

Business under supervision – pathologies serving the system of power in Russia

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The relations between Russia's authorities and business circles are subordinated not so much to rational economic calculations as to the interests of political elites. The key interest in this case is maintaining the current model of government. The formal and informal supervision of business by law enforcement agencies is an important element of Russia's economic reality. Despite the rhetoric of high-ranking officials, intended to suggest that the state is taking care of businesspeople's interests, it is evident that there is no will to devise a systemic solution to the most urgent problems, including the state institutions' disrespect for the rights of ownership.

This policy has not substantially changed since the outbreak of the economic crisis in 2014. It should be expected that repressive measures will continue to be applied towards businesspeople, while at the same time attempts at neutralising business circles' dissatisfaction will be made by establishing sham channels of communication with the authorities. In order to appease business groups, a working group on the dialogue between business and the authorities was established at the initiative of President Vladimir Putin in February 2016. This step is unlikely to improve the situation of entrepreneurs; moreover, it can be viewed as another example of the dysfunction of the Russian model of governance, of the ever-present 'manual control', and of the authorities' lack of interest in taking effective measures to actually improve conditions for doing business.

The place of business in the Russian state model

In Russia, the relationship between the authorities and business circles is one element of a general model of relations between the authorities and society. This model involves the absolute primacy of interests of political and bureaucratic elites at federal and local level over the interests and rights of citizens. A complex apparatus of control and repression, based mainly on prosecution bodies and the institutions of the judiciary, guarantees that these interests can be successfully pursued.

The Kremlin's policy towards business (as pursued since 2003, and symbolised by the Yukos case, which involved depriving Mikhail Khodorkovsky of his assets in revenge for his political ambitions) has involved, on the one hand, treating private property as a relative concept, and on the other, complicating the regulations governing the activity of businesses in such a way that the state administration bodies effectively curb their economic freedom by organising monitoring and supervision. The declared goal in this case is to increase the state's revenues and track down illegal activities. Economic success is possible only when it

is approved by the state's bodies. One example is the complicated system of licences which administrative bodies issue for conducting economic activity: 19 federal institutions have been authorised to issue licences for specific types of economic activity, and the lengthy process of issuing licences is often a source of corruption¹.

The repressive and non-transparent law is accompanied by its arbitrary application, systemic corruption and a lack of court independence.

Contrary to the rhetoric of top officials, which is intended to suggest that the state takes care of the interests of entrepreneurs, recognizes their role in the economy and is ready to create a business-friendly climate², statistics indicate that there is no will to devise a systemic solution to the most urgent problems. The most severe problems include disrespect for the right to own private property³, abuse of criminal law provisions in investigations focusing on businesspeople, arbitrary actions by con-

trol and prosecution bodies, as well as the partiality of courts which frequently manipulate the course of the proceedings, as a consequence of which businesspeople increasingly often lose cases brought against them by the authorities⁴. The practice of resolving civil law disputes using criminal law provisions is widespread, for example in cases involving fraud⁵. Using arrest as a preventive measure is also common. Between 2012 and mid-2015 the number of individuals on remand charged with economic crimes rose from 3840 to 6183⁶; and the number of criminal cases opened on the basis of economic crime charges rose by 22% in 2015, which is explained by a simplification of the procedures to initiate such cases⁷. The proportion of acquittals in cases involving economic crimes remains extremely low (below 1%), and at the same time very few businesspeople are subject to amnesty⁸. Over 70% of entrepreneurs claim that the level of risk associated with doing business has risen over the last three years (i.e. during President Vladimir Putin's third term)⁹.

Representatives of business circles also point to deteriorating conditions for doing business, caused by frequent amendments to tax laws, the actions of supervisory bodies which interpret legal provisions arbitrarily, increased reporting obligations, and discrimination during public tenders against specific companies¹⁰.

