

**Protection of business from corruption practices: the
national experience of the business ombudsman
UNODC SIDE EVENT**

**On ‘second best’ solutions
to limit corruption in imperfect
institutional environment**

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Research (and policy) question

- According to TI Corruption Perceptions Index 2014 Russia in 136 position (among 174 countries).
- But: more than two-thirds score below 50, on a scale from 0 (highly corrupt) to 100 (very clean).
→ Such 'developmental trap' is typical for many countries.
- **Who and how can change these 'rules of game' in weak institutional environment** (in absence of political competition, with weak NGO sector and limited freedom of mass media)?

Institutional context in Russia: early and mid 2000s

On one hand:

- Consolidation of state – with much higher state capacity and ‘restoration of order’
- A number of economic reforms (prudent macroeconomic police, radical simplification of tax regulation etc.)
- Economic recovery – with high GDP growth and increase of personal incomes
- Increase of FDI and return of capital investment

But on another hand at the same time:

- **strong increase in violent pressure on business after 2004** – on predatory policing of mid 2000s see Gerber & Mendelson (2008); Firestone (2010); Gans-Morse (2012), etc.

Motorola-Evroset case (2006)

Motorola shipped the phones — seven models in all, worth roughly \$17 million — to Moscow on March 20 and applied for the necessary declaration of compliance for their sale in Russia. It received approval on March 24. And on March 29, after the customs service approved the shipment, the shipment was seized. Six days later, Department K of the Interior Ministry, which investigates economic crimes, announced that it had taken the phones on a seemingly vague basis that they were "not designed for use in the territory of Russia" and, in an apparent contradiction, that Motorola's distributor, Yevroset, "concealed the fact that the phones imported to Russia were counterfeit." Interior Ministry destroyed the C115 phones, worth \$2 million, on April 25, 2006 with journalists watching their destruction — after saying that one model violated safety standards, although there was plenty of suspicions that not all the phones were destroyed. But the same model remained on sale in shops around Moscow.

(The New York Times, June 3, and June 14, 2006)

Chemists case (2006-2007)

In the middle of 2006, Yana Yakovleva and Alexei Protsky from SOFEX Co. were arrested by Federal Drug Control Service officers – after rejection of an offer to participate in the drug shipments to Tajikistan. On February 16, 2007, the Federal Drug Control Service was compelled to set Yana Yakovleva free after seven months of illegal detention. The decision to set her free was made under pressure of strong social movement in defense of chemical industry in Russia (because such kind of violent pressure from FDCCS was typical in the sector). In January 2007 meetings against repressions of the Federal Drug Control Service were held in Moscow and Samara. Nine deputies of the State Duma stood up for liberation of Yakovleva and Protsky. (<http://www.himdelo.ru/>)

Firms' behavior before the crisis 2008-2009

- Increasing informal violent pressure on business from enforcement agencies – as unexpected consequence of 'Yukos affaire')
- But: high economic growth => lost income opportunities in the case of resistance => dominant strategies of ***personal informal negotiations*** – with paying kickbacks or sharing assets with corrupted officers
- Some exceptions (mostly due to personalities of victims) with resistance to 'siloviki' pressure
- In all cases: application to **public defense strategies** – individual (like Evroset-Motorola case) or collective (Chemists case) => creation of **NGO 'Business Solidarity'** as result of this collective public action

'Business Solidarity': Timing

1. July 2006 – officers of Federal Drug Control Service (FSKN) used fully artificial reasons to arrest Yana Yakovleva and Alexei Protsky (owners of 'Sofex' company)
2. Public campaign in defense of Yana Yakovleva (about 100 articles in mass media, petition to president Putin, signed by members of State Duma, writers, scholars)
3. February 2007 - The court sorted out that FSKN's expertise contradicted basic chemistry laws and released Yakovleva and Protsky from the custody
4. February 2008 - acquittal of businessmen (followed by other similar cases in the sector)
5. March 2008 – launching of non-commercial partnership "Business Solidarity" united about 90 SME (mostly from chemical industry) and devoted to help businessmen under pressure
6. May 2008 – General Cherkesov left the office of FSKN director

‘Business Solidarity’: Limited Success Story

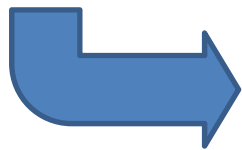
- Why this success was possible?
 - Yana Yakovleva as a businesswoman with personal connections to some policymakers, public persons and journalists => opportunities to organize effective public pressure on enforcement agencies
 - Not one firm, but dozens of similar firms in one sector facing such kind of pressure => reason for collective actions, foundation of NGO Business Solidarity
- Success story but with limited impact on environment: not enough incentives for broader collective actions => Business Solidarity as marginal case. Small organization with limited resources. No assets for “exchange” with ruling coalition.
- Nevertheless:
 - Important signal for other economic actors and for other business associations
 - Accumulation of organizational experience and skills

