3804	4276	3377	77,8
1917	2964	3080	2446	56,3
1918	597	402	357	8,2
1919	117	199	179	4,1
1920	116	194	147	...
1921	117	220	165	...
1922	180	318	259	10,5

*Source:* State Statistical Publishing House, 1957, p. 106.

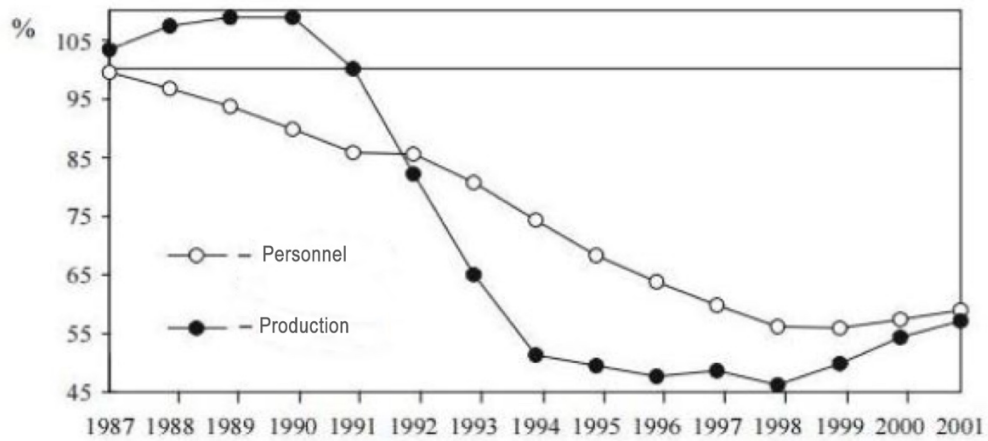
Table 4.1.6. Gross output of the Russian industry in 1913 and 1921 (comparison)

	1913	1921
LARGE SCALE INDUSTRY (INDEX)	100	21
COAL (MILLION TONS)	29	9
OIL (MILLION TONS)	9.2	3.8
ELECTRICITY (MILLION KWHS)	2,039	520
PIG IRON (MILLION TONS)	4.2	0.1
STEEL (MILLION TONS)	4.3	0.2
BRICKS (MILLIONS)	2.1	0.01
RAILWAY TONNAGE CARRIED (MILLIONS)	132.4	39.4

*Source:* Nove, 1969, p. 58.



Figure 4.1.1. Dynamic of the development of large-scale industry in Russia between 1914-1923



Source: Treyvish, 2002

Table 4.1.7. Net national income of Russia (in million roubles)

	Agriculture	Large-Scale	Small-Scale	Construction	Transport	Other Civilian
1913	7,292	2,408	981	878	833	3,835
1914	6,710	2,560	962	891	859	3,708
1925	6,931	2,671	769	655	1,088	3,750
1916	5,723	2,268	866	512	1,198	3,270
1917	5,838	1,764	769	367	658	2,908
1918	4,464	755	721	126	175	1,932
1919	3,878	399	481	96	222	1,571
1920	3,653	421	433	62	145	1,459
1921	3,282	384	481	60	178	1,357

Source: Markevich & Harrison, 2011

Table 4.1.8. Key indicators of gross industrial output between 1917-1920

Key indicators	Years			
	1917	1918	1919	1920
Number of workers	2596,4	2011,1	1334,5	1222,8
in thousands				
%	100	77.5	51.40	47.1
Gross output				
In million rubles	3848,2	1844,8	954,6	818,3
%	100	47.9	24.8	21.3

*Source:* Central Statistical Office SSSR, p. 230.

The policy of war communism, therefore, produced two interrelated consequences. Firstly, it contributed to the complete collapse of the economy. Secondly, and more importantly, it facilitated the rise of an illicit private sector that in the later stages of the political and economic course of the Soviet state grew into a much bigger phenomenon, the private ‘black’, or ‘shadow’ or ‘underground’ economy that attracted and sustained an immense amount of illicit capital.

As Pipe (1925) put it, "war communism split [the economy] in two: a state sector, which sold at nominal prices or distributed – free of charge- consumer goods by ration cards, and, alongside it, an illicit private sector, which followed the laws of supply and demand... [Indeed], the free sector batted on the state sector, because a large part of the consumer goods the worker purchased at token prices or received gratis found its way to the black market" (p.200).

The black market not only became ubiquitous in civil society, but also became a fundamental, albeit illegal, part of the economic life of the state. It was here, in the period of aftermath of the revolution of 1917, that the roots of the modern Russian shadow economy can be found.

This illegal supply of foodstuff in the period of 1917-1922, that ensured the survival of the people in conditions of general chaos, was also known as “bagging”, *or*

*meshochnichestvo*, a phenomenon that became highly significant during War Communism (Davidov, 2002; Davidov, 2007). It is not without reason that the researchers Strumilin and Zhirmunsky<sup>38</sup> regard “bagging” as the epitome of private trade during this time. Prokopovich (1952) who was the Minister of Food of the Provisional Government in 1917, wrote: “Baggers, men and women with sacks, mostly from factories, and artisans who made regular trips to a village (sometimes for 1,000 miles) for bread and other food products, saved many from starvation” (p. 147).

The following numbers demonstrate the number of bagging transportations on certain rail routes, in some places on an unprecedented scale.

Table 4.1.9. Bagging transportation

Kiev-Voronezh railway	3.5 mln poods <sup>39</sup> of bread between May and December 1917
Chelyabinsk - Troits district of Orenburg province	500,000 poods of bread in October 1917
Ekaterinoslav province	Up to 1 mln poods of bread in October 1917
Samara	10-15 thousand of poods of grain on a daily basis

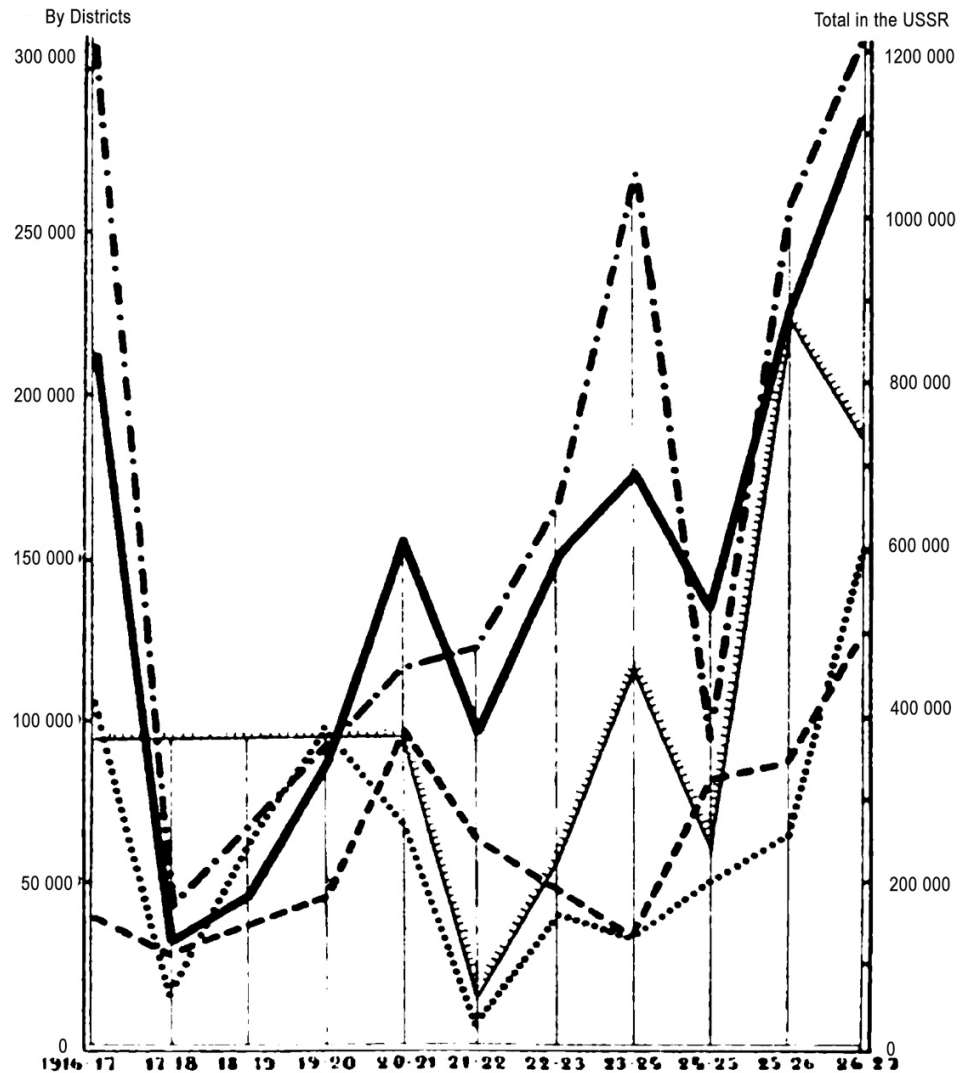
*Source:* Dmitrenko, 1924, p. 1

Peasants, for example, resorted to unofficial channels of distribution for grain, and illegal bartered their products, thereby skirting the state’s monopoly and enabling the development of the black market. The following Figure 4.1.2 illustrates the dramatic decrease in the state’s grain procurement in the period of War Communism.

<sup>38</sup> See: Dmitrenko, 1924; Zhirmunsky, 1924,

<sup>39</sup> Pood is a unit of mass equal to 36.11 pounds

Figure 4.1.2. Changes in state grain procurements by districts of the U.S.S.R.



Source: Central Statistical Office, SSSR, p. 381.

It was the burgeoning black market, and not the network of state outlets, that provided the urban population of the Soviet Russia with foodstuffs, and saved it from starvation. The private market flourished alongside the steady increase of the state sector (Szamuely, 1974; Malle, 1985). According to a survey conducted in winter 1919/1920, only 36% of bread was obtained in stores, with the remaining 64% being purchased

through the black market (Nove, 1990). As McCauley (1999) observed, “the illegal black market made its appearance and saved many urban dwellers from starvation” (McCauley, 1999, p. 31). One foreigner, who visited Russia in the spring of 1920, observed that all state shops were closed, but street trade flourished. As he noted, “everything is sold on the black market - from a pin to a cow. Furniture, diamonds, cakes, bread, meat - all this can be bought on the black market. Nothing can destroy the black market. It [is a] hydra [with] a thousand heads, which grows again” (Pipes, 1990, p. 260).

Therefore, the political and economic turmoil of 1917-1920 was caused by a host of factors – not only the legacy of WW1 and the civil war, but also the abolition of the market economy, the nationalisation of land and of almost all industries, the ban on private trade and on the hiring of labour, the state's control over the allocation of foodstuffs, the introduction of rationing, the procurement of grain through official channels, and other similar economic measures. Together with the institutional weakness, administrative inconsistency and lack of economic competence of the state, these were the most significant agents in the formation and development of the black economy.

It was during this period of War Communism that the widespread black economy that was to flourish in subsequent decades first emerged. War Communism favoured the inception of the black economy, which subsequently developed into a much bigger phenomenon, an organised network that embraced criminals, illegal entrepreneurs and state officials, and eventually formed organised crime in Russia. Central to this was a number of economic measures known as the New Economic Policies (NEP).

#### **4.2. New Economic Policies (NEP), 1921-1926**

By early 1921, the black market had become very powerful. As demonstrated above, its social and economic role was irrefutable. With no other feasible means of economic recovery, the government was forced to acknowledge that fact and recognise the necessity to turn the black economy to their advantage (Nove, 1990, p. 72).

Two factors prompted this decision. First, the regime realised that, in contrast to illegal entrepreneurs, existing state organs were ill-equipped to manage and administer the economy of Russia. This was recognised by Semkov, a member of Bolshevik Party, in his speech at the Communist Party Conference in 1921: “We have not learned trade laws... But the bourgeoisie (illegal entrepreneurs) brought the knowledge and the ability to trade...” (Larin, 1924, p. 6). New Soviet state institutions were formed, with the appointment of a new officialdom, consisting of Bolshevik representatives notable for their lack of education, and with little experience in the civil service, who often ‘pleased themselves’ (Nove, 1990) by expropriating resources under the pretext of nationalisation. Table 4.2.1 demonstrates the social background of selected secretaries and administrative managers commissioned by the Central Committee between 1917 and 1918 to administer Russian provinces.

Table 4.2.1 Social Background of State representatives

	Social background		
	Workers	Peasants	Office workers
Secretaries	51.60%	-	48.40%
Administrative managers	37.50%	12.50%	50%

*Source:* State Publishing House, 1925, p. 44

Even the more able officials had ‘little grip on the realities of administration’ (Nove, 1990, p. 44).

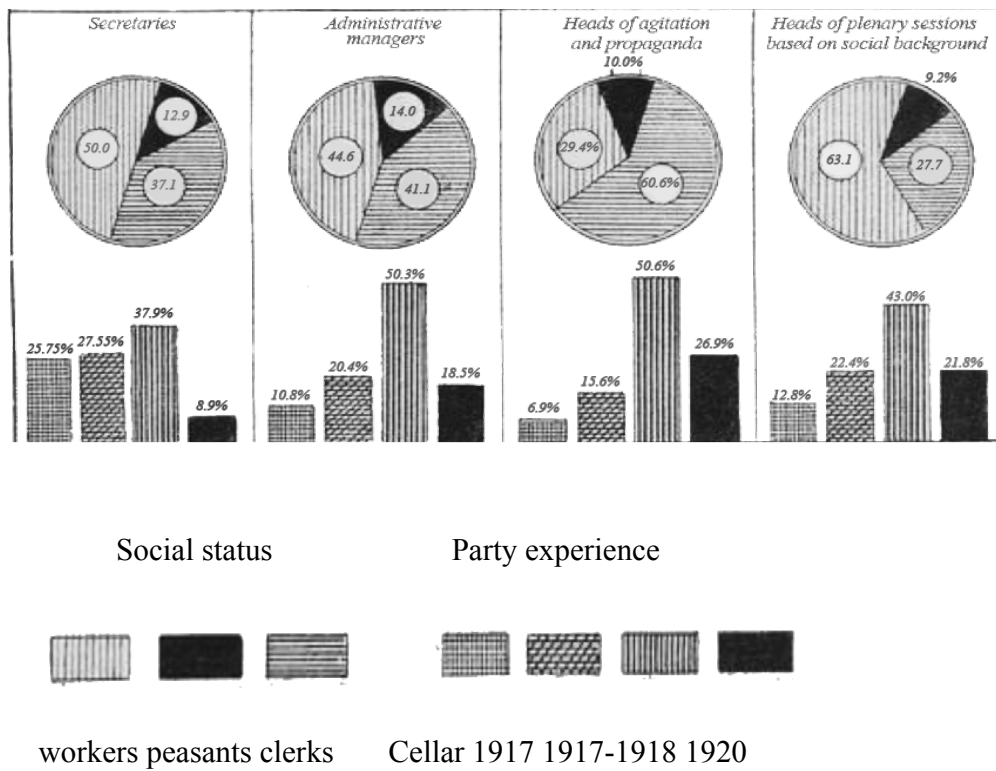
There was a prevalence of uneducated and inexperienced staff in the newly formed political and economic institutions, not only among the low-ranking officials, but also at the executive level. The following statistics show the social and educational background of the Supreme Council of National Economy of the Russian State, and of the executive personnel of the District Party Committees in the provinces, in the year after the Russian revolution.

Table 4.2.2 Senior officials of the Supreme Council of National Economy, 1918

Workers	107	31.6%
Peasants	2	0.6%
Office workers	180	53.2%
Intelligensia	49	14.6%

Source: State Publishing House, 1925, p. 71.

Figure 4.2.1 Executive personnel of the district party committees in the provinces



Source: State Publishing House, 1925, p. 51

Table 4.2.3. Appointment of members and member's candidates to the Central Election Commission of the USSR of the I, II and III Convocations, according to social status.

Convocation	%				
	Workers	Farm labour	Peasants	Hand craftsman	Clerks
I					
Members	46.2	-	-	-	40.2
Candidates	52.5	-	6.1	-	41.4
II					
Members	46.7	-	17.8	-	35.5
Candidates	50	-	6.5	-	43.5
III					
Members	40.1	-	25.5	-	34.4
Candidates	88	-	46.4	-	18.7

Source: Central Statistical Office of SSSR, pp. 16-17.

Secondly, the 1918-1921 civil war had left a legacy of roaming banditry, which at the time of economic scarcity and hardship fused with numerous rebellions against the miserable conditions. This wave of violence and mutiny, caused by the acute needs of the people, threatened the fragile Bolshevik regime. Its political institutions were new and untested, and were staffed with inexperienced personnel. At a time of acute economic need, the new power structure lacked authority or legitimacy amongst the populace (Barley and Tolbert, 1997, p. 96). The political and economic chaos that ensued, therefore, was "a matter of life or death for the regime" (Nove, 1990, p. 68)

Order had to be restored, and a series of fundamental reforms were devised. Known as the New Economic Policies (NEP), they were supposed to *temporarily* incorporate some free-market economic principles.<sup>40</sup> The 1923 Law on Concessions permitted joint ventures with foreign companies, thereby opening the door to direct foreign investment. The Law designed two types of foreign involvement. The first type enabled the foreign investor "to develop and exploit an opportunity within the USSR under the doctrine of *usufruct*, i.e. without acquiring property rights" (Sutton, 1968: *supra* note 1 at p. 8); the

<sup>40</sup> The decision to turn to the free market was made by the party leadership in 1921 (McCauley, 1999).



second type legitimised mixed joint stock companies, whereby the Soviets provided the investment opportunity and foreigners would supply the capital and managerial skills (Mckay, 1974, *supra* note 2, at p. 351). However, this regulative policy did not increase foreign investment and by 1932 the period of opportunity to discuss concessions had ended (Gsovski, 1948, *supra* note 25, at p. 68).

Another degree of economic freedom that was granted was the right to engage in small-scale production. This led to a formation of a mixed economy (Nove, 1990). The state controlled the banking sector, foreign trade and large-scale industries such as the mineral, mining, chemical, food and textile industries, whilst private agriculture, some private trade and small-scale manufacturing were now permitted.

People were not only allowed, but were in fact encouraged to engage in private trade. For example, the Soviet state allowed the formation of cooperatives, or so-called Voluntary Consumer Societies (VCS), to improve trade in foodstuffs amongst the population. In Moscow, in the first year of the NEP, around 450 VSC were established. The number of cooperatives in Petrograd (St Petersburg) in this year varied; some estimates suggest 550, whereas the chairman of the Petrograd's Consumer Society, A.E. Badayev, suggested in 1922 that the number was between 200 and 300 (Davidov, 2014, p. 46). The following Table 4.2.4 demonstrates the number of established cooperatives after the new legislation was proclaimed.

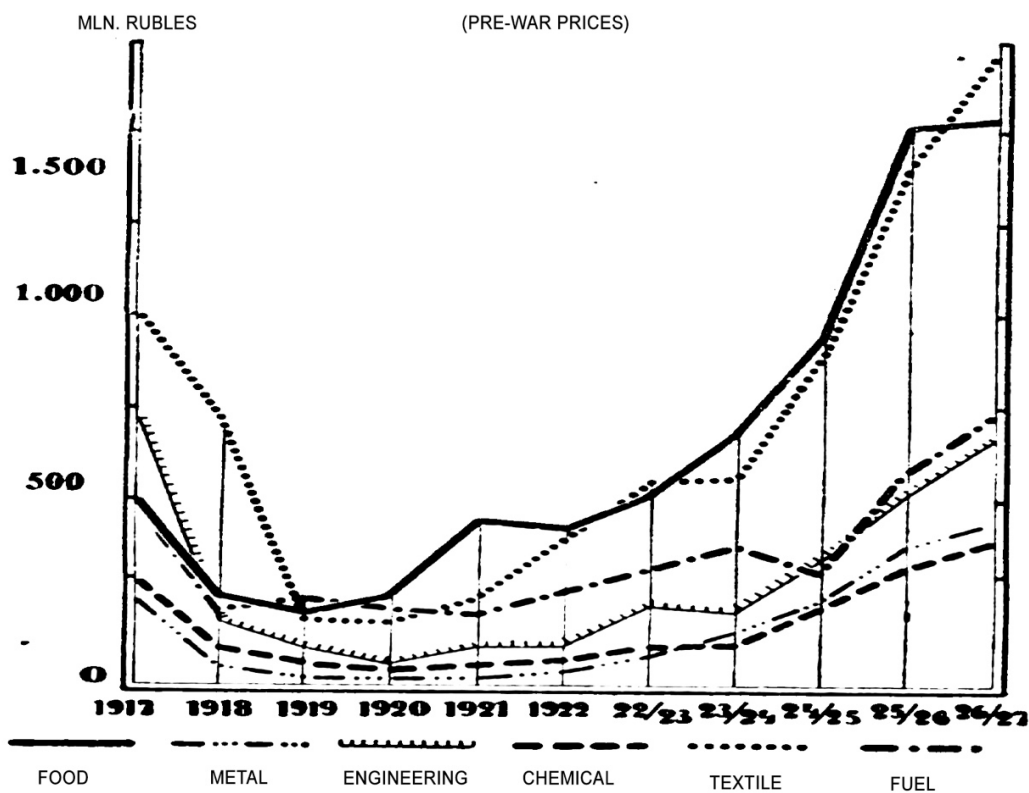
Table 4.2.4. Cooperatives in Russia between 1920 and 1926 (according to the Central Statistical Office data)

	Years						
	1920	1921	1922	1923	1924	1925	1926
Number	41842	48642	50694	43865	52019	73121	76381

*Source:* Central Statistical Office of SSSR, p.419.

The economy did indeed recover, as Figure 4.2.2 shows, but the changes also encouraged the illegal accumulation of assets and the squandering of state resources, through the aegis of a close collaboration between state officials and entrepreneurs (Larin, 1927).

Figure 4.2.2 The dynamics of gross output of the main industries between 1917 – 1925/27



Source: Source: Central Statistical Office of SSSR, p. 234

This period was marked by a dramatic rise in corruption amongst formal institutions and entrepreneurs, which in turn sowed the seeds for an established criminal network that fully exploited these links.

NEP legalised the private sector which at that time had operated illegally, and formed the black market.<sup>41</sup> To redeem the Bolsheviks' positions and to put the economy back in order, in March 1921 the government introduced the following measures: the temporary abolition of the monopoly on trade, the legalisation of private trade, the authorisation of state officials' cooperation with the private sector, and the provision for entrepreneurs of nationalised commodity funds and state resources, in exchange for their knowledge and experience in conducting private business. This was necessary as entrepreneurs had no access to private capital after the nationalisation of all private assets (Larin, 1927; Nove, 1999).

These measures had two main effects: they helped to put the economy back in order and the Bolsheviks to retain power, but they also prompted the emergence of a new phenomenon: an illicit collaboration of state agents and private entrepreneurs who were able to accumulate black assets, by means of the bribery and corruption that were inherited from tsarist Russia, and thus predetermined the formation of the Russian organised criminal network.

In the later stages of the Soviet era this collaboration would grow into a much more systemic phenomenon, the illegal network that eventually became a fundamental platform for the formation of Russian organised crime.

The next section provides empirical data showing the illegal accumulation of private assets that resulted from the emerged unlawful cooperation between state officials and private entrepreneurs. This analysis is heavily drawn from three reports on the origins of private, or as the Bolsheviks called it, "bourgeois", capital that was illegally accumulated in the Soviet Union, in the period between 1921-1924. These reports were presented by Larin (1927) in the Communist Academy between 19th March and 16th April 1927. They demonstrate how the accumulation of both legal and illegal assets was enabled by the involvement of state officials, acting through the new legislation.

All the material used in Larin's reports was taken from three main sources. Firstly, documents were prepared by various commissions for the study of private capital that

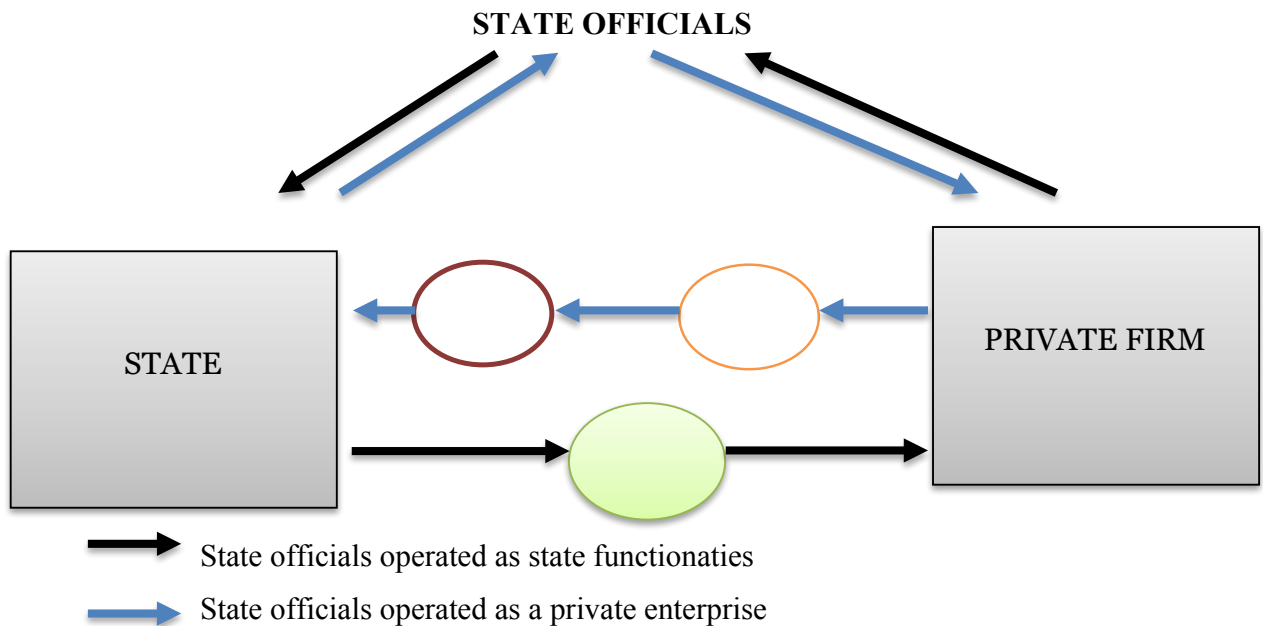
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<sup>41</sup> The growth of the private sector came to a halt during 1926 but "it was not until 1930 that private trade became (de facto) the crime of speculation and the employment of labour for private gain became in fact illegal" (Nove, 1999, p. 127)

had been formed to collect information about its illegal accumulation in various sectors of economy. Secondly, information survives from major court cases on economic crimes during the period of NEP, as elaborated by the Assistant Attorney of the USSR, Kondrushkin. Thirdly, information was officially provided to Larin by various government agencies as a result of 'special requests'.

#### **4.3. The Illegal Accumulation of Private Assets: State Officials and Entrepreneurs**

The decriminalisation of private trade was followed by a large increase in the number of private firms. State officials were amongst those who took advantage of the new laws and regulations. Whilst operating as state functionaries, they established various private enterprises, some under the name of their relatives or companions and some directly under their own names. They used their power, and the direct access to resources granted them by the state, and this combination allowed them to easily funnel public funds into their private pockets. Commercial directors of state factories, railways, trade organizations (both state owned and cooperatives), and other state agents set up so-called 'parallel' shops, 'parallel' trade associations and 'parallel' companies that allegedly provided state enterprises with a variety of commodities, products and services. In reality, however, the official trade was a front for the systematic theft, embezzlement and appropriation of state resources and public funds, which was only possible as a result of the power exercised by the officials within the Soviet institutions. Schematically it can be introduced as following:



- services and products private companies committed to provide
- services and products private companies provided in reality
- fully paid funds and resources

After illegally transferring the funds and resources into their private pockets, state officials usually left state service, and became private entrepreneurs. According to Larin (1927), **over 60%** of state functionaries in the period of the NEP became openly independent entrepreneurs, meaning that over a half of the state apparatus appropriated state resources in one way or another. This phenomenon became a widespread practice in the period of the NEP.

There are numerous examples of this practice:

1. One famous case was that of “Gukon”. In 1923 directors and managers of the state organisation "Section on saving livestock" under The Central Commission for

Assistance to the Hungry, set up a private company called “Optovik”. The main task of the commission was to save livestock by taking it out of the famine-depleted provinces and redistributing it among the provinces that had enjoyed a good harvest. Through their company, they expropriated 132 billion roubles (in contemporary prices) by acquiring tribal horses, taking the best livestock from state farms, arranging beneficial commercial ventures, and making fictitious transactions (Vishinskiy, 1955, p. 3-45).