¹ These include the Federal Security Service, the Ministry of the Interior (and its departments for migration service and combating drug trafficking), the Ministry of Emergency Situations, the Federal Service for Technical and Export Control, the Federal Tax Service, the Federal Veterinary and Phytosanitary Supervision Service, the Federal Service for Healthcare Supervision and similar supervision services focusing on other spheres of life, as well as the Ministry of Culture.

² For example, this rhetoric has been used by President Vladimir Putin. He devoted a large portion of his annual address to the nation in December 2015 to the situation of business (see <http://kremlin.ru/events/president/news/50864>, 3 December 2015).

³ The demolition of shopping and service facilities in Moscow on the night of 8/9 February 2016 received much attention. The reason for their destruction was that allegedly they had been built without permission. In all, 97 facilities were demolished with no previous attempts at clarifying the situation. This was done despite the fact that owners of at least half of the shops held complete documentation confirming that the structures had been legally built and that the ownership rights had been formally recognised by the relevant courts. The incident happened two months after the President's public appeal to respect the rights of entrepreneurs; <http://www.rbc.ru/rbcfreenews/56cd690e9a794783fc5559be>, 24 February 2016.

⁴ <http://www.rbc.ru/politics/20/10/2015/5624fe6d-9a794775dd228787>, 20 October 2015.

⁵ See the letter from Boris Titov, the ombudsman for entrepreneurs' rights, to Andrei Belousov, the President's adviser: ombudsmanbiz.ru/wp-content/uploads/2015/09/Белуосову.pdf, 15 September 2015.

⁶ Figures compiled by the Supreme Court of the Russian Federation; <http://www.rbc.ru/economics/16/02/2016/56c356f-f9a794756f30a2aba>, 16 February 2016.

⁷ <http://www.oilru.com/news/507574/>, 23 March 2016

⁸ <http://xakas.info/news/46354>; http://www.dp.ru/a/2015/04/24/Amnistija_ne_zahvativaet_p/, 24 April 2015; <http://www.novayagazeta.ru/politics/70380.html>, 19 October 2015.

⁹ A 2016 PwC survey conducted among executives of the biggest businesses; see <http://www.kommersant.ru/doc/2902156>, 28 January 2016

¹⁰ Statements by representatives of business circles delivered at a meeting with Vladimir Putin during a meeting of the Chamber of Commerce and Industry on 1 March 2016, <http://kremlin.ru/events/president/news/51413>

The repressive and at the same time non-transparent nature of the law and its frequent amendments are accompanied by the arbitrary application of specific provisions by state insti-

The formal and informal supervision of business by institutions responsible for the state's internal security (so-called *siloviki*) is an important element of Russian economic reality.

tutions, widespread systemic corruption¹¹ and a lack of court independence. Corruption – which is present in all spheres of life, from big contracts awarded in public tenders, through education and health care, to everyday contacts between citizens and public servants – is causing immense losses for the state and for business (estimated at several hundred billion US dollars annually¹²). In the Corruption Perceptions Index published by Transparency International, Russia has repeatedly been ranked far outside the top one hundred states covered by the survey (in 2015 it was ranked 119th out of 168 states, which suggests slight progress compared with 2014, when it was ranked 136th out of 175 states). Russia's courts, for their part, are not so much a separate power as a tool used by prosecution bodies and civil offices, including the Kremlin, to crush political and business opponents¹³. All this creates a situation of permanent uncertainty in relations between entrepreneurs

and the state, makes these relations feel like a 'game with no rules', and evokes fear of unjustified repressions.

The small- and medium-sized enterprise sector, which generates approximately 21% of Russia's GDP and is dominated by individual entrepreneurs, is particularly defenceless against the state apparatus¹⁴. In the case of big businesses (such as raw material companies, large private banks and the biggest trade and service companies), their relations with the state administration are mainly based on private contacts with political decision-makers and on individual channels of communication¹⁵.

