

**Governed by Bandits: The Evolution of Social Order through Violent  
Entrepreneurship in Post-Soviet Russia**

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### Abstract

Contrary to standard interpretations of Russia's decade of post-socialist transition as one of chaos and disorder, this study demonstrates that organized crime played a significant role in the re-creation of social order after the Soviet collapse. Drawing upon existing fieldwork and interview data on the Russian mafia, the study bridges neoinstitutional and rational choice theories with literature on Foucauldian political culture and economic sociology in order to frame "violent entrepreneurs" as significant actors in a socially embedded market for protection. New market relations transformed political and cultural relations as functions of government shifted from the state to localized spheres of criminal influence. This study challenges state-driven policies to prosecute organized crime as a means of introducing rule of law. More broadly, it confronts the traditional debate in transition studies between "institutional optimists" and "cultural pessimists" by arguing that social change is evolutionary and fluid rather than culturally predetermined or authoritatively imposed.

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## I. Introduction

### *Prevailing Assumptions*

At the close of the twentieth century, commentators reflected with apocalyptic trepidation on the state of post-Soviet Russia. Hopes of liberty and free markets became trampled in the dust of a chaotic, brutal robber-capitalism. After a visit to Moscow in the late 1990s, *New York Times* columnist Thomas Friedman described the sullied intermarriage between government ministries, mayoralities, private businesses, local oligarchs, and criminal elements. The sheer combination of social forces for evil amounted to case of “BizCzarism,” as he termed it.<sup>1</sup> For Russian political analyst Sergei Markov, the post-Soviet Russian state looks like a “Charles Atlas full of muscles.” Upon closer inspection, he notes that the Atlas is actually dead, prostrate and full of worms feeding off the remains.<sup>2</sup>

The panic is not unfounded empirically. Several scholarly sources from the 1990s report that organized crime controlled forty percent of turnover in goods and services as early as 1993, most of which consisted of smuggling and nonreporting of profits in the private sector to avoid the payment of taxes.<sup>3</sup> Widely cited data report an increase in organized crime groups in Russia from fifty in 1988 to 952 in 1991, 4,300 in 1992, and 14,050 in 1995.<sup>4</sup> Stephen Handelman’s work, which was among the first to introduce the West to the inner workings of the Russian *mafija*, illustrates the ominous rise of “nomenklatura capitalists” who abandoned former

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<sup>1</sup> Quoted in “Russian Organized Crime and Corruption: Putin’s Challenge.” *CSIS Task Force Report* (2000): XIII. In addition to this, the writers of the CSIS (Center for Strategic and International Studies) Task Force Report in 2000 on Russian Organized Crime and Corruption state (in the Foreword, XVII), “Most Russians, steeped in the history of 1000 years of autocratic rule, would welcome a strong government. Their idea of good government is tough government. Democratic politics and market economics as they have taken root in Russia are seen by average Russians in numerous polls as a vast Western conspiracy to weaken Russia. Now they hope Putin will impose law and order and slay the dragon of corruption and criminality.” The authors later add that Putin must “declare war against organized crime.”

<sup>2</sup> Ibid.

<sup>3</sup> “Ukreplennye zakonnosti i borba s prestupnostiu” (Strengthening of law and the struggle with crime), *Gosudarstvo i Pravo* 9 (1999): 74.

<sup>4</sup> Vadim Volkov, *Violent Entrepreneurs: The Use of Force in the Making of Russian Capitalism* (Ithaca: Cornell University Press, 2002), 18.

communist party positions en route to becoming major monopoly financiers. In effect, an underground legacy of *krugovaya poruka*, blended with unbridled capitalism and “official chicanery”, produced a “crisis of governance” and posed a threat to the future of the Russian state.<sup>5</sup> When President Yeltsin admitted that crime was “problem number one,” Handelman remarks dejectedly, “it sounded, unfortunately, like an admission of defeat.”<sup>6</sup> Quite clearly, the prevailing assumptions demanded that the state take back its control. At the end of the Yeltsin era, Senior Vice President of the World Bank Joseph Stiglitz warned in his keynote address at the bank’s Conference on Development Economics that emergent property rights in a highly imperfect Russian transition “contribute to the weakening of the state and the undermining of the social order through corruption and regulatory capture.”<sup>7</sup> In the aftermath, therefore, Russia emerged into the twenty-first century badly mangled and handicapped by parasitic elements from within, exhibiting strikingly un-“modern” feudal relationships and personalistic violent enterprise instead of constitutional order, property rights, and market relations. Russia became the “Wild, Wild East,” an open book of bribery, extortion and violence.<sup>8</sup> In the characteristic Russian political tradition, upon taking office Vladimir Putin called for a revolution from above: social order would arise from a “dictatorship of laws.” To recapture the state, policy experts identified the new leader’s goal: he would have to “uproot the very foundations of the criminal state that incubated in the ashes of the Soviet Union.”<sup>9</sup>

Much of this analysis lends itself to pessimistic, doomsday notions of the 1990s. Descriptions of violent criminal activity accurately portray the degree of uncertainty and strife

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<sup>5</sup> Stephen Handelman, “The Russian ‘Mafiya,’” *Foreign Affairs* 73 (1994): 88.

