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## Article

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# Informal Economy in Russia: A Brief Overview

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## Introductory remarks

Economic sociologists in Russia have always paid much attention to studying informal and shadow economy. They apply structural and institutional insights as two complementary approaches to the definition of the informal economy. When following the structural approach suggested in the early 1970s by Keith Hart, informal economy is defined as a set of economic activities which are not displayed in official reporting and/or formal contracting. This kind of informal economy consists of two major sectors. The first sector is presented by the unobservable economy of the households largely confined to subsistence production and redistribution, including informal work at the private land plots, informal credit relationships, and inter-family mutual aid. People employed in the informal household economy do not consciously conceal their activity from the state; the state just overlooks them.

The second sector is made up of the shadow economy, which involves enterprises consciously hiding their revenues in order to lessen their tax base. The shadow economy entails the non-registration of enterprise or some parts of the enterprise activity, employing a workforce without formal contracts and double book-keeping. Unlike the informal activities of households, the shadow activity of enterprises ought to be reported to the statistical and tax authorities, but in spite of this, such activity is often concealed from them (Barsukova 2000; Radaev 2002a). There is a relatively small but important part of the shadow economy associated with the illegal markets. They deal with the goods and services prohibited by the law (drug trafficking, prostitution, etc). Studying these markets is highly relevant for economic sociology (Beckert, Wehinger, 2011).

Within the framework of the institutionalist approach, the informal economy was put into a broad framework delineating all informal relationships that accompany formal institutions, in order to make them run smoothly and to compensate for their failures. An informal economy of this kind is an integral component of activities for all market actors.

In this overview, we discuss the major outcomes of the studies of the Russian informal economy, including the rise of the shadow economy in the Post-Soviet era, corruption and violence in business, the maintenance of inter-family reciprocal exchanges and the progressive legalization of business activities.

## Transformation of the informal economy in the Post-soviet era

The post-Soviet era saw the marked growth of the shadow economy in Russia. But the most important trend was not so much an increase in size as the institutionalization of informal relationships and their transformation of market substitution into an integral component of new market activities.

### From a fictitious and virtual economy to a shadow economy

The shadow economy did not play a particularly significant role in the soviet era, but the fictitious economy was flourishing. It meant that economic actors did not hide their output from the state, but tended to overvalue it. Under the soviet command system, it was critically important to fulfil the administrative plans in order to achieve additional inputs and higher monetary rewards. Hence, it put a lot of pressure on the enterprises and stimulated the intentional overvaluation of performance and reporting on the output that was not actually done, a process named “*pripiski*”. Enterprise managers applied a great variety of sophisticated calculative tools in order to pretend as though they had performed better than they actually had. Such evaluations were rather prevalent.

In the Post-soviet period, there was no need for “*pripiski*” anymore. In the 1990s, the fictitious economy gave way to

a new form of the virtual economy based on barter exchanges and payment arrears, which originated from the severe shortage of liquidity. Barter exchange increased from 2 – 6 % of industrial output in soviet times to its maximum of 50 – 70% of industrial output by the end of 1990s (Woodruff, 1999). It was important that goods which were bartered were normally overvalued, for the price of delivered goods was not constrained by the purchasing power of the clients (Gaddy, Ickes, 1999). This kind of virtual economy produced distorted signals for economic agents, while an overvalued price including inflated wages and tax payments pushed the economy into a further circuit of payment arrears.

In the late 1990s, when the economy was flooded with 'live' money and the virtual economy was fading away, observers realized that a large part of economic transactions were carried out in the shadow economy, which was characterized, conversely, by the undervaluation of performance and concealment of output aimed at tax evading. Nevertheless, fictitious and shadow economies were still closely interrelated. Fictitious firms and fictitious transactions are widely used as an important technical element of the 'grey' and 'black' business schemes concealing revenues from the tax authorities.

### From "blat" to networking

In the Soviet Union, one could obtain goods in short supply in two ways, other than through official stores. First, these goods could be bought on the "black market" at a higher price, though this quasi-market was rather limited in scope and technically illegal. Second and much more importantly, scarce goods could be acquired through informal channels by using strong and weak network ties. This type of informal exchange was called "*blat*" (Ledeneva, 1998).

The price for these goods was much lower than at the black market and was close to the state regulated level, but access to these goods was controlled by social networks. It was not so important to have financial resources, but gaining access to scarce goods and services and being well-connected were vital. "*Blat*" was neither a criminal activity nor an alternative to the planned economy, but rather a legitimate compensatory mechanism for economic failures of the planned economy. It enabled people to resolve their everyday problems such as obtaining desired commodities and services. "*Blat*" was based upon communal reciprocal ties, in contrast to the impersonal and strictly accountable formal economy (Jowitt, 1983: 275).

