

# **Small Entrepreneurs in the Russian North. A Question of Social Capital and Economic Security**

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## **Introduction**

In the 1990s large Russian cities and their metropolitan areas served as centres of political, economic and social modernisation, but other regional territories were lost in the peripheries.<sup>1</sup> Peripheral territories, being isolated from resource centres, still suffer from a number of negative circumstances. Regarding the Russian European North, we should consider the constant population decrease, low quality of human capital and economic dependence on natural resources. These factors negatively influence socioeconomic life within the North, and particularly, its small entrepreneurship.

This research was done in the Komi Republic, one of the Northern Barents regions,<sup>2</sup> which is famous for “Dutch disease”, or an overdependence on natural resources, since the 1990s. In the 1990s Komi received 63% of its export income through oil sales. This, James Alexander mentions, made

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<sup>1</sup> Vladimir Gel'man, “In Search of Local Autonomy: the Politics of Big Cities in Russia’s Transition”, *International Journal of Urban and Regional Research* 27, no. 1 (March 2003): 50.

<sup>2</sup> See the map of the Barents region at Appendix 1.

“Komi particularly vulnerable to the international markets”.<sup>3</sup> While economists argue about the threat to small firms’ well-being in economies with great reliance on its natural resources, nowadays the regional government proclaims the increase in natural resources extraction as the way to overcome the economic crisis.

Infrastructure difficulties and undeveloped transport connections also threaten the growth of entrepreneurship in the Komi Republic. Small and mid-size entrepreneurship is mostly concentrated in urban areas of the region (about 80%). Trade, retail and real estate are the most attractive sectors for small entrepreneurs in the Komi Republic.<sup>4</sup> The region is becoming depopulated: by 2000 the population was down to one million, and by 2013 was inhabited by less than 880 thousand persons. According to the Russian Federal State Statistics Service, by 2030 the Komi Republic will become one of the least populated regions in Russia, along with a few others in the North and in Siberia.<sup>5</sup>

The mentioned circumstances increase the vulnerability of small entrepreneurship and private property in the Russian Northern regions, while property rights generally used to be insecure in Russia since the 1990s.<sup>6</sup> While

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<sup>3</sup> James Alexander, “Komi and the Centre: Developing Federalism in an Era of Socioeconomic Crisis,” in *Unity or Separation. Centre-Periphery Relations in the Former Soviet Union*, ed. by Daniel Kepton and Terry Clark (Westport&Connecticut&London: PRAEGER, 2002), 66.

<sup>4</sup> Vladimir Abrashkin, “Komi Republic: Preventing the Paradox of Plenty through Effective Natural Resource Management”, thesis, (State University of New York, Empire State College, 2015).

<sup>5</sup> Indicators of population. Federal State Statistical Service. URL: [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/en/figures/population/](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/en/figures/population/)

<sup>6</sup> Vadim Volkov, *Violent Entrepreneurship. The Use of Force in the Making of Russian Capitalism* (New York: Cornell University Press, 2002); Stanislav Markus, *Property*,

the vast majority of the literature on private business in the former Soviet Union focuses on elites and large business, where sources of capital were often found through personal connections and corruption,<sup>7</sup> few scholars have argued about the importance of social networks for small and mid-size firms in dealing with unstable institutions and corrupt bureaucrats.<sup>8</sup>

In the specific northern region of Russia, I observed how small and mid-size entrepreneurs survive in a risky environment, how they use social capital and personal connections to state officials to develop their operations. Where social capital within a market is the focus, it could be regarded as a security factor. Entrepreneurship in developing economies is especially characterised by uncertainty, and a number of risks and threats produced by the state and private actors. From the human security perspective, which also includes economic security, social capital strengthens economic obligations and social expectations. As mentioned, if formal institutions are weak and state agents corrupt, market actors have to cope using different strategies for their security. My research focused on the implementation of social capital as carried out by

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*Predation and Protection: Piranha Capitalism in Russia and Ukraine* (Cambridge: Cambridge University Press, 2015).

<sup>7</sup> Oxana Green, *Entrepreneurship in Russia: Western Ideas in Russian Translation* (Gothenburg: University of Gothenburg, 2009); Alena Ledeneva, *How Russia Really Works. The Informal Practices That Shaped Post-Soviet Politics and Business* (New York: Cornell University Press, 2006).

<sup>8</sup> Anton Oleinik, *Market as a Weapon. The Socio-Economic Machinery of Dominance in Russia* (London&New York: Routledge, 2011); William Miller, Åse B. Grodeland, Tatyana Y. Koshechkina, A Culture Of Corruption? Coping with Government in Post-communist Europe (Budapest: CEU Press, 2001); Maria Sakaeva, "Businessmen in Legislative Regional Bodies: Status as Protection and Preference" [Bisnesmeny v regional' nih parlamentah: status kak zachita i preferencia], *Sociological Studies* 4 (2016): 142-146; Maria Sakaeva, "Parliament as a "Window of Opportunities": the Research of how Entrepreneurs with Deputy Status Achieve their Economic Interests" [Parlament kak okno vozmozhnostey: issledovanie povedeniya predprinimateley s deputatskim mandatom], *Economic Sociology* 13, no. 3 (2012): 96-122

specific entrepreneurs. I define them as specific because they occupy the positions of elected officials at regional and local legislations. Hence, they have an official political affiliation and a double identity – business and political. It should be mentioned, that political affiliation divides into official and shadow. Official political affiliation requires a political status - a position of elected officials, for instance.