<sup>6</sup> Ibid.

<sup>7</sup> Joseph Stiglitz, “Whither Reform? Ten Years of the Transition,” *Annual Bank Conference on Development Economics* (1999).

<sup>8</sup> Walter Goodman, “TV Weekend: Crime and Corruption in Russia,” *The New York Times* (10 March, 1995).

<sup>9</sup> CSIS Task Force Report, XIII.

that incipient mafia networks wrought upon society in the early 1990s. Assumptions about the factors that brought these networks about, however, become muddled in panic. Oftentimes, notions of disorder and the destruction of social capital stem from inaccurate analytical frameworks. Friedman's quip about "BizCzarism," however linguistically humorous or clever, becomes contextually significant in the Russian sense. Phonetically, one may perceive the term to sound like "bez-Czarism" ("без-царизм"), with the prefix "bez" signaling "without." Indeed, the 1990s were not only "without czars," but in a careful neoinstitutional lens, they were ultimately without a functioning state altogether. From this premise, we begin to see organized crime as a significant reaction to given institutional circumstances. The reality of post-socialist Russia fails to fit into standard scholarly recipes for transition.

*Literature Review: Divisions within Transition Studies*

To decipher Russia's potential trajectory towards liberalism and modernization out of socialism, contemporary scholarship typically divides itself between two primary schools of thought. We may classify the first under development theory and institutional optimism and the second under cultural pessimism. Advocates of the former tend to treat law as "technical equipment" or "social machinery"<sup>10</sup> that can be plugged into a society and effectively take root as a system of impersonal institutional practices. According to advocates of the later, post-socialist societies characterized by clientelism, under-handedness and elusiveness simply do not meet the cultural prerequisites possessed by Western liberal democracies to develop effective formal institutions. Neither perspective adequately resolves the contemporary puzzle of Russian politics and liberalism. By indulging in fatalistic "bottom-up cultural" or domineering "top-down institutional" divisions within transitology, we lose sight of the critical micro-evolutionary

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<sup>10</sup> Martin Krygier, *Rewriting Rights in Europe* (Sydney: Ashgate), 93.

middle ground that gives us reason to employ both institutional and cultural perspectives on social change towards liberty in a post-totalitarian and post-communist society.

In reference to the 1990s, scholars focusing on institutional and developmental theory typically argue that top-down legal and constitutional reform will cause a shift in longstanding behavioral patterns on the social level. Using Douglas North's framework of state formation, one may suggest that multiple centers of power will find it in their interest to coalesce under a single institutional framework with a monopoly on force so that they may negotiate and resolve disputes under a common set of assumptions. As rational actors, Russians in transition should theoretically recognize that a reformed legal system would lower transaction costs and subsequently shift their reliance on patron-client networks towards reliance on rule of law. This hypothesis, however, was largely overturned in Russia in the 1990s. Instead of responding to administrative and constitutional changes from "above," rational actors shifted their preferences to extra-legal forums of transaction. Kathryn Hendley writes, "The concept of rationality is content free, and connotes only interest-maximizing behavior."<sup>11</sup> Individuals are therefore not blind automata responding to technocratic changes by the state: they rather respond to new rules of the game on the street level. Privatization in the 90s did not cause a longstanding shift towards a general acceptance of the rule of law because the state failed to adequately establish a monopoly on force and North's "common set of assumptions." After Gorbachev's economic reforms, sharp openings in entrepreneurial opportunities incentivized the massive expansion of select patronage and racketeering networks. We may conclude, therefore, that social behavioral patterns arise out of and adapt to their institutional environment. They do not automatically follow institutional design.

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<sup>11</sup> Kathryn Hendley, "Legal Development in Post-Soviet Russia," *Post-Soviet Affairs* 13, no. 3 (1997): 240.

Undergirding institutional optimism and development theory is a deeper commitment to social constructivism.<sup>12</sup> Drawing on the tradition of Cartesian rationalism that suggests that man's achievements are the sole product of his reasoning, social constructivism presupposes that institutions serve human purposes and interests only if they have been designed for those purposes. In other words, "man's reason alone should enable him to construct society anew."<sup>13</sup> Also contingent upon this philosophical foundation is the "statist view" within literature on social capital, which suggests that social capital requires formal institutions to flourish.<sup>14</sup> In consequence, the state must actively nurture a stable and predictable environment in which civil society may emerge. Transitional Russia, however, offers an example of a virtual vacuum of power and the subsequent *self*-renegotiation of socioeconomic rules and institutions, ultimately challenging the preoccupation with deliberate and conscious social design prevalent in this school of thought.