2. A particularly notorious case involved the state trust “Konservtrest”, whose managers and directors siphoned off state funds through private companies (Vishinskiy, 1955, p. 98-149).

3. One case involved the Leningrad military port, where employees of the port set up a private enterprise called "Zavodopomosch" and signed a binding agreement to sell oil to the company. In reality, they stole 200 thousand pounds (equivalent to 3,200 tonnes) of oil that was taken out of the port, transferred by train and handed over to the enterprise. 80 tonnes out of the stolen 3,200 was sold back to the state-owned Izhora Plants, and the rest was sold to other state enterprises in need of the oil. It is important to mention the fact that the private enterprise "Zavodopomosch" did not possess any initial private capital, or any other means to subsidise the deal. The company had only one room in the hallway, one typing machine and one typist (Larin, 1927).

4. Another case involved the “Triangle” factory. The employees of the factory appropriated state resources by setting up a private company called “Martynov’s office”, which sold factory cable produced by the factory itself to the state. The factory had two gates, one for exported production and another for imported. The stolen cable was taken out of the factory’s warehouse through the “export” gate and immediately was “imported” back into the factories’ warehouse through the “import” gate, but this time with a full payment to “Martynov’s office” from “Triangle” (Larin, 1927).

5. Another instance of the appropriation of state resources involved the Head of the October Railway Supply who commissioned his father-in-law to supply burners, lamp-glass and wicks, despite the fact that the only valuable resource the man possessed was his well-appointed son-in-law. Having obtained samples of the required products from the Leningrad Single Consumer Society (LSCS), the father-in-law offered the samples

to the purchasing department. The latter endorsed the samples and paid in full prior to supply (Larin, 1927).

6. The Head of the Sales Department of the Leningrad branch "Transmostorg" (state agency) established a private enterprise named "Lakokraska" and conducted correspondence between himself, as the owner of this enterprise, and "Transmostorg", striking different deals and making different transactions. The stolen products were then redistributed to other state agencies in Moscow by his brother (Larin, 1927).

7. The head of the North-Western Railway personally negotiated the purchase of 1.6 ton of Swedish nails that were supposedly the property of the private agent. He instructed the bursary to pay immediately in full to the agent. In fact, however, the nails were taken from the state's abandoned barn. Another agent of the North-Western railway, an associate of the head, was also convicted and served five years in prison for colluding with bandits.

There were many other instances of stealing and appropriating the state's resources that took place during 1921-1922, and were later set for trial in the period 1923-1925. In general, in the first period of the NEP, the legalisation of private entrepreneurship was accompanied by numerous incidents involving the direct abuse of state agents' authority and access to resources, creating predatory environments which enabled the accumulation of illegal capital - the engine of the black market.

According to material prepared by the Assistant Attorney of the USSR, Kondurushkin, there were 56 trials of state representatives for economic crimes that took place in the period of 1921-1923, and cost the state about 54 million rubles in gold. This stolen money ended up in the private hands of state officials. The number of economic crimes in 1921-1923, however, was much higher than 56. According to Zhirmunsky (1924, p. 18), 150-200 million roubles in gold was stolen from the state during this period.

Another factor that exacerbated the process of appropriation was the lack of prisons (Krilenko 1923). An insufficient number of prisons in comparison with the frequency of economic crimes - which constituted 66% of all crimes in 1920, 73% in 1921 and

75% in 1922 (Kamalova & Zorina, 2012, p. 11) - made it difficult to keep convicts behind bars. This claim can be reinforced by the following official statistics:

Table 4.3.1. Criminality in the USSR between 1923 and 1924 (in thousands). Judicial statistics

Republics	1923				1924			
	State crime	Crimes against persons	Property crime	Office crime	State crime	Crimes against persons	Property crime	Office crime
USSR	1.6	48.7	99.2	28.2	2.1	91.1	145.5	32.2
Russia	1.5	46.5	94.8	26.7	2.0	85.9	138.3	30.6
Belorussia	0.1	1.9	3.2	0.9	0.3	1.5	3.3	0.6

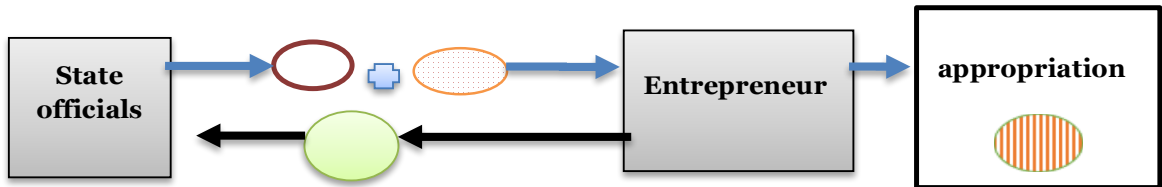
*Source:* Central Statistical Office of SSSR, pp.112-113

In 1923 the total number of crimes in the USSR was 177.7 (in thousands), but by 1924 it had reached 270.9 (in thousands) – an increase of almost 50%.

Even more, in order to “unload prisons” to reduce the burden on the young state, it was a common practice to apply amnesty (Zahartzsev, 2004) or, even without the amnesty, to set free those criminals who committed economic crimes, and to leave only the most dangerous criminals behind the bars, such as murderers. Consequently, once released, these ‘former’ state convicts soon began to operate again using accumulated stolen funds. According to the Assistant Attorney of the USSR, there were almost no large private entrepreneurs of the last period of the NEP (between 1924-1926) who did not face trial, and no less than 90% of them represented the state until 1921.



The second method of illegal accumulation was through the cooperation of state officials with private entrepreneurs and can be schematically represented as follows:



→ State officials operated as state functionaries

← Private entrepreneurs

○ Placement of order

○ Raw materials

○ Appropriation

○ Bribes and paybacks

They widely misused their official power to benefit private individuals, in return for bribes and paybacks. This practice was particularly widespread during the NEP era. Indeed, as shown in the scheme above, the instances of malfeasances dramatically increased between 1923 and 1925. If, for example, in 1923, 28.2 (thousands) malfeasances were registered, by 1924 the number increased up to 32.2 (thousands), while in 1925 it reached 37.9 (in thousands) – an increase of 26%.

The mechanism of this widespread illegal cooperation between state officials and entrepreneurs had three main characteristics.

First, in placing an order with a state factory, a private entrepreneur was guaranteed low costs, short production times and a high quality of production. This guaranteed

competitiveness with the state's products. In return, state officials were offered paybacks and bribes.

Second, when placing an order, private entrepreneurs signed a contract that stated that if the production did not meet the agreed deadline, the state factory would pay a forfeit. Initially, however, it was pre-arranged between the private customer and the state representative that the order would be deliberately delayed. The entrepreneur received the forfeit, which was then shared with the state official. However, this did not occur the other way around; private enterprises that did not meet the requirements of the state firm were not obliged to pay a forfeit.

Third, state factories subsidised the purchasing of raw materials by private businesses to enable fulfilment of the order. The private enterprise would pocket the money and then fail to fulfil the order, declaring itself bankrupt. For example, according to the 1927 report "Coordination of State and Cooperative Resources", the private "Moscow Textile Association" accumulated 500,000 roubles of prepayments from the state for producing orders, and then went bankrupt. This was replicated by the private association "Universnab", which accumulated 600,000 of roubles of prepayments. The same pattern followed with "Rustextile" and "Rostorg". All these private enterprises went bankrupt, taking the state's money with them.

It was during the period of NEP when the illegal cooperation between private entrepreneurs and state officials first emerged. Over the following seventy years, it would evolve into a fundamental aspect of Soviet organised crime. The characteristic feature of this cooperation was the length of time each venture was able to survive before detection. In the Leningrad port, for example, this illegal cooperation lasted six years, while it lasted five years in the Leningrad customs, and three years in the main military warehouse. Criminal networks conjoined private entrepreneurs with a large circle of state officials, in some cases between 50 and 100 state functionaries.

The following case illustrates the mechanism of the illegal cooperation between state officials and private enterprises.

Gregory Plyatsky was both a state official and a millionaire, with an annual revenue of up to 3 million roubles, who took advantage of the implementation of the NEP in 1921 to become self-employed and exploit his status as an insider. He stood trial no less than eighteen times for economic crimes (his cases included “The Franco-Russian Factory trial”, “The State Engineering Plant”, “Red Putilovites”, and the case of the Moscow Trust for the Metal Industry). Kondurushkin wrote: "In all cases convicted, but in all cases, is alive and well. Twice he was incarcerated in the KGB prison, and both times was reborn, like a phoenix". Plyatsky was associated with more than thirty government agencies. In one case, whilst being tried in a Leningrad court in 1925, the court heard that he would place a large order with the steel plant "Bolshevik", all sourced from the plant's stock. The price offered to Plyatsky by the plant was below its own cost price. The order was fulfilled a month ahead of schedule, and was of top quality, while a similar order that the state Sestroretsk plant placed with “Bolshevik” was executed a month late. In spite of the fact that the orders were made using the plant's raw materials, Plyatsky managed to obtain credit from the State Bank. The loan was in fact used by Plyatsky for his other businesses. On top of this, the plant manager Serov granted Plyatsky a mandate to represent the plant. When in 1924 the management of “Bolshevik” was asked by another state agency to cease all further production of Plyatsky's orders, the Head of the Department for technical orders, Kapterev, wrote a formal report saying: "The contracts with Plyatsky are signed according to the law and Plyatsky is a large and profitable customer for the plant". As was heard in the court case, during the three years between 1922 and 1924, Kapterev received regular bribes from Plyatsky, amounting to approximately 100 thousand roubles.

This scheme is typical of the relationship between private entrepreneurs and government agencies in the first years of the NEP. State assets were siphoned into the pockets of private companies through the illegal cooperation of private entrepreneurs and state officials. As Larin (1927) reported, “there are thousands of such criminal entrepreneurs who stubbornly engaged in economic enterprises with government agencies, and there are a large number of government agencies that continue to cooperate with them, continue to cooperate with individuals like Plyatsky. Eighteen times he was tried, thirty government agencies have suffered from it - and he still was

able again and again to enter into the business relations with the same or other state bodies” (p.6).

Illegal cooperation between state officials and private entrepreneurs was also prominent in the plundering of the state’s non-liquid assets.

After the 1917 revolution, the Bolshevik regime confiscated all private property, or, as the Bolsheviks used to call them, ‘non-liquid assets’. The appropriated assets, however, remained stalled and unused because the young Soviet state faced bigger challenges, such as retaining power and implementing War Communism. This could be seen from the report published by Konin (1925) in the Industrial and Economic Council of the USSR: “...in the upcoming years small industry will have no choice but to use the equipment that due to the technical obsolescence or inertness of some factories and plants was not used by the large industry” (p. 42). The existing political and economic situation created an absurd set of circumstances. On the one hand, piles of confiscated and unused assets lay in state warehouses, unaccounted for and unsupervised. These were continually replenished with new stocks, both produced and imported, which caused shortages of capital in the general economy. Finally, the government was forced to attempt to reduce this wasteful stockpiling. For example, in 1925 the Supreme Economic Council ordered the disposal of non-liquid assets, meaning that plants were granted permission to sell their stockpiles. This prompted a firesale of state property to private individuals at reduced prices. According to RCT (Workers-Peasant Inspectorate), in 1926 GUM (the main department store in Moscow) sold 80% of their imported haberdashery stock to private individuals at low prices, in their effort to reduce all ‘dead’ stock. In 1926, GUM sold 56% of its stock to individuals at heavily reduced prices.

The decree enforcing the disposal of state stock meant that whole industries ended up in private hands, which had two main political and economic impacts. On the one hand, the private sector boosted the Russian economy. On the other, the disposal of the state’s non-liquid assets, some of them strategic, and at nominal prices, enabled the accumulation of private capital. Most importantly, the private sector became an instrumental player in some industries, thereby shifting power from the state to the

private sector. The impact on the car industry, for example, was enormous. For instance, the state enterprise 'Leningradodezhda' sold used cars in good working order for a price of between 400 and 600 roubles per unit, although the market price for a good quality used car was at least 10 thousand roubles. Car sales to private individuals grew at a remarkable rate, that is "...various state agencies sold to private individuals 1661 cars, of which 1218 cars, 422 trucks and 21 cars for special purposes (and in addition, 4 thousand motorcycles)" (Larin, 1927). According to data provided by the Central Transport Management, dated 14 January 1927, to repair a used car amounted to, on average, 500 to 700 roubles. Consequently, the total costs of buying and repairing a used car amounted to one thousand roubles. Since the market price was about 10 thousand roubles, the margin of 9 thousand roubles, state liquid assets, went to private hands. Thus, a simple calculation shows that 1,600 cars that state enterprises sold at a reduced price created more than 10 million roubles of private capital. As Larin (1927) observed, 8% of the road transport of the USSR ended up in private hands.

The disposal of the state's stock not only enabled an accumulation of private capital and a depletion of state liquid assets, but also led the private sector to play an instrumental role in state-controlled industries, and therefore compete with the state. One case comes from water transport. The state enterprise 'Foncombalt' in Leningrad, sold 2 tugboats, 2 pontoons, 4 barges and 1 scow to a private entrepreneur, Legach, at a total cost of 5 thousand roubles, although the price for only one of the barges was much higher than this total sum. It is worth noting that this deal was backed and promoted by the engineers of the state enterprise, whose specialization was in water transport, meaning that they were well aware of the real value of the items. Having bought this water fleet, the entrepreneur then began to compete with the state shipping company by receiving orders from the state-owned transportation company 'Nefitetorg' along with other state institutions. Legach continued buying up the state's non-liquid assets for a heavily discounted price, including steel, hemp rope and sheet metal. He also bought 40 thousand pounds (640 tonnes) of steel from decommissioned vessels, and eventually signed the contract with the State Leningrad Forestry Institute. The Institute granted Legach the right to control approximately 18,000 hectares of forest for a period of six years, in order to extract coal.

As a result of the corruption, new private river and sea water transport companies thrived, playing a significant role in marine transportation. According to the Central Statistical Office (CSO), in 1923 the private water transport business was estimated at less than 3 million roubles, but by 1925 it had already reached more than 10 million roubles. According to the Central Office of Sea Transport estimate of 4th February 1927, the turnover of the private fleet in the Black Sea was approximately 2 million roubles, and 600 thousand roubles in the Caspian Sea. In 1925, CSO figures show that the private transportation fleet (sea and river) accounted for about 3.6% of the total water turnover of goods. By the following year, according to the preliminary data of the People's Commissariat, this had risen to 7% of the total water freight. The rise of the private fleet caused a retreat of the state sector. According to figures compiled in 1927 by the CSO, in 1924 the private sector had held 15.2% of the sea fleet in USSR, but by 1926 this had risen to 33%, bringing in about 2 million roubles in yearly revenue.

The illegal cooperation between state officials and private enterprises was also apparent in the imposition of so-called "predatory rents." During the 1920s many state fabrics and plants were inactive and inoperative. In 1921 the Soviet state created a 'lease fund' that allowed idle state-owned enterprises to be leased to private entrepreneurs. According to the CSO, the value of this fund was estimated at approximately 250 million roubles.

On the surface, it seemed a logical policy to lease idle state enterprises in order to boost the stock of liquid assets. However, the implementation of the policy was less than ideal. All of these state enterprises contained large stocks of reserves, and the state leased out these stocks and reserves along with the state enterprises, but without an explicit charge for them. Accordingly, these stocks and reserves were simply stolen from the state warehouses by the lessee, usually by way of illicit cooperation between state officials and private entrepreneurs, with the officials selling the stocks to the tenants who could either profit from a resale or use this stolen stock in their production. Thus, both state officials and private entrepreneurs profited from the illegal appropriation of state resources. The following cases illustrate how this illegal collusion and amassing of capital operated under the guise of the lease of the state enterprises.

1. The Department of Municipal Economy of Leningrad leased an entire street (Gorstkin Street) to two entrepreneurs, Shustrov and Epifanov, along with all the shops, depots and warehouses and all their stock, such as meat and vegetables. The net income of this lease amounted 800 thousand roubles.

2. The former house of the famous restaurateur Eliseev, No. 56, 25<sup>th</sup> October Avenue, was considered one of the best houses in Leningrad. It was rented out almost for free by the head of the state organisation 'Komothoz' to the actor Ksendzovsky, during a six-year period, in return for bribes.

3. Two factories, "Lightning" and "Bette", that produced galvanic elements were rented out to an entrepreneur named Gezerih, who took the factories on condition that he was permitted to undertake the valuation himself. Gezerih valued the stock at less than one-tenth of the actual value, which enabled him to sell his products at 30% below the prices of his state-owned competitors. Arrangements of this kind were common, and meant that it was not unusual for the products of rented state enterprises to undercut the products of state enterprises. Given that state factories paid the full cost of production whereas leased factories very often obtained materials and supplies almost free of charge, this is hardly surprising.

The illegal collusion between state officials and private enterprises was also noticeable in the case of what were known as 're-purchasing', or 'buying up' agreements. These referred to the purchasing of state products by private commercial enterprises through nominees in state and cooperative retail stores. This system was widespread during the NEP. According to the People's Commissariat on Trade and Production, during 1925/26, 35% of all the products produced by state industry for sale to the mass market were bought from private sellers. Fifteen percent of manufactured products were sold by public authorities (trusts, syndicates, local trades) to private traders, whilst the remaining 50% was bought by the private sector from retail state shops, through nominees. According to the data showing the trading profits of private capital, in 1925/26 the profit from illegal re-purchases amounted to no less than 25 million roubles. One common feature of these re-purchases was the degree of **organised collusion** between private traders and state functionaries. For example, a network of private agents

in Leningrad bought a large amount of goods from state retailers that enabled them, first, to supply 40% back to the market at a higher price and secondly, to illegally sell textiles in the cities, even in Moscow. Such large 're-purchases' would not have been possible without close cooperation with state officials.

Smuggling and stealing imported goods from the state were other methods of illegal cooperation between state officials and the private sector that enabled the formation and accumulation of private capital. The following example illustrates how this kind of cooperation worked.

Along the western border with Estonia, Latvia and Poland, so-called "transits", or private cars were positioned at 20-25 km from each other. These served as bases and warehouses for smuggled goods and were also used to plan out different operations carried out by entrepreneurs on the Russian side of the border. As Commissioner Zaleski, who was assigned to Batum in November 1926 to purchase confiscated smuggled goods, described:

*"..there is a procedure that if a border resident reports a contraband location to the frontier guard and the latter confiscates it, then one-third of the proceeds received from the sale of these confiscated goods is split 50 / 50 between the frontier guard and the informants. This created a kind of 'fishing'. At the border, there were Turkish companies that trade in smuggled goods. Border residents easily cross the border, buy (very often on credit) the goods from these companies, and smuggle the goods back. Further, the smuggler reports to the frontier guard, whom he cooperates with, that he found smuggled goods. The goods were then confiscated, sold at auction, and the informant and the guard got awarded with one-third of the proceeds. This award as a rule is much higher than the value of the confiscated goods. For example, a bundle of light-sensitive paper (for photos) in Turkey is valued in roubles at about 96 cents, whereas at auction it is sold from 10 to 14 roubles. Powder "Coty" on the Turkish side costs from 9 to 10 roubles, at the customs auction in Batumi it's sold between 54 to 60 roubles. Inspector Stal calculated the inventory of*



*confiscated goods verses calculated value along with the award for reporting the smuggled goods. It turned out that for the goods that were bought in Turkey for 2400 roubles the amount of award paid by the Russian authorities was 3000 roubles”.*

This illegal cooperation between state agents and private entrepreneurs became a widespread practice, and a feature of daily life. Trade in smuggled and semi-smuggled goods would not have been possible without the participation of state officials, or the highly-developed distribution network. The purchase, distribution and selling of imported goods involved a large and highly organised web of players, both state officials and private individuals. For one example, such a network emerged in Moscow in the years 1925-1926. Two private firms, ‘Techinstrument’ and ‘Elektrometal’ specialized in bribing state officials to allow them to buy high quality imported tools, which they not only sold on to private companies but also back to state agencies at inflated prices (details published in the newspaper *Pravda* from August 1, 1926). This network operated throughout the USSR. Likewise, the cooperative ‘Maslovosk’, set up by clergymen, bought up 15 tons of imported quebracho extract from state institutions, with the cooperation of state functionaries. They sold it on the free market at far higher prices (details published in newspaper *Pravda* from June 29, 1926).

According to the Customs Directorate, the total of smuggled goods in 1926 amounted to about 60 million roubles, the retail prices being 120 million roubles. The smuggled goods comprised 12% of all leather products and footwear, 11% of all haberdashery products, 20% of all wool fabric and 5% of all other manufactured products. Another source of illegal accumulation of private capital was credit from the state. There were different forms of private credit in the USSR. One took the form of prepayments paid by state institutions when they placed orders with private enterprises. Another involved the commodity loans offered by state enterprise, a widespread practice in the regions, where the State struggled to sell some types of products, such as salt and kerosene, due to the lack of a proper distribution network. It therefore needed the involvement of private traders and wholesalers. However, it was not only ‘difficult to sell’ goods that enjoyed credit. Under the guise of labelling goods as ‘difficult to sell’, private

entrepreneurs frequently used bribes and kick-backs to persuade state officials to allow them monetary credits for popular products. During the years 1925-1926 private enterprises were given credit of 190 million roubles. This amount allowed private entrepreneurs to operate freely and develop their other businesses, giving them a clear advantage. An example of this involved the distribution of Borjomi water throughout the USSR. Entrepreneur Keadze was an agent of the Georgian plant 'Kurpur', a body of the state institution 'Narkomzdrav', in charge of purchasing Borjomi water. Through Keadze's personal links with the manager of 'Kurpur', he was given a commodity loan. 'Kurpur' also acted as a guarantor and the State Bank granted Keadze 200,000 roubles of monetary credit. At the same time Keadze transported Borjomi to Moscow where he gained more credit, and so on.

According to the survey conducted by the Working-Peasants Inspectorate, often the same private company received a cash credit simultaneously at different banks. Table 4.3.2 presents entrepreneurial debts on 1<sup>st</sup> October 1925, owed to a variety of banks.

Table 4.3.2. Entrepreneurial debts

Banks	Debt (thousands of roubles)
Gosbank	2,692
Vsekobank	828
Mosgorbank	1,118
Ukrainbank	189
Khozbank	1,300

*Source:* Central Printing Administration, 1925, p. 29.

A number of ways were used to fraudulently obtain monetary credit during the NEP. In a case heard in a provincial court in Moscow in 1926, a private chemical plant, "Heating system", was allegedly producing melted fat. They applied for a loan at the State Bank. The State Bank instructed its agent to visit the plant. According to the agent, the plant was "running at full capacity", and the plant was granted a credit. Subsequently

it turned out that this was a single production of melted fat and a “show” was put on to convince the State Bank to grant the loan. Another example was a soap factory that demonstrated “continuous” production. However, it transpired later that it simply refined the same soap over and over again. Whenever the State Bank agent visited the plant, it always had stock to show him for the purposes of the mock production, and there was always someone on the production line “producing”. However, the mock production only took place when the State Bank agent visited.

To sum up, War Communism – one of the first major political programmes of the young Soviet state – crystallised the severity of the economic conditions of the time, and constituted a decisive political shift for Russia. It unleashed a major systemic crisis in Russia that nearly destroyed the Soviet economy; in turn, the implementation by the Bolsheviks of War Communism in the context of an economically backward nation, where the needs of capital investment and national security implied strict limits to investment in consumer goods, contributed to the demand for some consumer goods invariably exceeding the supply. This required a distribution system involving queuing and rationing. The greater the number of proscribed economic activities and the greater the shortage of consumer goods, the greater was the temptation to circumvent the law. These conditions further contributed to the economic crisis that, in turn, undermined the political order. Scarcity of food and basic stuff led to the emergence of the black market, one of the most important consequences of the economic crisis. As Richard Rosenfeld put it, “every recession...[is] associated with an increase in crime...which would be most responsive to changes in economic conditions”<sup>42</sup>.

Over time, the Bolshevik leaders realised that no military or similar coercive means can substitute for the state’s mobilisation of economic and financial resources that provide the economic foundations for state stability. It was the informal sector, or black market, which had the necessary resources, business skills and private capital, to revitalise the collapsed economy and therefore to preserve political power.

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<sup>42</sup> Christine Hauser and Al Baker, “Keeping Wary Eye on Crime as Economy Sinks,” *The New York Times*, October 9, 2008, [http://www.nytimes.com/2008/10/10/nyregion/10\\_crime.html](http://www.nytimes.com/2008/10/10/nyregion/10_crime.html) [Accessed April 6, 2011].

The dependence of the Russian State on these resources, therefore, turned into its dependence on the black market, thereby necessitating the transition to the mixed economy through the implementation of NEP. This transition facilitated mechanisms of cooperation between the state, and the informal sector of the black market. On the one hand, there was a combination of the weak state institutional system and weak legislative reforms. On the other, there were easy opportunities to appropriate stocks of nationalised resources.

Therefore, the collusive illegal network of state officials and private entrepreneurs, a phenomenon that became a key element of organised crime in Russia, accompanied the very founding of the Soviet state. The rise in criminality was both a product of the initial economic breakdown, and a political solution to it. As the following chapters show, this pattern of collusion between state officials and private entrepreneurs came not only to define the early years of the young Soviet state, but also to shape the political-economic development of the Soviet economy in the decades to follow.

Thus, focusing on the very beginning of the Soviet state, this chapter has aimed to help reveal some of the misconceptions about the formation of Russian organised crime and to illustrate that crises and transitions do facilitate the emergence of organised crime. First, it showed that the “black economy” emerged during War Communism and not in the 1970s-1980s, as is sometimes suggested in the literature. Second, it demonstrated that the establishment of illegal cooperation between the Russian state and non-state actors, as a precursor to a formation of the phenomena of organised crime, took place during the period of the NEP, between 1921-1926, and not – as many transitologists argue - during the 1990s. Third, and most importantly, it pointed to a long-running aspect in the nature of the relationship between the Russian state and Russian organised crime that has been largely overlooked. It was the post-revolutionary structural economic breakdown that forced the state to forge an alliance with organised crime, in order to help preserve political order. Once this devil’s bargain had been struck, the extensive mutual benefits of this relationship (protection for criminals and access to scarce resources for state officials) ensured that it would evolve into a long-standing institution of the Soviet and Russian political landscape.

## **CHAPTER 5**

### **THE SPREAD OF THE NETWORK:**

#### **ORGANISED CRIME AS AN INSTITUTION OF THE COMMAND ECONOMY,**

**1935 - 1985**

The 74 years of the existence of the USSR (1917-1991) can be categorised into distinct periods: War Communism (1917–1921); NEP (1921–1929); Collectivisation, Industrialisation (1929–1941); Stagnation (1969–1985); and Perestroika (1985–1991). Chapter 4 illustrated how a sequence of political and economic events after the revolution produced the ‘cooperative’ dependence of the Russian state on the informal sector, and laid the foundations for organised criminality in the country. At that time, it took the form of state officials, individually and with the collusion of private entrepreneurs, illegally appropriating private assets and producing scarce goods.

The aim of this chapter is to extend the examination of organized crime in Russia to the post-1935 period, which includes the period of Stalinism, the post-war economic revival of the 1950s-1960s and the period of stagnation and economic decay of the 1970s-1980s. These five decades saw the development and spread of organised crime and its functions in the USSR, spatially and functionally. Embedded in the shadow economy and underground markets, organised crime groups spread across the vast geography of the USSR and permeated most economic sectors, especially those involving the provision of consumer goods. Crucially, and contrary to the established view that organised crime ‘usually operates in niches where the state is absent’ (Shinar, 2016, p. 632), the spread of organised crime in Russia evolved in close cooperation with corrupt state officials, many of whom were gradually absorbed into the criminal networks. Across the period of WW2, the post-war economic revival and economic stagnation, the state-organised crime relationship was centered on the prospect of

mutual gain for the official and the criminal sides. Crime groups depended on corrupt officials and Party apparatchiks for protection, while state officials initially needed organized crime, its networks and mechanisms, as a means to address the deficiencies of the command economic system; and later (from the late 1960s onwards), for personal enrichment as well as career advancement.

### 5.1. Collectivisation, Industrialisation, 1929-1941; 1952

In 1929, political change in the Soviet state re-shaped economic and social realities. Once again, the state took a turn towards collectivisation to fulfil its procurement plan. This, as historians suggest (see Nove, 1989; Narkiewicz, 1966), was the beginning of the end of the NEP. Changes were accompanied by a number of decrees. One such heralded the beginning of "dekulakisation", or the liquidation of the more prosperous peasantry, which resulted in the dramatic decline of livestock, and the grain harvest (Table 5.1.1) and eventually led to acute shortages in foodstuffs, and the introduction of rationing.