The special role of law enforcement agencies in relations between the state and business

Formal and informal supervision of business by the law enforcement agencies responsible for the state's internal security (the so-called *siloviki*) is an important element of Russian economic reality. These agencies are commonly used by the authorities as a tool to exert control over society. In the context of the state's relations with entrepreneurs they perform additional, non-political tasks which involve ensuring a permanent supply of 'corruption income', illegal profits from extortion and protection money obtained by representatives of inspection bodies, prosecution bodies and institutions of the judiciary, as well as public servants at all levels. Inquiries and investigations carried out against various categories of entrepreneurs are frequently used as a pretext for legalising 'hostile takeovers' by companies sponsored by state institutions. Out

¹¹ <http://www.transparency.org/cpi2015#results-table>

¹² <http://vz.ru/economy/2009/11/17/349632.html>, 17 November 2009; <http://pasm.ru/archive/127691>, 25 August 2015.

¹³ The most-publicised cases of politicisation of courts include the 2003 Yukos case, the sentences for the participants in anti-Putin rallies on Bolotnaya Square in May 2012 and the trial of Nadiya Savchenko (September 2015 – March 2016). The mechanisms by which the Kremlin puts pressure on courts were exposed for the first time in 2008 by one of the top officials of the judiciary; <http://www.kommersant.ru/doc/891082>, 13 May 2008.

¹⁴ <http://www.vedomosti.ru/economics/articles/2015/09/24/609990-obyazatelnih-postavschikov>, 24 September 2015.

¹⁵ Businessmen who have been associated with Vladimir Putin for years, and who have direct access to him, are in the most favourable situation. These include Igor Sechin, Yuri Kovalchuk, Gennady Timchenko and the brothers Arkady and Boris Rotenberg. They have enjoyed wide support from the Russian state, in particular since 2014, when they were covered by Western sanctions.

of 200,000 investigations launched against entrepreneurs in 2014, only 46,000 were brought to the courts (which suggests that most investigations were launched without sufficient evidence), although 83% entrepreneurs lost their companies as a result of investigators' actions¹⁶. This prompts a conclusion that the prosecution bodies' real goal was to take over the companies' assets¹⁷. Frequently, individuals commit the alleged offences because they were prompted by provocative actions taken by public servants¹⁸. Equally important is the process of formally expanding the competences of law enforcement structures in the economic sphere, as evidenced for example by the act of granting prosecution bodies the right in 2014 to launch tax-related investigations without the participation of fiscal administration bodies.

In the situation of the economic crisis, competition for the division of resources is becoming ever tougher, resulting in an escalation of conflicts in the relations between entrepreneurs and state administration bodies.

Supervisory and repressive measures are frequently carried out in a selective and arbitrary manner which additionally complicates the situation for entrepreneurs. The competences of law enforcement agencies in the field of the supervision of business and combating economic

crime overlap; this means that conflicts arise which expose the informal relations operating within the economy. Moreover, criminal cases focusing on entrepreneurship are frequently the result of powerplays at the local level. The actions taken by regional authorities, including the lower structures of Federal Security Service (FSB) and the Ministry of the Interior, do not form a clear pattern at the national level.

The economic crisis: relaxing or tightening the rules of the game?

The operation of the above-mentioned mechanisms of relations between the authorities and business is becoming ever more complicated in the context of the economic crisis. The situation of business circles is deteriorating, in particular that of small- and medium-sized companies operating mainly in the trade and service sector, which have been the most affected by the crisis¹⁹. At the same time, spending cuts provoked by the recession have forced state administration bodies to increase their control and supervision activity, which is frequently unjustified, in order to justify the costs of their own existence. Entrepreneurs find it increasingly difficult to accept all the formal, legal financial burdens, not to mention the illegal levies (bribes, ransom money)²⁰. It is becoming increasingly difficult to obtain illegal income from businesspeople, and hence the dysfunction of the current model of coexistence between business circles and the authorities is growing. Compe-

¹⁶ Vladimir Putin mentioned this in his address to the National Assembly in December 2015, when he criticised the over-frequent use of arrest as a preventive measure in investigations; <http://kremlin.ru/events/president/news/50864>, 3 December 2015.