On the other side of the spectrum, Robert Putnam, Samuel Huntington and Piotr Sztompka offer variations on a pessimistic theme, arguing primarily that healthy and impersonal formal institutions will not thrive without a historically entrenched civic culture. Sztompka dooms subjects of post-socialism to "civilizationally incompetent"<sup>15</sup> cultural fortunes; others suggest that Russians returned to "pre-Soviet particularisms"<sup>16</sup> once the Soviet yoke came undone in 1991. If this were true, however, we would have to pretend that socialism never existed or substantially impacted people's behavior; Seventy-four years under socialist law

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<sup>12</sup> Friederich Hayek, *Law, Legislation and Liberty: Volume 1 Rules and Order* (Chicago: University of Chicago Press, 1973), 10.

<sup>13</sup> Ibid.

<sup>14</sup> Linda Cook, "Social Cohesion in Russia: The State and the Public Sector," in *Social Capital and Social Cohesion in Post-Soviet Russia*, ed. Judyth Twigg and Kate Schecter (Armonk M.E. Sharpe, 2003), 17-33.

<sup>15</sup> Piotr Sztompka, "Civilizational Incompetence: The Trap of Post-Communist Societies," *Zeitschrift für Soziologie* 22, no. 2 (1993): 90.

<sup>16</sup> Krygier, 99.



would become a general embarrassment to a country's cultural destiny. It is also unclear *what* pre-Soviet particularisms people have re-adopted (i.e. have Russians of the 1990s become just like Russians of the 1890s after the fall of the Soviet Union?). Not only is this empirically impossible to corroborate, but it is wholly unwarranted in dismissing people's fundamental *capacity* to govern themselves if given the freedom to do so. In his commentary on differences in social capital across Italy, Robert Putman suggests that civic traditions are almost impossible to change, merely highlighting the stereotype that "Italy, from Rome south, is really part of Africa."<sup>17</sup> Indeed, it is easy to incorporate the Italian case study and apply the same cultural sentence to Russia, which Google's founder Sergey Brin has called "Nigeria with snow."<sup>18</sup> Vadim Volkov identifies a similar stream of thought in the communist legacy approach to organized crime, which stresses the cultural heritage of lawlessness and informal relations inspired by state socialism and attributes racketeers of the 90s to the communist "variety of felon."<sup>19</sup>

This particular school of thought is bolstered by scholars' flawed attempts to treat social capital as a cultural, rather than institutional, phenomenon. Within literature on social capital, Coleman and Granovetter offer a more conducive model for the Russian case study. Rather than treating social capital as evidence of durable cultural norms absorbed by individuals, they identify the conditions under which social trust is generated through a rational choice lens, treating trust as endogenous to interpersonal relations. This approach is useful because it corroborates the premise that behavior and social norms constantly respond and adapt to their

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<sup>17</sup> La Palombara 1993, p. 530, quoted in Robert Jackman and Ross Miller, "Social Capital and Politics," *Annual Review of Political Science* 1, no. 1 (1998): 51.

<sup>18</sup> "Sergei Brin: Russia is Nigeria With Snow," [http://digg.com/news/technology/Sergey\\_Brin\\_Russia\\_is\\_Nigeria\\_with\\_Snow](http://digg.com/news/technology/Sergey_Brin_Russia_is_Nigeria_with_Snow)

<sup>19</sup> Volkov, *Violent Entrepreneurs*, 18.

institutional environment, and are not predetermined cultural formulas. Otherwise, accepting tenets of cultural determinism would make all further discussion on this topic unnecessary.

The theoretical framework of this project aims to bridge the gap between versions of top-down social engineering and bottom-up cultural pessimism. Neither culture nor institutions exist in a vacuum. Culture, behavior patterns, customs and habits naturally evolve and adapt to their institutional environments, thereby helping shape new institutions and reform existing ones. We face an *interplay* between the variables – not a choice between them. The process of social change is evolutionary and fluid rather than culturally predetermined or authoritatively imposed. Social order results from a spontaneous progression of combined social experience and the mobilization of resources within networks of personal relations. Networks of racketeers, in this analytical context, actually *facilitate* the development of social capital and trust rather than impede it. As racketeers’ redefinition of the market naturally led to a redefinition of social order and power relations in the 1990s, we develop an entirely new conceptualization of politics as a process inherent in everyday life. We may also subsequently better understand the overlapping roles of governance, market forces, and cultural evolution in individuals’ daily mediation of needs. Ultimately, to re-frame the traditional debate within transition studies, this project uses a micro-evolutionary and neoinstitutional framework of analysis, incorporating both aspects of rational choice theory and the dynamic historical and organic processes through which social institutions – in this case, the products of organized crime – arise.

### *Methodology*

The majority of research in this project relies on existing sociological on-sight fieldwork research in Russia throughout the 1990s. Primary source collection on the Russian “underground” in Soviet and post-Soviet conditions is a challenge. Archival and journalistic

evidence is sparse for a variety of reasons. No official data or records existed on organized crime in the Soviet Union because Communist Party officials denied the very existence of “bourgeois” criminal activity or private capital accumulation. By the 1990s, the few media outlets that reported on the topic could not financially sustain themselves sufficiently to store article archives. Anecdotally, few newspapers covered the topic due to a prevailing notion that organized crime was something obviously understood by everybody. More recent articles in the Russian and foreign press have begun to uncover organized crime since the fall of the Soviet Union and offer a mosaic-mix of interviews with entrepreneurs, “mafia kingpins” and officials, statistics from the Ministry of Internal Affairs, investigative reports, and criminal stories. This ongoing narrative on organized crime from the past decade has significantly deepened my institutional analysis of real-life events in the tumultuous post-Soviet market place. A comparative analysis between Russian and Western press in the 1990s has contributed to my presentation of the prevailing “western” assumptions about organized crime and their attendant policy prescriptions for reform to the Russian government.

