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Yaroslav Kuzminov

### On Corruption

1. In Russia, corruption has become systemic.

This means that:

- government policy is directly dictated by private interests of those in power, close to power or able to influence those in power;
  - supplementary and “shadow” incomes are the main and necessary portion of income of government officials;
  - corrupted behavior has become a normal feature of economic and economic culture;
  - the executive branch is actively using “shadow” forms of revenue mobilization and encouragement.
2. The irony of the current situation is that the Russian corruption scandal in the Western media, although it might have been poorly substantiated with specific facts and inspired by certain political quarters, came as an accurate reflection of what the Russian public opinion has believed to be true since as early as 1996.
3. Some definitions. It is necessary to distinguish between corruption and opportunistic behavior with regard to officials’ responsibilities before the government. The latter (which most frequently manifests itself in tax evasion) is characteristic of the majority of the population, of which the “shadow economy” is the most eloquent example.
4. Corruption in a narrow sense is a phenomenon whereby government officials deliberately ignore their responsibilities or act in violation of those responsibilities in exchange for certain material compensation. There are always two sides to corruption: the one who corrupts, and the one who, having been corrupted, acts in violation of his or her professional duty.
5. Alongside corruption in the narrow sense of the word, there are also bribe-taking and entrepreneurial activity by government officials. Bribe-taking is different from corruption in the sense that a government official is bribed to encourage performance of his or her duties, rather than otherwise. Bribe-taking is generated by vaguely defined responsibilities of government officials and the shortage (which is often created artificially) of the government’s administrative and financial capacity. In this case, the bribe-taking side is the one which is passive.

6. Entrepreneurial activity by government officials is different from corruption in the sense that in this case there is no party that corrupts. In this case, it is the perpetrators who order themselves to violate their official duties so that to obtain an entrepreneurial or rent income from the monopoly on the adoption or clearance of certain decisions.
7. One feature that is common to all the above forms is abuse of office in pursuit of private interests, or “privatization of government”. This is what can be defined as corruption in a broader sense. In subsequent discussion, it is “broad corruption” that we shall focus on.
8. Attempts have been made to explain the systemic nature of Russian corruption referring to such factors as proliferation of the informal economy or weakness of political arrangements. Naturally, these factors have an impact on the scale of corrupted activity and give it a certain share (by encouraging certain forms of top-level and grassroots corruption). However, in my opinion, by themselves these factors do not generate corruption as a phenomenon. It is quite possible to see a combination of a “shadow” (tax-free) economy with a much lesser degree of government degradation that that observed in this country - the resulting model would be that of a more liberal society with limited government functions and the absence of paternalistic expectations on the part of the population. On the other hand, even the most wrongly organized government can be much more efficient and internally consolidated as a result of suppression of those who oppose it.
9. A weak government is the sole basis of corruption. First, the administrative, control, financial and judicial “might” of the Russian state is inadequate to the volume of its obligations to individuals and corporations.
10. This generates a sustainable situation whereby the actually provided public services are chronically undersupplied. A classic example is the centralized management of state-owned blocks of shares and state-owned enterprises. The absolute maximum of what government can do is to launch attacks on individual economic entities. This is the reason why the government is fundamentally inefficient starting from the federal level, where the sheer magnitude of economic policy objectives renders such methods of pressure meaningless.
11. On the other hand, at regional and local governments are quite vigorous in terms of their administrative capacity. They interfere, in an active and focused manner, in corporate performance and property distribution. In terms of the volume of the powers that are **actually** exercised, government is dangerously deformed in favor of the regions. Some experts argue that “new feudalism” is emerging.
12. All the above factors generate a situation where the amount of public services is insufficient and their quality is unsatisfactory **by definition**. These are the fundamental economic prerequisites of corrupted behavior.