In the Post-soviet era, as the scarcity of goods and services disappeared, "*blat*" lost much of its value. But reciprocal ties were not entirely replaced by impersonal arm's-length ties with the rise of pecuniary relationships. Networking is still important for gaining access to cheap credit resources, reliable business information or arranging good jobs (Gudkov, Dubin, 2002). Post-soviet networking is not used for acquiring goods in short supply anymore, but rather as a business tool (Ledeneva, 1998). Instead of playing a role of market substitutes, connections serve as an element of the market economy embedded in social networks.

### From pilfering to tax evasion

There was a peculiar non-organized part of the Soviet shadow economy based upon pilfering, i. e. the abuse of the working positions in order to steal from the job and the misuse of state-owned enterprise resources. Stealing from the state was a wide-spread and semi-legitimate way of accruing additional private benefits. The soviet secondary economy was even named "cleptocracy" (Grossman, 1982: 253, 1989).

Drivers sold out the gasoline. The plumbers took away tools and instruments. Cooks stole fresh meat and deficit food items. The higher-rank employees could lie in order to receive a larger share of any misappropriated resources. If the boss had no direct physical contact with the resources and clients, he/she was entitled to certain systematic "donations" from the subordinates who hoarded these resources. It was stealing "according to rank". It was essentially a tacit privilege, and one of the perks of the job. What is remarkable is that managers considered these practices to be legitimate, especially in rural areas where stealing from the large collective farms was one of the basic sources of survival for households (Kosals, 1998: 71).

Pilfering is still present in the Post-soviet economy today. But a major source of obtaining extra shadow revenues has become different. Managers and workers started to 'steal' resources from the state in the form of tax evasion. The spread of such tax evading behaviour can be illustrated by the following examples. Firstly, there was a short period of time when Russian citizens were supposed to submit tax declarations. According to official data, more than two thirds of Russian citizens who were subject to tax declarations did not comply with these rules in 1996. Secondly, tax evading was even more widespread amongst entrepreneurial activity. According to the 1998 survey, consisting of data collected from 227 Russian entrepreneurs and man-

agers, 84 % of respondents pointed to tax evasion as a major form of non-compliance with legal norms in Russia (Radaev, 1998: 275-276).

### **From speculation to entrepreneurship**

In the soviet economy, entrepreneurships were illegal and were subject to the Criminal Code. They were also illegitimate from the standpoint of informal conventions, which were shared by the public. Shadow dealers selling goods and services in short supply were treated as "dishonest speculators" by their clients. Soviet small traders of imported goods (*fartsovshchiki*) were respected and despised by the public at the same time. They were blamed for higher prices and the very intention of private gain.

In the post-communist era, entrepreneurial behaviour was legally rehabilitated and publicly legitimized. Shadow dealers became legal or semi-legal entrepreneurs. In the 1990s, it gave way to a mass of small cross border traders, or "shuttle-traders" (*chelnoiki*) bringing imported goods independently/by themselves from Turkey, China, Saudi Arabia, and Poland. This grassroots entrepreneurship did not become very prestigious, but it was quite a legitimate activity. The people started to back shuttle traders when the state authorities tried to suppress them.

Informal employment was not considered to be mere idleness (*tuneyadstvo*) anymore. It was now treated as an element of a global trend in labour relations which made them more flexible, and therefore, informal (Portes, Sassen-Koob, 1987). In the soviet period, households' revenues from informal employment were normally a supplement to income earned in the formal economy. In the Post-soviet era, such shadow activity became a major source of living for a relatively broad social spectrum. At the same time most energetic and capable economic actors moved into official entrepreneurial activity leaving informal employment for deprived social groups, such as migrants from the CIS countries.

### **Informal inter-family exchange**

In soviet times, inter-family reciprocal exchange was stigmatized as a rudimentary phenomenon and largely ignored by the scholars. Economic reforms brought in dramatic changes and increased economic uncertainty for households. Some parts of public sector were disrupted or privatized, and the state cut down on the amount of distributed welfare services. Shock therapy was followed by massive

wage arrears producing additional tensions. Under these conditions the role of the household economy as a social and economic buffer was significantly raised. A large part of the value produced and exchanged here did not come through the market. It was redistributed through networks of relatives and neighbours using non-calculative practices of reciprocal exchange.