In addition to the available press, I am greatly indebted to a few scholars who have produced rare on-site analytical research on organized crime in the 1990s, with a particular emphasis on the work of Stephen Handelman (published in 1995), Federico Varese of Oxford University (published in 2001) and Vadim Volkov of the European University in St. Petersburg (published in 2002). Handelman’s work contains vivid journalistic accounts of criminal activity when it was at its peak. Both Varese and Volkov adopt neoinstitutional analytical assumptions and use primary archival documents from courts, police, the Interior Ministry, and thousands of newspaper and magazine articles published locally in their regions of study from 1989-2000. Both authors also present interview data collected over a period of several months in the mid and

late 1990s, covering the stories of local shop owners and their bandit authorities. Volkov's study incorporates accounts of criminal groups, heads of private protection companies, current and former police employees, experts, and business people. Specialized Russian press organs and investigative reports have informed both scholarly accounts. Varese's primary account covers Perm while Volkov's account covers St. Petersburg, Moscow, and Ekaterinburg. The combination of the investigative, journalistic, and interview data offers an altogether comprehensive "big picture" of organized crime within major metropolitan and criminally syndicated centers. The consistency of existing data on the subject indicates its ability to be replicated. Fieldwork and interview data result from research techniques that frame neutral questions and protect the identities of their interviewees. While different authors analyzing organized crime sometimes arrive at different normative conclusions on what "should be" done, their fieldwork is empirically consistent, showing comparable accounts of organized criminal activity by market actors and violent entrepreneurs in a variety of regions. While the aggregated interview and statistical data are often subject to estimates and subjective evaluations, it has shown to be robust, applicable to multiple studies, and therefore sufficiently reliable and valid.

The theoretical component of this study relies on an interdisciplinary nexus of scholarship across cultural, political and institutional studies. I derive the thrust of my analysis from the Bloomington School of institutional analysis, pioneered by Elinor and Vincent Ostrom at the University of Indiana, Bloomington. The primary arguments of this school of thought are discussed in the project. The Ostroms define institutions not merely as structures of top-down design, but as knowledge and decision processes in constant flux. Boettke and Aligica are the foremost authorities on this school of thought. I further combine the insights of cultural studies, social capital theory, political culture, and Austrian economics to re-conceptualize social order

through violent entrepreneurship as a bottom-up phenomenon. To this end, the contributions of Don Lavoie, Emily Chamlee-Wright, Peter Boettke, Michel Foucault, William Walters, and Friedrich Hayek are crucial to the project.

This capstone project therefore frames empirical findings on organized crime within an interdisciplinary theoretical discourse on social change. In Section II, I briefly explore classical definitions of organized crime and the historical evolution of order towards rule of law in order to establish the assumptions dominating existing literature and public policy on organized crime. This section will provide a useful contrast to the neoinstitutional framework, which I introduce in Section III. Section III includes the theoretical underpinnings to the later empirical section on Russian organized crime. I explore neoinstitutional literature on social change and organized crime to establish my analytical framework and main assumptions. In Section IV, I explore the applications of the theory to the Russian case study, examining the post-Perestroika institutional environment, the supply-side and demand-side aspects of the market for protection, practices of extortion and the evolution of enforcement partnerships. In Section VII, I analyze the Russian criminal territorialization of socioeconomic space in the neoinstitutional framework. This analysis summarizes empirical findings and challenges prevailing assumptions established earlier in the project. Section VIII contains a broader theoretical discussion on the problems of theoretical dichotomies within transition studies and ultimately offers a broader re-conceptualization of social change. The conclusions of the capstone may extend to other case-studies in the world and in history.

## II. Crime versus Rational Legal Order: Redefining Classical Dichotomies

### *Classical Definitions of Organized Crime*

To clarify my use of the term ‘organized crime,’ I will first explore a number of classical theories on organized crime to separate my approach from how others have approached the concept in the past. Abadinsky identifies organized crime as a non-ideological group of enterprises involving a number of persons in close social interaction organized hierarchically to secure profit and power by engaging in illegal and legal activities.<sup>20</sup> Pace and Styles see criminal groups as simple business organizations operating under various management structures dealing in illegal products. To show examples of the criminal trades, Posner cites loansharking, prostitution, gambling and narcotics to legalized fields.<sup>21</sup> Tomass takes a more generalized approach, in which agents of organized crime constitute a hierarchically structured and resource-sharing group that enforces informal rules and uses informal means to achieve informal ends without the voluntary consent of outsiders.<sup>22</sup> In the Russian context, some notions of the concept in the 1990s confuse it with Soviet definitions of *mafia* that denounced anyone with unreasonable sums of money as culprits of organized crime.<sup>23</sup> In short, organized crime traditionally fits under the umbrella of what Milhaupt and West call the “dark side of private ordering,” a form of either coercive or otherwise violent enterprise that groups itself outside of formal institutions and legal order.<sup>24</sup>

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<sup>20</sup> Howard Abadinsky, *Organized Crime* (Nelson-Hall 2<sup>nd</sup> Ed, 1985), 7, cited by Milhaupt and West, 42.