13. Second, government has found itself in a **populist trap** in terms of its internal organization. Lenin's slogan that government officials' wages should be equal to average wages of industrial workers, which had been rejected even by the Bolsheviks, was implemented in the 1990s. Nowadays, key government officials do not have immediate material incentives to perform in good faith their duties with regard to their employer, i. e. the government.
14. Today all participants of the political life - from liberals to Communists - have found themselves deeply involved in the demagogic social game playing with the public whereby any increase of public service salaries is viewed as a hostile act against the people. During the entire history of Russia as an independent state, only one institution, the Central Bank, has been able to use its legislated rights successfully for bringing its officers' salaries to about 30-40% of corresponding salary levels in the commercial banking system (thus providing certain protection against corruption pressures mounted by commercial banks). The Central Bank did succeed in that - only to become the target of attacks by the Chamber of Accounts and State Duma.
15. Naturally, there are also moral incentives for serving one's state - undoubtedly, these prevail at the absolute pinnacle of the state machinery. However, the economic circumstances of government officials' personal lives pay a very significant role in any state. In Russia, that role is purely negative.
16. Is there such a thing as an ascetic bureaucrat? Needs are determined by the environment - the social groups which officials and their family member socialize with. In Russia as a whole, a new phenomenon of "pursuit of material benefits" has taken shape which brought the desired level of consumption by the majority of urban population way beyond the limits that should be accessible to them, given the current labor productivity. Further, the contemporary Russia does not have a system of castes (a relatively rigid segregation of various social groups in social and everyday life), which was characteristic of Russia during the period of New Economic Policy (NEP) and China in the 1970-80s, where the Communist Party and government elite was isolated from "the triumphant bourgeoisie". The resulting situation is such that in the context of current market prices a minister's salary is not enough for going to a restaurant once a week; buying a car; buying an apartment; building a dacha; traveling abroad for vacation; paying for a private school or private college for children. In different historical contexts, this situation may generate totally different implications for government. In the current Russian context, attempting to live on the official salary would only mean continuous humiliation for the family of a key government official.
17. An intricate web of personal relations connects government officials to specific private interests. Sometimes such relations lead to a specific private interest "buying" a specific government official, but more often government officials find themselves involved in a web of mutual services carrying no remuneration, but concentrating at focal decision-making points (both in government and in the private sector). Such webs of people bound by mutual obligations have always existed in all countries of the world. What makes the current Russian situation

special, though, is that these webs of mutual services (rather than contractual relations) serve as the primary conduit of a much larger share of the GDP than in developed economies. In the system of government, this is the generator of the **main** portion of incomes actually available to key officials. Even honest officials, who would not ever think of being bribed or accepting a certain amount of money in exchange for a specific service, have so large portions of their income going through “the old boy network” that they are unable to exist outside that network and, consequently, resist indirect pressures. As a result, in their work government officials are guided by their personal interests as much as by the interests of their employer, i. e. the state. This the main reason why the state is weak.

18.The state’s interests are vague and unintelligible both for government officials and the electorate. Quite often, government officials lack a clear understanding of the interests of the state they are expected to serve. That is why they serve (with results for the state being worse at every subsequent stage) their department, their superiors, their friends and themselves and, finally, their “external clients”, seeing no moral problem in this situation. More often than not, they simply don’t have anything to betray.

19.The Russian state has failed to create a system of moral incentives and the incentives for career development of government officials are very weak. Meanwhile, such incentives are an important additional guarantee of an official’s being loyal to the interests of the state, or, at the very least, the state machinery.

20.Being inflated beyond proportion, the system of government cannot serve as an adequate policy instrument. In an attempt to compensate inefficiency of “cheap” officials by increasing their numbers, the state has grown to a size that exceeds the combined Soviet and Communist Party bureaucracy of the past. This resulted in an automatic expansion of government interference in economic and social processes, for each element of the state machine has claimed a separate area of responsibility. It is interference that we talk about here, rather than regulation. Such interference is often destructive, lacking a focus and not guided by public or state interests. At the same time, state regulation of economic and social life (understood as a consistent and open practice aimed at reducing uncertainty and risks, and providing society with a cushion against undesirable consequences of market operations) was steadily weakening.

21.In a state like this, there exist the following sources of deriving corrupt incomes:

- excessive regulation (overlapping regulatory functions by dozens of government agencies);
- uncertainty (lack of direct action) of laws and regulations known to the public and enterprises, which creates a large room for “case-by-case” interpretation of law by government officials.