The focus on persons requires attention to the concept of human security, defined quite broadly as the security of livelihood (food, energy, environmental needs and economic security). While in developing market economies, small and mid-size entrepreneurs provide for a great amount of the human needs of everyday life (food, clothing, services, etc.), the issue of business security lies within the broader agenda of human security. As phenomena emerging from and for the sake of social relations, social capital and human security appear to be neither only an individual, nor just a collective property, but both. In this paper I argue that the trust networks and personal connections to state agents<sup>9</sup> and politicians provide the specific entrepreneurs with opportunities to minimise or avoid risks for their firms and property, and hence to protect their ownership and business activities.

I will first provide a brief description of the institutional design of sub-national governance in Russia. I will then discuss theories that concern the institutional dimension of property rights and informality in business. Investigation of informality and trust networks requires first a description of the theories of social capital appropriated for my research topic, and then, an

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<sup>9</sup> I follow Stanislav Markus, who defines state agents as state authorities, bureaucrats, state employees. For more see: Stanislav Markus *Property, Predation*, 57-58, 89, 113.

account of my data collection and research methods. I present some of the resources and opportunities available to entrepreneurs with a “double identity” resulting from their special relations to state agencies and politicians. Finally, I observe how social capital works in the “shadow sphere”: generally, the different practices of informal entrepreneurial behaviour, and why and under what circumstances small and mid-size entrepreneurs with a double identity practice informal relations.

### **The Institutional Design of Sub-National Russian Governance**

In 2003 president Vladimir Putin fundamentally changed the design of sub-national governance – both at regional and local levels. Changes in the functioning of Russian regional government included the replacement of popular elections for regional governors (*gubernatory*) by appointments. The popular election of regional assemblies was not ended: members of legislative branches are still elected by the citizens of the Russian regions. The federal reforms also implemented the division of the Russian Federation into seven federal okrugs. Each okrug includes about 10 regions.<sup>10</sup>

The institutional framework of local governance was also seriously modified. With the 2003 municipal reform there are three main tiers of local government: settlements (*poseleniya*), municipal counties (*municipal'nyye rayony*) and urban districts (*gorodskiye okruga*). The second tier is the municipal county (MR) which covers larger territories and comprises groups

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<sup>10</sup> North-West Federal okrug includes the city of Saint-Petersburg and 10 regions, including all territories of the Russian Barents region: Komi Republic, Karelia Republic, Novgorod, Pskov, Vologda, Arkhangelsk, Kaliningrad, Murmansk and Leningrad regions, Nenets autonomous district (See Appendix 1).

of settlements. The third is the city district (*gorodskoy okrug, GO*).<sup>11</sup> City districts and municipal counties are governed by elected bodies, which in the case of cities are defined as “city soviets”. City soviets are not precisely legislative bodies, because they are not allowed to produce laws or other legislative initiatives.

Contrary to the restriction on the election of regional governors, the 2003 law provided the procedures for election and appointment of the chief executive figure at the municipal, county and city district levels. There are two executive officials – a mayor (the political face of the locality) and a head of administration (city manager).<sup>12</sup> City managers were elected by the members of city soviets from among themselves. Mayors continued to be popularly elected, as in the 1990s. However, in 2014 the Federal Parliament (State Duma) passed the next law limiting popular elections in Russia. Accordingly, the implementation of, or restriction on the popular election of mayors was left to the choice of regional governors. By 2015 all Russian regions had implemented the restriction on the popular election of mayors. Moreover, some regions had restricted mayors’ elections even before the decision of State Duma. Nowadays, a mayor and a city manager both are *de jure* elected (*de facto* appointed) by the members of the city soviets from among themselves.

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<sup>11</sup> Tomila Lankina, “Local Government”, in *Routledge Handbook of Russian Politics and Society*, ed. Graeme Gill, James Young (London&New York: Routledge, 2012), 165.

<sup>12</sup> Darrell Slider, “Governors versus Mayors: The Regional Dimension of Russian Local Government”, in *Local Government in Russia*, ed. Alfred B. Evans Jr., Vladimir Gel’man (Oxford: Rowman&Littlefield Publishers, 2004), 145-146.

Putin's reforms of government have undercut democracy and the powers of regional and local authorities. However, changes in institutional design have not decreased the movement of businesspeople to elected political bodies. Contrary to the restrictions on business activity for the members of Russian Federal Parliament, business activity is allowed for members of regional parliaments and city soviets, both for full-time and part-time members. The proportion of full-time lawmakers in Russian regions and local communities has decreased: since the beginning of the 2010s, regional and local governors have eliminated their portion. For example, in 2012 the regional parliament of the Komi Republic passed a law by which the number of full-time parliament members should be no less than 30%, contrary to the previous 50%. Not surprisingly, it caused the significant presence of businesspeople in Russian regional parliaments. As I will show below, in case of North-West federal okrug the average amount of parliament members elected from different businesses is about 50 %, with the highest proportion in Arkhangelsk region – 60 %, and the least amount in Nenets autonomous district – 36 % (see Appendix 2).

The highest portion of full-time members in city soviets have been fixed at 10% by the Russian federal law on local government. Full-time members are paid a fixed salary and required to be regularly involved in legislative activities and, most importantly, they have a higher level of responsibility. Cuts in the number of full-time parliament members means that the rest of the parliament or city soviet seats (that is, unpaid positions) can be occupied – primarily – by businesspeople.