<sup>21</sup> Richard Posner, *Economic Analysis of Law* (Little, Brown 4<sup>th</sup> Ed, 1992), 242, cited by Milhaupt and West, 42.

<sup>22</sup> Mark Tomass, “Mafianomics: How did mob entrepreneurs infiltrate and dominate the Russian economy?” *Journal of Economic Issues* 32, no. 2 (1998).

<sup>23</sup> Stephen Handelman, *Comrade Criminal* (Binghamton: Vail-Ballou Press, 1995), 21.

<sup>24</sup> Though Milhaupt and West consider the concept as an underground, “dark” affair, their institutional analysis eventually illuminates the “above-ground” aspects and organized crime in daily life. This theoretical conclusion is extremely important in later sections of this paper.

A mere engagement in illegal or underground activities, however, does little to delimit the functions of criminal groups. Because they employ hierarchical management structures, share resources, govern themselves by networks and internal rules, to what extent do organized crime groups differ from the internal organization of governments and firms? By focusing too much on the structural organization of criminal groups, analysts tend to overlook that ‘mafia’ as a phenomenon depends upon its social setting rather than on its internal structure to function effectively.<sup>25</sup> The “underground versus above-ground” dialectics in the literature identify forces of good and bad, but do very little to explain the functions of either side. Most importantly (and perhaps most egregiously), generalized concepts of “illicit” and “dark” habits within criminal networks oftentimes treat the existence of rational social order as either absolute, already existing, or necessarily defined by formal institutions. To clarify the role of organized crime in both “dark” and “light” aspects of social order, we must trace the evolution of the phenomenon from its point of origin. As Volkov theorizes in his critical analysis of “violent entrepreneurs” in Russia’s age of transition, organized crime is not a mere exercise in illicit business: it is the “constitutive basis of any modern nation.”<sup>26</sup>

### *The Historical Evolution of Order towards Rule of Law*

The functional evolution of organized crime is intricately intertwined with the history of power relations and statehood. Hendley and Volkov both analyze the evolution of localized extortion into formal legal rationality, starting with the feudal period. In the sixteenth century, competing maritime powers sought to increase the costs of protection of their competitors and achieve advantages for their own sailors and entrepreneurs. At the same time, princes and barons

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<sup>25</sup> Joseph L. Albin, R.E. Rogers, Victor Shabalin, Valery Kutushev, Vladimir Moiseev and Julie Anderson, “Russian Organized Crime: Its History, Structure and Function,” *Journal of Contemporary Criminal Justice* 11 (1995): 215.

<sup>26</sup> Volkov, *Violent Entrepreneurs*, 166.

held control over territorial monopolies and competed for sources of tribute from monarchs, constantly ending up in military confrontation. Because monarchies controlled aggregate wealth in society, they were in a prime position to charge protection rents from merchants and producers, who would use the income to purchase protection at lower prices than their competitors.<sup>27</sup> As society became more complex, burgeoning merchant classes began to rival each other for political power through patronage networks. Legal institutions eventually developed not so much for the competitors' mutual advantage as for the assurance of mutual *disadvantage*: naturally, contractual relations increased the cost of opportunistic behavior between disputing parties. A system of impersonal and predictable rules became indispensable for market (and consequently political) transactions. Hendley notes that courts emerged under the auspices of merchants before they came under the domain of the state.<sup>28</sup> Avner Greif makes a similar argument in his comparative study of eleventh-century individualistic Genoese and collectivistic Maghribi traders where he notes that Genoese traders remained in trade for centuries because they required the development of formal legal and political enforcement mechanisms to facilitate inter-economic trade with strangers.<sup>29</sup>

Consistent with a bottom-up analysis of the rationalization of legal arrangements in the medieval period, these accounts fit nicely with theories of state formation put forth by Weber and North. While Weber interprets the origins of modern "law" through the lens of organic political struggle and North tends to view the process as an outcome of custom and practice in the world of private enterprise, each account is consistent with a rational-choice analysis that presents legal order as fundamental to the reduction of transaction costs. Both politically and economically, a

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<sup>27</sup> Volkov *Violent Entrepreneurs*, 159-165.

<sup>28</sup> Hendley, "Legal Development," 231.