Table 5.1.1. Decline in livestock and in the grain harvest

	<u>1928</u>	<u>1929</u>	<u>1930</u>	<u>1931</u>	<u>1932</u>	<u>1933</u>
Cattle (million head)	70.5	67.1	52.5	47.9	40.7	38.4
Grain harvest (million tons)	73.3	71.7	83.5	69.5	69.6	68.4

*Source:* Socialist Development, 1936, p. 342-343, p. 354

Private shops and private dealers were now banned (Decree from May 20, 1932) and private entrepreneurship became a crime (Decree from August, 22, 1932). The following tables, Table 5.1.2 and Table 5.1.3 respectively, provide figures which demonstrate the compositional change in social classes in the USSR, and in the ownership of productive

assets by types. These illustrate the sharp decline in the share of the private sector, and the increased domination of the state in small-scale industry.

Table 5.1.2. Change in social classes in the USSR, 1913-1937

	1913	1928	1934	1937
Working class and white-collar workers	16.7%	17.3%	28.1%	34.7%
Collective farms peasants, cooperative artisans and craftsman	-	2.9%	45.9%	55.5%
Individual peasants, individual artisans and craftsman	65.1%	72.9%	22.5%	5.6%
Bourgeoisie (landowners, large and small urban bourgeoisie, merchants, better-off-peasants)	15.9%	4.5%	0.1%	-
Other population (students, retirees, army and others)	2.3%	2.4%	3.4%	4.2%

*Source:* Statistical Collection, 1950, p. 6

Table 5.1.3. Production assets by types of ownership

		<u>1928</u>			<u>1936</u>		
		Industry	Agriculture	National Economy	Industry	Agriculture	National Economy
Socialist Property:							
a)	State Property	97.9%	63.6%	77.8%	99.95%	96.3%	98.7%
b)	Cooperative- collective farm property	96.6%	62.6%	76.5%	97.35%	76.0%	90.0%
Individual farmer excluding exploitation of other labor	collective property the of other	1.3%	1.0%	1.3%	2.6%	20.3%	8.7%
	Small private property based on personal labour and is the main source of existence	2.0%	31.9%	19.6%	0.05%	0.6%	0.2%
	Capitalist private property based on the exploitation of other labour	0.1%	4.4%	2.6%	-	-	-

Source: Statistical Collection, 1950, p. 17

Another policy involved the channelling of investment into industrial goods and equipment rather than consumer goods. The following are the relevant figures:

Table 5.1.4. Gross Industrial Output 1926/27

<u>1926</u>	<u>1928</u>	<u>1932</u>	<u>1937</u>	<u>1940</u>	<u>1945</u>	<u>1946</u>	<u>1947</u>	<u>1948</u>	<u>1949</u>	<u>1950</u>
In	Billions	of	rubles							
15.9	21.4	43.3	95.5	138.5	127.0	106.0	129.3	163.1	195.4	239.8

Source: Statistical Dynamical Series, 1913-1951, p. 43



These measures contributed to inflation, a massive drain on cash resources (Linz, 1984) and not only accelerated shortages in foodstuffs, but dampened the output of consumer goods and services (Tucker, 1977).

The structural imbalance between demand and supply created great economic pressure and left the state with no choice, but to once again legalise private trade. This time, however, the private sector was limited only to handicraft industries and collective farms. The reasoning behind the limits was two-fold. First, they were underpinned by socialist ideology. As Larin (1927) explained, if foodstuff and artisan products were produced and consumed by the same labour, it dovetailed with social democratic ideas; all production that involved the exploitation of labour constituted capitalism. Another reason, suggested by Keeran and Kenny (2010), was that this kind of private activity did not pose a threat to socialist ideas: “[b]ecause the socialist sector could not realistically assume responsibility for every small repair, service, and petty exchange of goods, private economic activity occurred in every socialist country. Kept within bounds, private activity occupied a natural and unthreatening place” (p.64).

The legalisation of trade in foodstuffs and goods within consumer markets, and the government’s willingness to encourage private ownership of items such as livestock, improved the economy. We have already seen the same effect in the previous chapter. These measures contributed to the increase in foodstuffs in the market and consequently to the recovery of the economy. This can be observed from the illustrated data below:

	<u>January 1934</u>		<u>January 1938</u>	
	<u>State and collective</u>	<u>Private</u>	<u>State and collective</u>	<u>Private</u>
Cattle	12.3	<b>21.2</b>	18.0	<b>32.9</b>

*Source: Statistical Collection, 1960, p. 263-264*

According to the People's Commissariat of Agriculture of the USSR, by 1950, more than 65% of the foodstuffs consumed within cities were bought on collective-farm

markets. Products such as meat, dairy products, vegetables, eggs, berries, honey, mushrooms and freshwater fish were bought by townspeople at the markets, rather than from state shops. Table 5 shows the index of sales volume from collective-farm markets in 1940 and 1950. As we can see, there was an increase of 60% in trade in foodstuffs.

Table 5.1.5. Index of sales volume on the collective farm market

	<u>1940</u>	<u>1950</u>
All products	100%	<b>160%</b>
Including		
Grain crops	100%	<b>406%</b>
Potato	100%	<b>295%</b>
Meat	100%	<b>114%</b>
Milk and dairy products	100%	<b>116%</b>

*Source:* A Concise Statistical Collection, 1955, p. 142

The share of the collective-farm market in the trade in foodstuffs between 1940 and 1954 increased by half, as the following Tables (5.1.6 and 5.1.7) illustrate.

Table 5.1.6. Retail turnover including public catering between 1940 and 1954

	In billions of roubles			In %		
	1940	1950	1954	1940	1950	1954
All retail trade turnover	<b>203.6</b>	<b>409.2</b>	<b>531.7</b>	<b>100</b>	<b>100</b>	<b>100</b>
including						
State trade	<b>128.1</b>	<b>261.8</b>	<b>335.7</b>	<b>62.9</b>	<b>64</b>	<b>63.1</b>
Cooperative trade	<b>47.0</b>	<b>97.8</b>	<b>146.2</b>	<b>23.1</b>	<b>23.9</b>	<b>27.5</b>
Collective farm market	<b>28.5</b>	<b>49.6</b>	<b>49.8</b>	<b>14.0</b>	<b>12.1</b>	<b>9.4</b>

*Source:* A Concise Statistical Collection, p.135

Table 5.1.7. Share of Farm Market in the Sale of Foodstuff

	In millions of roubles			In %		
	1940	1950	1954	1940	1950	1954
Total volume of sales	<b>137.9</b>	<b>256.9</b>	<b>312.5</b>	<b>100</b>	<b>100</b>	<b>100</b>
including						
State and cooperative trade	<b>110.5</b>	<b>210.0</b>	<b>264.0</b>	<b>80.1</b>	<b>81.7</b>	<b>84.5</b>
Farm market	<b>27.4</b>	<b>46.9</b>	<b>48.5</b>	<b>19.9</b>	<b>18.3</b>	<b>15.5</b>

*Source:* A Concise Statistical Collection, 1955, p. 135

Not only were collective farms permitted to trade on the free market, but individual farmers were also permitted to engage in private production (Moshkov, 1966). As Soviet law permitted those employed on collective and state farms to have an agricultural plot of a maximum size of  $\frac{3}{4}$  of an acre, individual farmers were able to sell products produced in their household in the cities. However, in order to produce and sell, they needed the means of production – all of which were in the hands of the state. Consequently, a lack of the means of production prompted the theft and appropriation of state property, as “...this growing and selling invited illegal abuses such as diversion of socialised property (seeds, fertilizer, water, fodder, equipment, and transportation) to support the private plots and bring the produce to market” (Keeran and Kenny, 2010, p. 67).

Soviet law also permitted private activity in other sectors. Professionals, for example, were allowed to legally sell their services, while craftsmen were permitted to undertake home repairs. However, these private undertakings easily slipped into illegal activity and steadily took the form of economic crime – stealing from the state. As Grossman put it, “[t]he peasants steal fodder from the kolkhoz to maintain his animals, the worker steals material and tools with which to ply his trade ‘on the side’, the physician steals medicines, the driver steals gasoline and the use of the official car to operate an unofficial tax” (1985, p. 29-30).

The legalisation of private trade also opened the gap between official prices, and prices charged by private sector. The following Table 5.1.8 illustrates this:

Table 5.1.8. Official prices vs market prices

Source: Nove, 1969, p.196

	Private market prices					1932	1932
	<u>1928</u>	<u>1929</u>	<u>1930</u>	<u>1931</u>	<u>June</u> <u>1932</u>	Official price (kopeik/kg)	Free price (kopeik/kg)
Foodstuff							
Rye flour	100	225	350	525	2,303	<b>12.6</b>	<b>89.5</b>
Potatoes	100	160	280	520	1,552	-	-
Beef	100	125	359	663	1,264	<b>111</b>	<b>414</b>
Butter	100	201	602	979	1,078	<b>502</b>	<b>1,146</b>
Eggs	100	134	330	572	868	-	-
Rye bread	100	-	-	-	-	<b>10.5</b>	<b>111.0</b>

This had a two-fold impact. It boosted the accumulation of private assets that were then re-invested in the shadow economy, and thus provided a boost to the flourishing black market, which displayed the same dynamics as during the NEP. It also contributed to the ‘rent-seeking’ type of organised crime-state relationship, where both state representatives and individual entrepreneurs, either independently or through collusion, directly preyed on state property. This took mainly two forms.

First, there were large-scale thefts of money, raw materials and other state property, alongside counterfeiting, currency operations and the smuggling of goods. All these illegal activities were operated by state officials. In 1932, for example, the theft of cargoes from railway transport reached tens of millions of roubles<sup>43</sup>.

The following data illustrates the involvement of state officials and state workers in criminal activities between October, 1<sup>st</sup>, 1929 and March 10<sup>th</sup>, 1930, in some industrial areas of Russia.

<sup>43</sup> Stalin and Kaganovich. Correspondence, July 20th, 1932. 1931–1936. Moskva: (ROSSPEN), 2001: 235-236. Available at: <http://istmat.info/node/26792>.

Архив:

РГАСПИ Ф. 81. Оп. 3. Д. 99. Л. 106–113

Table 5.1.9. State officials and state workers involved in criminal activity

	Number of individuals involved in criminal activity	Warehouses and shops workers	Theft, embezzlement and misappropriation	Forgery and fraud	Bribery	Squandering
Leningrad	97	83	—	—	—	—
Ivanov industrial district	103	68	26	43	29	39
Samara industrial district	365	124	—	—	No details available	—
Nizhnegorod district	32	14	—	—	No details available	—
Total	597	289	26	43	29	39

*Source:* ROSSPEN, 2001, p. 245-247.

As we can see, 597 state officials and state workers were engaged in criminal activities, all within only 18 months and only in four districts. Among them 26% were state officials, and 48% were warehouse and shop workers.

Second, private assets were obtained through informal activities operated by private individuals, themselves colluding with state officials. There is much evidence to support this. The following document, *On speculation among the workers of IPO, 1930*<sup>44</sup>, that was prepared under the column “confidential” by the Political Administration under the Council of People’s Commissars in 1930, vividly illustrates the informal economy that existed in this period:

<sup>44</sup> “Confidential”: Lubyanka to Stalin On the Situation in the Country (1922-1934), v.8, part 2, 1930, Moscow, 2008: 1080-1082. Available at: <http://istmat.info/node/26959>

*September 26, 1930.*

*No. 386868 Top Secret*

*Due to the fact that part of the textile factories of the IEP temporarily suspended its work as a result of the difficulties with raw materials, the labour force is inactive. This contributes to the increase in the engagement in speculation among the workers.*

*The aggravation of the foodstuff shortages and the vibrancy of the private market, on the one hand, and the lack of supervision of trade unions to this phenomenon, on the other, contribute to the involvement of more and more significant groups of workers in speculation that begins to take on a considerable significance. One of the reasons for the creation of favourable conditions for the development of speculation is the inadequacy of accounting for the needs of individual workers in the distribution of coupons for scarce industrial goods (at the factory "March 8" women were given male suits, in the collective of unemployed men the latter received women's shoes).  
Bonjachkin factory. The worker, who allegedly received seven coats for family members, sold them, making profit of 300 roubles.*

*Verchneseredskaya factory. Weaver, regularly receiving cigarettes for 4 members of the family, in which no one smokes, has accumulated them [cigarettes] in considerable quantities and sold them on the market at an increased price.*

*Shuiskaya factory No. 2. A worker received a drying oil and nails which she resold at a speculative price.*

*Being unsatisfied with the opportunities to speculate locally, some workers travel by themselves and send their wives to agricultural areas where they exchange manufactured goods for food, which in turn are resold in cities at higher prices.*

*Town Vichuga. Employees of the Shagovskoy factory bought herrings from shareholders, who received them from the Central Revision Commission, and brought them to Puchezh, where they sold, 12 times more expensive than the actual price.*

*There are instances when workers leave their jobs at factories to trade on the market in more profitable businesses.*

*Shuysky District. Worker at factory No. 2, having left her job, engaged in buying up the goods received from the shareholders and exchanging them in the village for agricultural products which are subsequent resold at higher prices. Her weekly income reached 199 roubles.*

*At the Shuisky Bazaar, a worker who left his work in a cloth factory, sells leather shoes that he buys from shareholders.*

*Recently there were instances of members of the party being involvement in speculation. They exchange manufactured goods for food and then resell the latter at higher prices.*

Private trade, both legal and illegal, developed to the extent that it reduced the absolute dominance of the public sector in cities. According to various estimates, in 1952 the private (small-scale) sector supplied from 6% to 8% of the production of consumer goods and household services. This sector was represented by all sorts of artisanal workshops (sewing, repairing, jewellery-making, watch-making). It also included activities such as scrap collection, household construction and repair work, teaching and tutoring, and handicraft production (Katasonov, 2014, p. 86). Estimates suggest that between 114,000 to 150,000 private enterprises and workshops operated in 1953. They were called “artels”<sup>45</sup> and employed about two million people who produced almost 6% of the gross industrial output of the USSR, 40% of furniture and 70% of metal dishes<sup>46</sup>, to name a few examples.

Artels had been sanctioned to provide private enterprises with wasted, rejected or defective material. In reality, however, they were trading high-quality raw materials with private cooperatives that shared territory with state factories, thereby establishing

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<sup>45</sup> Artels were traditional labour collectives in Russia that were based on several principles: voluntary association for specific types of activity; the equality of all members of the artel; joint responsibility; eligibility for leadership

<sup>46</sup> [https://kprf.ru/rus\\_soc/99271.html](https://kprf.ru/rus_soc/99271.html)

a supply chain. Persuasive evidence of an unprecedented scale of illicit economic activity in that period is provided by the example of the Department of Military Construction No.1<sup>47</sup> where the entrepreneur Nicolay Pavlenko managed to make 25 billion of roubles through illegal production - an immense profit at the time. During the period 1946 and 1947, the magnitude of private capital illegally accumulated through embezzlement, theft and misappropriation of state assets reached 997 million roubles, and this was from only six state institutions and enterprises (Table 5.1.10).

Table 5.1.10. Illegal Private Capital accumulated during 1946 - 1947

	The Ministry of Commerce	Department of Consumer Cooperation	The Ministry of Aviation Industry (Department of Workers Supply)	The Ministry of Forest Industry (Department of Workers Supply)	State enterprises of Commercial Cooperation	Cooperation of disabled people
<u>1946</u>	131,5 (million roubles)	269,8 (million roubles)	2,2 (million roubles)	3,5 (million roubles)	27,3 (million roubles)	8,7 (million roubles)
<u>1947</u>	151,1 (million roubles)	342,7 (million roubles)	3,7 (million roubles)	3,9 (million roubles)	36,5 (million roubles)	16,0 (million roubles)
Total	<b>282,6</b>	<b>612,5</b>	<b>5,9</b>	<b>7,4</b>	<b>63,8</b>	<b>24,7</b>

Source: Kommersant, 2013.

Alongside the formal, legal economy, therefore, new illicit industries and sectors were successfully established. It is remarkable to note that the Soviet shadow economy completely fulfilled the requirements of the population for the consumption of illegally produced goods (Grossman, 1977). This collusive pattern of “state-private enterprises” was noted in Chapter 4. The employment of aspects of a market economy, prompted the emergence and formation of networks of state officials and private entrepreneurs, the

<sup>47</sup> <http://libanomaly.ru/100avant/83.htm>



core purpose of which were illegal accumulations of private capital through fraud, appropriation and embezzlement of state assets.

There were other crimes that were committed alongside those that constituted the shadow economy. Evidence is provided by the following Memorandum of the Minister of Internal Affairs, S. N. Kruglov, “On the state of criminality” in the USSR dated 02.04.1948, to J. Stalin:

*Following is the data of the state of crime in the country in 1947:*

<i>Murder for the purpose of robbery</i>	- 2827
<i>Armed robberies</i>	- 2462
<i>Unarmed robberies</i>	- 20046
<i>Domestic murder</i>	- 8327
<i>Impudent form of hooliganism</i>	- 10259
<i>Aggravated theft</i>	- 118998
<i>Ordinary theft</i>	- 182143
<i>Pickpocketing</i>	- 20534
<i>Livestock theft</i>	- 31536
<i>Fraud</i>	- 7035
<i>Other crimes</i>	- 48998

*In 1947, out of 567,897 persons who were brought to trial, 419,320 were convicted<sup>48</sup>.*

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<sup>48</sup> <http://istmat.info/node/18436>

The following data from a special department of the Ministry of Internal Affairs of the USSR from December 1953 illustrates the number of arrested, and convictions between the years 1930-1936 and 1939-1953, provided by the Political Administration under the Council of People's Commissars and by the People's Commissariat for Internal Affairs.

Справка  
о количестве арестованных и осужденных  
по делам органов ОГПУ-НКВД  
за 1930-1936 годы

Годы	Всего арестовано	ИЗ НИХ:			Всего осуждено	ИЗ НИХ:				Жен. осужденны:			
		За контрреволюционные преступления	В том числе в высшей степени тяжести	Другие преступления		ВМЗ	Лесера и тюрьмы	Ссылка и высылка	Прочие меры	Трибуналом и судами	Женской коллегией ОГПУ	Особым Совещанием	Прочими органами
1930	331 514	266 629	41 141	64 865	202 069	20 201	114 443	58 816	11 609	-	9 072	19 377	179 620
1931	429 065	343 234	100 963	135 331	180 696	10 651	105 683	63 269	1 093	-	13 357	14 592	152 747
1932	410 433	195 510	23 484	214 893	141 919	2 723	73 946	36 017	29 223	49 106	6 604	26 052	60 457
1933	505 256	283 029	32 370	222 227	239 664	2 154	138 903	34 262	11 345	24 334	-	25 330	-
1934	205 123	90 417	16 785	114 256	73 999	2 056	59 451	5 994	11 493	32 572	12 585	1 003	32 831
1935	193 083	108 935	43 686	84 148	267 076	1 229	185 846	33 601	16 400	18 465	-	29 452	119 159
1936	131 163	91 127	32 110	40 044	274 670	1 143	219 418	23 719	30 415	14 353	-	18 969	14 138
Итого	2 255 722	1 379 461	249 401	326 261	1 391 093	40 137	392 690	225 675	122 588	328 865	41 621	134 725	683 832

- 40 117  
1350 гир  
УО Жогартыника 1 Спецотдел МВЗД СССР  
нояковник /Табиров/

11 декабря 1953 года

Справка  
о количестве осужденных по делам  
органов НКВД-МВД-МЗД  
за 1939-1953 годы

Годы	Всего осуждено за контрреволюционные преступления	В том числе по ст 58-10	Меры наказания						Ссылка и высылка	Прочие меры	Жен. осужденны:		
			ВМЗ	25 лет	От 16 до 25 лет	От 11 до 15 лет	От 6 до 10 лет	От 3 до 5 лет			До 2 лет	Военной коллегией трибуналом судами	Особым Совещанием
1939	63 889	24 720	2 552	526	-	883	23 723	29 534	-	3 753	2 535	50 868	13 021
1940	71 806	18 371	1 649	-	-	529	21 514	43 684	-	2 142	2 288	25 894	42 912
1941	75 411	35 116	8 001	-	-	507	40 678	23 815	-	1 200	1 210	45 872	26 524
1942	124 406	61 623	23 278	-	-	774	69 893	18 142	-	7 070	5 249	46 358	72 448
1943	78 441	24 089	3 579	897	-	846	57 222	8 885	532	4 287	14 88	53 307	25 154
1944	75 109	14 130	3 029	14 779	-	875	46 902	7 633	421	649	821	64 493	10 611
1945	123 248	14 868	4 252	31 663	-	2 433	70 850	10 791	944	16 472	668	96 667	26 531
1946	123 294	15 512	2 896	16 289	-	2 144	80 742	16 101	2 367	14 935	957	114 974	8 320
1947	78 810	8 391	1 105	12 095	259	3 356	49 215	8 623	3 030	666	458	63 417	13 593
1948	73 269	8 496	-	36 991	1811	2 687	25 790	3 603	1 510	419	298	56 012	12 257
1949	73 125	14 768	-	37 678	1123	1 730	21 450	2 044	434	40316	300	36 665	38 460
1950	60 641	13 191	4 76	29 909	818	1 414	20 458	1 522	345	5 225	425	41 222	19 419
1951	54 725	11 254	1 609	30 366	394	964	15 769	1 234	415	3 125	599	45 699	9 076
1952	28 800	6 348	1 612	12 984	319	486	6 395	491	149	773	591	22 842	958
1953	8 403	3 246	198	4 769	76	149	2 665	211	24	38	273	8 199	204
Итого	1 115 422	274 125	54 235	233 909	4 850	19 777	253 721	126 813	10 171	43 638	18 263	785 999	229 428

УО Жогартыника 1 Спецотдел МВЗД СССР  
нояковник /Табиров/

11 декабря 1953 года

As the documents show, whilst between 1930 and 1936, out of an arrested 2,255,722, the number convicted was 1,391,093 where 1,329,460, or 40%, constituted political prisoners, between 1939 and 1953 the number of political prisoners reached 1,115,427. As we can see, the majority of convicts were not criminals.

By 1953, the shadow economy operated at full capacity. Josef Stalin's death in 1953 aided the expansion of the shadow economy, as his death led to two significant political-economic changes with far reaching implications for the consolidation of the criminal world and the state bureaucracy. Thus, his death was a turning point in the advancement of the Soviet organised criminal network. Firstly, economic policies towards the private sector were radically changed (once again!) by Nikita Khrushchev, who not only outlawed the private sector, but also adopted the death penalty as a punishment for being engaged in a private economic activity (Kline, 1987; Vaksberg, 1991). The Rokotov-Faibishenko<sup>49</sup> case is a vivid example of the state's hostile policies towards entrepreneurial activities, at that time considered to be immoral and contrary to communist ideology. Secondly, as an outcome of changes to criminal law, around 8 million inmates were gradually set free from gulags and prisons. Notwithstanding the fact that the majority were not criminals (see documents above; see Applebaum, 2003), those of them who came under political pressure to pursue a criminal career and represented the criminal world in the true meaning of the word, served as a recruitment drive for the black market. This fresh cohort of additional criminals played a vitally important role in organising, shaping and advancing the existing criminal network between officialdom and illegal entrepreneurs.

On the one hand, the liberated criminals became a nuisance and a burden to the existing 'free' illegal entrepreneurs. Stimulated by lucrative opportunities to amass tremendous wealth, these criminals extorted money from corrupt officials and illegal enterprises, who reluctantly paid up in return for being left alone. Vyacheslav Ivankov, for example, the most notorious thief in the 1970s, nicknamed Yaponchik, developed an

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<sup>49</sup> Rokotov and Faibishenko were among the first entrepreneurs in Russia who made enormous profits from trading in scarce basic products. They were sentenced to 15 years imprisonment and confiscation of all property, with a later retrial that resulted in the death penalty.

extensive business extorting money from the underground Soviet millionaires -the so-called “tsehovikov” (shop floor) speculators, trade professionals, collectors, and corrupt officials. He benefited from the fact that the victims would not go to the police as they would have to explain the origins of extorted millions. His criminal businesses also involved the smuggling of antiques, icons, drugs and jewellery. According to one source, “he had a reputation for flamboyant brutality, often taking recalcitrant black marketeers into the woods outside town and torturing them” (Klebnikov, 2000, p. 17). On the other hand, black marketers also made useful allies for corrupt state officials, by establishing illegal distribution chains for scarce products.

## **5.2. Stagnation, 1975-1985**

The economic stagnation of the 1970s and 1980s had a wide range of economic, political and social causes. It was particularly conspicuous for its immense shortages of consumer goods. As Kotz (1997) observed, “the Soviet economy operated with perpetual shortage of goods relative to demand, which allowed producers to readily dispose of whatever they produced, whether or not it was what the customer really wanted” (p.41).

These persistent shortages affected the development of institutions that were necessary for encouraging growth in production and services. Consequently, the institutional landscape of the USSR in this period was characterized by its sheer inefficiency and weakness. This had a two-fold implication for the development of organised crime; whilst it furthered the acceleration of the already present ‘black market’ and its illicit activities such as hoarding, over-application for material allocations, under-the-counter sales, etc., it also intensified the illegal cooperation between illegal entrepreneurs, state officials and criminals, as “... ministries and [state]enterprises made their own supply and procurement arrangements, and unofficial ‘expeditors’ (tolkachi) supplemented the supply system by semi-legal deals” (Nove, 1999, p. 368). It was during the 1970s – 1980s that the term ‘shadow economy’ was coined, referring to the hidden income from a variety of economic activities that were

permeated by patronage and corruption, as well as bribery and nepotism, characteristics that were widespread throughout the political and economic institutional system.

During the economic stagnation that ensued, the “increases in money incomes were not matched by the rise in supplies in goods and services, which was reflected by the growing gap between the official and free-market of foodstuffs...” (Nove, 1990, p. 372). This facilitated the development of the black market, which was fully operated by the illegal network of state officials, entrepreneurs and criminals. As Lampert (1984) put it, “The Soviet form of political management itself helps to create an environment in which illegal practices flourish... In the first place, because the mechanism of directive planning is highly imperfect, the managers of economic units feel obliged regularly to break the law in order to meet their targets in the face of constant difficulties with the supply of needed goods and materials. In this way “unofficial” practices become part and parcel of “official” production and exchange” (p. 367).

The existence of the black market, or shadow economy, contributed to two phenomena: while it provided livelihoods for millions of people by taking a leading role in operating the legal economy of the Soviet system by supplying scarce goods, it also provided substantial rents for organised crime - those who were able to exercise control over the sector, thereby creating "opportunities for bureaucratic rent seeking...to regulate access to scarce resources" (Robinson, 2007, p. 1218). This, in turn, facilitated and advanced the use of informal and shadow economic practices and networks. The combination of these two factors, the sustainability of the formal economy on one hand, and the accumulation of illegal assets, defined the relationship of the Russian state and organised crime, the nature of which was determined by the dependence of the formal economy on the informal sector. This type of dependence produced an unwritten and unspoken bargain that was struck between the two elites, the state and organised crime. That is, “the Brezhnev leadership struck a new but tacit bargain with the urban population: to tolerate the expansion of a wide range of petty private economic activities, some legal, some in the penumbra of the legal, and some clearly and obviously illegal, the primary aim of which was the reallocation by private means of a

significant fraction of Soviet national income according to private preferences” (Millar, 1985, p. 697).

This bargain further embedded the two key institutions<sup>50</sup> of the Soviet economy, corruption and the shadow economy, both of which “tended to perform certain social functions in a more efficient manner” (Clark, 1993, p.72). Both, in turn, were organic to the evolving network of state and organised crime.

### *Elites and corruption*

Soviet institutions were built on networks of patronage and kinship (Bach, 2011). Having meaningful connections was the key criteria by which important administrative positions were filled, and a career could be advanced (Franke et al., 1999). The use of informal corrupt practices, such as *blat* (the exchange of favours) (Ledeneva, 1998; Ledeneva, 2013), which flourished alongside patronage (Holmes, 1993; O’Dwyer, 2006), clientelism (Stefes, 2006; Robinson, 2007), and the bureaucratisation of public life (Clark, 1958), became an informal institution and a symbol of the 1970s – 1980s: “a blat-networking and informal exchange at a grassroots level had been established (Ledeneva, 2013, p. 1). As Clark (1958) put it, “...Soviet officials were, by virtue of their strategic positions in the running of the Soviet economy, placed in a day-to-day situation marked by the *increased* opportunity for personal and institutional aggrandizement” (p.74). This unwritten customary way of behaviour regulated relations from top to bottom: “deputies and departmental heads, [and] their relations with their subordinates, right down to the ordinary chauffeur” (Vaksberg, 1991, p. 7). This tradition, which dates back at least to the late 17th century (Clark, 1958; Raeff, 1957; Torke, 1988; Givens, 1980), continued under the Bolshevik regime and was elaborated and put into daily practice in the 1970s – 1980s. According to the note of the Department of Administrative Apparatus of the Communist Party from 21 May, 1981, cases of bribe taking by state officials rose from about 4,000 in 1975 to about 6,000 in

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<sup>50</sup> Here, institutionalisation is the process of embedding some concepts, such as a mode of behaviour, belief, social role or particular value, within an institution or society as a whole.