## Theoretical Framework

According to economic theory, property rights are one of the basic economic institutions for reducing costs, risks and uncertainty. Armen Alchian and Harold Demsetz note that despite a strong property rights' agenda in the social sciences, many questions have still not been investigated. Particularly, the social conditions necessary for property rights to function, and their changes in time and space.<sup>13</sup> Neoclassical economic theory concerns the gap between ideal types of property rights and reality. According to new institutional theory, property rights play the most important role in business security and economic growth. My research is about relations between business owners and a range of different actors (state officials, market players and politicians), which is why property rights are understood as a field of interaction between economic and state representatives, between individuals, groups and other actors.<sup>14</sup>

Douglass North and Barry Weingast point to the main dilemma of the economic politics – protection and grabbing. The state is strong enough for both strategies.<sup>15</sup> A grabbing state is a serious danger for owners, when state agents (mainly bureaucrats) have the freedom to violate laws.<sup>16</sup> Stanislav Markus points out that the predominant state-centric concepts in the debate

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<sup>13</sup> Armen Alchian and Harold Demsetz, "The Property Right Paradigm," *The Journal of Economic History* 33, no 1 (March 1973): 18.

<sup>14</sup> Douglass C. North, "Institutions and Credible Commitment," *Journal of Institutional and Theoretical Economics (JITE)* 149, no. 1 (March 1993): 11-23.

<sup>15</sup> Douglass C. North, John J. Wallis, and Barry R. Weingast, *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History* (Cambridge: Cambridge University Press, 2009).

<sup>16</sup> Joel S Hellman, Geraint Jones and Daniel Kaufmann, "Seize the State, Seize the Day: State Capture and Influence in Transition Economies", *Journal of Comparative Economics* 31, no. 4 (December 2003): 754.

about property rights and private entrepreneurship in developing market economies underestimate bottom-up initiatives by the potential victims of property rights violations. He suggests paying more attention to local practices rather than to institutional design and central policy initiatives.<sup>17</sup> In my research on specific entrepreneurs, I take Markus' work as my point of departure, following his idea that bottom-up activities favouring business protection require more attention. I address the capability of small market players to decrease their vulnerability. They seek alternatives through formal political positions, that is, membership in legislative bodies. However, my research differs from Markus' design, because its focus on small market players instead of large firms, like the ones he investigated in Russia and Ukraine.

According to new institutional economists, property rights are shaped by institution-building. Douglass North defines institutions as the rules of the game, which limit the freedom of individual choice.<sup>18</sup> They focus on how institutions prevent individuals' illegal behaviour. New institutionalism proves the crucial role of the state in the protection of property rights. According to the theory, state intervention in the economy should be limited. As Thriann Eggertsson argues, within the property field a correspondence is required between social norms and formal rules.<sup>19</sup>

The idea of the dependency of market development on social relations is not new. In the 1970s, Mark Granovetter considered the importance of personal

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<sup>17</sup> Markus, *Property, Predation*, 44-45.

<sup>18</sup> North, *Institutions and Credible Commitment*, 12.

<sup>19</sup> Eggertsson, *Economic Behavior and Institutions*, 101-102.

trust and social relations for markets and private business.<sup>20</sup> He emphasised the productive influence of social connections on the market process. Social capital can be implemented productively within markets, social networks promote cooperation and solidarity for intra-firm and inter-firm relations.

In the 1990s, the euphoria towards the positive influence of social capital on society was disproved by studies of developing states and transition economies, including Latin America and the former Soviet Union. Supporting the idea that the lack of social trust weakens contracts and agreements, authors showed that social capital and personal trust can be fertile soil for corruption,<sup>21</sup> for shadow trade, drugs and weapons trafficking.<sup>22</sup> Contrary, Apostolis Papakostas in his book “Civilizing the Public Sphere: Distrust, Trust and Corruption” attacks not only the normative view of social capital and personal trust, but also challenges cultural studies of corruption and informality.<sup>23</sup>

Theories of social capital develop the sociocultural dimension within market studies that are closely connected with the property rights paradigm. Researchers of social capital used to overestimate its productive functions for society: information, communication, education, etc. They noted that social capital is highly useful in local communities, especially those which face a shortage of financial and other material resources, so that society should work

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<sup>20</sup> Mark Granovetter, “The Strength of Weak Ties”, *American Journal of Sociology* 78, no. 6 (May 1970): 1360-380.

<sup>21</sup> Susan Rose-Ackerman, *Corruption and Government: Causes, Consequences, and Reform* (New York: Cambridge University Press, 1999).

<sup>22</sup> Alejandro Portes, “Social Capital: Its Origins and Applications in Modern Sociology”, *Annual Review of Sociology*, no. 24 (1998): 1-24.

<sup>23</sup> Apostolis Papakostas, *Civilizing the Public Sphere: Distrust, Trust and Corruption* (New York: Palgrave Macmillan, 2012).

on the promotion of social capital. Robert Putnam defined the concept of social capital in its connections to culture, cooperation, mutual support and interpersonal trust.<sup>24</sup> Putnam's thesis of the dominance of social capital over material resources applies to Russia. As I show below, trust and reputation are significant for local business because they can be converted into other types of capital.

The conception of social capital adopted in this paper closely parallels that of James Coleman. He developed the so-called net approach, defining social capital as intergroup resources important to rational and self-interested actors. People and groups mostly implement horizontal social ties and connections within a group because their goals cannot be achieved without them.<sup>25</sup> The net approach to social capital is more appropriate for my research because entrepreneurs evaluate any resource, including social capital, in terms of rationality and utility. Rationality and utility constrain a key part of the net approach to social capital. Moreover, the security of market players depends on their capacity to get access to informal, politically enrooted nets. Contrary to J. Coleman, who defined social capital as a contribution to group well-being and security, my research shows that personal connections of specific entrepreneurs seem to be a contribution to their individual security. It means that social capital is personal, rather than group resources.