22.During the past few years, Russia (and its state machinery) have departed from the “wild cat capitalism” model. But what was it that came instead? Bribes and criminal

“covers” have been replaced by long-term relations between government officials and corporations with corporations being involved in a network of more civilized mechanisms of property protection of which state institutions form only the tip of an iceberg. At the same time, it would be wrong to say that it is corporations that always use government officials: quite often the situation is reverse. Corporate relations emerge that have hierarchical common interests; new informal corporations necessarily include structural units of the state machinery or specific government officials.

23. The experience of the past few years clearly demonstrates that, unlike in the Soviet period, the state is no longer able *to force* any considerable corporate or population groups to act against their own interests. Consequently, corruption is largely generated (or tolerated) on the grassroots level, i. e. amongst broad population groups and most enterprises.

24. Grassroots corruption (corruption generated by individuals, households and enterprises) exists as one of the elements accompanying the informal economy. When a party to a market transaction benefits from not paying taxes, it would normally be able to force the other party to perform the transaction unofficially, or “in the shadow”. The methods of used to force transaction parties into doing business informally are purely economic ones: the offer of a better (tax-free) price; or simply a refusal to enter into the transaction officially in a situation where no competitive offers are available. In Russia, large competitive markets have been formed which operate on the basis of cash that is unaccounted for (“the so-called “black cash”) (these include show business, consulting services, large segments of the publishing business, mass media, and the second-hand car market). On these markets, any firm that has taxes included in its prices is doomed to bankruptcy.

25. It goes without saying that the two-thirds of Russia’s able-bodied population involved in informal economy never think that what they are doing is criminal. People are simply following the maxim: “No matter how much you might steal from the state, you’ll never get back what the state has stolen from you” and regard this as taking justified vengeance on a stupid and good-for-nothing state. However, due to the fact that informal economy is non-transparent and does not have universal mechanisms to enforce compliance with complicated contracts, each “gray” or barter transaction entered into by an enterprise has a potential for insider theft and market deception. Corruption has started to erode not only the state, but also enterprises regardless of their ownership status.

26. It is possible to single out the population groups involved in corrupt relations (even if passively). These are, with some degree of approximation, the groups which have incomes that are not accounted for and, therefore, an opportunity to “share” such incomes with government officials: entrepreneurs, employees of most enterprises, farmers, small traders. At the other extreme are non-working pensioners and those budget-sector workers who have no access to informal earning opportunities (e. g., librarians). In other words, it is the economically active part of the Russian population that is involved in, or connive at, corruption.

27. Why do people resort to corruption (offer to “show gratitude”, look for “the right guy” instead of following formal procedures etc.)? They do not trust the state (do not see the state as something that is consolidated or solid). It is the lack of trust in, and negation of, the state - not the state as such, or Russian state as such, but the state in its present form and condition - that form the economic and political activity patterns observed in the country today. At the same time, Russians have not become natural born liberals: they are weary of the weak state and long for resolute action and the iron hand. The question is whether the would-be leadership will be able to demonstrate these qualities consistently and for a long time. The right assessment of the available resources has the decisive importance here. It is better to slightly underestimate such resources than to overestimate them. For if the next regime too fails to change the structure of the state for the better and improve the perception of the state in society, that will spell imminent demise of the Russian Federation and disintegration of the central government which will have proved its uselessness.
28. Top-level corruption (corruption on the part of political authorities of the country). What provokes the higher authorities, serving as a representation of the state itself, to support corruption and resort to it?
29. The impossibility of adopting the needed decisions under open democratic procedures. A constitutional collapse is in place: the legislative and executive branches, federal center and regions are struggling with each other due to fact that their responsibilities had been correctly delineated - as result, their activities are all blocked hopelessly. A political agreement is impossible here, for the very essence of “big-time” politics, the entire mechanism of self-identification of political forces which have been formed over the past ten years are not dialogue-based determination of the national development strategy, but rather a demonstration of political opposition. That is why buying votes is easier than convincing a member of parliament, parliamentary faction or party. The way the attempted impeachment went and about 50 percent of the laws were adopted illustrate the above point.
30. The search of covert support at election with a view to staying in power.
31. Once again, the populist trap: the need to provide valuable officials with material incentives at a higher level than is “acceptable”.
32. The method of privatization through loans-for-shares auctions selected in the mid-90s was, in fact, an arrangement enabling the government to afford huge chunks of property to beneficiaries picked at the government’s discretion. By doing this, the government made itself vulnerable to extreme corruption pressures: it was then that the creation of financial groups tightly knitted together with government structures was completed.
33. Chronic underfinancing of government agencies makes ministries, departments and their structural units look for additional sources of funds. This directs their activities to fighting with other agencies for sources of rent: licensing fees, allocation of budgetary resources and provision of supplementary paid services. Funds can be