1980, an increase of 50% (Moiseev, 2014, p. 19). The review of some 343 articles produced by the Western publication *The Current Digest of the Soviet Press* (CDSP) suggests that 855 Soviet officials were convicted of involvement in bribes and corruption during the period 1965 - 1990 (Feldbrugge, 1984), with 399 of them from the Russian Republic alone. Clark (1993) provides this data (Table 5.2.1):

Table 5.2.1. Official Convictions and the Soviet Criminal Code, 1995 – 1990 (by Republic)

<b><u>Property crimes</u></b>	
Theft	74
Embezzlement	98
Negligent Destruction	1
Lack of Protection	6
<b><u>Personal crimes</u></b>	
Aggravated Homicide	1
Grave Bodily Injury	1
Beatings	2
<b><u>Ownership Crimes</u></b>	
Extortion	15
<b><u>Economic Crimes</u></b>	
Poor-Quality Output	13
Report Padding	18
Enterpreneurialism	2
Speculation	8
Illegal Trade Alcohol	1
Violating Trade Rules	3
Poaching	1
Precious Metals	1
<b><u>Official Crimes</u></b>	
Abuse of Authority	53
Exceeding Authority	2
Neglect of Duties	28
Taking a Bribe	57
Giving a Bribe	5
Middleman in Bribery	1
Forgery	8
<b>Total</b>	<b>399</b>

Source: Clark, 1993, p. 80

The follows section provides just a few examples.

1. The minister of culture, Ekaterina Furzeva took bribes in the form of diamonds and expensive outfits, in return for granting permission to famous artists to allow them to go on overseas tours (Vishnevskaya, 1998).
2. The Minister of Fisheries, Alexandr Ishkov and his Deputy, Vladimir Rytov, established an illegal trade in caviar that involved an extensive network of bribes and corruption. Through bribes, the double bookkeeping system was set up to sell the stolen caviar at a high price to underground entrepreneurs. The illegal profit was shared within the established criminal network: the seller gave a percentage to the head of the section, the head of the section gave a cut to the head of the department. Furthermore, the deputy director of the store gave some of their gains to the director, and so on up to the ministerial offices. In all, a wide range of people profited from the illegal activity. According to the senior investigator, Prosecutor General Vladimir Kalinichenko, the very existence of such an extensive network of corruption made it possible to assume that the frauds were significant: "Imagine that a can of red caviar costs 5 roubles, and in a restaurant with a tariff it costs 20 roubles. If you replace herring that costs 32 kopecks with caviar, it would yield a profit five to six" (cited in Vaksberg, 199, p. 13)
3. High authority officials established a practice of sending University administrators lists of "recommended" school leavers to be admitted. The price of every recommendation had a tendency to increase since it had to be shared with colleagues, from the very top of the administrative ladder down to the very bottom. For example, the Krasnodar area committee of the party would take bribes between 4,000 – 6,000 roubles, and up to 10,000 roubles, in return for obtaining a place in the Kuban Medical Institute in the town of Krasnodar. As the number of interested parties was so high, the entrance exam became an auction. Those who paid the most, or those with the most powerful protectors, were admitted (Vaksberg, 1991, p. 17)



4. A criminal network of inveterate bribe-takers, including the Deputy mayor of Sochi, Voronkov; the Party First Secretary of the Krasnodar District Party Committee (*kraikom*), Medunov; B. Dudnikov, the director of the Polar Fisherman Resort Hotel; V. Magalentssev, an engineer at the hotel; and B. Cherkezia, the local construction administration's chairman were all convicted and sentenced to 15, 12, 15, and 10 years in prison (and the confiscation of their property) for the embezzlement of an estimated 80,864 roubles, through submitting false repair bills, and the hiring of non-existent ghost workers (Clark, 1993, p. 169-179). As Solovyov and Klepikova (1983) put it, "in the Krasnodar territory, and especially in the famous resort city Sochi, graft and other kinds of corruption in Party and government organisations had attained an almost official status. One had to pay a bribe to buy a car, get an apartment, a promotion, or even a hotel room. There wasn't a single system that would function without bribery" (p.62).
5. V. Voronkov, the Deputy mayor of Sochi, was sentenced for 13 years of deprivation of freedom with confiscation of his property, for bribery and abuse of office.<sup>51</sup>
6. Brezhnev's assistants, Gennadi Brovin and Viktor Golikov, were found guilty of taking millions of roubles in bribes.
7. Shibaev A.I., Chairman of the All-Union Central Council of Trade Unions (AUCCTU), was found guilty of corrupt practices at the AUCCTU, and the mismanagement of union funds (Doder, 1988, p. 62).
8. M. Shmatov, the chief of the Gelendzhik office of the anti-corruption department, and R. Martina, the senior inspector of the anti-corruption department, were charged with extortion of bribes and sentenced to 11 and 8 years respectively, with property confiscation<sup>52</sup>.
9. B. Borodkina, the manager of the Gelendzhik Restarant and Cafeteria Trust of the local municipal administration, was convicted of receiving close to 562,000 roubles of bribes. She was executed for her crimes (Clark, 1993, p. 171).

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<sup>51</sup> *Literaturnaya gazeta*, November 12, 1980, p.12

<sup>52</sup> *Sovetskaya Rossia*, April 1, 1983, p.2

10. The “diamond affair”, an intricate system of corruption and illegal trading in diamonds and foreign currency, involved B. Buriatia, the famous circus clown; A. Kolevatov, the director of the State Circuses, the Soviet Ministry of Culture department; Galina Churbanova, L. Brezhnev’s daughter; and many other elite representatives<sup>53</sup>.
11. The case of Yuri Sokolov and Gastronom No. 1. According to Washington Post Moscow Bureau Chief Dusko Doder, the equivalent of \$4 million was found in a safe box hidden under the apartment floor of Y. Sokolov, the director of “Store Number one of the Gastronom Trade Association of the Moscow City Soviet Executive Committee’s Chief Administration for Trade (Doder, 1988, p. 200).

In a private conversation with A. Vaksberg, General Sergey Krylov said, “The Party, the MVD, the whole system from top to bottom reeks of corruption” (p.106).

### *Shadow economy*

The shadow economy, or the black market, was able to expand into all aspects of trade and consumer services, increasing the number of underground entrepreneurs and boosting their stock of illegal capital, as legal services proved incapable of competing with the shadow economy. Yet, it was not only underground manufacturing that sustained the black market; the fraudulent appropriation of state property, the use of state facilities for the production of unrecorded goods and their illegal distribution, the accumulation of massive amount of capital – all these illegal and illicit activities formed the shadow economy.

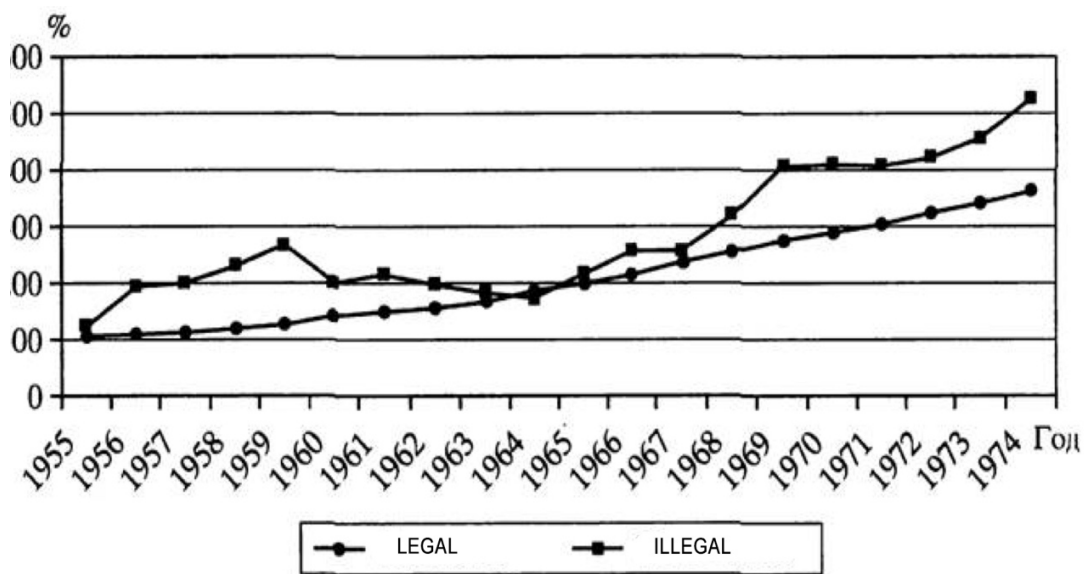
The growing demand for the services of the black market turned illegal business into a highly profitable activity. Illegally accumulated assets found their way back into the legal economy. People bought cars, carpets, furniture, crystal and gold, mainly as stores of value. In addition, people spent money on food, clothing and shoes. Even in the case of transactions between shadow businesses, the recipients of income needed the services of the legal sector.

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<sup>53</sup> See Burns J., “Two Scandals Have All Moscow Abuzz” in *New York Times*, February 27, 1982; and Doder D., “Soviets Said to Arrest, Fire Officials in Scandal” in *Washington Post*, February 27, 1982

The following data demonstrates the growth of the legal and illegal income of the population, between 1955 and 1974 (Figure 5.2.1) and the growth of the monthly salary of workers compared with the growth of the total size of money spent on goods and services, and saved in savings banks (Table 5.2. 2).

Figure 5.2.1. Growth of legal and illegal income of the population of the USSR between 1955 and 1974



Source: Bokarev, 2007: 212

The graph above demonstrates the sharp increase in underground activity and illegal incomes by the end of 1970s. While in the second half of the 1950s illegal incomes grew, in 1961 they declined noticeably and remained stable with some fluctuations until 1967. This decline can be attributed to the change in the attitude of the authorities towards the shadow economy. From 1967 to 1970, illegal incomes increased again and from 1970 the growth of illegal incomes markedly accelerated (Table 5.2.2).

Table 5.2.2. Monthly salary vs spending and savings

	1960	1970	1975	1980	1985	1988
Monthly salary (in billions of roubles)	80.6	122	145.8	168.9	190.1	219.8
Percentage of 1960		152	180	210	236	273
Total spent and saved (in billions of roubles)	103.2	223.2	329.9	464.6	590	718.4
Percentage of 1960		216	320	450	572	696

*Source:* Koriagina, 1990, p. 113

Within the existing system, all forms of the shadow economy inevitably acquired a criminal connotation and were associated with some or other violation of the law. Almost every entrepreneurial undertaking resulted in many breaches of the law that were subject to prosecution.

The following table shows the correlation between economic activity in the USSR and crime growth rates.

Table 5.2.3. Correlation between crime growth rates and growth of economic indicators in the USSR, 1970s-1980s

<b>Economic indicators</b>	<b>National income</b>	<b>Capital assets</b>	<b>Industrial production</b>	<b>Retail trade</b>
<b>Type of crimes</b>				
Total	0,300	0,162	-0,602	0,622
Serious crimes	0,297	0,005	-0,707	0,739
Group crimes	0,570	0,186	-0,306	0,733
Economic crimes	0,021	0,731	0,038	-0,569
Murder	0,290	0,195	-0,719	0,822
Severe injuries	0,366	0,324	0,555	0,816
Rape	0,399	0,005	-0,576	0,748
Plunder	0,241	0,360	-0,620	0,809
Robbery	0,376	0,236	-0,482	0,761
Embezzlement	0,293	0,097	-0,714	0,794
Theft	0,398	0,081	-0,334	0,606
Abuse of power	0,552	0,247	0,155	-0,385
Bribery	0,106	0,828	0,084	-0,339

*Source:* Statistical Collection, 1999, p. 10-18; p. 38-75.

The table shows that any unofficial and illegal economic activity in the USSR was associated with some form of crime. The national income was closely related to the abuse of power. This can be explained by the fact that overall economic activity at that time relied upon the location of scarce materials, which was usually associated with some or other official abuse. Capital assets were most closely correlated with bribery - without bribes it was difficult to obtain any necessary machinery and equipment. Industrial products were closely linked with the theft of state property. The retail trade was associated with criminal offenses such as group crimes, severe injuries, etc. There are a few reasons for this correlation. Firstly, the spread of private enterprises increased opportunities for predatory behaviour. Individuals who run small private businesses had to pay off criminal groups that began to coalesce into informal business structures involved in construction, drug trafficking, the illegal trade in goods from state shops, and the theft of industrial alcohol and sugar (Keeran and Kenny, 2010). Those who refused to pay faced severe punishment. Secondly, working in a state shop was highly profitable, given the ample opportunities for corruption, and the appointment process involved a fierce struggle between criminal groups. As Vaksberg (1991) put it, “The violence that was meted out in these cases seemed to the uninitiated both strange and incomprehensible” (p.23).

Altogether, the data suggests that between the 1970s and 1980s practically the entire economy of the USSR was, one way or another, connected to criminals.

One of the common illegal private activities that developed at that time was theft of industrial alcohol and sugar from state enterprises that widely used alcohol, as a private transaction in illegal markets. By the 1970s, the number of technically illegal small enterprises had mushroomed all over the country whilst the Kremlin turned a blind eye. The work of Vladimir Treml (1985) illustrates this phenomenon. According to Treml, in 1979 the illegal production and distribution of alcoholic beverages provided an unregistered income equal to 2.2% of the Gross National Product. Moreover, alcohol served as a means of building trust. Consequently, alcohol became a compulsory component of bribes, very often replacing the rouble, not least due to “the loss of

confidence in the official monetary system” (Terml 1985: 28). Terml claimed that between 1/5 and 1/4 of all alcohol transactions were illegal.

It is very difficult to estimate the scale of illicit business in Russia between the 1970s and 1980s as sources of information are very scarce. According to Hewett (1988), nearly 20,000 million Soviet individuals were engaged in underground production activities (p.180). Another reliable source to draw on is the Berkeley–Duke Survey on the Second Economy in the USSR, prepared by California’s American Duke University. This Survey was based on 3,000 questions answered by Soviet immigrants to the USA in the 1970s-1980s. The main goal of the study was to shed light on the real state-planned Soviet economy. The research found that few lived purely on their income from the state; most people profited from some sort of side-business. A substantial part of commercial turnover had been sold through illegal channels. People were aware of the potential consequences of running private businesses, but ironically, the heavily corrupt system protected them from being prosecuted. The survey revealed that side-income amounted to up to 33% of total household income. The private sector employed as much as 12% of the total labour force. To be more precise, every tenth individual worked for himself, not for the state, whilst every third individual profited from the private sector. The side-income of the Russian population in the period of stagnation counted for over half of the family budget. Finally, Belikova and Shokin (1989), two Soviet sociologists, estimated that 83% of the Soviet population were engaged in illegal activities (p. 51).

### **5.3. The Network**

The shadow economy compensated for the deficiencies of the official, command economy, and considerably improved the everyday economic life of ordinary citizens. Moreover, its services were not only in high demand amongst ordinary consumers, but amongst high-ranking officials. Over time, the dynamics of the shadow economy began to converge with the interests of relatively privileged officials, party bosses and representatives of the law enforcement agencies. Gradually, the latter themselves became involved in illegal business. They offered support to the newly emerging Soviet businessmen, and both sides thrived. If an independent group of entrepreneurs was daring enough to attempt to operate independently, not sharing with or relying upon the

ruling elite, they usually faced violence (Vaksberg, 1991, p. 23). Criminals also depended on the protection of those who were in power.

A vast illegal network of extortion and plundering was set up, which included the ruling elite. This network established its own rules and principles of operation. Not only cash but other forms of payment were used to pay for services provided by one of the members of this network to another. *Blat* facilitated exchange between members of the network, their career progress, enrichment, and acquisition of power, both political and economic. It also enabled the members of this network to protect each other from downfall. The Soviet economic reality provided a fertile ground for fostering the growth of the shadow economy, operated by an illegal, yet well organised and functioning, system of collusion, between entrepreneurs, state officials and criminals. There was no particular need to conceal the illicit profits from crimes; they were re-invested back into new businesses, with plenty of opportunities provided by the shadow economy. Within this criminal network, state functionaries and criminals became intertwined, and the former quickly turned into the latter.

The upper echelons of power, those who had a privileged access to state resources, were especially vulnerable to black market approaches; not only did they show 'relative tolerance for private illegal and semi-legal production, allowing a kind of compromise with the "second economy' (Millar, 1990, p. 253), but they fully exploited any opportunities to enrich themselves illicitly. They had a significant role in the distribution of illegal incomes, partly through their activities in bribing police, officials and party members, and partly through the establishment of collusive partnerships with illicit entrepreneurs and criminals. The newly restructured network functioned as a distributor of appropriated goods and production, and maintained new shadow markets. State representatives frequently patronised underground businessmen. Having received their support, underground entrepreneurs expanded their illicit activities with impunity, meaning that the number of underground operations increased. Criminal networks controlled the Soviet black market, including many transactions in spare parts, automobiles, timber and gems, at an estimated value of 110 billion roubles (\$60.5 billion). In some areas, the power of criminal networks rivalled the power of the Soviet government (Shinar, 2016, p. 635).

In turn, Communist Party bureaucrats trafficked in anything they could get their hands on, including jobs, favours and merchandise, all paid for with cash. As Finckenauer and Voronin (2001) have noted, "Government and party officials left no stones unturned in seeking opportunities to line their pockets" (p. 6). This contributed to the formation of criminal-corruption structures closely linked to the party and state apparatus. The scale of these criminal networks can be demonstrated by the fact that by 1985, in comparison with 1971, the number of large scale misappropriations and embezzlement of state property increased five-fold, and 4% of the participants accounted for 62% of the total amount stolen (Newspaper *Izvestya* from Dec 23 1989). Between 1980 and 1987 alone, the number of executives convicted of economic crimes increased almost threefold.

The following examples are court proceedings, introduced by A. Vaksberg in his book *The Soviet Mafia*. Vaksberg was an investigative reporter at *Literaturnaya Gazeta*, who gained access to 60 volumes of transcripts of court proceedings in the Supreme Court of the Russian Federation.

1. The Case of 'Ocean' – an illegal network of caviar distribution.

The Minister of Fisheries, Alexandr Ishkov<sup>54</sup>, set up the firm Soyuzrybpromsbyt, governed by Vladimir Rytov, the Deputy Minister of Fisheries. In 1976 the latter was entrusted to set up the chain of shops "Ocean"<sup>55</sup> which operated hundreds of shops all over the country selling seafood, including black and red caviar - items that were in short supply. The illegal scheme worked in the following manner: the ministry officials would obtain an agreement to open a branch of Ocean in some town while the local officials would appoint people to govern it. The top ministerial officials would meet an order from the local officials for extra quantities of seafood for the local branch of Ocean. These extra provisions would never appear on the counter, but would be distributed amongst underground dealers, at 5 or 6 times the official price.

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<sup>54</sup> Ishkov persuaded the Chairman of the Council of Ministers, Alexei Kosygin, to transfer the sale of the fish products to the Ministry of Fisheries, at this time under the jurisdiction of the USSR Ministry of Foreign and Domestic Trade

<sup>55</sup> The idea to engage in illegal trade also coincided with the sharp increase in state production of seafood, as fisheries in those years became a rapidly developing industry.



Approximately a third of the illegal proceeds would be seized by those directly involved in the illegal enterprise; the rest would be allocated to bribe those ‘qualified’ to guarantee the protection of the criminals. These accumulated illegal proceeds provided capital for illegal banks in numerous regions throughout Russia. On top of this, Rytov, the Deputy Minister of Fisheries of the USSR, and his accomplices, struck an agreement with a foreign firm. According to this agreement, thousands of tins of caviar, mis-labelled as herring, were distributed to their Western trading partners.

## 2. The Fruit and Vegetable Mafia.

In the late 1970s, The Minister of Railways, Ivan Pavlovsky, assigned 34 wagons from Caucasus to Kazakhstan to urgently transfer soaked grain to Moscow. The wagons disappeared and according to the official report, they had been sent in error to a different destination, through the inefficiency of some petty official in the railway hierarchy. In reality, the Caucasian criminal network that had penetrated all parts of the party-state machine had appropriated 34 wagons of fruits and vegetables, which ultimately enabled them to pocket several million roubles.

## 3. The Chuvashain Autonomus Republic’s criminal network included local champion athletes, local and Moscow-based bureaucrats, secretaries of area committees, ministers of the autonomous republic, ministers of the Russian Federation and others, together with their leader Yegor Ligachev. The bureaucrats and officials would grant credits, obtain scarce goods, sign false agreements and fictitious invoices and turn a blind eye to daylight robbery. This criminal network appropriated millions of roubles designated for the construction of a railway line, from the Volga port to the soon-to-be-built tractor factory in Chuvashiya.

## 4. The Cotton affair

The political and economic leadership of Uzbekistan, the head of The First Secretary of the Central Committee of the Party, Sharaf Rashidov, and his network defrauded the Soviet central bank out of some 3 billion roubles by adding fictitious noughts to the

records<sup>56</sup>, or so-called “pripiski”<sup>57</sup>, thereby falsely inflating the yields of the Uzbek cotton harvests. This criminal network also implicated officials within the Kremlin.

5. The Minister of internal Affairs, Shcholokov, in collusion with General Kalinin, would sell hundreds of items from the special private shop that served the exclusive patronage of the minister’s family and their immediate circle. The items, that were in short supply and would have cost 5 to 10 times more on the black market, were sent to the Georgian republic for onward sale to Shcholokov’s accomplices. As was stated in court by General Kalinin, every autumn he would hand in 120,000-150,000 roubles in three and five rouble notes, in exchange for crisp new hundreds.

6. One famous case in the 1970s involved the director of the Karaganda fur factory, Snopkov, who colluded with the head of the legal advice office, L.M. Dunaev and the head of the criminal law department of the Higher School of the Ministry of Internal Affairs J. Epelbeym. They pooled illegal capital, purchased equipment, and established a private enterprise on the same premises as a state factory. Every second product was diverted to the ‘black market’ and workers were paid not only official salaries, but also unofficial ones. This enterprise was supervised by the representative of the Police Department, P.P. Zhaton. These three state officials rented a suite at the Metropol Hotel in Moscow on a permanent basis, to host high-ranking officials. Services were paid not only in money and valuable gifts, but also in expensive prostitutes, which were especially appreciated by the officials of the central apparatus. The Deputy Chief of the Department of Combating Theft, Embezzlement and Appropriation of State Property in Karaganda district colluded with these entrepreneurs by providing them with information about forthcoming swoops and investigations. For this part of the illegal undertaking, he was paid 8 thousand roubles, on a monthly basis (Radov, 1989).

Government officials and Party elite did not only cooperate with illegal entrepreneurs, but also with criminals. Corrupt officials stopped short of openly running illegal businesses or protecting their operations. They needed independent operators and

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<sup>56</sup> One extra nought was worth millions of roubles.

<sup>57</sup> *Pripiski* is the indication in an official document sent in for accounting and audit purposes of non-existent ‘production achievements’ which attract material rewards or honours

protectors who could establish and manage informal channels for the distribution of scarce products. Consequently, the new breed of thieves, released from gulags after Stalin's death, were there to 'lend a hand' to government officials to manage and protect their illegal enterprises.

The establishment and management of informal distribution channels required the formation of illegal networks within related sectors, such as transportation and storage, all managed through bribes and corruption. Over time, more sectors joined in and adjusted their logistics and services accordingly. It is here that we see the beginnings of a genuine merger of the formal state with the informal economy and criminal underworld, albeit in a decentralised and as yet, mostly covert manner.

To sum up, this chapter has sought to trace the evolution of the network of organised crime in the USSR. It found that firmly embedded in the shadow economy, throughout Soviet history, were Communist Party apparatchiks and state officials.

This remarkably well-organised and functional network resembled some of the organised crime communities in Europe that were discussed in Chapter 1. It spread across the USSR and functioned in practically all economic sectors. Structural problems with the distribution of goods and trade in the USSR prompted the state to seek the assistance of the black market economy; it offered a series of material inducements to rent-seeking actors, both at the level of the state and on the side of the criminal 'partners'. This, in turn, contributed to the expansion of a horizontal collusive illegal network, or organised crime, that controlled the spread of informal and illegal activities, or the shadow economy, and relied on the cooperation of selected state officials.

## CHAPTER 6

### PERESTROIKA AND THE CHANGE OF THE SYSTEM,

#### 1985-1991/2

“You must not be involved in any shady affair or business, no arrests, no detentions. You are a different person and you must start thinking differently. This period is an ordinary change of generations, in ten year guys like you will be at the helm. We’ll infiltrate the highest sphere of power structure. We possess everything: money, power, authority, and the only thing we are lacking **is the legal power**. And we’ll procure that through the help of guys like you.”

Vladimir Suchov, 1998, *I Am A Thief In Law*, p. 11

As Handelman (2002) put it, perestroika “was the real beginning of organised crime” in Russia (p.86). This chapter examines a short but critical period in the transformation of Russian organised crime, from a largely horizontal web of group and networks, into a hierarchy of power, part of which ultimately merged with the state.

This chapter identifies three key nodes in this evolution. Firstly, the economic crisis of the last years of the USSR further boosted the role of the shadow economy and the criminal networks that controlled it. Secondly, a series of economic and political reforms initiated by Michael Gorbachev in the late USSR played an instrumental role in the spread of activities by Russian criminal organisations: they received a major structural boost from new economic opportunities and reforms, including the opening of new markets. Thirdly, a series of legislative moves that were introduced as part of the new political economy of perestroika effectively legalised large swathes of criminal activity. The illegal trade in weapons, the majority of which came from the cold war-era overstock, the counterfeit trade in fake branded clothes, cosmetics, cars, medicines and discs, money laundering, tax evasion and contraband business all flourished. These factors will now be examined in some detail.

## 6.1. The Structural Crisis of the USSR

It would be difficult to understand the role of *perestroika* in the evolution of organised crime in Russia without inquiring into the scale of the economic crisis that contorted the USSR in the first half of the 1980s.

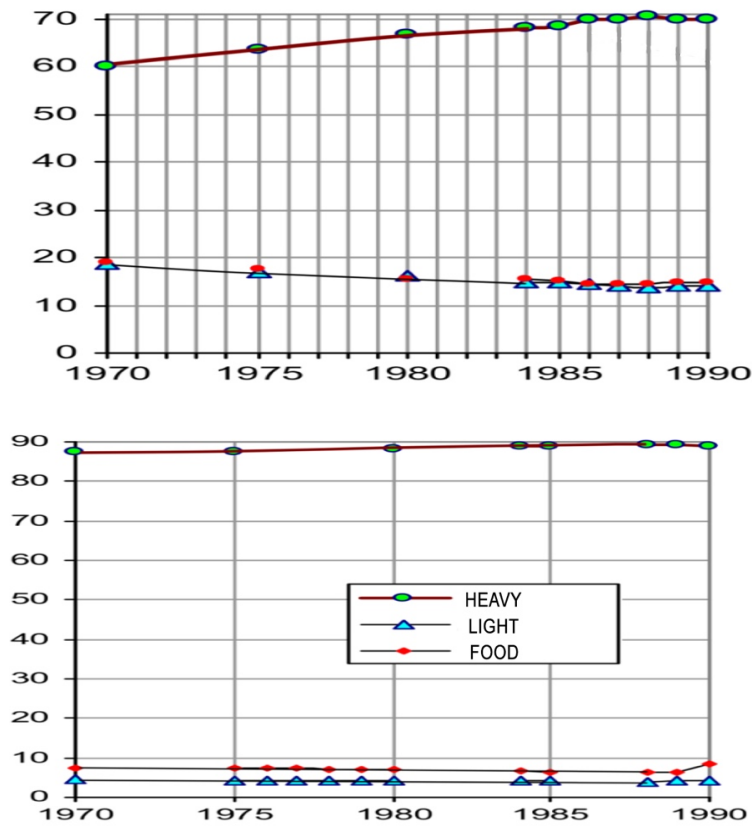
The decline of world oil and commodity prices (Figures 6.1.1 and 6.1.2) put a stop to the windfall of export earnings, and the relatively benign era of Brezhnevian stagnation, bringing fresh awareness of the numerous underlying problems of the command economy. Academic diagnoses as to what was the most important facet of the crisis vary to this day. Many blame the continuing state subsidisation of unfeasible enterprises, and the generally wasteful approach to resource management<sup>58</sup>.