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<sup>24</sup> Robert Putnam, *Bowling Alone: The Collapse and Revival of American Community* (New York: Simon&Schuster, 2000), 93-113.

<sup>25</sup> James S. Coleman, "Social Capital in the Creation of Human-Capital", *American Journal of Sociology*, no. 94 (1988): 98.

Social capital can be viewed as a security factor because of one more reason. In the case of fragmented societies, different local networks and institutions do not seek interaction. As Zora Popova notes, “trust and norms at the micro-level are present only among the members” of a particular community.<sup>26</sup> I also investigate the role of social capital in property rights security on the ground level, that is, in local communities and among small market players.

More broadly, security of property rights could be seen as the core factor of human security within the particular local community, while local entrepreneurs – not large companies or the state – provide for the everyday needs and services of citizens. According to the Commission on Human Security, human security means not only the amount of human rights, but “creating political, social, environmental, economic and cultural systems, that together give people the building blocks of survival, livelihood and dignity”.<sup>27</sup> From that point of view, it is also important that systems-building is a bottom-up process to no less an extent than it is a ruler-centric one. Entrepreneurs’ strategies for dealing with state officials, with or against unstable laws and rules, influence their sustainable development, and ultimately, the sustainability of local communities.

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<sup>26</sup> Zora Popova, “The Social Capital as a Security Factor”, *Journal of Regional Security* 7, no. 1 (2012): 8-9.

<sup>27</sup> Human Security Now. Commission on Human Security. New York 2003. URL: [http://www.un.org/humansecurity/sites/www.un.org/humansecurity/files/chs\\_final\\_report\\_-\\_english.pdf](http://www.un.org/humansecurity/sites/www.un.org/humansecurity/files/chs_final_report_-_english.pdf) (Retrieved 15 October 2017). P. 3-4.

## Data and Methods

This paper examines the role of social capital and informal relations in small and mid-size entrepreneurs in Russian cities. Social research on informality requires qualitative methods, particularly interviews. All the semi-structured and in-depth interviews were collected by the author in two cities of the Komi Republic in 2012–2015.<sup>28</sup> Out of 28 interviews, 6 were conducted with small and mid-size entrepreneurs with any type of parliament membership (regional or local), 11 with small and mid-size entrepreneurs with extensive business experience and without official parliament affiliation, 5 with state actors (members of regional parliaments<sup>29</sup> and city soviets, political party functionaries), and 6 with experts (from media, business associations, and lawyers). Of the interviewed business actors, three-quarters represent small business. Among interviewed legislative members, one-half represents the local (municipal) level.

In order to show the high amount of members with business background in regional parliaments I collected the quantitative data about the occupations of the parliaments' members in North-West Federal Okrug (see Appendix 2). Data collection was made from the official websites of each regional parliament. Indeed, North-West regional parliaments contain a large complement of members with backgrounds in private business and state-owned enterprises – an average of 50 % in the parliaments, elected in 2008-2012 years.

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<sup>28</sup> Names and personal details of my informants are not provided here because research is ongoing on the project and the topic of shadow spheres is sensitive.

<sup>29</sup> The regional parliament of the Komi Republic [Gosudarstvenniy Sovet Respubliki Komi] is elected by citizens of the region for four years.

Collected data about regional parliaments supports the well-known finding, that the Russian socioeconomic system is characterized by the weak division of politics, business and civil society. Finally, it limits the number of groups with access to political and economic resources and who wield authority.<sup>30</sup> This also caused a methodological problem, in that the precise differentiation of my informants on the basis of formal positions was hardly possible. Particularly, the interviewed heads of regional and municipal business associations identified themselves as experienced entrepreneurs. In truth, many executives of quasi-civil organizations moved there from the business sphere. Not rarely the leaders and members of Russian business organizations continue their own business activities.

I designed and piloted a qualitative survey of small entrepreneurs with parliament membership in Saint Petersburg between January and May 2009, as a master's paper at the European University of Saint-Petersburg. The research started in 2008 with the question about benefits and opportunities available to the entrepreneurs with deputy membership (regional and municipal levels) – the business activity of those members of local parliaments and municipal bodies who came to politics from business. At first, my interest was in their motivation, election strategies and the resources they extract for their firms through deputy status. The pilot survey showed that the productive research question however should be more about trust

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<sup>30</sup> According to the concept of social development created by D. North, J. Wallis and B. Weingast, Post-Soviet states are included among the societies of limited access. For more see: Douglass C. North, John J. Wallis, and Barry R. Weingast. *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History* (Cambridge: Cambridge University Press, 2009), 148-189.

networks and informal relations created by specific entrepreneurs in the political sphere, rather than just about benefits and opportunities for their businesses.

The pilot survey also showed how to interview several groups of informants in order to encourage more appropriate and complete data. Also strategies were needed to encourage honesty in the interviews. First, it was emphasised that the use of the recording device and personal details were optional. Many interviewees agreed to being recorded, but some requested anonymity and requested handwritten records only. Second, I established my credentials by providing links to my academic publications and confirmation of my identity at the relevant universities. Also used were well-known approaches to asking sensitive questions (third-party perspective; normalisation of wrongdoing, etc.).

The study used a “snowball” method and chain-referral sampling to find and select interviews (Tansey 2007). The interviews of business and state actors relied more on chain referrals due to the shadow topic. Using the existing networks, which included both personal and professional nets I created a snowball sample, never interviewing more than 3 persons from the same network. From 2012 until 2014 I worked for a regional newspaper, covering social and economic fields. Attendance of business and policy-related events in the Komi capital allowed me to develop a range of useful contacts.. Also in 2015-2016 a set of audio records and comprehensive observations were made during public discussions and round tables in the capital, where the topics relied on contemporary problems in regional state-business relations and challenges to entrepreneurship in Komi.