<sup>29</sup> Avner Grief, "Cultural Beliefs and the Organization of Society: A Historical and Theoretical Reflection on Collectivist and Individualist Societies," *The Journal of Political Economy* 102, no.5 (1994): 912-950.



series of elimination contests eventually diminished the number of hands in which power rested. North comments on the exclusionary nature of developing property over larger domains, explaining that “an organization which has a comparative advantage in violence is in the position to specify and enforce property rights.”<sup>30</sup> Following the medieval period, Volkov notes that civilizations become most highly developed where the ruling forces successfully impeded free acts of aggression between competitors for power, turning them into a “complex of refined moral and ethical norms.”<sup>31</sup> Once a state claimed a monopoly on legitimate coercion within the confines of its territory, it could begin to provide general protection as a public good, one that is characteristically neither rival nor excludable. Ultimately, political struggle and the expansion of economic horizons created a demand for standardized institutions that could enforce contracts, help settle disputes, and protect private property rights.

The process of legal development is reflected in Hendley, Murrell and Ryterman’s analysis of the seven top strategies that enterprises tend to use to pursue efficiency and predictability in business relations, which move from relational contracting and self enforcement to enforcement through private connections and third party arbiters and eventually to litigation and the court system.<sup>32</sup> While local relational contracting is successful when commercial relations are carried out repeatedly over long periods of time, they are unsuccessful once an agent becomes unsure of the other party’s motives. As a result, he develops a demand for third-party enforcement to relieve himself of the costly calculus of potential opportunism. Hay and Shleifer note that private rules will not be known or accepted by rival parties and will become

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<sup>30</sup> Douglass North, *Structure and Change in Economic History* (New York: Norton, 1981), 21.

<sup>31</sup> Vadim Volkov, “The Political Economy of Coercion, Economic Growth, and the Consolidation of the State,” *Problems of Economic Transition* 43, no.4 (2000): 24-40.

<sup>32</sup> Kathryn Hendley, Peter Murrell and Randi Ryterman, “Law, Relationships and Private Enforcement: Transactional Strategies of Russian Enterprises,” *Europe-Asia Studies* 52, no. 4 (2000): 627-656.

too burdensome to enforce consistently.<sup>33</sup> A move towards third-party enforcement embeds the market transaction in a wider network of relations, which ultimately facilitates trust between opportunistic strangers.

Rational legal order, as a result of this evolution, becomes the linchpin of all further discussion on the requisites for a successful modern society. It is here that scholars, not least of whom included the “shock-tastic” analysts of the Russian transition, became preoccupied with social classifications of “formal” and “informal,” public order and private disorder, and other repeated dialectics. Carrothers notes that rule of law – defined as a system in which laws are public knowledge, clear in meaning and equally applied – is often treated as the only blanket formula capable of facilitating social relations.<sup>34</sup> While the concept is arguably the most socially desirable of the options in Hendley et. al.’s scale on a macro level, it tends to cover up institutional nuances in developing nations with a film of utopian expectations, which, when unmet, yield disastrous and apocalyptic conclusions. Without rule of law, some claim, corporations, banks and labor unions would not function and regulatory mechanisms, tax systems, and customs systems would become overly inefficient. Crime, Carrothers writes, the ever creeping “dark side” of social order, erodes public support for democracy and hurts the economy.

When crime is traditionally treated as an insidious and underground phenomenon in an institutional vacuum, we may easily conclude that Russian organized crime contributed to the dissolution of social order in the 1990s. This argument, however, presupposes *a priori* the existence of rule of law or competency of the state. Its derivative logic assumes that capital in a

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<sup>33</sup> Jonathan R. Hay and Andrei Shleifer, “Private Enforcement of Public Laws: A Theory of Legal Reform,” *American Economic Review* 88, no.2 (1998): 398-403.

<sup>34</sup> Thomas Carrothers, “Rule of Law Revival,” *Foreign Affairs* 77, no. 2 (1998): 95-106.

society will be channeled by predetermined institutional mechanisms towards predetermined ends. Expectations of reform consistently circulate back to the state, the presumed ultimate arbiter and carrier of social capital and civilized order. Linda Cook applies this framework in a sociological lens, assuming that the development of civil society and social capital is contingent upon formal institutions. The public sector, in other words, is foundational to the development social cohesion and networks of trust. Given the general transitional environment of the 1990s (one only need to think of worms carving out the system), the state, as Cook argues, must re-establish its credibility to regain its levees of social coordination and pull its subjects out of the underground.<sup>35</sup> Because of the *de jure* existence of a state, this argument precludes the possibility that the state *de facto* does not exist, and that competing organized criminal forces are in fact engaging in a state-building and order-creation process. By trapping informal and “criminal” elements in the theoretical underground, proposals demanding one institutional system prevent the possibility of entrepreneurial discovery – indeed, even in a violent sense – to correct failures in the market for order and protection.

Importantly, one must qualify the difference between treating rule of law as a *desirable* means toward achieving social order and as an *unconditional* means of *assuring* social order. Indeed, it became both theoretically and empirically clear by the enlightenment era – and most clearly advocated by Adam Smith and David Hume – that human progress and civilized society would not develop without the guarantee of property rights, the free transfer of property by voluntary contractual agreement, and the commitment to promises between parties.<sup>36</sup> Institutions that safeguard individuals against the threat of violence to life and property provide favorable conditions for economic activity. In North’s analysis, an economically productive state will

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<sup>35</sup> Cook, “Social Cohesion in Russia,” 17-33.