attracted openly, as has been the case with the customs, Ministry of Internal Affairs and Federal Tax Police Service. However, more often government agencies are not at liberty to attract funds by themselves and have to establish affiliated or even private enterprises that specialize in the provision of paid services. In the latter case, the resulting profits are appropriated by the senior management of the agency and their friendly entrepreneurs, rather than by the agency itself.

34. The lack of independent courts and supervisory law-enforcement agencies. Executive agencies continue to control judges and prosecutors using financial means and their administrative resources. "Pocket justice" remains a wide-spread phenomenon.
35. The state is unable to exercise its powers as owner of assets. *De jure*, these powers are exercised by federal government agencies which do not have financial, information or personnel capacity to actually apply these powers to most assets the government owns. *De facto*, the assets are managed by regional administrations which, however, do not enjoy a number of formal rights that are necessary for ensuring successful economic activities (e. g., the right to alienation or long-term mortgage). Similarly, regional administrations are not responsible for their decisions before their electorate, because it is the federal government that is the owner of record. That creates a fertile ground for inefficient economic decisions and abuse: semi-owners can effectively redistribute financial resources of the enterprises under their control to support their political or social projects, but they cannot ensure efficient operations of the enterprises *per se*.
36. External corruption (a situation where foreign governments or firms opt to "ignore" corruption or event accept it) has become wide-spread starting from 1993.
37. The opening up of the national economy to the outside world and virtual absence of government regulation of external economic activities of corporations and individuals have served to perpetuate illegal outflow of capital from Russia. Capital flight is estimated at US\$ 7 billion (in 1994) to more than US\$ 20 billion (starting from 1996). The fact that capital flight is taking place through informal channels - first via joint ventures and later via bogus or real partner firms - has been evident for governments of countries - new partners of Russia from the very start.
38. The use of "discriminated" Russian capital deprived of any political rights is economically attractive to any country.
39. The windows of capital flight are not anonymous: institutional conduits are required. In a number of countries, bribes given to foreign government officials can be excluded from taxable income as productive investments.
40. Russia's entry into a number of international agreements can only be explained by the assumption that a chain of key government officials had been bribed. The most recent example is the Agreement on Avoidance of Double Taxation between Russia and Cyprus adopted by the State Duma and signed by the President of the Russian Federation. In Cyprus, the corporate profit tax is only 4%. The Agreement

contains a clause barring the signatories from terminating it during the first five years. According to some estimates, Cyprus accounts for up to 50 percent of Russia's annual capital flight.