Interviewing small and mid-size entrepreneurs, both with and without parliament membership, I asked about negative and positive features of business activity in Russia, including questions which concerned threats to business, and ways of protection. Also of interest was to what extent and for what reasons social relations with the state's agents are profitable for business owners. All the entrepreneurs were asked how they collect, use and transform social relations and personal ties to politicians and state agents. Interviews with experts allowed me to analyse the informal behaviour of entrepreneurs, the business opportunities and strategies of those players who occupy a privileged position on the market.

### **Institutional Trust and Business Security**

Research on specific entrepreneurs adds a new aspect to the discussion about institutional trust. Anthony Giddens defines institutional trust as trust shown towards abstract systems (laws, courts, constitutions, financial system, etc.).<sup>31</sup> Entrepreneurs with and without parliament membership have different attitudes towards courts and the legal mechanisms of property protection. Politically non-affiliated entrepreneurs state that, except in rare cases, it is impossible for small and mid-size businesses to appeal against sanctions. Moreover, appeals or taking matters to court can have unpredictable effects, for example, pressure on businesses, or unscheduled inspections by state representatives. In contrast to ordinary businesspeople, actors with a “double identity” can more successfully apply to the law.

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<sup>31</sup> Anthony Giddens, *The Consequences of Modernity* (Stanford: Stanford University Press, 1990), 102-104.

The challenge is not that entrepreneurs simply do not trust the state and its institutions. Even according to classic economic theory, the state does not deserve trust, because of the opposing interests of state agents and market actors.<sup>32</sup> The challenge for the state and its sustainability is that entrepreneurs perceive the state as a potentially disruptive, ineffective agent interested only in confiscating part of their private benefits not rarely in violent ways.

The Russian state, respondents point out, at any time can seize their profits on legal grounds. Talking about the state's "grabbing hand", very often they mean the imposition of taxes. High and changeable taxation – in the context of high-level corruption – negatively influences the willingness of entrepreneurs to pay taxes. Respondents guess that changeable game rules are beneficial to the state and its agents: the federal government creates and modifies "traps" for businesses in order to extract as much profit for the state budget as possible. The amounts of taxes and fines are not based on fairness and the law, but on political, elite-connected interests and short-term aims. The following interview illustrates the idea.

*I do not like the state system. Let's have a look at fiscal politics. The tax police has a plan, right? But, I am not sure. Me, my firm, was checked by the tax police for four months. A tax inspector called me before the inspection and said: "Well, your quiet life is over. There is a deficit of money for the Sochi Olympic Games."<sup>33</sup> We have received the resolution from above to double tax fees". After that they [tax inspectors] came and started checking. The tax*

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<sup>32</sup> North, Wallis, Weingast, *Violence and Social Orders*, 15, 88-89.

<sup>33</sup> The 2014 Winter Olympic Games took place in the city of Sochi, Russia.

*police take the position that all of us [entrepreneurs] owe some duties to them. But contrarily, they have their own duties towards us. From the tax police's view we are a priori guilty – they believe that we are not honest. The tax inspection, I'll just mention, ended with nothing; moreover, they found out that the regional taxation agency was in debt to my firm. (an entrepreneur, owner of a computer service)*

My respondents point to the following list of dangers and difficulties for small business: high taxes, unstable, inconsistent and complex state regulations, illegal inspections and administrative barriers, bribe-seeking bureaucrats. Respondents agree that state agents do not respect private owners and businesses as the sphere of independent, private economic activity. Tax police and other fiscal control bodies provoke especially negative connotations; entrepreneurs characterise them as illegitimate and at the least very unfair. The Russian state and its agencies are compared with racketeers.<sup>34</sup> One respondent defined Russian fiscal politics as the “state racket” [gosudarstvennyi reket], comprising the state’s activities and decisions in tax policy, the levels of taxes and fines, the uncertainty and changeability of taxes and fines. The respondents’ opinion is that tax police and other regulatory agencies serve mainly to create financial costs and barriers for entrepreneurs.

Compared to the 1990s, since the beginning of the 2010s the main threats to property rights have been created by state officials and politicians. My findings support the arguments of other scholars about the replacement of market predators (gangs, organised criminal groups) by state predators,

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<sup>34</sup> A racketeer is a person engaging in a racket – illegal violent activity. “Racket” refers more specifically to the activities of organized criminal groups.

including low-level state agents. Each group of interviewees very often said that various state agents are not able to protect business, but prefer instead to act as predators. When a firm becomes larger and more successful, state officials start to show great interest in it. What is more, bureaucrats are not interested any more in getting regular financial benefits (through bribes or other corruption practices), as it used to be in the 1990s, but they now seek to capture entrepreneurs' ownership rights.

The particular group from which causes the greatest danger in today's Russia are the so-called *siloviki*.<sup>35</sup> Insecure property rights are caused by institutional features of the business environment. The *siloviki* have occupied privileged positions among the Russian political elites for about the last 15 years on both the federal and regional levels. Not surprisingly, they have many opportunities to use state institutions to their own advantages. They can initiate firm inspections by any agency with the authority to monitor entrepreneurial activity.