Since the 1990s, these inter-family exchanges became subject to active sociological research for Russian scholars borrowing anthropological ideas from the newly recognized Marcel Mauss and Karl Polanyi. These horizontal ties were conceptualized as the use of specific social capital based upon network structures and accumulated mutual obligations. It was specified as an activity which was not regulated by formal institutions in contrast to the patron-client relationships, which were based on resources of administrative capital and were just an informal side of the existing formal order (Barsukova, 2009).

Empirical estimates of the involvement of inter-family exchanges varied depending on measures from 40 to 70% even for the urban population (Gradoselskaya, 1999; Radaev, 2002a). More detailed ethnographic studies demonstrated the almost total involvement of households, especially in rural areas. It was explained that reciprocal exchange was perceived as an everyday routine that was not reflected in terms of economic transactions.

It is remarkable that a change in material status does not exclude households from the networks of mutual assistance, but it may change the configuration of these networks. In poor families the number of ties is normally smaller and ties with relatives are stronger, while in well-off families the number of ties significantly increases and goes far beyond dense and closed kinships ties (Shteinberg, 2009).

Among the other empirical findings, it was further demonstrated that the direction of inter-family transfers was not a function of the material status of households, but rather a reflection of more complex social relationships. For example, older generations normally became donors, with their children and grand-children as recipients. Despite the lower level of income and well-being, grandparents maintain their status by providing small amounts of material support to their relatives (Radaev, 2002a). Interestingly enough, the wife's parents were more privileged if compared to the husband's parents, irrespective of their material status (Barsukova, 2005).

With regard to the characteristics of social ties, non-calculative inter-family exchange is more intensive between relatives than between friends and neighbours, and the amount of material support circulated through these strong ties is greater. However, informal credit relationships, assuming that money should be paid back, (with no interest or with little interest involved) are more widely spread in the networks of weak ties (Barsukova, 2005).

In some important areas, inter-family informal exchanges can allow the households to use their limited resources in a more flexible and optimal way (Fadeeva, 1999). Fundamentally, it is not so much a manifestation of instrumental rationality and utility maximizing demonstrated by self-interested actors, but rather a compliance with the cultural norms of the moral economy which provides safety nets for sustaining and repairing the social fabric in turbulent times.

### Corruption as an embedded phenomenon

From a great variety of definitions of corruption, we have chosen one that places corruption into the framework of agency theory according to which corruption is presented as a relationship between three actors, i.e. a Principal establishing formal rules, an Agent appointed by the Principal to implement these rules, and a Client presenting a third party interested in the violation of these rules (Gambetta, 2002). Within this conceptual framework, corruption is defined as the abuse of office by the Agent in order to achieve private gain from the Client by deliberate violation of the formal office rules defined by the Principal in favour of the Client.

Economists normally treat corruption as a manifestation of rational behaviour of self-interested autonomous actors searching for the optimal use of limited resources (Rose-Ackerman, 1999; Shleifer, Vishny, 1993). Economic sociologists do not reject this view entirely but add an important dimension to it presenting corruption as an institutionally and culturally embedded phenomenon. Developing on this insight, Russian economic sociologists have put forward the following statements derived from their empirical studies:

1. Legal definitions of corruption do not always coincide with conventional moral judgements, which treat at least some illegal actions as legitimate, for example, bribing the road police.

2. Corruption is not confined to mere bribe-taking. It is also considered to be a manifestation of group commitment and loyalty, and a facilitator of the interpersonal exchange of mutual favours (Radaev, 2000a, 2002b).

3. The hierarchical structure of informal payments with bribe-taking according to rank and the redistribution of obtained money from lower to higher administrative layers, cements the whole system and reduces both the subjective and objective risks of being caught and sentenced.

Scholars distinguish between several types of corruption in the Post-Soviet society, namely:

■ **Business corruption:** Bribes and informal payments in relationships between business and public officials

■ **"Otkaty":** Kickbacks in inter-firm relations between company managers

■ **Everyday life Corruption:** Informal payments and gifts presented by the individuals in order to receive 'proper services' in health care and education, and to avoid formal sanctions for non-compliance with the rules

■ **Political Corruption:** Buying seats in the public offices and the secret funding of civil servants to lobby the interests of political and economic groupings (Barsukova, 2009a).

Business corruption is the most important example here. According to our 1998 survey data, the vast majority of entrepreneurs and managers (87%) reported the existence of bureaucratic extortion in Russian businesses. Two thirds of respondents (65%) had their own personal experience of extortion from public officials. What is remarkable is that only 20% of interviewed entrepreneurs and managers believed that it was possible to avoid bribes within Russian business under present conditions (Radaev, 1998). Many things have changed since the end of the 1990s but not the spread of corruption in relations between business and public officials.