41. Until 1999, discussing Russian corruption had been an informal taboo in international financial organizations and governments of developed economies. The situation brings to mind an old joke about the Russian Civil War hero, Vassily Chapayev, who says to his aide, Petka: "Look Petka, Honduras has been bothering me recently". "Just don't scratch it raw, man, it will first turn blue and then fall off".
42. The "fall off" approach exemplifies the liberal model of fighting corruption (i. e., corruption will be swept away by competition on the political services just like competition on goods and services markets sweeps away inefficient firms). However, although quite successful in the United States in the 19th century, the liberal model has one serious constraint: a minimum state created by income-earning individuals to be as close to themselves as possible. What could be feasible within a city, county or state (schools, police precincts, sanitation control, even National Guard) was formed exactly at that level. The graphic example of the democracy existing overseas has cultivated rational voters who know their rights and, as of habit, scrutinize the state.
43. In Russia, the state has traditionally been non-transparent for its citizens; its decision-making institutions have been distanced from the population and outside electoral control. The liberal economic reforms have been accompanied by neither minimization of the state, nor decentralization of state functions to the municipal level. The post-Soviet Russia has inherited a Soviet state.
44. When the Soviet state was inherited, it no longer had the built-in stabilizer that the Communist Party had been. The CPSU had two important functions: exercised internal control over the behavior of key Party and state officials, and ensured feedback to the Party and state machinery from the population (via primary Party cells).
45. In today's Russia, these functions are not in place.
46. The electoral mechanism and freedom of information remain formal substitutes of these functions in the new Russia.
47. The electoral control mechanism is dysfunctional due to the underdeveloped legal, political and economic culture of the electorate and, most importantly, due to the abstract nature of the "election prize" for the electorate as a whole. Russians are not interested in programs offered by election movements not because they are too fond of soap operas, but because their interests are mostly concentrated at the municipal and submunicipal levels - the "pariahs" of our political system. On the other hand, the experience of the 1990s has cultivated among the population a firm distrust in programs of those seeking power at the federal and regional levels.



48. In between election campaigns, 90% of the population are effectively deprived of the right to be heard, for that right is for sale only (in the mass media). Those groups which have money and power selectively “turn on” voices from below only when it is consistent with their private interests. Private interests of the very narrow (and quite non-sustainable) coalition of financial oligarchs and government officials are fighting each other on the mass communication arena.
49. Russia has an original tradition of public control over the state. This is a tradition of broad public discussion of the most important state problems and decisions. It is important to create channels for such discussion and ensure information exchange among individuals. The last time when such channels were in place was during the period of Gorbachevian perestroika: the famous policy of glasnost. The public interest was mobilized at the macrolevel and focused on the ways of development of the country as a whole - but it immediately and effectively influenced people’s behavior within their own communities.
50. If we compare the period of economic reforms in the 1990s to the outburst of public expectations, public interest and public activity which the country saw in 1983-1991, then we will find that people kept amazingly silent during the reform era. Especially amazing is the fact that those were the same people! In the 1990s, the state distanced itself from shapening public perceptions so emphatically that only being personally acquainted with the reformers convinces me that there had been no ulterior thinking behind that error.
51. We are not talking of political indoctrination or brainwashing (although, by the way, these methods have been actively used in mass media to promote private interests throughout the 1990s). It is an obligation of the state to create institutions enabling popular involvement in politics in addition to elections. Not only were such institutions not created: the overthrow of the CPSU was accompanied by the elimination of the weak semblance of public information institutions which the dying Soviet system could afford to have in the 1980s. Everything was placed at the discretion of private interests (evidently, based on the belief that Russian Carnegies and Rockefellers had already accumulated their startup capital and started giving away their wealth for the benefit of the people).
52. There are no mechanisms in place to enable mandatory broad public discussions of draft laws, budgets, largest investment projects implemented or supported by the state. Institutionally, that would mean an obligation of the state-owned mass media to dedicate one or two pages to materials pertaining to the discussions initiated by the executive or legislative branches. Society is isolated from participation in the management of issues that “are too complex and delicate”, with such management delegated to a compact group of professionals and experts. There are virtually no mechanisms in place to trace popular attitudes to specific economic and social policy alternatives. The most what the authorities seem to be able to do is to carry out large scale public education campaigns whereby even small children are taught that taxes must be paid. With the state totally passive in terms of organizing information flows, the population is fed every imaginable type of dirt through the media which promotes social indifference and legal nihilism.

53. What is to be done? History does not know a single example of corruption-free society. Dishonest people would always find loopholes in the state and economic system to use for personal enrichment. Defeating corruption in Russia means to eliminate the systemic nature of corruption, making it an economically and politically marginal phenomenon.

54. Today, having no protection against the state and criminal quarters, individuals and corporations invest in alternative structures, in particular for settling economic disputes, or in parasites sucking on the flesh of a weakened state. The people prefer to pay useful state officials rather than paying the useless state. The would-be leadership have a choice: to try to arrest and overcome this trend, or to accept this trend and try to guide it to the extent possible. Russia's new President must have a very clear understanding of the following:

- what are the forces gnawing away at the state; what are their interests; and how can they be suppressed;
- how can one mobilize the emerging economic and social interests of the population and corporations, in particular by shapening such interests legally and politically;
- which changes in Russia's state system can make it possible to restore an effective state.