*In the 1990s we [small entrepreneurs] were very scared of reketiers.<sup>36</sup> My car was set on fire by them. And now who is scaring us? Those [guys] with the shoulder straps.<sup>37</sup> They are more dangerous, a million times more than the reketiers. You have a factory for example. A Silovik might call you and say: "If you do not give it to me, I will do something to be able to arrest you – put*

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<sup>35</sup> Members of the coercive agencies of the state (e.g., the police, military, security services, customs). In Russia there are also the Federal Security Service, Military Police, Ministry of Internal Affairs, etc.

<sup>36</sup> The organized criminal community, street gangs, alliances of mainly young men or boys, have produced many dangers for small entrepreneurs and small business in Russian cities in the 1990s.

<sup>37</sup> The respondent means the members of the coercive agencies of the state.

*drugs into your pocket or into your car”. Or whatever... Everything is easy today. (interview with a local parliament member, small entrepreneur in trade business).*

The privatization of institutions<sup>38</sup> by powerful individuals and groups negatively influences the business environment. Kathryn Hendley et al. note that in the mid-1990s 61% of Russian firms applied to courts or were ready to in some cases. Moreover, entrepreneurs highly esteemed this method of enforcing the order and the law.<sup>39</sup> Contrary, others argue, that in the 2000s weak state institutions and insecure property rights cause distrust towards the state and official rules.<sup>40</sup>

### **Entrepreneurs with Deputy Status: How Social Capital Works**

As I mentioned, the opportunity to avoid or minimise risks is the crucial function of deputy status for entrepreneurs. The following opportunities are the most important.

***Protection from capture and state violence.*** For my research, it was highly important to understand whether political status is being used for business protection and what kind of protection it allows. Corporate raiding, *siloviki*,

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<sup>38</sup> “Privatization of the state” means that various bureaucrats or clans of bureaucrats, under the guise of belonging to national state institutions and organizations, as representatives of the state apply power and administrative resources to advance personal or group interests. The phenomenon is widespread among developing market economies, including Post-Soviet states. (For more see: Stanislav Markus, *Property, Predation*, 86-88).

<sup>39</sup> Kathryn Hendley, Peter Murrell, and Randi Ryterman, “Law, Relationships and Private Enforcement: Transactional Strategies of Russian Enterprises,” *Europe-Asia Studies* 52, no. 4 (June 2000): 644.

<sup>40</sup> Ella Paneyakh, *The Rules of the Game*.

business capture – these topics have already been well investigated in post-soviet studies. My respondents stressed protection from capture and attacks as one of the main privileges of being politically affiliated market actors. Owners of a double identity have the opportunity to resist raiders through their personal ties within political and administrative bodies. This can be used in case of real or potential dangers. My research shows that in a face of state predators, specific entrepreneurs stay safer, compared to ordinary entrepreneurs.

*“I can resist for a long time, because I am a public figure. I have worked here [in the regional parliament] for so many years that it is not easy to run me over. (interview with member of regional parliament, businessman).*

Privileges available to specific entrepreneurs are not caused simply by political status: personal abilities and attempts to be included in the social ties and relations to political class members and powerful actors are important. In case of necessity, such ties can be converted into specific economic benefits.

***Unconscionable market practices.*** As mentioned, Russian small business suffers from the “privatization” of state institutions. My research also proves that actors with double identity (political and business) are able to use their status as a weapon against market competitors. Not rarely, my informants among small entrepreneurs described cases where any entrepreneur in a city can face numerous unscheduled inspections initiated by state agencies like regional taxation agencies. They mentioned cases of inspections ordered specifically by politically affiliated competitor firms, which had particularly

or systematically privatised state agencies in order to use so-called administrative recourses to compete in a “grabbing” way.

*She was not able to compete with my firm and that is why she has “signalized” to the tax agency. It is hardly possible to make such a manoeuvre if you do not have a patron “upstairs”. If you have a patron it is not a big problem, I think. Nowadays it is more difficult to protect your rights in court. To my mind, in the past courts were more law-abiding than now (interview with the owner of a furniture firm).*

As Ella Paneyakh notes, applying the law is not a common way to resolve conflicts of interest in Russian small business. On the contrary, the law can be used to punish the businesspeople who break informal agreements or rules.<sup>41</sup> Politically affiliated businesspeople have special relations with the law and its representatives. Their experience demonstrates two sides of the coin named “political affiliation” – protection and attacks. Being involved in political bodies, they have access to extraordinary resources like administrative support. While I did not get details about attacks practiced by such “unordinary” market players, there is no doubt that such cases happen.

*It is possible to go to the police head and request him not to notice some dubious cases. I know one parliament member, honestly, he was a member of Russian State Duma. He has a large business... He got the support of the head of one of the law-enforcement agencies. Doing so, he has not only protected his business, but also produced “difficulties” for his competitors (interview with a regional parliament member, businessman).*

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<sup>41</sup> Ella Paneyakh, *The Rules of the Game*, 71-72.

***Litigation with the state.*** Russian entrepreneurship has a very specific feature: it is impossible to follow all official rules and norms. Ella Paneyakh writes about the crucial barrier to small entrepreneurship, defined as the “costs of legality” - business costs caused by changeable, contradictory and numerous formal rules and norms.<sup>42</sup> It means that entrepreneurs have to pay a high price if they decide to become visible to the state, to be honest to the state’s representatives and to follow its laws conscientiously. Changeable rules can be easily reinterpreted by state representatives, but not to the entrepreneur’s advantage. State agencies, if they have such an aim, are able to put sanctions on a firm.

My informants define their own position as “on the verge of the law”, meaning that the state’s control agencies are interested in finding some kind of breach of the law, and have great power to define what a legal breach is and what is not. Changeability and the contradiction in formal rules cause uncertainty in everyday business activity. State inspectors on the ground (e.g. sanitation and epidemiology services, firefighters, and others) are highly critical in defining whether an entrepreneur is breaking a norm or not. In other words, laws and norms relating to business activity are under the continual interpretative power of low-level state functionaries.