Others point to structural economic imbalances that stemmed from the prioritisation of the military and heavy industrial complex and extractive industries, at the expense of consumer-oriented sectors (Fig.6.1.3; Cherniaev, 1995). Some sources suggested that while approximately 40% of industrial production was related to defence, the production of enterprises engaged in the military-industrial complex reached about 70% of all industrial production (Yager and Neu, 1992). Shortages in consumer-goods became chronic and spread across the vast Soviet territories, revealing the multifaceted structural crisis of the command model and gradually undermining the political system. Heightening the sense of a systemic crisis, various non-economic events, such as the Afghan war, the Chernobyl disaster, a powerful earthquake in Armenia, all required significant remedial expenditure. Externally, the Soviet policy of providing multibillion-dollar loans to dozens of different countries contributed to the increase in external debt (Table 6.1.4). As a result of these factors, there was a dramatic decline in economic performance (Table 6.1.5).

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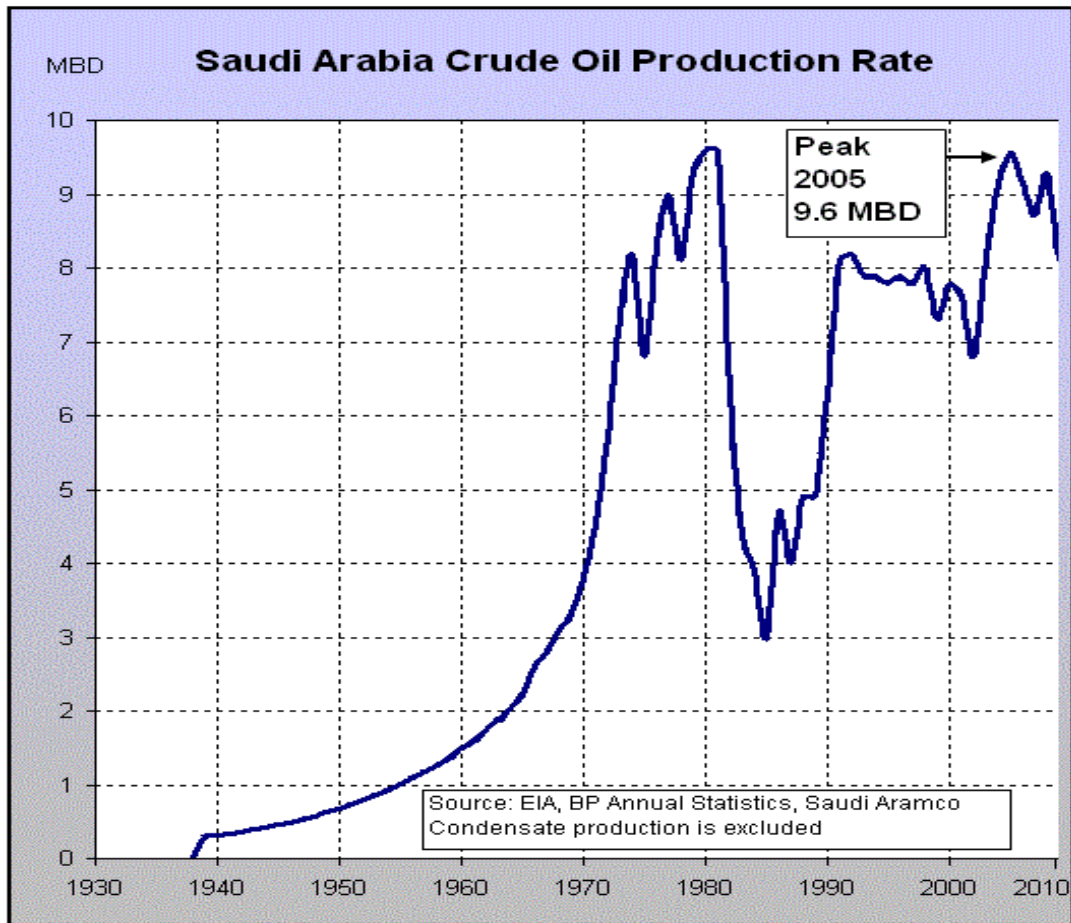
<sup>58</sup> The World Bank, *Russian Economic Reform: Crossing the Threshold of Structural Change*. Washington D.C.: The International Bank for Reconstruction and Development /The World Bank 1992: 105-106

Figure 6.1.1. Share of the production of the main branches of industry in the total volume of industrial products



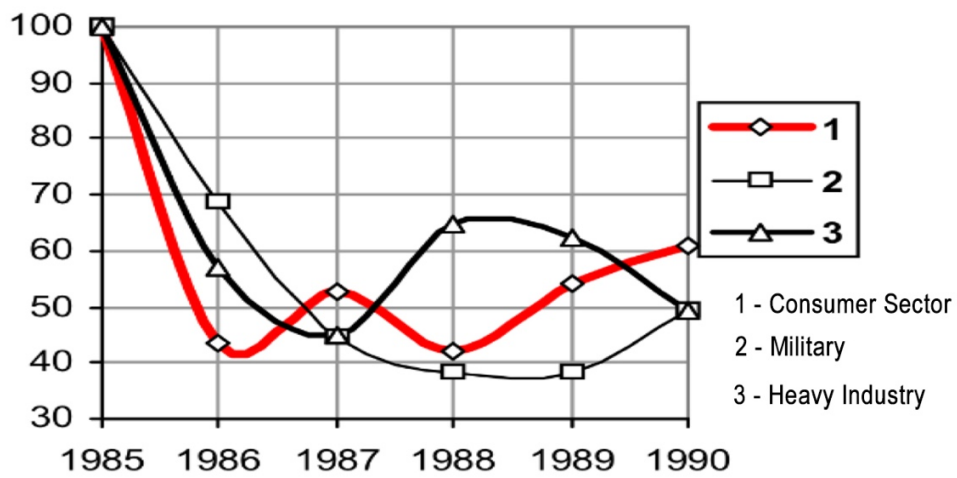
Source: Goscomstat, 1991.

Figure 6.1.2 Price of Saudi Arabia oil(\$/barrel)



Source: WorldCT, 2015. Available at:  
<https://worldct.wordpress.com/2015/03/12/the-saga-of-saudi-aramco/>

Figure 6.1.3 Average export prices



Source: Rosstat 2016

Table 6.1.4 External debt of the U.S.S.R. between 1975 and 1991 (comparative data)

Type of debt	External debt of the U.S.S.R. (billions of Roubles)											
	1975	1980	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Gross debt	12.5	20.5	21.9	22	22.3	29	36	40.8	42.4	50.8	53.6	61
Commercial debt	8.2	11	12.8	12.6	13.2	19.5	25.9	30.1	33.7	40.5	35.6	31.8
Official debt	4.3	9.5	9.1	9.4	9.1	8.5	10.1	10.7	8.7	10.3	18	29.2

Source: *Statistical Abstract of the United States, 1990 – 1993 (Comparative International Statistics)*.



Table 6.1.5 Key indicators of economic and social development of the USSR between 1980 – 1985

	1985 (%)	
	1980	1984
Gross Domestic Product	119	103.6
Production national income	119	103.5
National income used for consumption and accumulation	117	103.1
Fixed production assets of all branches of national economy	137	105.7
Industrial production	120	103.9
Gross agricultural output	111	100
Cargo turnover of all types of transport	115	101.6
Capital investment	118	103
Labour productivity	116.5	103.4

Source: *SSSR v tsifrah v 1985 godu (Kratkii statisticheskiy sbornik)*, 1986, pp.17-18. *Financi i statistika*, 1986. Moskva.

The shortages and structural imbalances were wide-ranging in their impact. First, they unleashed a social crisis which manifested itself in deteriorating living standards; there was a rise in inflation, shortages of foodstuffs, large gaps between official (subsidised) and free-market (read black market) prices, and a growth in savings banks deposits. Tables 6.1.6 and Table 6.1.7 below provide illustrative evidence.

Table 6.1.6. Free Market Prices of food (official prices – 100)

1965	1970	1978	1984
135	154.5	200	220

Source: A. Nove, 1989, p. 372

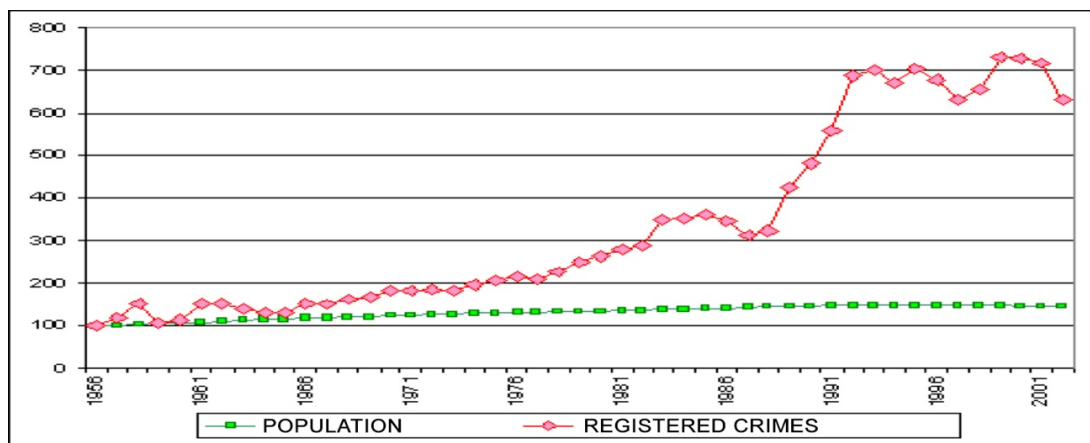
Table 6.1.7. Savings Bank deposits (billion of roubles)

1960	1970	1980	1984
10.9	46.6	156.5	202.1

Source: A. Nove, 1989, p. 372

Secondly, the severity of the economic crisis boosted the already flourishing shadow economy. Hoarding, corruption and under-the-counter-sales became commonplace. According to some sources, out of 2,700 disclosed corruption cases in 1992, two out of three involved civil servants.<sup>59</sup> According to statistical data provided in the report ‘Social development of the U.S.S.R’, published in 1990, while in 1980 recorded youth crimes amounted to 500,800, by 1985 these had soared to 588,100<sup>60</sup>. Fig.6.1.4, Fig. 6.1.5, Fig.6.1.6 and Table 6.1.8 show the sharp rise in crime rates in the late 1980s and the beginning of the 1990s.

Fig. 6.1.4. Population and crime dynamics in the U.S.S.R between 1956 - 2001

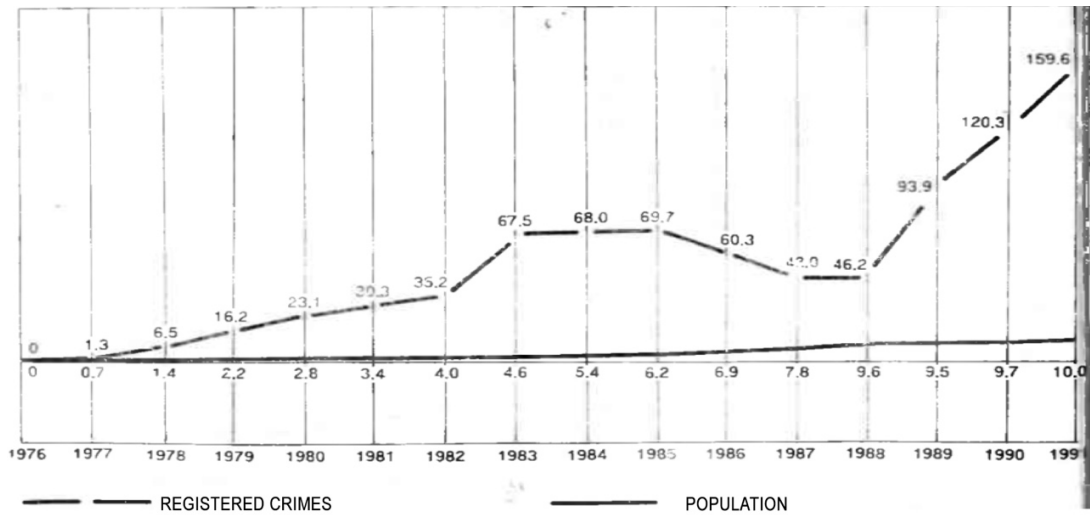


Source: Luneev, 2006.

<sup>59</sup> ‘Crime in Russia: The high price of freeing markets’, *The Economist*, 19 February 1994, p.57)

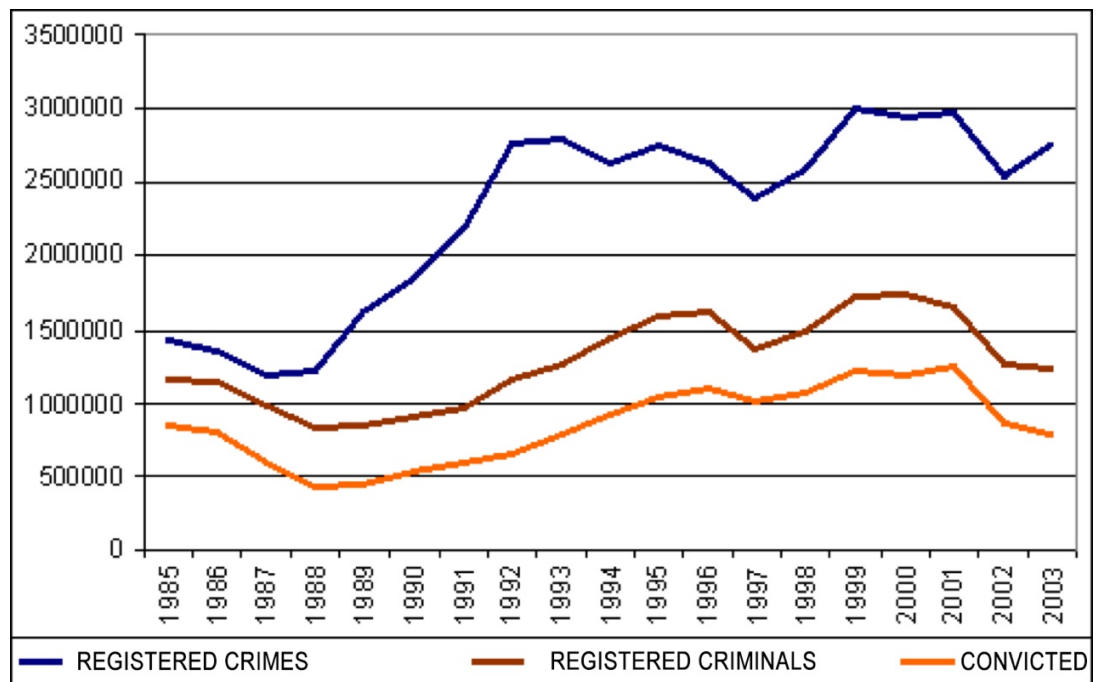
<sup>60</sup> *Social development of the U.S.S.R*, Moskva, Financy y statistika, 1990

Fig. 6.1.5. Increase in registered crimes and in numbers of the population (in percentage compared to 1976)



Source: Lunev, 2006; Statistics collection, 1992.

Fig. 6.1.6. Number of registered crimes and criminals in Russia between 1985 and 2003



Source: Lunev, 2006.

Table 6.1.8. Crime rates in Russia

	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>
Considered allegations of crime	2278551	2354470	2665940	2695759	2977701
Registered crimes	1185914	1220361	1619181	1839451	2167964
Identified individuals committed crimes	969388	834673	847577	897299	956258
Convicted	580074	427039	436988	537643	598823
Murdered	25706	30403	39102	41634	44365

*Source:* Luneev, 2006; Statistics Collection, 1992.

As demonstrated in Chapter 5, towards the early 1980s organised crime had gained in economic strength. Its dependence on the illegal capital provided by the informal sector put pressure on the state, and the same mechanism of interaction between the two sides, the ‘elite bargain’, was once again used. The state forced organised crime into cooperation, with communist leaders employing the same mechanism that their predecessors had endorsed almost 60 years ago. They legalised private trade that, despite having hitherto been illegal, nonetheless constituted an important facet of the informal economy. According to some sources, during this period the total amount of illicit capital possessed by state officials amounted to approximately 70-80 billion of roubles (Kalabekov, 2010, p. 21). It also contributed to the dramatic growth in the number of criminal groups. According to the independent experts from the Russian corporation, RAU, “More than 4,000 organised criminal groups were brought to light in Russia, including more than 1,000 with international and interregional connections. One group out of four enjoys the protection of corrupt bureaucrats in various state

structures<sup>61</sup>. Another report states that the Moscow region alone had 156 organised crime groups. Of those 156 groups, 72 had teamed up to form 21 larger groups (Kislinskaya, 1993).

The ensuing economic and social disorder fuelled the trend towards economic predation. The outcome was two-fold. Firstly, it benefited the informal sector that had been operated by the network of state officials who doubled as illegal entrepreneurs, and criminals. Secondly, it forced the state to reconsider its economic policies.

## **6.2. Gorbachev, Reforms and Legalisation of Organised Crime**

The socio-economic crisis of the early 1980s would prove to be a unique opportunity for organised crime to come out of the shadows.

The economic crisis prompted political reforms that were endorsed by the XXXVII Party Congress in March-April 1985, by the Plenum of the Central Committee of the CPSU. These reforms contained a package of radical market reform measures. They included the introduction of market mechanisms in many sectors of the economy, followed by the abolition of the centralised command administrative allocation system, the introduction of freely negotiated prices and a principle of self-sufficiency and competition for the enterprises, more open foreign trade and private cooperative enterprises of many kinds. The reforms had a two-fold effect on organised crime. Firstly, they de facto legitimised many areas of activity that had thrived in the realm of the shadow economy and organised crime before the political change.

Secondly, these reforms brought new economic opportunities such as technological innovation, financial liberalisation, new markets and many other ventures that attracted more and more people who became new businessmen. Inevitably, the two groups – the former criminals and shadow economy dealers, and the new businessmen attracted by the change - merged into the new social layer, the ‘new Russians’ (Smith, 2012). It was this social group that was best placed to capitalise on the changing political-economic context and the rise of the market. Many of the most powerful business tycoons that

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<sup>61</sup> “Crime Wave, Corruption – What Can Be Done”, The Current Digest Of The Post Soviet Press, 10 March 1993, p.12

would come to define Russian capitalism from the 1990s onwards had their initial business ventures and capital built precisely in the short economic space between 1985 and 1991. Effectively, through the process of economic reform, the shadow economy became at least partly a function of the new market. In the absence of adequate regulations, organised crime was a major (and in many instances, the only) network that controlled access to the national market.

Four specific reforms were instrumental in legitimising the existing network of organized crime:

*The Law on State Enterprises* was proclaimed in July 1987<sup>62</sup>. The Law prescribed two amendments: the right to appoint a director of a state enterprise was now transferred to workers, and state enterprises were granted the right to directly engage in planning and international trade. In practice, however, any planning was wholly dictated from above<sup>63</sup>. According to some sources<sup>64</sup>, by the end of 1988, after one year of self-management, only 20 per cent of enterprise directors had gone through any form of election<sup>65</sup> and 60% of managers were frequently required to implement unprofitable schemes, which primarily benefited state officials and criminals. The case of the Uralmash plant is a vivid example of how the Law on State Enterprise benefited the nexus of state officials- director enterprise- criminals by enabling it to seize control over Uralmash<sup>66</sup>. When the employees of the Uralkhimmash Corporation attempted to install their own director in place of the incumbent Sergey Glotov, Pavel Fedulov, who had a

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<sup>62</sup> The core of the Law on State Enterprise, and its most radical element, was *samoupravlenie*, or self-management, which decreed that it would be the responsibility of employees, convened in general meeting, to make major decisions for the enterprise, including the election of the director. Subsequently, the incumbent state enterprise directors perceived their employees as a threat to their position. Therefore, striving to secure their position as a director of state enterprise, instead of stepping onto the path of self-efficiency and looking for independent suppliers and partners, they habitually turned for help to local party-state administrators who managed the elections of the director of a state enterprise jointly by the local Party organisation and the relevant higher agency (Fitzler, 1994:, p.242) – both of which were, in practice, in close cooperation with criminals.

<sup>63</sup> *Ekonomicheskaja gazeta* 17 (1988), 2

<sup>64</sup> L. Shcherbakova, 'Anketa direktora', *EKO* 3 (March 1988), 59-75, 63.

<sup>65</sup> *Argumenty i fakty* 41 (1988), 7

<sup>66</sup> For a more extensive account see Ploitkovskaya, 2004.

notorious criminal record and maintained tight links with criminals, presented court rulings, obtained through corrupt links with the representatives of the judicial system, stating that Pavel Fedulov was a rightful co-owner of the Uralkhimmash Corporation and the present director, Sergey Glotov, was in fact the real director.

Article 7 of the Law on State Enterprises granted state officials who managed state enterprises the right to lease any assets through cooperatives (Grigoriev, 1992), via the introduction of the *Law on Cooperatives* in 1988. While the principal objective was to legalise what were essentially private illegal enterprises, its vagueness and crudeness produced a number of negative outcomes that led to the aggravation of serious contradictions, not only in the national economy but also in the consolidation of organised crime. Leasing within state enterprises was decreed by ministerial officials through normative acts on lease arrangements. This had a tangible effect as the introduction of leasing enabled enterprise directors to separate profitable sub divisions, put them on leases, and give them favourable consideration in the allocation of funds (Shcherbakova 1990). Subsequently, the absolute number of cooperatives increased. State enterprise directors and managers set up cooperatives and “leased” state assets to themselves. While in 1991 there were 2,400 leased enterprises, by 1992 there were 9,500, an increase of almost 75% (Desai and Goldberg, 2001). Directors preferred to set up lease buyouts “to secure inputs at subsidised prices, sell goods at uncontrolled prices, and pocket the difference” (Desai and Goldberg, 2001, p. 221). During this period output declined. This decline can be attributed to the widespread embezzlement, theft and misappropriation of the state's non-liquid assets by the new cooperatives which, very often, rented offices within the premises of state enterprises, providing them with unique access. In fact, the embezzlement of state or public property in 1991 increased by close to 45% compared to 1987 (the following pie chart, Figure 6.2.1, show both the change in the mode of criminal activities, and the increase in embezzlement, theft and appropriation of state assets after the proclamation and implementation of new laws and regulations). According to some estimates, for example, more than 1,000 out of 1,300 tons of gold were sold between 1989 and 1990 and only 1 billion USD remained from a reserve of 15 billion USD (Lisichkin et al., 2003).

Kruchkov, then the chairman of the KGB, in his speech in the XXVIII Congress of the Communist Party noted:

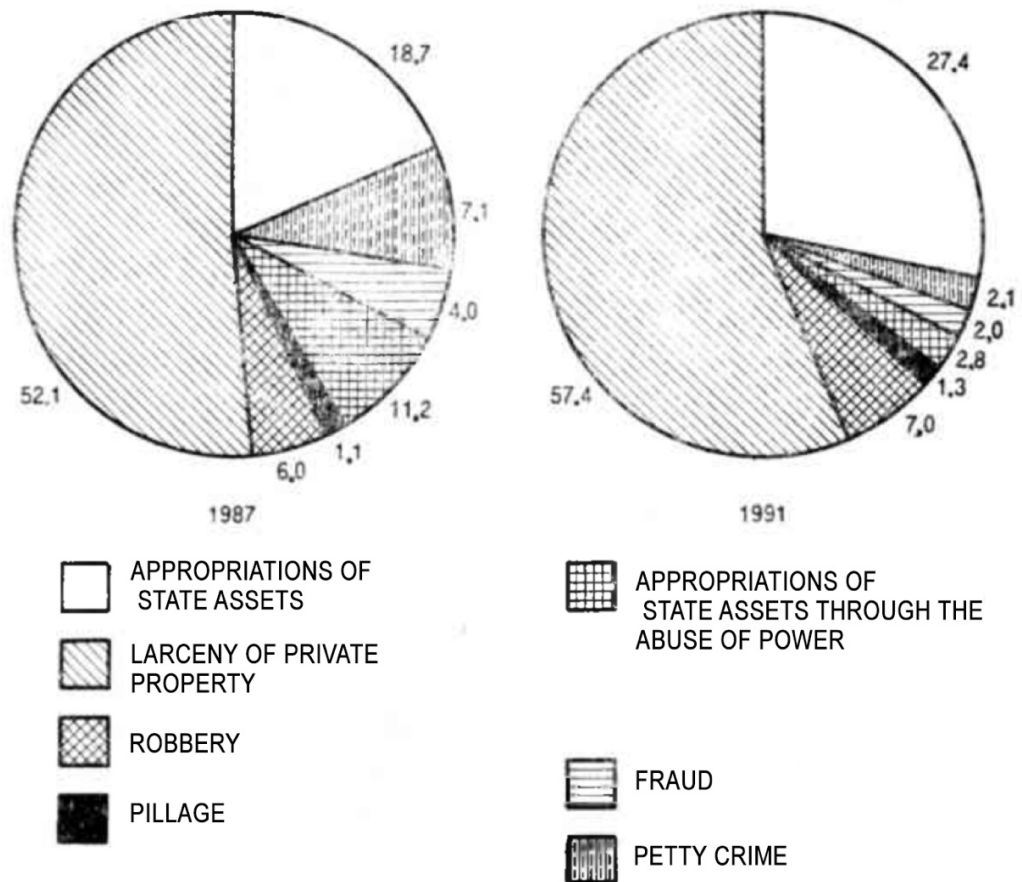
*"According to the official account, in June, 1990 there were about 200 thousand cooperatives in the country, with 4.5 million people employed. In fact, there were more people. The cooperative sector is growing but it is not only not conducive to the stabilization of the consumer market, it destabilizes the economy and increases inflation. About four fifth of all cooperatives are set up within state enterprises and state organizations. These cooperatives use state funds and acquire most of the raw materials. Currently there are ongoing investigations of many cases involving organized crime. In one of them, under the investigation by the Moscow Department of the KGB, six representatives of the banking system and cooperatives were arrested for the financial fraud operations and state funds embezzlement on a large scale"<sup>67</sup>.*

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<sup>67</sup> XXVIII Congress of Communist Party of the USSR, July, 2-13, 1990



Figure 6.2.1 Change in criminal activity



Source: Statistics Collection, 1992

According to the International Monetary Fund (1991, p.18), in 1990, some 170,000 cooperatives had been established by leasing sections of state enterprises. According to some sources, 80% of cooperatives were integrated within state enterprises or operated under their protection<sup>68</sup>.

Cooperatives were associated with crime. Rather than focusing on production,

<sup>68</sup> *Sovetskaia torgovlia*, 29 March 1990, 1

cooperatives engaged in the resale of stolen or heavily-discounted stocks and other state illiquid assets (International Monetary Fund, 1991, p. 26-27). This led to a sharp decline in the supply of affordable goods, and consequently to an increase in the state deficit. For instance, the cooperative "Omega" that shared its premises with the state enterprise "Kruzhevniza", bought ready-for-trade jerseys from Kruzhevniza, converted them into hats and resold them at market prices (Velichko, 2007, p. 49). The outcome of the Law on Cooperatives was identical to that of the Law on State Enterprises, with both having three far reaching implications. First, the law legalised the cooperatives that had operated within the shadow economy of previous years controlled by the network of criminals-state officials-illegal entrepreneurs. Second, it also legalised some types of criminal activities, such as speculation, thereby creating dichotomies in their legal status. Table 6.2.1 shows the reduced number of recorded speculations in the Soviet Union between 1987 and 1989. The decrease resulted from the introduction of the Law on Cooperatives rather than from any significant *change* in behaviour.