<sup>36</sup> Wolfgang Kasper and Manfred E. Streit, *Institutional Economics: Social Order and Public Policy* (Northampton: Edward Elgar, 1998), 20-35.

protect property rights in order to allow private market production from which it may extract taxes to better provide public goods like courts and police. In a mutually reinforcing relationship, private firms will choose to operate in the official economy because it provides the institutional framework within which they can maximize gains. Volkov adds that the state must not be thinking about survival and short-term gains or be involved in the interests of private individuals in order to ensure general social trust in its institutions, provide impartial mediation of conflicts, and specify individual property rights. Indeed, a state that “realizes the interests of owners rather than its own interests is more productive.”<sup>37</sup> In setting parameters for analysis, Volkov identifies a strong state as one with a capacity for compulsion and administration and an explicit delimitation of what is in and outside the state. A weak state, in turn, has gaps in its capacity to enforce law through police and violates institutional boundaries between state and citizen, thereby becoming unable to carry out the Smith-Hume prerequisites.

Analysts of the Russian transition were not wrong in identifying the characteristics advocated by Smith and Hume as ideal end-goals. Rather, they made a mistake by assuming that strong institutional structures were in place against which darker underground criminal elements provided resistance. The existence of organized crime requires that a central body delineate what it means to be “criminal.” The agents over whom the body governs must generally accept those conditions. Yet the very fundamental grains of social order and prosperity - primary enforcement mechanisms, the guarantee of property rights and the institutional oversight over contractual promises - may not *de facto* belong to a state while it is in crisis, transition, or formation. In this context, we seek an alternative institutional definition of organized crime.

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<sup>37</sup> Volkov, “The Political Economy,” 33.

### III. An Institutional Analysis of Organized Crime

#### *The Rational Actor and the Origins of Social Order*

To successfully chart the micro-institutional mechanisms of organized crime, we must first develop an analytical grammar in order to explain how and why social rules develop. Ludwig Lachmann embeds an understanding of social order in an open system that consistently changes and avoids comprehensive event regularities: “The formation of expectations,” he writes,” is an “act of our mind by means of which we try to catch a glimpse of the unknown.”<sup>38</sup> The development of order out of a world of lawless uncertainty requires that each person establish a basis for anticipating how others will behave in order to receive reassurance that others will not act in an opportunistic manner of detriment to his well being. An individual’s capacity to anticipate future events, however, is dependent upon his existing knowledge. As long as new knowledge constantly accrues to the beat of a changing environment, long-term planning becomes extremely difficult. Leading neo-institutional scholars in the Bloomington School lay down the fundamental assumption that human beings have limited rationality and limited information about their environment.<sup>39</sup> “Fallible creatures,” writes V. Ostrom, “need to accommodate their plans to changing levels of information and knowledge.”<sup>40</sup> No decision maker will know all the consequences emanating from his actions. “A proneness to error will plague all human efforts.”<sup>41</sup>

Social order in this school of thought therefore depends upon human cognitive abilities to formulate, determine and enforce rules. In each decision situation facing a human being, an

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<sup>38</sup> Ludwig Lachmann, “From Mises to Shackle: an essay on Austrian economics and the Kaleidic society,” *Journal of Economic Literature* 14 (1976): 59.

<sup>39</sup> The Bloomington School of institutional analysis is pioneered by the works of Vincent and Elinor Ostrom, described in this section.

<sup>40</sup> V. Ostrom, cited in Paul Dragos Aligica and Peter J. Boettke, *Challenging Institutional Analysis and Development: The Bloomington School* (New York: Routledge, 2009), 59-60.

<sup>41</sup> *Ibid.*, 66.

individual must internally assess his environment, determine the potential outcomes of his actions, and commit to a method of responding to that environment consistently over time.<sup>42</sup> In other words, individuals unconsciously develop strategies to minimize the risk of living in the social world. Planning becomes an essential strategy for organizing information in an assessment of alternative possibilities of action. Vulnerability, uncertainty, ignorance, learning and adaptability are key factors necessitating the organic development of rules and their institutionalization.<sup>43</sup>

E. Ostrom defines rules as “prescriptions commonly known and used by a set of participants to order repetitive, interdependent relationships.”<sup>44</sup> They are, in essence, a means of intervention in the structure of incentives facing each decision maker. Searle describes them as a “reservoir of non-intentional capacities, abilities, tendencies, habits, dispositions, taken for granted presuppositions and know-how generally”<sup>45</sup> Importantly, we should stress that the development of institutions rests on a spontaneous and organic combination of *shared perceptions*. V. Ostrom writes that stability in a rule-ordered environment depends upon these shared definitions; “rules are not self-formulating, self-determining, or self-enforcing.”<sup>46</sup> Changing circumstances constantly temper those definitions, thereby transforming the social environment in a feedback loop back to the individual. In Lachmann’s work particularly, the tension between individual and structure becomes aggravated. In reality, however, the development of order does not depend exclusively on individual voluntarism or on an irreducible

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<sup>42</sup> Ibid.