As mentioned above, the state and its agents act as predators – that is the common attitude of all kinds of entrepreneurs encountered in my research. However, there are different strategies against this. Specific entrepreneurs actively apply to the courts in administrative disputes with state agencies like

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<sup>42</sup> Ella Paneyakh, *The Rules of the Game*, 51.

the tax police, sanitation or fire safety agencies. Litigation with the state, or what I call “law attacks” against state agencies, sometimes enable businesspersons to reduce economic costs. Being included in political structures, specific entrepreneurs have access to “inside” information and informal paths of communication to judges. They are thereby more experienced in ways of communication within state agencies and political bodies, which require attention to specific language, behaviour and particular rules. These factors positively influence their ability to protect themselves in cases of business risk.

*Not so long ago the Agriculture Control Service imposed on me a few fines, so I filed court cases and have won two. They [representatives of the agricultural service] charged me with the absence of required licenses. They demanded the licenses, which did not even exist at that moment, so they did not grant me the licenses. They knew that the licenses were a fiction, but demanded them anyway. (interview with a mid-size business owner, informally politically affiliated, trade business).*

**Access to state officials.** Businesspeople with deputy status, compared to ordinary entrepreneurs, have easier access to state officials, city and regional politicians. Such privileges seem to be obvious and are expected. However, this administrative resource is highly important and is available to specific entrepreneurs not simply due to their official positions. Specific entrepreneurs do not spend time waiting for doors to open: they do not face the particularly Russian bureaucratic paper-war (*volokita*)<sup>43</sup>. They have open access to city

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<sup>43</sup> Volokita is similar to administrative barriers and is defined as obstacles to starting and doing business that result from the introduction of excessive bureaucratic procedures and

managers, heads of different departments and other officials in order to resolve business problems. They become stronger members of the political group than of the economic one.

Access to state officials depends on personal abilities, trust, respect and personal influence. According to my informants they do not just open doors and get closer to decision-makers; advantages depend on your personal skills, administrative resources and your own level of influence.

*Avoiding additional payment.* Researches in different Russian regions showed that the relationship between local business and authorities is often based on the principle of “taxes+”<sup>44</sup> or “additional payments”.<sup>45</sup> It means, that businesspeople are obligated to support financially or by other available means the social and economic initiatives of city and regional authorities. My respondents also provided some examples. Various material obligations burdening local business include not only taxes, but buying buses for public transport, building playgrounds for kids, holiday presents for children and poor families, disabled and aged people. In order to force entrepreneurs to provide unofficial payments, city authorities can use administrative pressure, for example, the refusal to grant licenses, operating permits.

Payments are mostly regular and obligatory. Politically affiliated entrepreneurs are not excluded from the “taxes+” system; however, they can choose to pay or not for a particular purpose. They can accept or ignore an

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rules set by different regulatory agencies in some cases (but not always) in order to receive additional payments.

<sup>44</sup> Anton Oleinik, *Market as a Weapon*, 227-228.

<sup>45</sup> Ella Paneyakh, *The Rules of the Game*, 85-86.

offer. They define informal payments as investments, not costs, like ordinary entrepreneurs do. In the case of double-identity actors, I define “taxes+” as specific investments to reputation: if you pay, in the future you will succeed in getting market privileges and benefits from state authorities. There are various forms of benefits: licenses and permits required of businesses in a particular branch (trade, real estate, etc.), access to information and decision-makers. It can be considered an exchange – financial and material resources must be provided by business in exchange for economic and noneconomic advantages given in return by state authorities.

### **Social Capital in the Shadow**

In Russia municipal and regional politics and economic development are characterised by the high concentration of power in the hands of city or regional authorities. Trustful relations with them have great significance for businesspeople. Specific entrepreneurs are therefore willing to become members of a so-called “closer circle”. The main condition for membership is loyalty. It means that members of regional legislative bodies or city soviets should support not only the party in power – ‘Edinaya Rossiya’ (United Russia); they also have to support a city manager or a major – their decisions, ideas, strategies, etc.

Members of city soviets exchange their political loyalty for economic benefits. However, this looks simple only at first glance. As my research shows, social capital – but not purely formal loyalty – is the most important form of capital for specific entrepreneurs. My respondents, both businesspersons who have moved into politics, and experts, paid strong

attention to personal ties and close relations, mentioning them as an important condition for economic success. Business actors quite often do not have a strong obligation to “pay off” received benefits. In other words, the exchange is not rarely based on pure personal relations, not on material interests, as used to be emphasised in the literature on Russian corruption.<sup>46</sup>

However, relations between local authorities and entrepreneurs are mostly informal and kept in the shadows. That is the nature of local relations, where informal deals and communications are more effective in the decision-making process than official agreements. The latter requires more time, effort and other costs. Informal state-business groups on the municipal level include different representatives of local politics, regional patrons, small (or mid-size) business, and various state agents. In contemporary Russia, politicians and bureaucrats are included in business activities as owners or managers. Reasonably, it is not easy to separate politics from business, because they create a set of symbiotic structures. For example, many city authorities in Russia own a few firms and businesses.

The common origin of city authorities and owners of double identity simplifies their professional communication, the creation of trust and networks. Their similar business origins provide certainty, common values and norms. However, for my research another side of the narrative was more important. These informal groups are characterised by the replacement of market relations with quasi-market practices, where enforcement and violence are more effective and widespread than pure market practices. Informal state-business groups on the municipal level are based on social

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<sup>46</sup> Susan Rose-Ackerman, *Corruption and Government*.

connections, in-group solidarity and contract relations – all components esteemed positively by social capital theorists.