Table 6.2.1. Recorded speculations

	1987	1988	1989
Number of speculations	22671	24325	23644
Increase in %		7.3	-2.8

*Source:* Statistics collection 1992

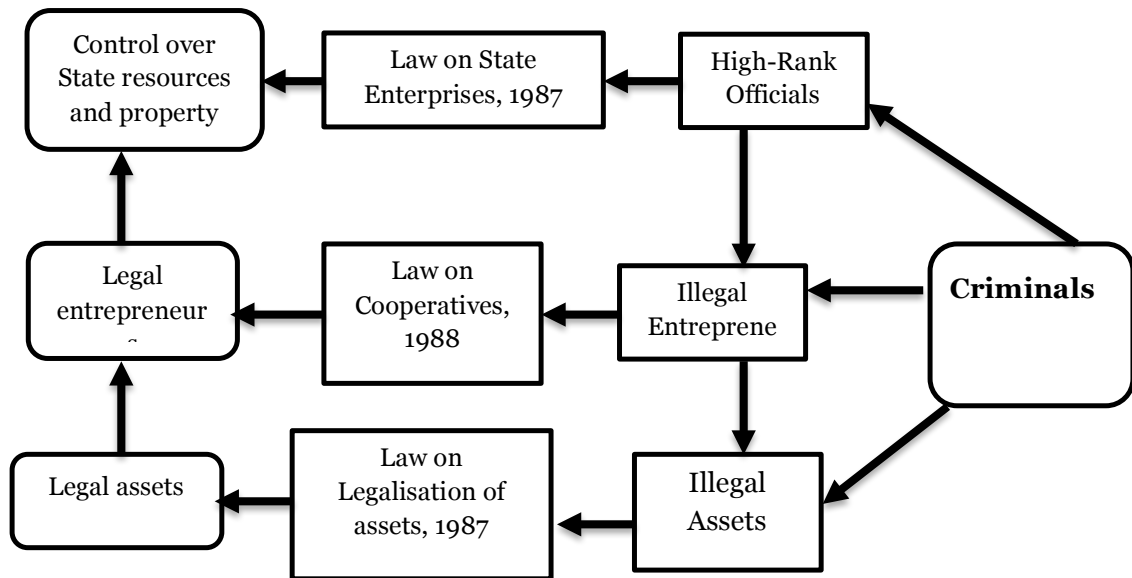
Third, the Law on Cooperatives effectively gave criminals an unwarranted upgrade from outlaws to bona fide businessmen; state officials combined their control of liberalised state enterprises with running formerly illegal, and now legal, enterprises, in partnership with (former) criminals turned legal entrepreneurs. Thus, criminal networks not only gained access to state resources, but through new legislation they also acquired new status, with formalised connections to official agencies – and all with the state’s implicit blessing. This process of legitimising the business partnerships between official

agencies, and criminals, smoothed the path towards the criminal infiltration of all the most prominent state institutions.

Organised crime groups also used cooperatives to launder money (Coleman, 1988). The process of decriminalisation, or, what Dimaggio and Powell (1983) call imparting *institutional legitimacy*, was further accelerated by the adoption of the **Law on Legalisation of Assets in 1988**, one of the new economic reforms that helped consolidate cooperation between state officials and criminals.

This stage was a tipping point in facilitating the consolidation of political and economic power in the hands of the various networks of organised crime (Figure 6.2.2 schematically illustrates this process), blurring the line between state officials and criminals, legal and illegal. This also led some experts to conclude that “...we are witnessing a replacement by criminals of the most important state functions that are subject to the jurisdiction of the state and civil society” (Zorkin, 2010)

Figure 6.2.2. The process of legalisation and organisational change of criminal structure as a direct response to the government's three stages of legitimization of the illegal economy during Gorbachev's term, 1985-1989



Fourth, the Law on Cooperatives also sanctioned *joint ventures* between private enterprises and direct foreign investment, which aimed to enable greater productive efficiency, export diversification and another source of hard currency. The establishment of joint ventures contributed to the emergence of new schemes of fraud, embezzlement and theft. Stocks of raw materials were plundered from state enterprises for resale abroad. This theft was enabled by the fact that officials now very openly wore two hats: they were active in the newly established private joint ventures, whilst simultaneously being directors of state enterprises. According to Kryuchkov (1990), revisions, inspections and audits that took place in 1989 identified 468 million roubles worth of state-owned goods that had been stolen (p.122). For example, large shipments of metals were sold to foreign firms under the guise of being metal scrap (Bogdanov and Orlov, 1990, p. 29).

This process was accelerated by the adoption of the *Law on Legalization of Assets* in 1988, one of the new economic reforms of that period that helped consolidate cooperation between officials, criminals and entrepreneurs. Moreover, the total elimination of the Ministry of Foreign Trade's control over foreign trade only eased the process of hiding stolen assets abroad. As Yegor Gaidar, the first post-Soviet prime minister stated, "[i]n the structure of Soviet foreign trade contracts there were lots of mysteries" (Klebnikov, 2000, p. 65).

*The Privatisation Law* in 1992 took place against the background of insufficient property rights, incomplete corporate legislation and a distinct lack of control mechanisms. The created 'legal vacuum' unleashed the process of appropriative redistribution of wealth. Justly, the process of privatisation<sup>69</sup> was dubbed "piratisation" or "prichvatisation", meaning "grabbing" and "plundering" (Table 6.2.2). This view is echoed by some political leaders. A. Chubais, for example, admitted, "We gave away [state] property to those who were close to it – the bandits... but who gave the right to the reformers to give to bandits, directors and state secretaries what belonged to the people?" (cited in Kalabekov, 2010, p. 24). V. Putin later reflected that, "a substantial part of economy was controlled by oligarchs and criminal structures, thieves and bandits (cited in Kalabekov, 2010, p. 24). Y. Kalinina acknowledged that "the privatisation was fraudulent with no barriers to theft and deception" (cited in Kalabekov, 2010, p. 24).

One example of this comes from a privatization process that took place in Nizhniy Novgorod, a major industrial city in central Volga (Karpanos, 2015). Yuri Igonin, a privatisation expert for the local police, depicted the process of privatisation whereby officials collaborated with criminals by selling them information about all possible participants, such as their addresses and telephone numbers. Igonin said that the

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<sup>69</sup> Some sources find a resemblance between the privatisation of the late 1990s and early 2000s, and the nationalisation of the 1917; the essence of both relied on the principal of theft, or in academic terms the "expropriation of socialist property. After October 1917, expropriated private property became state and collective property. Since August 1991, state and collective property has been turning rapidly into private property. In place of the confiscation of private property of the 1920s, we have privatization of state property in the 1990s" (Kuznetsova, 1994, p. 448-449).

potential investors were asked ‘politely’ to leave the city without a chance to participate in the auctions. “They were stopped at the door of their hotel on the day of the auction by local criminals who said: “You don’t want to go to the auction, all right?” and then they took out guns” (Gordeev, 1994).

Another example is the series of notorious “aluminium wars” in Siberia in the 1990s. In a court hearing at the London Commercial court, Roman Abramovich, who was fighting against his former friend Boris Berezovsky, confirmed that “Every three days, someone was being murdered” (*Independent*, 4 November, 2011). According to the newspaper *Independent*, “It was against a backdrop of murders, extortion and intimidation that Mr Abramovich came – reluctantly, he claimed – to buy the giant Krasnoyarsk aluminium smelter”. A. Kulikov, the Minister of Interior, confirmed that “the aluminium complex of Russia is entirely criminalised” (cited in M. Vagrius, 2003).

The initial stage of privatisation led to the consolidation of the banking, industrial and criminal elites. According to the Ministry of Internal Affairs who supervised the privatization, between January 1992 and March 1994, 27,600 organised crimes (77 crimes a day) related to 88,600 privatised enterprises (109 enterprises a day) meaning that 70% of privatised enterprises had links to crimes. According to some sources, in 1995 a network of Chechen criminal group controlled the distribution of the oil production of Yukos’s sister company, Yuganskneftegaz (Panyushkin, 2006, p. 82-92).

Table 6.2.2. The classification of sold state enterprises

Classification of the value of sold enterprises (in millions of dollars)	Actual value of sold enterprises (in millions of dollars)	Number of sold enterprises in each classification (in pieces)	The average cost of 1 sold enterprise (in millions of dollars)
151-650	3430	10	342
75-150	830	8	103.3
37-74	760	14	54.1
18-36	630	28	23.3
8-17	530	46	11.4
Less than 8 million	1020.	319	2.5
Total	7 млрд. 200 млн.	500	14.4

Source: Lisichkin and Shelepin, 2003

The introduction of voucher funds to aid privatisation was another example of the criminal undertakings operated by the political and economic elite and criminals; a \$23 billion loan package granted by the IMF and several commercial institutions was misappropriated after the falsification of financial figures provided by the Russian government in collaboration with a handful of tycoons (*The Moscow Times*, Sep 10, 1988). Voucher ownership benefited both the corrupt Soviet-era managers of Moscow banks, and organised crime.

The newly introduced regulations proved to be counterproductive, due to the Soviet and then Russian leaders' ambivalence on the matter of reform. The legislative ambiguity, inefficiency and loopholes in regulative policies and laws created a power vacuum that provided criminals and newly emerged entrepreneurs and state officials

with an unprecedented opportunity to engage in illegal activities. This opinion is shared by Varese (1994) who cites the interview between the magazine *Sovetskaya Torgovlya* and an anonymous Mafioso who says that “in the absence of clear moral values and beliefs, the Mafia has permeated the entire fabric of society [where] the laws of the state do not work, or work selectively. It is useless to fight the Mafia, and wise people have understood this and are collaborating with us” (p. 246).

This made possible the subordination of new legislation and regulations to the criminals’ own interests, and also enabled the misappropriation of state resources and state assets, the extorting of bribes and blackmail of citizens (Levin and Satarov, 1999). The following are a few examples.

The ineffectiveness of the taxation and customs regulations adopted in the 1990s manifested in an overly high rate of taxes, their ever-changing nature<sup>70</sup>, and the unpredictability of their collection by state agents, and prompted entrepreneurs to opt for conducting business in the unofficial, shadow economy, rather than in the official one, thereby involving themselves in the shadow arbitration system and avoiding the official judicial institutions. Different sources estimate that “...the shadow economy in the mid-1990s constituted between 20 percent and 45 percent of GDP” (Kosals, 1998, p. 59). The ineffectiveness of tax regulations and taxation resided in the fact that the tax rate, if paid with full accuracy and correctness, reached up to 90 percent of profits. On top of it, tax inspectors were highly corrupt, so that “one cannot deal with tax inspectors without a bribe” (Gilinskiy, 2002, p. 217). Additionally, conducting business in Russia was very expensive due to the high costs of legal economic activity, meaning that “one has to bribe when registering a business, when renting premises from state bodies, when acquiring licences to utilise premises, when obtaining low-interest bank credit, when submitting reports to tax inspectors, when completing customs formalities and so on” (Gilinsky, 2006, p. 283).

The ownership of private property in the USSR, the very notion of which is anathema to socialist ideology (Tiefendrun, 1998, p. 46), was underpinned by the dogma of "the

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<sup>70</sup> The taxation system for joint ventures has changed three times since early 1992 (The Moscow Letter, vol. 1, no. 22, 15 November 1992, quoted in Varese, 1994).

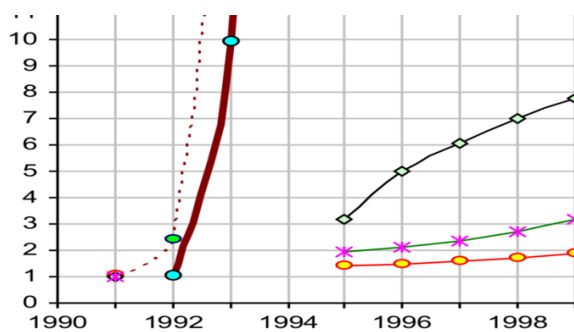


eradication of private ownership of the means of production and of the exploitation of man by man that private property entails” (Stephan, 1995). This inconsistency of the intellectual property legislation with the goals of post-Soviet Russia and its new direction toward the adoption of a market economy (Fleishman, 1993) manifested in widespread piracy. Due to the absence of any copyright law, piracy flourished on an unprecedented scale, with the 1990s considered “by most accounts, a period of impunity for pirates in Russia” (Sezneva and Karaganis, 2011, p. 155). Goods ripe for piracy included optical discs (movies, music, software), the “illegal copying [of which] on an industrial scale began in the early 1990s, as formerly state-run optical disc factories across the region lost their primary buyers and turned to production for the black market” (Sezneva and Karagani, 2011, p. 155). As experts maintain, “up to 95 % of the computer software distributed in the former Soviet Union is pirated” (Yasmann, 1993, p. 48). The legal selling of Ripley’s book ‘Gone With the Wind’ was discontinued by a Muscovite publisher, after various vain attempts to stop the illegal distribution of unauthorised versions by more than ten other Russian publishers (Varese, 1994). Despite the fact that the Law on Copyright and Related Rights was eventually approved in 1993, its ineffectiveness was apparent. As Varese (1994) comments, “the law itself provides for a 'transitional period' (which ended on 1 January 1994) during which users have the right to use, for example, computer software and data banks without the author's consent and without paying compensation” (p.243). Consequently, “...piracy of all types of intellectual property, and indeed in the other countries of the CIS, is the rule rather than the exception [...] and the actual enforcement of the law may prove very difficult” (Yasmann, 1993, p.48).

The legal complications in property rights reduced the number of applications concerning the resolution of property disputes. Consequently, in seeking protection, people resorted to an alternative, and often criminal, method, that could provide more effective security and well-being; the payment of protection to criminals, or criminal organisations, who in return provided the so-called ‘krysha’, or ‘roof’. Over time organized crime became intertwined with every aspect of social life in Russia, playing the role of the provider of administrative, judicial and security services (Varese, 1994).

The anti-alcohol policy, implemented in May 1985, opened up a new and extremely lucrative market for organised crime; "It created much the same effect as Prohibition did in the United States as a new wave of bootleggers and bathtub vodka-makers cashed in" (Anderson and Atta, 1989, p. 14). Illegal sales of so-called "samogon", or moonshine, increased by 42% in 1986 (Terml, 1987). It also accelerated inflation<sup>71</sup>. The increase in illegal production undermined Soviet state tax revenues and prompted the state to resort to money-printing, thus fuelling inflation, also known as "rouble overhang" (Fig. 6.2.3). It was, in fact, the first time after WWII that the state had printed money.

Figure 6.2.3 Inflation (Russia is —)



Source: Statistics Collection of Russia, 2016; Rosstat, 2016; Statistics collection, 1991.

### 6.3. Arbitrage and Institutional Deficits: Reforms Bring Opportunities

The new political and economic changes, also known as *glasnost*, and *perestroika*, or openness and re-construction, had not only legalised the shadow economy that was controlled by the network of illegal entrepreneurs, state officials and criminals. It also produced tremendous economic arbitrage opportunities. According to some estimates, in 1988 the increase in illegal activities in Russia, as a result of the new economic opportunities, accounted for some 1,400 million roubles (Koriagina, 1990). This

<sup>71</sup> According to the Soviet scientific literature of the early 1990s, the total loss to the economy during 1987 was 1134.9 trillion roubles; a huge proportion of the Gross Domestic Product, which amounted to 1465 trillion roubles. This figure was made up predominantly of saving deposits in the state Central Bank and accumulated assets in the informal sector (about 240 milliard roubles) (Statistic Collection, 1990, p.125).

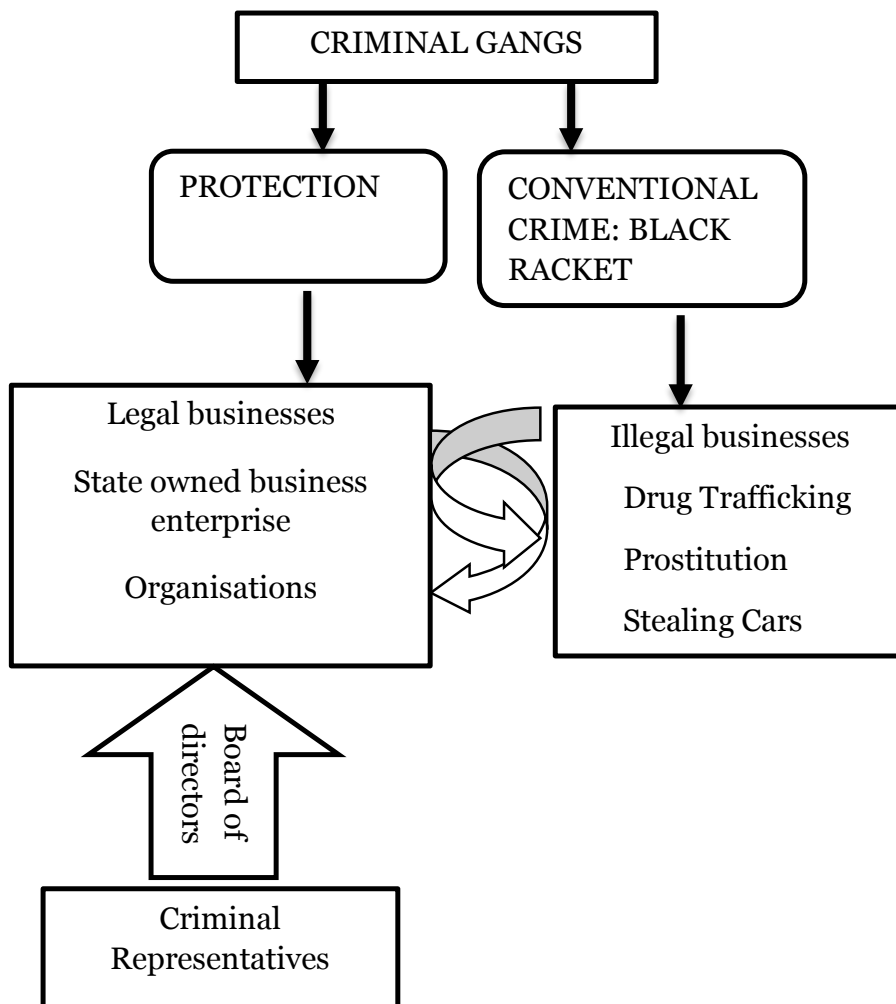
transformation changed the rules of the game, and the boundary between legal and illegal disappeared. New entrepreneurs found it difficult to avoid illegal activities, and their interests became mixed with the interests of criminal groups and their allies in the bureaucracy. Doing business was almost impossible without cooperating with criminal groups, who left no choice for businessmen, but to pay protection money, in order to make it possible to open and run a business. In his exclusive interview with *The Sunday Telegraph* (21 April, 2012), Oleg Deripaska, a billionaire businessmen, admitted that he paid protection money to criminal gangs. A source close to Mr Deripaska said that he was forced to pay gangs. “The payments are called *krysha*, money paid to protect clients. It literally means roof in Russian. You are paying to protect your roof,” the source said. Deripaska itself said: “The first time I was directly threatened ... two weeks later my commercial director was shot two times in the head. This was how, finally, I decided it was better to pay for the moment to stay alive and for my people to stay alive.” He added: “I hated having to pay, but there was no other safe choice, for me or my staff. I saw it as a temporary, unpleasant necessity while I did everything I could to clean up the industry and put in place security that was needed to make my businesses and my staff safe.”

In 1994, the Ministry of Internal Affairs (MVD) issued a report stating that about forty thousand businesses, including two thousand in the state sector, were controlled by organized crime. By 1997, over two-third of the country’s businesses, including approximately five hundred banks were controlled by or had been influenced by organized crime (Volkov, 1999, p. 748; Weber, 1997, p. 2).

Organised crime used the threat of force to maintain certain rules and conditions for business activities (Volkov, 1999). Amongst the newly emerged criminal activities racketeering, for example, was the most widespread. The ineffective and untrustworthy police and military forces left no choice for small and medium enterprises (SME) but to adopt a “do-it-yourself approach to protection” (Varese, 2001, p. 18), that is, hiring the services of criminal gangs who would take care of the SME, including opening and operating these businesses, in return for paying an estimated fee of between 20 to 30 percent of profits (Volkov, 1999). Those enterprises that did not voluntarily hire such

gangs faced very brutal consequences and were invariably forced to, all under the guise of “security services” and “debt recovery”. Very often, “protection” services took the form of the seizure of shareholding control, where criminal representatives became shareholders. Figure 6.3.1 schematically illustrates this process.

Figure 6.3.1. Seizure of legal businesses by criminal gangs through criminal activities



It has been estimated that, by the mid-1990s, 80% of businesses paid protection money in Moscow and Leningrad (Varese, 2001). In Moscow the various groups included the Podolsk, Dolgoprudnenskaya, Orehovskaya, Ismailovskaya, Taganskaya, Solntsevskaya, Georgian, Armen, Dagestan, Tambov, Azerbaijan, Chechen, Lyubers and Kazan. Some of them were connected to the underworld who hired them to effectively perform as bouncers while black-market operations were conducted (Schreck, 2016). Over the next decade, these groups would establish ties to the upper political echelons and facilitate an effective interweaving of legitimate business with the underworld. A case in point was Otari Kvantrishvili who was associated with the notorious gangster Vyacheslav Ivankov in Moscow. Kvantrishvili started his criminal activity in the 1960s, was a wrestling trainer for the police in the 1980s, and later became a vice president of an enterprise that exported natural resources with the support of government associates. He was an influential figure among well-known criminal groups in Moscow in this period, one of them being Lyubers.

The new political and economic changes, broadly conceived as globalisation, that is, “globalisation of trade, technology, transportation, communications, information, and financial systems”, also opened new, and enlarged pre-existing, “opportunities for criminal enterprises to operate across national borders” (Williams, 2001, p. 109). These changes were designed to ensure integration with the international economy. They included easing restrictions on movement in and out of the Soviet Union. The freedom to travel abroad brought many positive changes; it increased labour migration, tourism, international students, as well as the import of consumer goods, jobs and capital across international borders. No less than one-third of the Russian population communicated with people in foreign countries (Shlapentokh, 2012). Yet, it also produced negative consequences. Notably, it presented an opportunity for organised crime groups to forge relationships, “mostly of a business-like character”, with foreign nations and other organised crime groups (Clines, 1989; Freeland, 2000). There was a dramatic increase in the interaction between foreign and domestic organised crime groups. For example, Soviet organised crime groups established connections with the criminal underworld in the Soviet émigré community of Brighton Beach in Brooklyn, along with other groups

in New York, Miami, Los Angeles, Chicago, Israel, Belgium, Poland, and Austria<sup>72</sup> just to name a few (Clines, 1989; Lowy, 1994). These close connections enabled the establishment of spheres of influence, such as the control of cooperatives, markets and groups of speculators; foreign currencies exchange; the prostitution business, narcotics and gambling; the sale of automobiles; robbery and extortion, the trade in stolen and smuggled non-ferrous metals, and many others (Powell, 1991, p. 64; Coleman, 1988, p. 44; Clines, 1990). Chechen groups, for example, controlled the Southern Port in Moscow, a key river terminal and an open-air car market, which enabled them to establish a business trading in both used and new cars (Modestov, 1996, p. 30-58). Russian Mobster Ludwig ‘Tarzan’ Fainberg, who helped a Colombian drug dealer to purchase six Russian military helicopters, was also involved in the purchasing of a submarine for Colombians who were always seeking new transportation methods for transferring cocaine. He described his attempt to purchase a submarine in Russia when he contacted a friend who was in the Russian government: *“Let me ask you a stupid question, is it possible to purchase a submarine?”* The response was *“With missiles or without missiles?”* Similarly, the key components of Russia’s nuclear stockpile became available on the international black market (Cockburn, 1997, p. 61-63).

Another significant opportunity offered by globalisation was technological openness. Access to the Internet, for example, proved to be an efficient tool for ordinary people to establish connections with people and institutions anywhere around the globe (Shlapentokh, 2012, p. 356). New technologies provided efficiency in sea freight, logistics management, the packing industry, and foreign exchange provision (Naim, 2007, p. 21; Abate, 2004). Thus, the “aggressive and inventive adoption of new technologies has helped traffickers to lower risk, increase productivity, and streamline their business” (Naim, 2007, 21). The adoption of new technologies in conjunction with the economic reforms also benefited organised crime. One of these opportunities facilitated money laundering, the most frequent financial crime, which was facilitated

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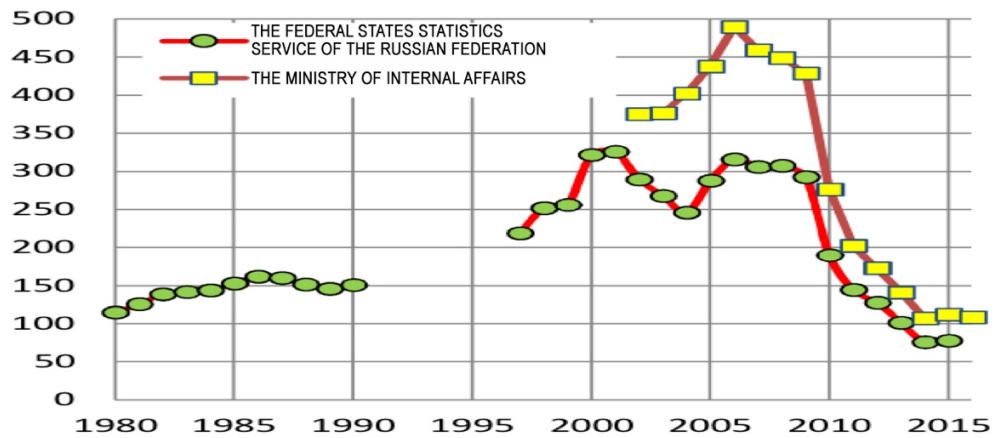
<sup>72</sup> *Russian Mafia Reportedly Increasing Activities* from DIE WELT, in Daily Report Western Europe, 9 February 1991

by the combination of the free movement of capital, and new technologies in the banking sector. Financial crimes were endemic amongst organised crime groups in Russia, and included banking crimes, counterfeiting, embezzlement, illegal bank acquisitions, the issuing of false cheques and other bank transactions schemes (Lebedeva, 1993). According to some sources, an attempt in 1992 to appropriate over 25 billion rubles from the Russian Bank by a Chechen organised crime group would have collapsed the Russian's monetary system (Handelman, 1993, p. 12-15, p. 30-31, p. 34, p. 40, p. 50). The criminals succeeded in stealing a substantial amount of funds. The estimates vary; some sources suggest that over \$700 million roubles were stolen (Jennings, 1993), others claim that the amount stolen reached 'only' \$500 million roubles. This fraud involved organized crime groups, entrepreneurs, corrupt bank employees and leading Russian commercial banks (Aslund, 1995; Konstantinov, 1997; Lieven, 1998).

To make matters worse, "the Russian mafia helped make \$12 billion 'disappear' from the country's primitive banking system this year (1993)" (Elliot *et al.*, 1993, p. 30).

The technological advances and financial liberalization also enabled criminals to establish their own banks that laundered criminal money. Figure 6.3.2 shows the growth of newly established banks in this period.

Figure 6.3.2 New banks



Source: Luneev 1997

The majority of these commercial banks in this period were co-owned by criminal groups. Gennady Petrov, for example, the head of a prominent ring known as the Tambov organised crime group, was a co-owner of Bank Rossia. Another instance is the takeover of hotel cashflows by the Chechen gangs that opened a gateway to the financial markets, and thus the takeover of dozens of banks (Konstantinov, 1997, p. 377-381; Maximov, 1998, p. 61-163). According to some sources, around 85% of all banks had various connections and links to organised crime<sup>73</sup>.

The following Table 6.3.1 shows the commercial bank capital owned by non-financial organizations and private individuals, who were very often connected to criminal gangs. In 1995, as much as 62% of the authorised funds of the former state banks ('old banks') and 69% of the new banks belonged to non-state enterprises and companies.

<sup>73</sup> See Financial Times, 14<sup>th</sup> February, 1997 *International conference on money laundering in Prague*;



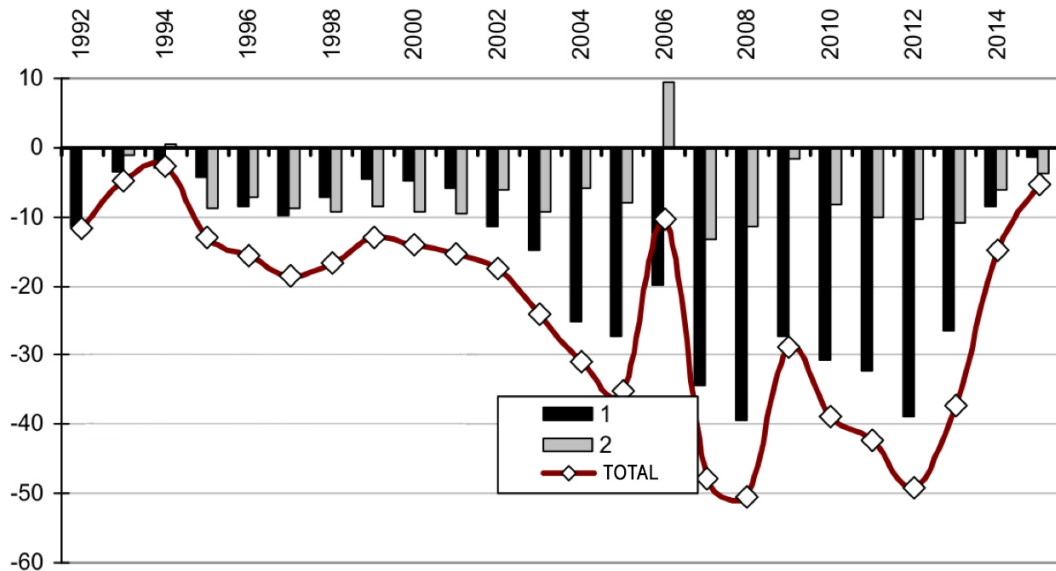
Table 6.3.1. Bank Ownership (Percent of share capital) in February 1995

Type of shareholder	Total sample of banks	Former state banks	New banks
State owned enterprises and other State institutions	14%	15%	13%
Privatised enterprises	26%	31%	21%
New private companies	38%	31%	48%
Individuals	18%	18%	18%
others	4%	6%	1%

*Source:* Belyanova, 1995, p. 34

Shelley (1997) presented a World Bank study which showed that at least 40% of the total 2 billion USD outflow from Russia was through organised crime. Other estimates suggest that the annual outflow of capital from Russia in the 1990s reached \$20-\$25 million, in ten years (Persikov, 2001). According to Lvov (2004), “during the years of reforms, the outflow of the capital reached \$500 million” (p. 34). Different estimates suggest that the total outflow amounted to between \$400 million and \$800 million and perhaps more, while “[a]ccording to the experts of the Association of the Russian Banks, the amount of transferred capital in the 1990s varied between \$800 milliard - \$1 billion”. Figure 6.3.3. illustrates the outflow of capital from Russia.