The most systematic studies of corruption were carried out by the INDEM Foundation in the 2000s (Satarov, 2002, 2008). They discovered the complete dominance of business corruption, whose estimated volume exceeded by ten times the other forms of corruption altogether, although there was an important change in the models of institutional subversion and corresponding types of business

corruption (Hellman, Schankerman, 2000). In the 1990s, the model of state capture by large entrepreneurial companies dominated in the state-business relationships (Hellman, Jones, Kaufmann, 2000). In the 2000s, along with the consolidation of the state, it moved from the state capture to a new prevalent model of business capture when public officials and state protection agencies did not take regular bribes but seized profitable businesses. At the same time, the state capture was being largely replaced by more sophisticated systems of exchange between state authorities and businesses (Frye, 2002; Yakovlev, 2010).

There is a lot of discussion over managerial kickbacks used in business-to-business relationships to obtain better contracts. In actual fact, this type of corruption had declined by the end of the first decade in the 2000s. As for the everyday life corruption, it stabilized over time during the 2000s and even decreased amongst the spheres in which formal rules were properly specified and enforced (for example, issuing domestic passports and passports for international trips). Nevertheless, families used to offer bribes for admission of their children to better secondary schools or universities and in order to avoid regular military service.

Russian corruption is rhetorically blamed by everyone but it is justified by many at the same time as an instrument enabling the rigid formal institutions to work smoothly. Corruption is institutionally embedded, in a sense that formal rules are often introduced by the public authorities as principally incomplete and even controversial. It leaves room for uncertainty and alternative interpretation. Entrepreneurs cope with this uncertainty by giving bribes to public officials, who are supposed to check the public's compliance with such rules. Public procurement contracts present a good example here. It was demonstrated that in more corrupt localities of Russia, public procurement contracts were allocated to less efficient firms, and therefore, corruption had negative welfare implications (Mironov, Zhuravskaya, 2011).

Corruption is also culturally embedded, since many people consider it a cultural norm – though a resentful norm – rather than a deviation. Only 13% of Russians expressed active disapproval of corruption (Satarov, 2008). It is explained by long-standing give-and-take habits, gift exchange as the manifestation of gratitude and the personalization of relationships, since the demarcation line between gifts and bribes is rather vague (Satarov, 2002). Russians are still tolerant with regard to petty bribes, such as informal

payments to the road police for non-compliance with the rules.

The negative impact of corruption was thoroughly discussed (Paneyakh, 2008; Radaev, 2002b). The evidence pointed to additional transaction costs which resulted from excessive regulation and informal taxation imposed on businesses, the reduction of competition and the adverse selection of market actors, the waste of public resources and undermining of institutional trust. Combating corruption remains on the agenda of each Russian Federation President. In spite of this, the results have so far been modest.

### Use of violence in business

Russian businesses in the 1990s demonstrated a high incidence of opportunistic behaviour involving defaults on business commitments. Contract infringements were reported by 90% of the interviewed managers in 1998, of which one half pointed to a high incidence of infringement. As a result of a weak state, which was unable to protect property rights and corrupt arbitration courts, which failed to provide effective contract enforcement, the use of violence in Russian business became an important tool to resolve disputes. Evaluating the Russian business environment in the course of a 1998 survey, 79% of the interviewed managers reported that threatening behaviour and force were applied in business relationships. 43% of managers had personal experience of this kind (Radaev, 2000b, 2002b).

Historical studies devoted to the Sicilian and American mafia supported the idea of the functionality of organized criminal groupings, which provided protection to businesses (Latov, 2001). The most important study was published by Vadim Volkov, presenting the political economy of violence. This study was based on a series of interviews with acting criminals, entrepreneurs, and police officers. It revealed the channels of recruitment of members to the organized criminal groupings, and described the evolution of their activity in the 1990s (Volkov 1999, 2000, 2002).

The state failed to maintain its monopoly on violence at that time, and this 'institutional vacuum' was immediately filled by organized crime. New criminal (bandit) groupings recruited professional sportsmen and military men who had gained experience during the Afghan and Chechen wars. They graduated from the trivial extortion of newly

emerged businesses (racketeering) to working within protection firms that obtain secret information, enforce contracts, resolve business conflict, recover debts, and facilitate investment to the firms they favoured.