There is one other empirical point that seems to contradict the idea about the widespread informality in Russian regional-local relations. My research shows that politically affiliated entrepreneurs are not interested in the implementation of trust networks and special relations with state officials without compelling reasons. This is because administrative support requires a payoff which ultimately causes the dependency of an entrepreneur. It sounds trivial, but reciprocal relations with state agents and local authorities are not always profitable for the double identity owners, even if benefits are important and available. In some cases it is more profitable and safer to follow market strategies and not seek administrative resources. Personal agreements are not based on official contracts, which is why opportunism is highly probable and not preventable. There is one important exception – the threat to property rights. In such cases entrepreneurs do not hesitate to use their specific positions within political structures to prevent potential attacks.

*I am head of the organization, I visit all events and meetings, and they [competitors] are afraid of me. I am familiar with the city manager. It is impossible to grab away my business, because by the time I had made a name, I was not infamous businessman They were afraid that I could use some connections, networks, or some personal contacts somewhere (interview with a member of regional parliament, businessman, trade business).*

Unexpectedly, my research shows that actors with double identity occupy a vulnerable position. It is easy for city managers or governors to force private

owners to vote for any decision or to support their politics. One informant in Saint-Petersburg provided an example how this works: a member of a city soviet decided not to vote for a bill because it contradicted his personal position and political values. He was going to leave the city for couple of days by road, when he was stopped by police and forced to go back to take part in a vote on the bill.

## **Conclusions**

This study shows that informality and trust networks within the political sphere play an important role in entrepreneurial success of even small and mid-size business. State-business connections on the local level are more personalised and based mainly on mutual trust than on corrupt dependence, as in elite networks. I found that entrepreneurs who occupy positions in regional parliaments and city soviets, could be defined as *privileged market actors*. They have access to advantages and opportunities crucial to business security in contrast to so-called ordinary entrepreneurs.

On the one hand, privileged entrepreneurs, as others, do not trust the state and its institutions. On the other hand, they create and support social ties and informal relations to state representatives in order to protect their businesses from the threatening activities of fiscal and other state control bodies. As the research prove, specific entrepreneurs convert politically connected informality into economic benefits. The paradox of the described practices is that in order to protect and develop their firms businesspersons need to become a part of the state. The rules governing informality and social capital exploitation within political sphere become more visible when we compare

the practices and norms of politically affiliated entrepreneurs in contrast of ordinary market actors.

The research on politically connected entrepreneurs in Russian cities concerns the more fundamental question of what constitutes the logic of interaction between the state and markets, and between private actors and state agents in the post-Soviet space. Another important finding concerns personal skills and behaviour within the political space. Opportunities caused by political status are not enough for business success, which requires the ability to use them in an appropriate way, and depends on personal characteristics and human capital (knowledge, professional and communication skills, and personal influence). Moreover, different economic and political players, with various amounts of political, economic, social and other sorts of capital, compete with each other for access to privileges.

The idea of the crucial meaning of informality, patronage and personal connections to political figures is not new in transition economies, including the post-Soviet states. A broader question is how the movement from business to politics mirrors the nature of markets and entrepreneurship in developing market economies. Investigating specific entrepreneurs improves our knowledge not only of post-Soviet development, but of the diversity of entrepreneurial practices.

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## Appendix 1.

### Map of the Barents Region

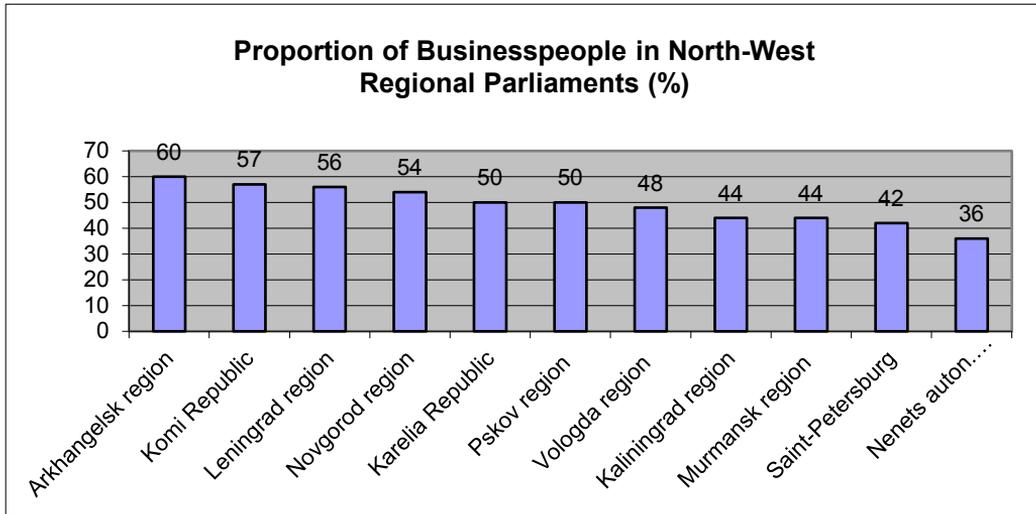


Source: Arctic Centre. University of Lapland.

<http://www.arcticcentre.org/EN/communications/arcticregion/Maps>

## Appendix 2.

Proportion of businesspeople in regional parliaments of North-West federal okrug



Author's calculations

Legislative bodies were elected in 2008-2012 years.