55. Self-containment of the state. Narrowing the areas of immediate responsibility of the state (in the form of regulatory obligations or arbitration); divestiture of state functions to self-regulating associations of the various social and economic actors or to local communities. The lessons of experience in several such areas where such divestiture has taken place demonstrates that state interests (if the state is indeed interested in the development of an efficient and more sustainable market economy) have not been harmed. Inside the state *per se*, it is necessary to be guided by the principle "I own what I control" and to divest a large number of ownership functions from the federal center to subjects of the Russian Federation and further down the line, i. e. to municipalities. The state must be relieved of a huge mass of small administrative and arbitration commitments (that are, in fact, rarely honored in practice), while keeping the functions of the ultimate guarantor and final arbitrator.

56. Some of the state's regulatory powers must be delegated to voluntary professional associations of market participants. We mean, for instance, the regulation of operations on a given market and primary arbitration. The existing examples of such associations include NAUFOR (association of stock market participants) and KONFOP (consumers' societies), as well as organizations of lawyers. In this case, the state adopts general operating norms for such associations, and acts as the guarantor of enforcement of their decisions and the supreme instance of appeal. The state also guarantees the freedom to join an association (including for non-residents) and compliance with democratic procedures inside the association.

57. The legislative and executive branches of government should be brought closer to people. This requires building anew the entire system of power at the municipal and submunicipal levels. Municipal governments must be granted tax, police and judicial powers. The Great Britain (municipal counselors court). The result: restoration of transparency and accountability of government, its missions, promises and performance. Development of a rational electoral behavior from the bottom level upwards.

58. The state's ownership powers must be delegated from the federal level to the regional one. Such delegation must cover 80-90% of federally-owned assets with the exception of the nation's largest enterprises. This would help restore the severed link between the various levels of government and accountability within the state system.

59. The only way to reduce the "shadow" economy as the breeding ground of corruption is to carry out a radical tax reform. The total tax liability to the state budget and extra-budgetary funds should not claim more than 50 percent of the wage bill as is currently the case. If we assume that tax-free economy generates 40% of the GDP, then the optimal level of personal income taxation will be 25-27% (including 15% covered by payments to extra-budgetary funds). Rich individuals, i. e. individuals encumbered with property, must pay a reasonable property tax (0.5-1.25% of the market price). In Russia, attempts to introduce progressive income taxation are nothing but social demagoguery and only serve to push more incomes into the shadow economy.

60. Constitutional reform. Given the various options of implementation of constitutional reform, it is necessary to secure the achievement of the main objective - to rule out the current situation of a constitutional paralysis whereby the authorities have to resort, as a matter of course, to behind-the-scenes (fundamentally corrupt) methods of political dialogue with the opposition. It is also necessary to avoid a situation whereby the authority vested in the various branches of power is not supported by adequate responsibility (for example, no one is responsible for the budget once it is adopted: budgets are submitted by the Government and subsequently modified by the Duma - as a result budgets have no authors).

61. Improving the legislation and judicial system along the following lines:

- to complete codification and systemization of laws; abolish conflicting laws;
- to modify the civil legislation with a view to limiting opportunities for the use of one-day firms and fraud involving "temporary" legal entities;
- to ensure that all legislative acts are consistently made unambiguous and long-term direct-action pieces of legislation. In the conditions of a low legal culture, it is especially important to ensure that legal norms are relatively simple both in terms of their being comprehensible for those participating in

the political and economic life, and in terms of control opportunities. While doing this, it is necessary to ensure that the “end product” is as specific and realistic as possible, so that to limit the opportunities for discretionary interpretation of laws by government officials;

- to introduce a system of municipal courts (dealing with misdemeanors and civil cases) and professional arbitration courts whose decisions would be based on the current legislation and specific circumstances of the case with an opportunity of appeal to a court of general jurisdiction.