By the end of the 1990s, criminal groupings were largely pushed away by legal security agencies, which were closely associated with the state. They proved to be more competitive in the market for protection services, while organized crime was largely marginalized. Many former criminals preferred to convert themselves into "honest businessmen" (Volkov, 2002). At the same time, entrepreneurs realized that dealing with non-state violence was a costly and risky business. The consolidated state took over the monopoly on violence under Putin's administrative regime. At the same time, formal institutions became more effective in the protection of private property rights (Pappe, Galukhina, 2009). Dispute resolution in the arbitration courts became a normal practice for an increasing number of market actors.

However, consolidation of the state was accompanied by the active commercialization of state agencies imposing rule of law but at the same time selling protection services on their own (Kosals et al, 2008). These privatized administrative and coercive resources of the state were extensively used during a new wave of re-division of private property at the beginning of the new millennium. This institutional subversion was backed by the corrupt and dependent court system (Barsukova, 2008). It also stimulated new forms of predatory competition by arranging inspections of state controlling bodies for the rival firms and the use of law firms for taking and stripping of the most valuable assets.

Facing this fundamental change in law enforcement practices, the focus of studies for economic sociologists moved from organized crime to the economic activity of the police and formation of new court practices. It was implemented in a series of research projects carried out at the Higher School of Economics in Moscow and the Institute for the Rule of Law at the European University at St. Petersburg.

## The legalization of Russian businesses

By the end of the 1990s, even large legal firms in Russia were still largely involved with the shadow economy, and used so called "grey" (semi-legal) business schemes. The prevalence of such business schemes was backed by the mechanism of the informalization of rules, which worked

quite effectively to transform formal rules into complex sets of informal institutional arrangements. Russian legislation was incomplete and controversial. Besides which, the law was not perceived by the market actors as an incontestable rule that one had to unconditionally comply with, but as the subject for creative adaptation to pre-existing business practices (Radaev, 2005).

On the political side, influential interest groups needed a developed "grey" market as a source of shadow revenues. The direct involvement of political and state institutions and their leaders in the facilitation of shadow dealings was recognized as one of the major reasons for the low risk of tax evasion in Russia at that time (Yakovlev, 2000: 142-146).

Nevertheless, the start of the new millennium was marked by an explicit 'social movement' driving the market actors toward the formalization of their activities. At the same time, a common understanding emerged that legalization could not be successfully achieved merely by the adoption of "good laws" and reduction of taxation rates. It presumed a necessity of fundamental changes in the institutional arrangements. New conventions of coordination were urgently required, allowing the competing market sellers to avoid the notorious "free-rider problem", meaning the unwillingness of any rational market player alone to take the legalization costs upon her/himself. The lack of trust between business actors and public officials presented a further barrier.

These coordination problems were resolved though not entirely by a new generation of business associations, which were capable of setting up a productive dialogue with the public officials. As a result, the legalization of Russian business was actively begun. In spite of the higher legalization costs, business owners and managers did have both long-term and short-term incentives for bringing their activity out of the shadows. These incentives could not be explained by the economic calculation of transaction costs alone. Business leaders considered the increasing risks of sanctions and opportunity costs, which resulted from the potential re-division of markets. The invasion of global sellers bringing new rules of exchange to the domestic market was also taken into account. The personal and civil motives of business leaders, such as a desire to improve social status, were also important for decision-making (Barsukova, 2009a; Radaev, 2002c).

Public authorities also contributed to this evolution. State controlling bodies imposed more control, putting addition-

al pressures upon shadow dealers and trying to improve the fiscal capacities of the state. Most primitive and restrictive forms of corruption were eliminated. Some tax and customs rates were reduced to create economic incentives for tax compliance.

Practically, the legalization of business could not be implemented as a single action, but rather as a continuous process of step-by-step changes in institutional arrangements, balancing positive and negative sanctions (Radaev, 2002c). It took almost a decade for the leading market sellers to purge all forms of shadow dealing and establish a new business reputation.

As a result, the shadow economy has been shrinking over the years, although some facets of it have remained or moved to the online trade sector. New important issues, such as the protection of intellectual property rights, were placed on the agenda. It dealt with the production and distribution of counterfeit goods with the unauthorized stamping (forgery) of commodity trademarks and parallel import of branded goods, which had been introduced into the civil turnover in Russia without the correct authorization of the brands' right holders. Series of applied research projects were carried out by the Higher School of Economics and funded by business association "RusBrand" during the 2000s on the subject of "grey" imports and counterfeit products. Along with overall positive trends observed, they revealed persistent legislation and law enforcement problems as well as many controversies amongst the behaviour of market sellers and final consumers, with particular regard to intellectual property rights. This in turn created a new, largely unexplored area for economic and sociological studies (Primary Trends in the Counterfeit Markets, 2010).

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