¹⁷ More than 60% of entrepreneurs complain that criminal investigations are commonly used as a means of taking over assets. See the letter by Boris Titov, ombudsman for entrepreneurs' rights to Andrei Belousov, the President's adviser, of 15 September 2015, ombudsmanbiz.ru/wp-content/uploads/2015/09/Белюсову.pdf

¹⁸ <http://www.rbc.ru/economics/11/12/2014/54884aac-cbb20f731c43a21c>, 11 December 2014.

¹⁹ <http://www.garant.ru/article/602378/#ixzz41xi7ghz3>, 21 January 2015. Decreased consumer demand caused a 10% drop in retail turnover in 2015 as compared with 2014, and the consumers' saving strategy has a negative impact on the service sector in particular.

²⁰ According to experts, the actual tax rate applicable to businesses in Russia, after summing up all tax and para-tax burdens, is 65–70%; http://www.survey-invest.com/nikolay_ostarkov__nalogovaya_nagruzka_na_biznes___70___/, 21 January 2014. Plans have been made to increase para-tax burdens in order to save the state's finances; <http://www.rbc.ru/economics/04/03/2016/56d9a5d29a7947b0897de24a>, 4 March 2016.

tion for the division of resources is becoming ever tougher, resulting in an escalation of conflicts in relations between entrepreneurs and state administration bodies. In this situation, entrepreneurs seem to be becoming ever more desperate in their appeals to the authorities. This is becoming more and more important in the context of upcoming elections (the parliamentary elections in September 2016 and the presidential election in March 2018).

Despite growing economic problems, no actions have so far been taken to actually reduce the supervisory and repressive measures performed by law enforcement structures on entrepreneurs.

Fearing that dissatisfaction in business circles may increase, the authorities cannot openly ignore the repeated complaints from entrepreneurs. However, to a large extent, gestures made towards them are purely formal concessions instead of systemic solutions to the problems. Examples of this include the Kremlin's initiative of establishing the 'Party of Growth', led by Boris Titov, the ombudsman for entrepreneurs' rights²¹, as well as the nature of most of the 'pro-business' amendments to the law adopted in 2014. These amendments were accompanied by the simultaneous tightening of certain regulations. Although small business was relieved from planned controls until the end of 2018, no limitations concerning *ad hoc* controls were introduced. Only around 15% of individual entrepreneurs are entitled to the three-year 'tax holiday', which in addition is de-

²¹ The party's platform is to refer to the idea of defence of entrepreneurs' rights, which most likely is intended to channel the potential of dissatisfaction within business circles as part of political activity supervised by the Kremlin. In particular, it is intended to block any attempts at forming an alliance of businesspeople and anti-Kremlin liberal movements.

pendent on the goodwill of regional authorities, who are directly interested in maximising the income to their local budgets. The presidential ban on tax increases until the end of 2018 only apply to taxes regulated in federal law. Non-tax burdens have been on the rise, and the amounts of numerous administrative fines have been increased²².

Despite the mounting economic problems, so far no actions have been taken which could serve as a warning sign to law enforcement agencies to substantially reduce their control and their repressive measures targeted at entrepreneurs. The competition for control over financial flows is becoming ever tougher, which results in the excessive activity of law enforcement agencies in their relations with business. It also encourages the Kremlin to take measures to centralise the 'management' of the relations between entrepreneurs and state security institutions. This is probably intended merely to organise the mechanisms of formal and informal control over business, instead of relaxing them, and to make them ever more dependent on the vertical model of state administration in the context of the economic crisis and upcoming elections. This is probably the role which the working group for dialogue between business and law enforcement agencies, established in mid-February 2016 by President Vladimir Putin, is intended to play.

Institutionalisation of the dialogue between business and the 'siloviki': breakthrough or shadow-boxing?