62. Reforming the territorial system, the system of financial, material and enforcement support of courts, procuracy bodies and investigative bodies of the Federal Security Service. To complete the creation of a mechanism of financing and material support of the judiciary that would be independent from the executive branch; to strengthen the Bailiffs Corps as a separate “power” agency responsible for enforcing court decisions and ensuring personal security and independence of judges. In addition to budgetary financing, the judicial system must have transparent supplementary financing obtained through collection of court duties and fees, charges for engaging in the legal profession, and payments for services provided by legal counselors. Courts and procuracy bodies must be organized on the basis of territorial entities that would not coincide with the existing administrative and territorial structure of regions and large municipalities.

### 63. Public service reform

State apparatus. Today the state treats its officials in an unfair and disparaging manner; government officials feel socially and politically vulnerable. Saving on the government apparatus has become a way of reducing budgetary expenditures that is most popular among both the government of the day and the opposition.

It is necessary to realize that the new class of government officials is the skeleton of the state and much more of a personification of the state than the politicians. Today, many government officials have stayed loyal to their respective agencies. This is the absolute most of what they can be expected to do in the situation where the declared interests of the state become dispersed. However, a culture of pursuing consolidated interests of the state is more easily created on the basis of a culture of departmental loyalty.

To this end, the state machinery should be consolidated and streamlined; government agencies made bigger in size and smaller in number; and overlapping activities eliminated. For example, in the area of economic regulation there should be only two ministries - Ministry of Finance and Ministry of Economy - and an independent Anti-Monopoly Service. The responsibility for pursuing the state industrial policy should be vested with state concerns or agencies under the overall coordination of the Ministry of Economy. The Government Apparatus should incorporate the mushrooming Presidential Administration, including the corps of Presidential Representatives at the subfederal level. This country is not too rich and cannot afford having two branches of executive power.

Creating an efficient state has a price. To have an efficient state in place, society will have to pay quite a high price for the performance of *responsible* government officials. It is necessary to consistently create a system of social guarantees for public servants. Underfinancing of bodies of the state, including the judiciary, is inadmissible. Whereas other budget sector organizations have opportunities to earn the money they do not get from the budget, the only option left for underfinanced government officials is corruption. It is possible, and indeed necessary, to save on the state apparatus by elimination those parts of it that are dysfunctional, but government officials must not be underpaid.

Whenever the issue of financing of and incentives for government officials is discussed, there emerges a demagogic opposition to any qualitative improvement in this area. Let us consider the arguments put forward by our opponents:

- being unable to pay much smaller pensions, budget sector wages etc., the state should not raise salaries of government officials. Based on this reasoning, high wages of surgeons or university professors should not be paid as long as there is an unpaid nurse or unskilled laborer anywhere. Salaries should not be confused with social benefits for their respective objectives are entirely different.
- no matter how well they paid, government officials will steal. Obviously, those inclined to steal will likely continue to do so. Higher compensation levels, however, will attract more decent people to government service; competition for state jobs will emerge; as such competition develops, there will be more chances to reveal various abuses committed by specific officials. Finally, as pure economic logic suggests, the threshold of what can be obtained through stealing will grow and government officials will have more to lose if they are discharged from public service in disgrace. If the enhancement of material incentives for government officials is combined with efforts towards more transparency and control, and if punishment for misconduct becomes harsher and unavoidable, the preventive efficiency of such a salary raise will be quite high.

The level of remuneration of decision-making government officials must be high enough to ensure that that can live reasonably well without having to look for alternative earnings. Salaried must be raised at least 3 or 4 times; key officials at federal agencies and courts must be entitled to higher performance and length-of-service bonuses. We recommend that remuneration packages should be differentiated by rank: the salaries of rank-and-file government officials will remain unchanged; those of division chiefs will be doubled; those of department heads will be increased 4 times; those of Deputy Ministers - 6-7 times (it would be useful to recall that after such an increase a Deputy Minister's salary will still be at around US\$ 1,500 per month, which is on par with the remuneration of medium-level managers at an average commercial firm). The most senior public servants (a corps of 200-300 people) will be paid US\$ 2,000 - 5,000 monthly with subsequent pensions being at least 50% of the monthly salary.