Figure 6.3.3. Outflow of capital from Russia



Source: Central Bank of the Russian Federation, available at: <http://www.cbr.ru>

To summarise, the period of the late 1980s and the decade of the 1990s – the period of structural political and economic reforms in the USSR and the Russia – is firmly associated with the rise of “organised crime that became more international, wealthier, and more politically influential than ever before” (Naim, 2007, p.13). The aim of this chapter has been to understand how this period became transformational in the nature of Russian organised crime and its relationship with the Russian state. As I aimed to show, the short years of Gorbachev’s perestroika and other reforms created a political-economic context where organised crime began to assimilate into the changing state power structures. Namely, it started to evolve from horizontal webs of groups and networks into a vertically organised state structure that included state officials, illegal entrepreneurs, criminals and the new business elite. The biggest factor driving this process however, was yet to come.

## CHAPTER 7

### THE OLIGARCHS, POWER ‘VERTIKAL’, AND VLADIMIR PUTIN (1995-)

Over the past decade or so, it has become commonplace to associate the Russian state under Vladimir Putin with the Russian mafia or ‘Mafia state’ (Dawisha, 2015; Browder, 2015; Khlebnikov, 2000). Putin’s personal background in the KGB, the power elites associated with his reign, as well as their methods of operation and relationship with the private sector nationally and internationally, are typically referred to as key elements of Russian kleptocracy. This thesis does not dispute the central presence of criminal networks in the history of Russia’s political economy. Indeed, the previous three chapters illustrated that cooperation between elements of the state and criminality had been an immanent feature of the Soviet economy throughout its history. However, in contrast to what current literature suggests, this thesis finds that the foundations of the merger between the state and organised crime are not directly associated with the reign of Vladimir Putin. As this chapter will show below, the foundations of that close relationship were laid down in the 1990s, a period that was regulated by vague laws and faltering institutions and which saw many of the barriers between the state, business and criminal groups, erode.

#### **7.1. The 1990s: From Organised Crime to Oligarchy**

Today, Russian capitalism during the 1990s is synonymous with the rise of the oligarchs (Hoffman, 2003) and oligarchic structures (Gustafson, 1999). The story of their rise to the very top of power in post-Soviet Russia is the quintessential story of Russia’s political economy. It centres on an impoverished state that had been running

large fiscal deficits (around 6% of GDP in 1994-95), and successive governments under president Boris Yeltsin, whose approval ratings in early 1996 – a crucial year of presidential elections in Russia - were as low as 8%. Trying to save the country disillusioned with the ‘market bolshevism’ (Reddaway and Glinski, 2001) from a return of the Communist Party to power, yet isolated from foreign investors who became wary of the endemic corruption during the short period of 1991-1994 (Freeland, 2000), a group of new Russian businessmen and bankers found a solution (e.g. Browder, 2015).

The plan was simple. A group of business leaders and tycoons would provide loans and funding for the state budget and key enterprises (and finance Yeltsin’s re-election campaign), in exchange for being granted temporary managerial control of Russian key state enterprises. When the initial terms of loans expired, the enterprises were to be put up for privatisation auctions. In reality, the auctions were not fully open or transparent, and the companies were sold to *de facto* managers at dramatically undervalued prices. The scheme would become known as loans for shares scheme, “under [which], the gems of the Russian economy - the most promising companies in the industrial and energy sector - were in fact sold out to businesses in exchange for minimal loans to the Government”<sup>74</sup>. The loans from the seven bankers<sup>75</sup> became the shares of the few oligarchs who, from 1995-6 onwards, controlled the Russian economy.

While this is now an established (and chronologically accurate) narrative of the process, existing accounts tend to miss one important element in the story of loans for shares: the role of organised crime in *making* the oligarchs. According to the Russian law agencies, in late 1998, around half of the commercial banks were controlled by organised criminal groups, while 60% of these commercial banks were state banks and 40% were owned by private enterprises and individuals (*Rossiyskaya Gazeta*, 1998). By the end of 1995, these banks controlled 12 “crown jewels” and “behemoths” of the

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<sup>74</sup> Global Program Against Money Laundering, U.N. Office For Drug Control And Crime Prevention, Russian Capitalism And Money-Laundering at 7, U.N. Sales No. E. 01.XI.6 (2001)

<sup>75</sup> The Russian oligarchs were nicknamed “The Seven Bankers”, and their hegemony referred to as ‘the rule of the seven bankers’, a name that correlates with a group of seven noblemen, who ran Russia in the 17th century during a brief period between the czars.

Russian economy (Freeland, 2000, p. 170): the Norilsk Nickel plant, the North-Western Shipping Company, JSC “Mechel”, Sidanco, Novolipetsk Steel, Yukos, the Novorossiysk Shipping Company, Sibneft, Surgutneftegaz, JSC “Nafta Moscow” and the Murmansk Shipping Company. The largest state-owned enterprises ended up in the hands of organised criminal networks.

A vivid example of the emergence of the new oligarchs in Russia and their rise to the top of the pile with a controlling interest in the Russian economy is the period known as the ‘aluminium wars’. After the collapse of the USSR, the industry was divided by violent disputes in which smelter managers, metals traders, journalists and others were slaughtered. There was a fierce battle for control of the world's biggest aluminium smelter, Krasnoyarsk in Siberia. Russian aluminium production was in crisis, with alumina, the key raw material, in short supply in the domestic market. A lucrative practice of tax evasion in this period, called ‘tolling’, was widespread in the Russian aluminium industry. In this form of tax evasion, onshore firms set up offshore companies to buy their goods at artificially low prices. The offshore company sold the goods on the market at market prices and booked the profits in the tax haven. The state’s new policy to sell off its resource assets attracted such fierce competition that it is estimated 100 aluminium executives were murdered (*The Guardian*, 6 July, 2003). In the words of Roman Abramovich, who testified on the events of that period, “Every three days, someone was being murdered”. These periods of asset-grabbing, such as the aluminium wars, produced a few dozen tycoons, among them Oleg Deripaska who controlled Sibirsky Aluminium Investment Industrial Group and Roman Abramovich, who acquired most of the rest of Russia’s aluminium industry.

Oligarchs had adapted themselves to the new political and economic situation and understood how to take advantage of the process of restructuring the existing illegal cooperation of criminals, illegal entrepreneurs and state officials. They followed the rules of the game. One of them, for example, was to pay for personal and political protection. Roman Abramovich admitted paying for Berezovsky’s political influence in return for his agreement to protect Abramovich’s financial interests. According to Abramovich, the sums, in excess of \$500m, may have been paid to a third party, Badri

Patarkatsishvili, who was a notorious criminal and a business partner of Berezovsky, to protect Abramovich in the aluminium wars. The second rule was to pursue the political route carefully. While Berezovsky, for example, was a supporter of President Yeltsin when he oversaw the breakup and sell-off of valuable state assets, he later failed to stay on the right side of Vladimir Putin, whose sensitivity to political interference from ambitious oligarchs has condemned more than one to prison and Berezovsky to exile (European CEO, 2012).

The close following of these rules opened up unprecedented economic opportunities for oligarchs and contributed to the involvement of criminals with the subsequent consolidation of the privatized assets in a few hands. These tycoons permeated the top structure of the Russian state through the enormous power of the financial wealth they amassed, as a result of the opportunities afforded by the political and economic changes. They now owned Russia's material as well as immaterial resources; from oil and commodity companies in the extractive industries, to new financial companies and banks, to TV stations and mass media. The front pages of their newspapers supported the re-election campaign for Yeltsin. In late 1996, with Yeltsin's election victory assured, the tycoons and their political partners became the rulers of the new Russia.

## *The Oligarchs*

Let us see who these oligarchs were and how they became the new business elite, before they infiltrated the state.

### **Mikhail Khodorkovsky**

The gradual decomposition of the Communist Party of the Soviet Union (CPSU) through bureaucratization, and its partial merging with criminal enterprises, contributed to the formation of a network structure where everyone was tied to each other. Consequently, some divisions of the CPSU became a springboard to membership of the new economic elite. VLKSM, or The All-Union Leninist Young Communist League, for instance, also known as Komsomol, was the youth division of the CPSU that developed under the supervision of Egor Ligachev, the second-ranking member of the Gorbachev leadership (Kryshtanovskaya and White, 1996). It produced many prominent oligarchs who had tight links with criminality<sup>76</sup>. Under the auspices of the Central Committee of the VLKSM, a number of scientific and technical centres for young people were formed and many of them began their business careers as part of the new wave of Russian entrepreneurs. Mikhail Khodorkivsky was the deputy chief of Komsomol at his university. When the new economic opportunities arrived, he used his connections with high-ranking people to exploit them. As he himself admitted in 1991, “It wasn't the money, but the patronage. At the time, you had to have political sponsorship” (Slevin, 1991).

One of the possibilities the Komsomol offered was to make money by providing advice to factories and industry on technical issues. Factory managers had some discretionary funds to use as they liked. His first profit of 170,000 roubles (at the time, an enormous amount of money) was obtained fraudulently through his company, the Centre for Scientific and Technical Creativity "Foundations of Youth Initiative" that had performed scientific research for the highly prestigious Institute of High

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<sup>76</sup> Shamil Basaev, for example, became a Chechen terrorist commander

Temperatures. The work has never been done. As Sheindlin, the director of the Institute, recalls, “They said, 'give us a little bit of money. We will work for something interesting. But we will work honestly'. There: *honestly*, they said.” For two years Sheindlin did not hear a word from them. But he figured they were busy with the money, that is, “they used this money to increase the money – many, many times” (Hoffman, 2002, p. 108).

The Centre for Scientific and Technical Creativity of Youth "Foundations of Youth Initiative" later produced the Innovative Commercial Bank for Scientific and Technological Progress and the banking association ‘MENATEP’. According to a 1995 confidential report, CIA accused MENATEP of being linked to Russian organised crime, and of being “controlled by one of the most powerful crime clans in Moscow, and that it had set up “illegal banking operations in Washington” (Gupta, 1997, p. 133; Friedman, 2000). As far back as 1995, the Menatep bank was named in a CIA report as a possible Solntsevo organised criminal group front, and this bank – which failed in the crisis of 1998/1999 – proved a major player in the multi-billion Bank of New York case (Galeotti, 2005, p. 68). There are speculations among Moscow bankers and politicians that Menatep was connected to the missing cash and gold of the Communist hierarchy. No one knows how much money was involved or where it went, but the speculation often implicated the “kids” of the Komsomol, the most successful of whom was M. Khodorkovsky (Hoffman, 2002, p. 125). Khodorkovsky has denied a role in saving the party's money. But he made an ambiguous statement in 1990s: “A bank is like a waiter. Its business is to cater to the clients independently of their political beliefs or affiliation with this or that camp. Its job is to take or give money to someone, registering the deal. So, it is not clear to me, what is the fault of those banks that kept the Communist Party money on their accounts? Had I been offered to keep them in my bank, I would also have considered it as an honour” (Bunin, *Forty Stories*, p.174, cited in Hoffman, 2002, p. 126).

Khodorkovsky was connected to the 1998 killing of Vladimir Petukhov, the mayor of the Siberian town of Nefteyugansk, where Khodorkovsky’s former company, the oil giant Yukos, was headquartered at the time. Petukhov allegedly had a conflict with the company for non-payment of taxes and was ready to institute criminal proceedings



against Yukos.

According to Bloomberg, Russia's Investigative Committee claims it has evidence that Khodorkovsky ordered Petukhov's assassination. Yukos' former security chief, Alexei Pichugin, is currently serving a life sentence for killing Petukhov. The Russian newspaper *Novaya Gazeta* detailed how Yukos obtained funds that it used to acquire weaker oil companies. Focusing on just one region, Volgograd, the newspaper described how tens of millions of dollars earmarked for local schools, bridge and infrastructure projects were diverted into Yukos's accounts in a complex arrangement involving meaningless IOUs, shell companies, and kickbacks to local officials (*Novaya Gazeta*, Feb. 1, 1999)

### **Boris Berezovsky**

Boris Berezovsky's first enterprise, a car dealership called Logovaz, was used to siphon off money from Avtovaz, the largest state car producer in Russia, and later on from Aeroflot, the state carrier, with the subsequent acquisition of other business interests, such as banks and the Russian TV channel ORT. The General Public Prosecutor's Office accused Berezovsky of stealing more than 214 million roubles (\$8 million) from Aeroflot, and of legalising stolen funds. In 2007 he was found guilty in absentia by a Russian court of embezzling £4.4m from Aeroflot, and jailed for six years. He was given a second sentence of 15 years over Avtovaz in 2009.

Berezovsky's business was linked to organised crime groups who provided a *krysha* or roof, protection, not just from the political and security authorities but also from other organised crime groups, which in the 1990s dominated business sectors, including car sales. According to Moscow police reports, Berezovsky started his dealership in close collaboration with Chechen criminal gangs who gave him protection. Chechen crime groups fought for control of Moscow with rival Solntsevo gangs. The connection to the Chechens was his Georgian business partner, the prominent criminal, Arkadi "Badri" Patarkatsishvili, whose responsibility was debt collection and protection against

gangsters. According to the former head of the Presidential Security Service, General Aleksandr Korzhakov, “[i]n Soviet times Badri Patarkatsishvili was one of the directors of an auto-repair network in Georgia. One of his brothers, Merab, is a thief-professing-the-code; another brother, Levan, is an ‘authority’ of a Georgian organized crime group. Badri also has an alias, like any gangster. In the criminal underworld, he is known as ‘Badar’” (Klebnikov, 2000, p. 16). Patarkatsishvili used his contacts with Georgian and Chechen organised crime groups as well as connections in the world of secret services to advance his business interests (Global Organised Crime Project 1997; Satter 2003). His chief bodyguard was the former KGB and FSB officer Andrei Lugovoi<sup>77</sup>. He had close ties with members of the Duma, the Prime Minister, the Defence Minister, the Deputy Prime Minister and the head of the Finance Committee. A current member of the Duma, Iosif Kobzon, who was also a popular singer, co-owned a company, “21<sup>st</sup> Century”, with Otari Kvantrishvili. Yeltsin’s campaign manager, Sergey Lisovsky, also co-owned a business with Otari Kvantrishvili and the criminal gang Solntsevo Brotherhood.

Berezovsky was also linked to the notorious murder of Vladislav Listiev, a popular TV personality who tried to clean up the ORT channel, a giant TV station, identified by Forbes as mob-connected and which Berezovsky partly owned in the 1990s. Listiev told friends that Berezovsky was supposed to transfer \$100 million in cash to a mafia-connected executive who was being bought out. When Berezovsky delayed turning over the money, Listiev was murdered in his apartment building in Moscow (*Forbes*, 1996).

Boris Berezovsky had a vested interest in the political realm of the Russian state and provided financial support to the Russian leaders. He himself and his network, for instance, played an instrumental role in financing the 1996 election campaign of the Russian president Yeltsin, whose political triumph secured the financial interests of the economic elite. In his interview with a reporter from the Russian newspaper, the *Kommersant Daily*, on 13<sup>th</sup> March 1998, Yeltsin claimed that the Russian business elite comprised the only real supporters of the government. There are allegations that Berezovsky colluded with criminal groups such as the Chechen terrorists who

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<sup>77</sup> Andrei Lugovoi is the suspected assassin of Alexander Litvinenko in London

kidnapped Russian citizens in return for ransoms. Berezovsky, representing Yeltzin's party, played the role of a 'rescuer' by paying ransoms for the victims.

Also in 1994, Berezovsky secretly signed over to Yeltsin a 26 percent interest in ORT, Russia's largest TV station. This was confirmed by Yeltsin's former bodyguard, Alexander Korzhakov, and by Berezovsky himself (*Moscow Times* and Interfax Russian News, 1998).

Roman Abramovich, whose early business career is closely associated with Berezovsky, claimed that he paid Berezovsky, and his criminal business partner, Arkady Patarkatsishvili, "protection" money and capital to purchase political influence during Yeltsin's rule. Abramovich recalls:

*"In 1996 I paid him approximately \$80million. Then in 1997, I paid around \$50million. Then I paid around the same amount in 1998, despite the shortage of cash caused by the financial crisis. In 1999 I also paid about \$50million. The government of the time was dominated by old-style ministers from the Soviet era. Having someone who could have a voice in that inner circle was vital if one wanted to build a business that required government support. In this era, a number of powerful individuals appeared who could get the ear of those close to the government. Mr Berezovsky was one of such people. There were also people like Mr Patarkatsishvili, whose influence derived from their connections to criminal groups" (Mirror, 2011).<sup>78</sup>*

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<sup>78</sup> For a full interview with Roman Abramovich see "Roman Abramovich revealed: The dangerous world of Roman and Russia's oligarchs", available at: <http://www.mirror.co.uk/news/uk-news/roman-abramovich-revealed-the-dangerous-world-89764>).

## **Alexander Smolensky**

In its early years, Smolensky's Stolichny Bank had dealings with unsavoury gangs and dirty money. According to the interview on October 3, 1988 with a leading banker, “[Smolensky] had criminal elements” (Hoffman, 2002, p. 51). In 1992, a criminal investigation was opened against Smolensky – he was involved in the theft of \$30 million that was fraudulently transferred from the Central Bank to Stolichny Bank. This criminal undertaking involved Dagestanian and Chechen criminal groups who faxed a series of wire transfer requests, ordering the Central Bank to immediately transfer millions of dollars to various Moscow commercial bank accounts, including about \$30 million to Stolichny Bank. Later, the Central bank discovered that the wire transfers were fake.

In 1993, the Ministry of Finance opened an investigation into the disappearance of \$25 million from a Stolichny account. The money had allegedly been transferred to a Vienna bank. Austrian police joined in the investigation. According to a Russian newspaper, *Sovershenno Sekretno*, which often had sources in the security services, Smolensky and another man had fraudulently taken \$32 million, and stashed \$25 million in a company in Austria owned by Smolensky's wife. Later, the newspaper said, Smolensky's bank acknowledged a “mistaken” borrowing of \$4 million and repaid that sum.<sup>79</sup>

In the mid-1990s, a classified CIA report identified Stolichniy Bank as a front for organised crime. According to the Austrian newsweekly *Wirtschafts Woche*, police records alleged that Stolichniy's owner, Alexander Smolensky, was an international drug dealer.

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<sup>79</sup> Sergei Pluzhnikov, Sergey Sokolov, «Operation SBS», *Sovershenno Sekretno* 6, 1999. Cited in Hoffman, 2002, p.53.

## **Oleg Deripaska**

Oleg Deripaska entered the business world when still a student at Moscow State University. In 1992, he worked as a financial officer of a Military-Financial Investment Company, and then as a broker on the Russian commodities exchange. His career is closely associated with the work of the Chernoy brothers (Michail, Lev and David), some of the most fearsome names in the criminal underworld (or thieves in law) to this day (*Independent*, 2011). In the early 1990s, Deripaska founded a small metals trading operation and established a foothold within the domestic metals industry. According to *The Financial Times*, by the mid-1990s nearly all the profits from these operations were used to acquire the initial package of shares of the Sayanogorsk Aluminum Smelter, the nation's third largest electrolysis plant in Eastern Siberia. Deripaska became director general of the plant in 1994. In 1997, the smelter became the core asset of Sibirsky Aluminium Group, the forerunner of Basic Element.

According to *The Globe and Mail*, in 2011, Deripaska emerged as the big winner of the 'murky' aluminium wars of the 1990s. He faced allegations that he was involved in serious crime as he built his fortune in Russia's metals industry after the collapse of the Soviet Union. Some of the claims were made at the start of a hearing in the High Court in London, brought by Michail Chernoy, a Ukrainian-born billionaire living in exile in Israel, who was demanding \$1 billion (£650 million) from Mr Deripaska over the sale of a stake in Rusal, the world's biggest aluminium producer. Mark Howard QC, for Mr Chernoy, said in the written submissions: "Much of the highly selective material relied upon by Mr Deripaska (whether admissible or inadmissible) implicates Mr Deripaska himself in serious criminality, at least as much as Mr Chernoy." (*The Telegraph*, 2017)

Djalol Khaidarov, an Uzbek businessman, had told prosecutors in the US, Israel and Russia that Mr Deripaska was involved in bribing a governor in Siberia to secure the takeover of an aluminium plant. The statement also alleged that he was a member of an organised crime group and ordered the murder of Vadim Yafyasov, a businessman, in 1995. The court documents also quoted Mr Khaidarov as telling Israeli police in 2001 that people such as Mr Deripaska employ former agents of Russia's security service and "constantly receive information from the security authorities." (*The Telegraph*, 2017).

According to the Los Angeles Times (24 March, 2017), Deripaska reportedly had ties to organised criminal groups. In the late 1990s, the U.S. State Department refused to allow Deripaska to visit the United States and according to the *Wall Street Journal*, the entry ban related to concerns by US law enforcement officials that Mr Deripaska had ties with organised crime in Russia. *The Guardian* (18 February, 2001) wrote that Oleg Deripaska faces a \$2.7 million damages civil action in a New York court, alleging “numerous criminal acts, including murder, extortion, mail and wire fraud and money laundering”.

Throughout the 1990s, the alliances forged between the economic and political elite and criminal groups underwent a gradual, yet very profound, transformation. New economic opportunities afforded many reforms, and international openness provided previously unknown opportunities and mechanisms of competition for (the now legal) business and criminal groups, on a vast scale. Exploiting weak, non-existent or corrupt regulatory institutions, the three groups eventually merged into powerful, cross-sector, business groupings.

They influenced policies of the federal government because that government was weak, financially as well as politically (Robinson, 1998; Sakwa, 2008; 2014a, 2014b). The federal government was internally as well as geographically divided (regional governments were given lots of autonomy under Yeltsin) and had only patchy control over the actions of regional and local political leaders (Hanson and Teague, 2005, p. 661). The new oligarchic groups established spheres of influence across the economic and political realms, assigning control to members of the established network in charge of valuable assets in manufacturing, service and resource sectors. As a result, they wielded substantial power over the distribution and allocation of property rights, and often became leaders of political parties.

The whole structure of Russia’s political economy appears to have been carefully divided between competing oligarchic groups. The financial sector, for example, was dominated by individuals like Vladimir Potanin, who owned Onexim Bank, A. Smolensky, who owned Stolichny Bank, Oleg Boiko, who founded Natsionalny Kredit Bank, and Pyotr Aven, who was Minister for Foreign Trade between 1991 and 1992,

and later become a president of Alfa Bank. The media was in the hands of V. Gusinsky, who owned NTV channel and was granted a license to control Channel 4. The oil business was in the hands of Roman Abramovich, Boris Berezovsky and Vagit Alekperov, who also served as a Deputy Minister of Fuel and Energy in the last Soviet government. The security services were also controlled by the representatives of this network. General Vladimir Rushailo, for instance, who was the head of the Moscow RUOP (police organised-crime squad) between 1993 and 1996, and the interior minister of Russia since 1999, was linked to the oligarchs Abramovich and Potanin. In the political sphere, they provided financial support for those political leaders who were ready to adapt political and economic policies to serve their interests. This involvement was supported by close cooperation with criminals.

## **7.2. The Absorption of Organised Crime into the State ‘*Vertikal*’**

It would be the political change of 1999/2000 that would spur the next phase in the relationship between the Russian state and organized crime. Faced with the legacy of the devastating financial crisis of 1998, the disgust of the Russian public who had become frustrated by market reforms and lawlessness, as well as the risk of open investigation into corruption by members of his own family, Boris Yeltsin stepped down as Russian President on 31 December 1999. An internal war of clans in the Kremlin around the successor to Yeltsin produced an unlikely winner. Vladimir Putin, previously head of the FSB, was appointed acting President of Russia.

The new leader inherited a system of organised crime led by the elite of business oligarchs, who effectively ruled the Russian state. Immediately after Vladimir Putin was formally elected president, on 28 July 2000, he expressed the aim of restoring order to state institutions and making them work more effectively by establishing the central state with the presidential administration as the dominant political institution. The new

leadership was quick to realize that unless it could strengthen the state's economic foundations, political stability would be endangered.<sup>80</sup>

As Putin (1999) himself put it, “[t]he analysis of the economic potential of mineral resources, the conditions of fixed capital and technologies... provides ground to draw some conclusions as to the value and place of [mineral] resources in the progress of a national economy: 1. Mineral raw materials provide an important potential for facilitating economic progress within the country. 2. The comprehensive contribution of extraction to the progress of national industries is the key to the transformation of Russia in the near future into a leading economic power with a high standard of living for the majority of the population” (p.2). In this connection, the new leadership urged the establishment of a **vertical system** of financial industrial incorporations supported by the state, that is, “[g]lobalised economic processes require comprehensive state support and the creation of large financial and industrial corporations” (Putin, 1999, p. 2). The importance of the resource sector for the Russian state, it was argued, cannot be left purely to the market, to be shaped through the mechanism of demand and supply.

This led to the decision to rein in the oligarchic clans of the mid-1990s and to curb their influence. On 28 July, 2000, Putin hosted a widely publicised meeting with 21 oligarchs. There, he effectively offered them a choice. The first was to agree to cooperate with the state, “...to come to an agreement of redistribution of political and economic power” (Hanson and Teague 2005, p. 659; Tomson, 2005). As business leaders of the new, Putin era, the oligarchs were invited to “contribute” financially to Putin's party (United Russia), to stay away from politics, and play according to the new rules of the game. In this scenario, their shady “privatised” enterprises and acquired wealth would remain unchallenged.<sup>81</sup> However, should they refuse to play by these new

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<sup>80</sup> This belief is also shared by some scholars and researchers. Hesselbein (2010), for instance, argues that “no donor or military intervention can substitute for a state's own mobilisation of resources” (p.1).

<sup>81</sup> Some sources suggest that this cooperation, at this particular moment, was a turning point in the political economy realm of the Russian state. It contributed to the second transition; to the centralisation of the management of the economy. Some sources compared this transition to the ‘market authoritarianism’ of Pinochet-era Chile (Reddaway and Glinski, 2001).



rules, they would be primarily associated with their shady functions and origins, and links to organised crime.

The fallout from the deal prompted many tycoons to leave Russia and seek refuge abroad. It is a widespread belief that Khodorkovsky's<sup>82</sup> refusal to follow this agreement prompted the state's attack on Yukos.

Those who opted in, and many of the lesser ones who were not invited to the March meeting, started to build a new relationship with the new political vertical of power in Moscow. Inevitably, in the new type of cooperation, some businesses practices became shared, contacts and functions merged. With the new generation of political executives entering the stage in Moscow, new conflicts over assets and markets emerged, with many of them addressed by the old methods, but by the new people. Over time, the businesses and business functions of the initial oligarchs were absorbed into state structures, a process that was reinforced by a parallel development of the growth of big Russian state corporations, or Russian 'state capitalism', often referred to as Russia, Inc., or Gazprom state (Illarionov, 2006).

Two key processes defined the building of new hierarchies of power and governance across Russia. First, the windfall of buoyant oil revenues, and the internal re-formulation of the relationship between the state and the oligarchy, meant that the structure of the economy in the country was increasingly dominated by state-owned (either full or partially) corporations. By 2012, the Russian state controlled huge chunks of the country's largest and strategic companies, including TRanfekt, Sukhoi, Rosneft, Sberbank, United Energy Systems, Aerooflit, and Gazprom. In the process of statization of economic assets, the oligarchs of the 1990s were replaced by state bureaucrats or civil servants, many of them with background in the KGB and personal linkages to Putin himself (*The Economist*, 21 January 2012). Effectively, many of the networks previous run by the oligarchs, which included organized crime elements, were now absorbed into

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<sup>82</sup> Khodorkovsky accumulated considerable wealth in the mid 1990s through seizing control of a number of Siberian oil fields unified under the name Yukos, one of the major companies to emerge from the privatization of state assets during the 1990s, also known as a scheme "Loans for shares".

corporate structures controlled and used by the state. Second, at the political level, the new 'nativist' elite associated with the Putin reign has marginalised most of the more 'modernistic' business elite of the 1990s (Monaghan, 2012). This process facilitated a centralisation of power, in large part because regional governments, which enjoyed considerable autonomy under Yeltsin, have lost it under Vladimir Putin.