It is likely that the President took the *ad hoc* decision to form the above-mentioned working group (officially called a working group on monitoring and analysis of law enforcement practice in the field of entrepreneurship) in the

²² <http://www.garant.ru/article/602378/#ixzz41xi7ghz3>, 21 January 2015.

aftermath of his meeting with the head of one of Russia's organisations grouping businesspeople, and in reaction to the catalogue of problems then presented to Putin²³. Although the decision to form the group can be viewed as a gesture towards entrepreneurs (the group is led by Sergei Ivanov, the head of the President's Office, and the President himself presided over the group's first meeting on 23 March 2016), much suggests that this is intended to be a tool to discipline businesspeople rather than a real platform for dialogue and defence of their interests.

The official communiqué regarding the group's establishment states that the group's task would be to analyse legal provisions which, in the opinion of representatives of entrepreneurs, in effect hinder doing business. The group's composition is noteworthy: on the entrepreneurs' side the talks are to be conducted by four main organisations grouping businesspeople²⁴, while on the authorities' side the group includes representatives of the General Public Prosecutor's Office, the Investigative Committee, the Ministry of the Interior and the FSB (as well as Ivanov himself, who is associated with the law enforcement structures and has played the role of an informal coordinator of contacts between the law enforcement agencies and the Kremlin). The group does not include representatives of the parliament or the 'civil' ministries responsible for preparing laws; nor does it include representatives of the fiscal control bodies or the judiciary, who play a crucial role in shaping the relations between the state and business. The group's meetings are planned to take place at least quarterly, which can hardly be interpreted as a declaration of intensive work.

²³ On 15 February, a meeting took place between President Putin and Alexander Shokhin, president of the Russian Union of Industrialists and Entrepreneurs.

²⁴ The Russian Union of Industrialists and Entrepreneurs, the Chamber of Commerce and Industry, *Delovaya Rossiya* and *Opora Rossii*.

The group's first meeting in March 2016 was devoted to a general discussion of demands voiced by entrepreneurs regarding most of the desired amendments to the laws. The Kremlin was well acquainted with these demands, as they have been repeatedly presented, but have so far not been met²⁵. The initial result of this discussion was that in May 2016 the President submitted to the State Duma a package of two bills which partly satisfy the entrepreneurs' demands. This means that formally, some progress has been made compared with the current state of affairs²⁶. Regardless of the final wording and the scope of the amendments, the main problem, in the context of common practice observed in Russia so far, will involve the implementation of the amended provisions: they are likely to be resisted by both the prosecution bodies and the courts.

At the same time, the Kremlin refuses to discuss specific cases of the 'siloviki's' abuse of power towards business circles, thereby refusing to focus on the key problem involving the practice of interpreting and applying the law. This suggests that the ostensible appreciation of businesspeople as partners in the discussions with the authorities is intended to conceal the real nature of the group as another channel for discussing primarily technical

²⁵ Including limiting the period for which prosecution bodies are allowed to keep material evidence in investigations against entrepreneurs, allowing notaries public to work in prisons, introducing different categories of penal measures depending on the behaviour of the accused and the scale of offences, and reducing the scope of application of criminal law provisions in cases involving business fraud.

²⁶ The bills slightly expand the category of business offences in which no criminal investigation should be launched; propose less strict regulations regarding individuals who engage in business fraud for the first time; and meet the demand to allow notaries public to speak with businesspeople under arrest. At the same time, penal measures for economic crimes categorised as fraud were significantly stepped up. This will have a negative impact on entrepreneurs, for example because it is common for prosecution bodies to apply this category of crime. 26 May 2016, <http://www.rbc.ru/economics/26/05/2016/5746d8f09a79470115e2de52>; 27.05.2016, <http://www.kommersant.ru/doc/2997127>

issues (such as minor amendments to laws), rather than analysing the nature of specific systemic pathologies (arbitrary actions by specific services, cases of abuse, common infringement upon citizens' rights) which it is practically impossible to eliminate in the present Russian state model. At the same time, the

fact that this body was formed is clear proof of the dysfunction of the Russian state and of the current institutions established to defend entrepreneurs' rights (principally like the office of the ombudsman of entrepreneurs' rights). It is also proof that Vladimir Putin's 'manual control' of the state is strengthening.

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