Today, the actual cost to the budget of a senior public servant is 10-20 times higher than the remuneration he or she receives in cash.

According to our estimates, an effective increase of salaries of 15,000-20,000 key officials in all branches of government is likely to cost about Rb 10 billion a year. This is roughly equivalent to US\$ 400 million, or 0.25% of the next year's GDP forecast, and compares to a net loss of US\$ 5-6 billion a year as a result of capital flight, including a net loss to the budget of up to US\$ 2 billion a year. The revenue shortfall resulting from informal transactions inside the country is estimated at US\$ 10 billion. If efforts towards greater accountability in public service are able to stop at least 10 percent of these flows, the investment will be generously recovered to the budget that same year.

Sources of the proposed salary increase include a drastic reduction in numbers of junior and medium-level administrative staff at government agencies, and reduction of the number of government agencies.

These proposals relate to the federal level of government only: regional administrations will still be free to make their own determination guided by both the federal-level standards and local realities.

*Supplementary earnings* of government officials must be confined to the two permitted activities (teaching and academic work), and capped to a maximum of two times the average wage paid to persons working at a given teaching or academic establishment on a part-time basis.

*Career strategy and moral encouragement.* A consolidated public service must feature a single system of ranks, incentives and awards for achievement and length of service used by all government agencies. Today, a public servant's career, with the possible exception of the Armed Forces, lacks clear milestones.

The system of ranks must be transparent and linked to the occupancy of certain positions. The compensation packages must be clearly defined and linked to the corresponding ranks of service. Rank-based compensation must be paid with no regard to the position occupied by a particular public servant, including during the periods of being in reserve or retirement. In the latter case, rank-based compensation would be paid in lieu of pension.

The procedure of discharging or demoting public servants must be taken away from the state and transferred to special courts of honor composed of retired public servants appointed for life. The executive branch may decide not to use an official who have fallen out of grace, but it cannot discharge him or her from public service.

It is necessary to restore the system of state awards which is now in shambles and plays virtually no role in the structure of public service incentives. It is a great mystery who gets orders and medals of the Russian Federation, what is awarded, and how the award procedure works (in fact, I would prefer this to be a mysterious

affair for I've heard many rumors, which I choose to ignore, of state awards being sold). Today, the only award the Prime Minister can give to a retiring Vice-Premier is a Government Diploma of Merit.

At this point, it seems reasonable to recall the classical functions of a system of state awards. Awards are given for exceptional deeds (special achievements) and for impeccable service. The latter function does not exist in Russia today (it only demonstrates itself when ageing politicians or actors get their belated awards and are decorated with highest degrees of contemporary Russian orders. It is thanks to such ceremonies that we become unexpectedly aware of such orders' existence). As for special achievements in civil service, there does not seem to have been any since 1991.

Tsarist Russia had a system of state awards that successfully interacted with career and rank advancement. A much more obscure, but still workable system existed during the Soviet period. One of these two systems can be recreated: the existing system of awards can be abolished without anybody taking note.

64. Each government official must have an area of personal responsibility. All administrative decisions must have their accountable authors who would be awarded for success and sanctioned for failure, and held responsible for violating the law of their professional duties. The impersonal collective (departmental) nature of most administrative decisions makes neither reward nor punishment possible.

65. Creating, for control purposes, of feedback channels to link the population with those at the pinnacle of power. First of all, it is necessary to build upon the experience of the Moscow Mayor's Office and a number of federal "power" ministries. I mean the establishment of the so-called "hot lines" which anybody can use to report instances of extortion, or other illegal behavior of state and municipal officers. It is obvious that in cases like this immediate public investigation is unlikely to yield positive legal results. Officials suspected of misconduct must be covertly watched by the control agencies.

66. The state must create and maintain on a sustainable basis institutions enabling public scrutiny of state activities. As regards legal arrangements, it is necessary to ensure individuals' right to sue the state, an individual agency or government official once a sufficient security has been deposited. In terms of institutional and economic arrangements, it is necessary to have all state-controlled mass media allocate "free forum" space, and to adopt a procedure governing national-wide discussion of draft laws (including the draft laws on the state budget) before they are submitted to the Duma for vote.