2009: Structure of Incentives Shift

- Economic Crisis 2008-2009 brought 4 main changes in the structure of economic agents incentives:
 - Crisis → Capital flight ↑ → Stronger control on firms activity & prosecution of entrepreneurs
 - Decline in incomes → not enough money to pay kickbacks for corrupted officials



Much higher cost of 'doing business as usual'



Incentives for collective actions to change the environment

'Business Russia' and collective action

- 'Business Russia' as 'peak association' trying to respond to the demand for rule of law from business community.
- Why BR? Because it tried to represent the interests of successful mid-sized business facing the strongest violent pressure
- 2009: Non-public stage – Lobbying the amendments to Criminal code and Code of criminal procedure (in State Duma and Presidential Administration) => prohibition of pre-trial arrests of entrepreneurs, but violation of this prohibition due to opportunistic incentives of corrupted officers in police and securities services
- 2010: Turn to more comprehensive public activity – including analysis and dissemination of best practice (like Kaluga) and development of broader policy advice for the government on improvement of investment climate. **Private investment supporting economic growth** – as asset for 'exchange' with ruling coalition
- October-November 2010 – meetings of BR General Council with Vladimir Putin and Dmitry Medvedev => '**BaC**' as one of ideas

Center “Business against Corruption”

- Institutionalization of collective attempts to protect entrepreneurs => NGO ‘Center of public procedures Business against corruption’ created in Feb 2011 by BR according to the order of first vice prime-minister
- Aim: to defend entrepreneurs facing unfair criminal prosecution
- Model of operation:
 - System of formal public procedures
 - Mass media resonance
 - Grievances to federal officials on regional subordinates



First attempt of public control on law enforcement

“BaC”: How does it work?

1. Gathering information on the case:
 - Request to applicant for detailed information
 - Request to the regional office of "Business Russia"
 - Request to counter-part of applicant
2. Obtaining a legal opinion from lawyers cooperating with BaC
3. Decision of Co-Chairs to put the case to Public Council consideration
4. Consideration by the Public Council – as quasi-court procedure
5. Response to the applicant and resorting to top level officials in General Prosecutor Office, Ministry of Interior, Investigative Committee, Supreme Court etc

“BaC”: Main focus

Category	Applications		Applications considered by Public Council	
	N	%	N	%
Criminal Prosecution & Raider Attack	83	14%	41	48%
Raider Attack	278	46%	27	32%
Criminal Prosecution	119	20%	15	18%
Corruption	28	5%	1	1%
Administrative Barriers	26	4%	1	1%
Other	76	12%	0	0%
Total	610	100%	85	100%

Source: BaC data for February 2011 – November 2013
In September 2015 – 906 application totally (since Feb 2011)

One of “Success Stories”: Malov’s Case

- In **2006** Dmitry Malkov, owner of agricultural enterprise “Agromol” was accused in criminal intent of stealing 1.8 mln rub
 - While the money was a subsidized interest rate under the National Project “Agro Development”
 - Pressure to sell the business by local security officers
- In **2008** he was sentenced to 5.5 years in prison (“Fraud” - art. 159 of Criminal Code)
- In **February 2011** he applied to “Business Against Corruption”. In March 2011 BaC launched the public procedure and supported his application
- In **December 2012** the Supreme Court rejected the conviction and completely acquitted Dmitri Malov due to *absence of corpus delicti*

Two sides of one coin

- Very few success stories - only 22 according BaC website. Clear resistance of the system (Malov's case as example) – due to close personal interconnection between courts and law enforcement agencies. → **BaC can't replace independent court**
- But: it plays signaling role for low- and middle-level officers in law enforcement agencies → **number of raider attacks decreased radically**

Overall conclusion

- Bad equilibrium with corruption is based on incentives from both sides: business and government. It is not enough to have 'political will' for the move from bad equilibrium to good one.
- It is necessary to have:
 - driving forces for this process – also on both sides: honest people in the business + honest people in the bureaucracy.
 - Selection mechanism allowing to identify honest and dishonest behavior → BaC public procedures
 - Non-political instruments of pressure on governmental officials → BaC supervisory council
- That is 'second best solution' – but it allows to start the move from bad equilibrium.