The most striking example of this process is probably the story of Rosneft, a state-owned Russian oil company which ended up owning the assets confiscated from Khodorsky's Yukos (as well as many other regional oil and gas companies). Rosneft's chief executive, Igor Sechin, is a close associate of Vladimir Putin. Throughout Putin's reign, Sechin has held important governmental posts, including those of Deputy Chief of Staff (1999-2004); Assistant to the President (2004-) and Deputy Prime Minister (2008-2012), whilst being the head of the largest Russian oil giant.

However, the emergence of the new *vertical*, as well as the new principles of the relationship between the state and business, proceeded against an economic and social background in which informal institutions and practices have retained their strong presence. As a result, as Richard Sawka argues, a *de facto* dual state has emerged in which the legal-normative system based on constitutional order is challenged by shadowy arbitrary arrangements, ... or 'the administrative regime', populated by various conflicting factions. The tension between the two is a defining feature of contemporary Russian politics (Sawka, 2011).

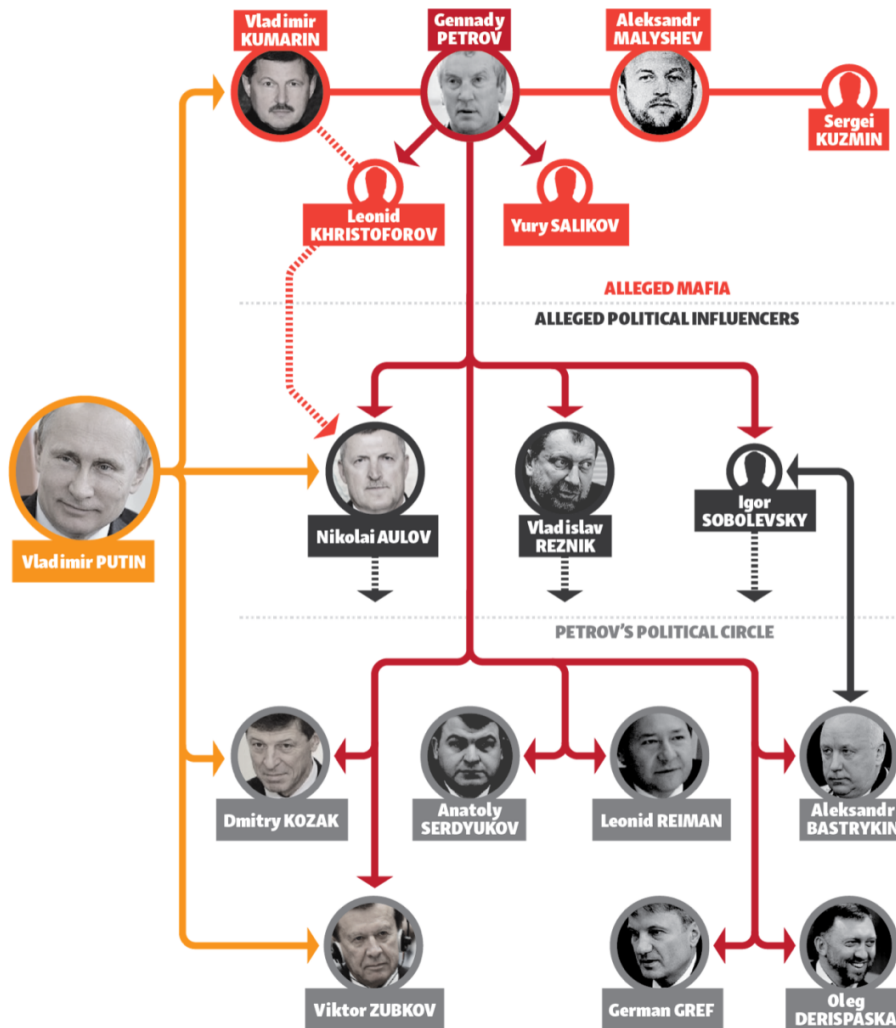
As Ledeneva explains, new rules of the game were agreed, known as 'sistema' (or system of governance). Sistema is an open secret that represents shared, yet not articulated, perceptions of power and the system of government in Russia. It stands for the workings of power networks and methods of informal governance applied by political elites, intertwined with the existing formal institutional structures (Ledeneva, 2012). Most commonly, *sistema* refers to the clash between official policies and unofficial influence, include the role of organised crime.

Irrespective of the motives that drove the new restructuring of the Russian state political and economic order into a vertical system during the 2000s, this had a direct impact on the hitherto horizontal nature of Russian organised crime networks. The newly formed vertical control system reorganised relationships between organized criminals, and absorbed them into state institutions which were in turn subordinated to the pinnacles of political power, thereby ‘statising’ Russian organized crime. The investigation, published by the Spanish Ministry of Justice (Fig.7.2.1) reconfirms this observation.

Figure 7.2.1 Vertical control system

# HOW THE MAFIA AND POLITICS MERGE IN RUSSIA

A Spanish judge's request for the arrest of reputed Russian organized-crime figures has cast a spotlight on alleged underworld ties among senior allies of President Vladimir Putin. A document that is part of the case built in Spain sketches a web of suspected connections.



By Carlos Coelho

Source: Spanish Ministry of Justice Available at: <https://www.rferl.org/a/how-the-mafia-and-politics-merge-in-russia/27719894.html>

*Vladimir Kumarin.* Alleged Tambov gang co-founder. Former VP of main St. Petersburg gasoline supplier, once known as the ‘Night Governor’ due to his political influence.

*Gennady Petrov.* Alleged leader of the Tambov organized-crime group. Former co-owner of Bank Rossia with Putin’s friends, including Yury Kovalchuk and Nikolai Shamalov.

*Aleksandr Malyshev.* Founder of the Malyshev gang, a rival which fought against Tambov for supremacy in St. Petersburg. Later joined forces with Tambov, moved to Spain.

*Sergey Kuzmin.* Alleged high-level member of Tambov group, longtime associate of Gennady Petrov and Aleksandr Malyshev.

*Leonid Khristoforov.* Allegedly a leading Tambov gang figure. Close personal and business relationship with Petrov, in contact with Aleksandr Malyshev and Vladimir Kumarin.

*Yury Salikov.* Alleged key Tambov gang member, business partner of Petrov and Kuzmin. Had residential address directly opposite Petrov’s in the Balearic Islands.

*Nikolai Aulov.* Deputy Director of the Federal Drug Control Service. Spanish investigation alleges he used his power to protect and serve Petrov and the Tambov gang.

*Vladislav Reznik.* State Duma lawmaker from United Russia Party, Deputy Head of Financial Markets Committee. Allegedly has close business and personal ties to Petrov.

*Igor Sobolevsky.* Former Deputy Head of Russia's Investigative Committee. Allegedly reported to Petrov on operations by security forces against crime groups.

*Dmitry Kozak.* Russian Deputy Prime Minister. Spanish document cites 2007 call in which Petrov voiced satisfaction when Kozak was named Regional Development Minister.

*Anatoly Serdyukov.* Former Russian defense minister, son-in-law of Viktor Zubkov. Spanish document alleges he has business ties to Petrov.

*Leonid Reiman*. Former Russian minister of communications and IT. Spanish document alleges he was a business associate of Petrov and employed Sobolevsky's daughter.

*Aleksandr Bastrykin*. Head of the Russian Investigative Committee. Said to be called 'Sasha' by Petrov and to have thanked Petrov when he was appointed by Putin in 2007.

*Viktor Zubkov*. Russian Prime Minister 2007-2008, first Deputy PM 2008-2012. Spanish document alleges he made political decisions that aided Petrov and his group.

*German Gref*. CEO of main Russian state bank Sberbank since 2007, former Minister of Economic Development and Trade. Referenced in the Spanish papers as a contact of Petrov's.

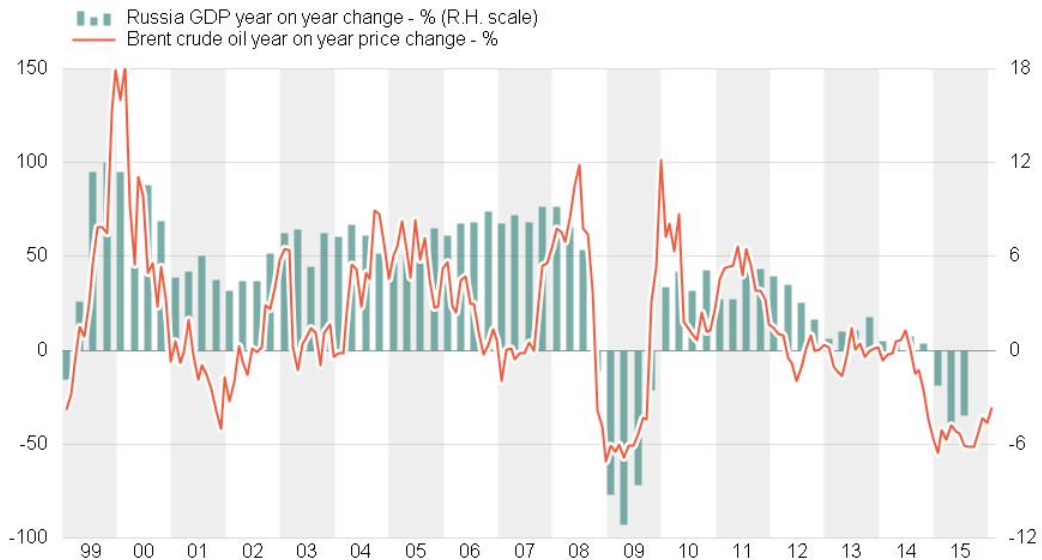
*Oleg Derispaska*. Tycoon who controls Russian aluminum giant Rusal. Referenced in the Spanish papers as a contact of Petrov's.

Why would Putin pursue this path? The answer is essentially political-economic in nature. Politically, according to Ray Silvius, Putin's engagement with the oligarchs constituted a vital measure to re-assert the Kremlin's power. This was one of the many important aspects of his first term in power, when his strategy was designed to consolidate the Russian state (Silvius, 2015). However, there were also important structural economic reasons as well.

After experiencing a severe economic crisis, including a default on its debt in August 1998, the Russian economy, helped by high oil prices, embarked on a period of growth from about 2001/02 (Figure 7.2.2). Putin presided over the (unprecedented by Russian standards) socio-economic recovery, with annual GDP growth rates of about 6.6% during his first two terms in office (Hanson and Teague, 2005, p. 663). The oil-fuelled growth was also paralleled by the progressive articulation of a new Russian foreign policy, and a vision of the country in the world order, which understands multilateralism as a retreat from US-centric approaches to global governance (Silvius, 2014).

Figure 7.2.2

### Russian GDP and Brent crude oil price



Source: Thomson Reuters Datastream, data to 28/01/2016

Vincent Flasseur | @ReutersGraphics

Putin's Russia therefore, did not need to rely on business functions and networks of organised crime to resolve the problems of the official economy. Unlike in the USSR, where the market did not function, but distributive problems needed to be resolved, in post-Soviet Russia, the state no longer depends on organised crime for its governance function, as the market is now the official economic system in the country, and its institutions are part of the official state policy. This transformation in the historical reliance of the state on the governance methods of the criminal underworld explains the transformation of Russian organised crime from a horizontal network of shadow economy and illegal groups (1921-1985) to a hierarchal network of state-centred power structures (2000- ), where the major business functions of the organised crime networks were absorbed into the state *vertikal* of corporate and political power. However, despite this significant transformation in the state-organised crime relationship, informal institutions continue to play a central role in the Russian political economy to this date.

## CONCLUSION

Having critically engaged with major social science approaches to the phenomenon of organised crime, this thesis has sought to develop a political-economic critique of organised crime in Russia, and specifically, inquire into its relationship with the state in the USSR and post-1991 Russia.

My research shows that, regardless of the historical or political context, organised crime is never easily identified; nor is it a clearly discernible empirical entity. This is largely because a broad range of people, structures and events can be considered to enable organised criminality, albeit in different ways and with different impacts. Organised crime is best understood as an umbrella concept which covers a broad range of phenomena, and there is no agreement on what its 'essence' or 'nature' might be. Due to its in-built complexity, the term 'organised crime' has taken on an existence of its own, quite independent from the social reality it supposedly relates to.

This thesis has argued that the fragmented and often contradictory literature on organised crime not only hinders any appreciation of its nature, but also hampers the selection of the appropriate conceptual framework for its effective analysis. The American academic community follows an actor-centred approach to organised crime, and portrays it in terms of its key actors – the organisers - who, in turn, can be distinct forces or separate groups, or in terms of distinct types of criminal groups and criminal activities. In general, this vertical approach suggests that organised crime is a mafia-type organisation. European scholarship has maintained a hierarchical approach, which prioritises the dynamics of the interrelationships within organised crime and their organisational context. They focus on organisers of crimes and the context of their operations: their collaborations and collusion with structures of power; communication and social support. However, what unites these two polarised communities is their ahistorical, homogenising approach to theorising organised crime.



It manifests in the apparent lack of interest in using historical research to substantiate or moderate their understanding of organised crime. This is particularly evident in the existing IPE scholarship on organised crime, which is remarkable for its neglect of historical trends in state-organised crime relations as a contributory factor to organised crime's growth. Important changes, such as new political or structural reforms, changes to formal and informal institutions, the creation and severity of institutional vacuums, structural problems within capitalism and the effects of globalisation, are clearly instrumental in explaining the phenomena, yet prioritising them in the still developing IPE literature on organised crime has come at the expense of a more nuanced and historical analysis of organised crime, as a social phenomenon, and an important, albeit informal, political-economic institution.

Both parts of this thesis have argued that the history of crime and the history of capitalism are inextricably linked. This interrelationship suggests that organised crime is not a transitory phenomenon, but an immanent feature of any capitalist system, both legal and illegal. From this perspective, capitalism is an institutional, social and economic structure which provides ample opportunities for the development of criminal behaviour within the different economic classes. Periods of transition from one form of capitalism to another only exacerbate the incidence and extent of this criminal behaviour, and render it more apparent. This conception of capitalism and its impact on organised crime has been informed by the history of American capitalism, which demonstrated how the de facto unregulated nature of the competitive capitalist system gave rise to an exploitative economic elite (the 'robber barons'), who facilitated the imbrication of businesses and the state, and presided over tremendous inequalities.

Those conditions led to relatively pervasive criminal behaviour. The development of the formal political and economic institutions in the USA was hampered by rampant corruption, institutional inefficiency and social injustice, all of which were of primary benefit to the members of the colonial elite during the colonial era (1600-1790) and the post-independence slave economy (1790-1865). Corruption, inefficiency and injustice all helped to preserve and solidify the structure of class inequalities upon which capitalists depended. The 'gilded age' of capitalism at the end of the 19th century and

the beginning of the 20th, during which inequality soared to unprecedented levels, witnessed stark institutional and social failings, which eventually contributed to an increase in crime. This trend was particularly prevalent in the newly formed ghettos which housed various ethnic minorities, recent arrivals to the United States, and ‘ghetto crime’, in the form of organised crime, was therefore a response to the economic opportunities that were available to these new and disadvantaged groups. Thus ‘ghetto crime’ was the origin of the Italian, Black and Jewish mafia.

European historians have also demonstrated that the roots of organised crime can be traced to the exigencies associated with the disintegration of feudalism, with bourgeois revolutions and with state reformation, and also with the subsequent evolution of capitalism. Piracy and banditry are early instances of flourishing underworlds within Europe, as was the development of the Sicilian mafia, which emerged as a product of entrenched class differences, and the particular political and economic structure of the Sicilian state.

But despite these insights, the academic study of organised crime remains an preoccupation of the 20<sup>th</sup> century, often examined in the disciplinary silos of sociology, criminology, and related sub-fields. The corollary of such divisions has been the trend towards an emphasis on the contemporary facets of organised crime, especially those associated with, and enabled by, globalisation. In the study of IPE, for instance, there is a consensus that organised crime is intimately related to processes and institutions of governance. Yet the generally a-historical approach to the study of organised crime as an informal institution often leads to a narrow or deficient understanding, of the relationship between organised crime and the state on the one hand, and organised crime and business on the other.

This general disregard of the close historical relationship between the state and organised crime has been replicated in approaches to the phenomenon of Russian organised crime. The predominant view of organised crime in Post-Soviet Russia suggests that it evolved as a response to the turbulent years during the transition from socialism to capitalism. As the disintegration of the USSR in the early 1990s resulted in great political and economic turmoil, this has naturally attracted the attention of the

majority of IPE scholars. It is therefore not surprising that the mainstream accounts of contributory factors to the emergence and development of organised crime focus on social injustice, new criminal opportunities, ineffective regulatory policies, the disregard of laws and regulations and transitions from autocracy to democratic regimes. Some accounts also recognize the role played by general political and economic instability, and by internationalisation and globalisation, as a means to explain the existence of collaborative networks between state agents and criminal organisations in some states. All these accounts can be understood as part of a generic theory of institutional vacuum, or institutional failure, and purport to demonstrate that organised crime typically appears because the institutional conditions are unable to prevent it.

However there is a theoretical need to understand the role of organised crime as not only an organisation in a strict legal sense, but as an institutional legacy, an institutional feature of a particular context, or a coordinated response to a variety of structural and institutional deficiencies. It does have many important characteristics on which all scholars agree, but it differs according to the socio-economic and historical context in which it evolves. Organised crime tends to play an important role as a socio-economic institution, particularly in times of transition from autocracy to democratic regimes. During such transition times, the problems associated with social disparities, new and unregulated economic opportunities, ineffective regulatory policies and the disregard of laws and regulations tend to be magnified. Most accounts of organised crime in Russia follow this pattern of thinking. During the economic transition of the 1990s, it is argued, radical reforms broke down the society's previous organisational framework, thereby creating social disorder and chaos, while the weak state regulatory system was unable to provide any social, economic and political stability. This created an institutional vacuum in which criminal organizations emerged. They seized the opportunity afforded by the weak and failing institutional system to cement their power and authority, and to fill the vacuum left by the state.

This thesis has challenged these accounts. The problem with these dominant conceptions of Russian organised crime is that, whilst they offer a diversity of factors that played a contributory role in the emergence of organised crime, focusing in

particular on the role of the disorderly transition from a state-controlled to a free market economy, they do not provide a full account of the emergence and development of organised crime in Russia and its role in the Russian political economy today. This is largely because they neglect the historical context which would enable them to trace the development of Russian organised crime throughout the twentieth century. Effectively, the ability of mainstream thinkers of Russian organised crime to understand the long-term socio-economic and political roots of organised crime in Russia is hindered by viewing Russian organised crime through the prism of concepts developed as a response to American organised crime.

This thesis has suggested that Russian organised crime is a much more complicated phenomenon than a clearly delineated criminal group or criminal organisation; it is embedded in the broad complex of historical experiences. Disregarding this historical aspect has created gaps in the IPE literature on Russian organised crime, which appears to be skewed towards the American understanding of the firm borders between legality and illegality, and the state and the criminal underworld. As a result of this bias, the literature on Russian organised crime overlooks the lineage of the state-organised crime relationship. I have demonstrated how unlawful means and activities such as embezzlement and corruption are not novel phenomena within the Russian system. On the contrary, they have always been an integral part of the political and economic structure. I also argued that institutional deficiencies and power vacuums offer only a partial explanation for the growth of organised crime in Russia and its role in the country's political economy. The problem of organised crime cannot be solved purely through the reform of the state, and that the origins of Russian organised crime lie beyond the extent and range of the institutional vacuums, the structural problems of capitalism and globalisation. Instead, I have argued that Russian organised crime is not a contemporary phenomenon at all, but a long-standing feature of the Soviet political economy, and thus, long preceded the anarchic 1990s.

Drawing on the long history of organised crime in the USSR and Russia, this thesis has demonstrated that organised crime in Russia did receive a boost to its scale of operate and scope of activities as a result of the radical political-economic restructuring

of the late 1980s and the 1990s, and the institutional deficiencies of that period. However, under closer examination, these have existed throughout Russia's history. The specific context of the state-organised crime nexus in Russia has been determined by the type of economic context and economic reforms during various periods of history. Organised crime has always maintained tight links with the state in Russia, and often fulfilled many useful functions on the part of the state. The rise of organised crime in the 1990s therefore, was just a manifestation of a much longer trend, and can be traced back to the 1920s, a seminal decade that witnessed great political and economic changes in the young Soviet state, which provided a platform for the emergence of Russian organised crime.

Russian organised crime is highly adaptable; during periods of centralised control it takes the form of illegal trade and illegal production, whilst under capitalism it mutates into the appropriation and theft of state assets. This capacity of organised crime to continually reinvent itself has ensured the enduring nature of the interdependence of organised crime and the Russian state, from the provision of 'emergency economic aid' in the era of War Communism (in the form of NEP) and Industrialisation, and the 'outsourcing' of the stagnation period, to the 'legalisation and institutionalisation' during the era of perestroika, and 'statization' after 2000.

This thesis has also challenged the vertical approach which conceptualises Russian organised crime as a readily identifiable clear-cut group, such as a form of Mafia. Whilst the vertical approach focuses solely on the dynamic *within* a definitive group or organisation, it ignores the contribution of external structures to the shaping and defining of organised crime. Therefore, the concept of Russian organised crime has greater affinity with the horizontal approach, which incorporates an analysis of the contribution of external structural factors, including significant historical change. Deploying a historically based approach in the analysis of organised crime enables a more comprehensive understanding of the nature of the relationship between the Russian state and organised crime. This reveals that during severe economic crises involving scarcity and economic disruption, the Soviet (Russian) state was dependent on the resources, functions and networks of organised crime and its facilities, whereas

periods of stagnation and prosperity changed the balance of power, and rendered organised crime more dependent on the state.

Specifically, organised crime was established as a network in the era of War Communism and the NEP, during which organised crime emerged out of the economic chaos, inequality, and political upheaval of the severely disrupted nation. The political and economic events that took place in this period, and their consequences, provided a fertile ground for the emergence of the black market, which was operated by an illegal network of state officials, illegal entrepreneurs and criminals. More elaborately, it produced a mechanism of illegal cooperation between the state and private entrepreneurs. This mechanism relied on the changeable nature of the regulatory framework, which was a product of the shift in political and economic strategy, and on the appropriation of state assets, that was enabled by the hasty introduction of new economic regulatory policies in the context of a weak administrative system. The effective administration of the state was handicapped by uneducated and unexperienced officials, whose direct access to state assets made them an easy target for rapidly organising criminal elements. These were able to ingratiate themselves by providing industrial goods to the state, and extremely scarce consumer goods to citizens. Thus, criminal networks were able to easily and quickly integrate themselves into Soviet society. The dependence of the Russian state on the illegal economy was clear, as during the period of economic collapse the Russian state had no choice, but to turn to the black market, in order to preserve its power, even legalising private trade in order to utilise elements of a market economy. As the black market system grew, this network grew with it and eventually became "the lubricant that made the inefficient Soviet economy run"<sup>83</sup>.

The reach and power of this organised crime network was further strengthened during the period of economic stability, in the 1970s and early 1980s. In this case, the enormous corruption of the political elite in the Brezhnev regime "sponsored" their illegal

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<sup>83</sup> Handelman, "Why Capitalism," p. 40

activities. During this era, the heavy reliance of the Soviet economic system on a thriving shadow economy further enabled and strengthened the illegal collusion between the elite of the government and illegal business. These two groups collaborated with criminals to make outrageous speculative profits, by taking advantage of their power, and the inefficiencies of the planned system. This in turn, further boosted the shadow economy, at that time operated by the newly restructured nexus of organised crime (characterised as state officials – private entrepreneurs – criminals), with each element able to contribute according to its specialist skills.

The implementation of the policies of *Glasnost* and *Perestroika*, which were designed to facilitate the social and economic restructuring of the Soviet Union, coupled with a paucity of controlling mechanisms, allowed a fundamental shift in the nature, character and favoured activities of Russian organised crime. In particular, it became considerably more aggressive. The implications of this shift were numerous, and overwhelmingly malign. First, it intensified the already widespread looting and embezzlement of state resources. Second, it led to a greater political and economic instability, which in turn encouraged the development of new criminal elites, as new building blocks in the nexus of organised crime. Third, it undermined state authority, as the weakening of the central government authority left organised crime in a position to become the dominant force in the country, and it effectively shaped the business environment to suit its own needs.

As organised crime continued to fill the power vacuum left by the Soviet government, it began to create structures that cemented its control of the economy. This symbiotic phase was characterised by the legitimising and legalising of illegal cooperation, and the redistribution of criminally-acquired assets among the newly legitimised economic and political elite. It also produced a qualitative change in the mechanisms of interaction between the Russian state and organised crime, as it furthered the financial empowerment of the network of corrupt state officials, criminals and the new economic elite. The success of an entrepreneur's business career came to be dependent on the ability to bribe government officials, and state industrial managers, and on forging amicable relationships with criminals. By the late 1990s, there had been a considerable shift in the balance of economic and political power towards the organised crime network, and subsequently to the merging of the interests of the state apparatus with the

interests of organised crime. This network not only retained its horizontal structure, but also widened it: thus, organised crime played an important role in financing the election of political leaders and in enabling the rise of the oligarchs; both were subsequently dependent on organised crime in order to retain power. In exchange for funding, organised crime elements were permitted to take control of important segments of the economy. The government had effectively been supplanted by oligarchic groups with tight links with criminal gangs, and the state was therefore essentially criminalised.

The political changes of the early 2000s introduced a new political and economic system that was sensitive to political interference from ambitious oligarchs. The new regime was determined to undermine the oligarchs' privileged access to the corridors of power, and ability to hold the state hostage whenever the regime needed financial or other support. Consequently, the whole nexus of organised crime has been weakened. The new political and economic system significantly restructured the mechanisms of interaction between the state and organised crime, so that the state has been able to assert its authority over the oligarchs. The new leadership under Vladimir Putin particularly targeted those who had flaunted their proximity to power in the most provocative manner, and flagrantly exploited various tax minimisation schemes. The government was determined to set out some new rules for the political game, and in attacking a handful of oligarchs became able to discipline the rest. There was an implicit threat: either comply with the government's ground rules, or forfeit any assets 'gained' in the 1990s. Those who refused faced persecution and criminal investigations. The government did not break the link between the acquisition of wealth and criminal activity, but it took it over, thereby restructuring organised crime into a new hierarchical formula. By default, organised crime became a part of the state, with the government at the top of this hierarchy. In other words, the statisation of organised crime was cemented.

The major conclusion following from this thesis is that the role of Russian organised crime in the political economy of the Russian state has been instrumental throughout Russian history. Organised crime served as a safety valve for the legal economy, and thus its relationship with the state has often been characterised by collusion and mutual



commitment. The Russian state has used organised crime in times of political and economic chaos, to revitalise its destroyed economy in the aftermath of disruptive and misfiring politically-motivated reforms, and during times of relative political and economic stability, in order to supplement the formal economy.

### **What are the limitations of the research?**

Researching this topic has been somewhat difficult since accurate information on the nature and activities of organised crime is not readily available. Moreover, the information that is available, especially that of a statistical nature from the Soviet period, is not very reliable. Reasons for this are numerous. First, all those involved in criminal activities naturally maintain a high level of secrecy, a secrecy that is often enforced by the threat of violence. Second, changes in legislation often falsify the image of organised crime by altering the definition of what constitutes criminal activity. Third, the various anti-corruption and anti-crime campaigns have had different degrees of diligence, meaning that any statistics that result are largely incommensurate. Furthermore, with regard to the quality of statistics, the inconsistent reporting methods used in the USSR resulted in data that varies greatly depending on the source. There was also a tendency to understate actual activity, given the propaganda value of distorted figures. Fourth, forecasting the number of unreported criminal activities is much more difficult in Russia than in West countries, because the post-Soviet period which was characterised by considerable degrees of crime and corruption lasted for only a few years, and because the political and economic situation in Russia has undergone rapid changes. Lastly, public charges concerning corruption and criminal activities have long played a part in the politics of confrontation. Accordingly, reports on corruption and criminal activities can often better be understood as an indication of power struggles between Russia's political and economic elites rather than a sound and reliable analysis.

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