<sup>43</sup> Ibid., 57.

<sup>44</sup> Elinor Ostrom, “An Agenda for the Study of Institutions” (1986), in *Polycentric Games and Institutions: Readings from the Workshop in Political Theory and Policy Analysis*, ed. Michael McGinnis, 89-114 (Ann Arbor: University of Michigan Press, 2000).

<sup>45</sup> Searle 1999: 107-108, cited by Paul Lewis and J. H. Runde, “Subjectivism, social structures and the possibility of socio-economic order,” *Journal of Economic Behavior and Organization* 62 (2007): 1671–86.

<sup>46</sup> Vincent Ostrom, “Artisanship and Artifact,” in *Polycentric Governance and Development*, ed. Michael McGinnis, 11 (Ann Arbor: University of Michigan Press, 1999).

social structure. Intentional agency and structure are in fact recursively related: people draw on structure to formulate behavior, and that behavior may either reproduce or transform that structure.<sup>47</sup> Decision makers may change strategies and objectives as they develop new common understandings.

This theoretical conceptualization of order very crucially impedes upon standard assumptions within transition studies, which stress either deterministic qualities in the environment or the volition of an orthodox, rational actor who will change his behavior as long as institutions are designed correctly. In Mark Granovetter's terms, such extremes would amount to oversocialized and undersocialized understandings of social change.<sup>48</sup> When analyzing the specific institutional attributes of organized crime, the scholar must avoid falling into a functionalist trap most often propounded by neoclassical economics, which leads us to believe that efficient institutions will automatically arise in response to prevailing economic conditions. In line with Granovetter's critique, this classical notion in the rational choice tradition relegates the role of the individual in shaping the dynamic processes of social change by stressing the inevitability of institutional responses to market demands. Quite to the contrary, the rise of institutions (such as protection rackets) is a highly discursive affair, constantly in flux, and constantly feeding back to individuals. A key assumption underpinning this study of Russian organized crime takes Granovetter's critique seriously: Institutions are "constructed by individuals whose action is both facilitated and constrained by the structure and resources available in the social networks in which they are embedded."<sup>49</sup> We must take organized crime out of the dialectical underground and treat violent entrepreneurs as significant, rational actors

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<sup>47</sup> Paul Lewis and J. H. Runde, "Subjectivism, social structures and the possibility of socio-economic order," *Journal of Economic Behavior and Organization* 62 (2007): 1671–86.

<sup>48</sup> Mark Granovetter, "Economic Institutions as Social Constructions: a Framework for Analysis," *Acta Sociologica* 35 (1992): 3–11.

<sup>49</sup> *Ibid.*, 9.

who live in the social world. The following section delineates in more careful detail the functions of organized criminal groups within their institutional environments.

### *The Mechanics of Organized Crime*

Recent scholarship has made impressive headway in framing “the mafia” as a significant functional social phenomenon. Diego Gambetta’s analysis on the Sicilian mafia pioneered the redefinition of organized crime out of the arena of illicit and underground activity into a genuine market for protection. From his neoinstitutional perspective, organized crime is a set of firms which: a) are active in the protection industry under a common trademark with recognizable features, b) acknowledge one another as legitimate suppliers of authentic Mafioso protection, and c) succeed in preventing the unauthorized use of their trademark by private firms.<sup>50</sup> As an institution, it is a “governance structure” and an “organization of collusive agreements” designed to safeguard against cheating on goods, promises, or rights.<sup>51</sup> The most commonly cited functions of organized crime include the minimization of risks in enterprise, the guarantee of the fulfillment of contract obligations and the provision of enforcement mechanisms for the resolution of disputes.<sup>52</sup> Several definitions also include the acquisition of information, real estate foreclosure, corporate monitoring, lending, and *crime control* itself.<sup>53</sup> To return briefly to previous conceptions of organized crime, these definitions differ from romanticized or structure-based definitions. Using Albin’s classifications of organized crime, the neoinstitutional perspective focuses on *syndicated* organized crime, as opposed to political-social organized crime, mercenary organized crime, or in-group organized crime. In the latter categories, groups

<sup>50</sup> Diego Gambetta, *The Sicilian Mafia: The Business of Private Protection* (Cambridge: Harvard University Press, 1993), 155.

<sup>51</sup> *Ibid.*, 24.

<sup>52</sup> Thomas C Schelling, “Economic Analysis and the Criminal Enterprise,” *Public Interest* 7 (1967): 61-78, cited by Fiorentini (1999); Gambetta, *The Sicilian Mafia*; Volkov, *Violent Entrepreneurs*; Milhaupt and West, “The Dark Side.”

<sup>53</sup> Volkov, *Violent Entrepreneurs*, Milhaupt and West, “The Dark Side.”



will use violence either for purely financial profit or for psychological and social gratification of belonging to a deviant society. In the former category, which is of primary concern in the present analysis, violence is used towards the active provision of protection services.<sup>54</sup>

Schelling notes that organized criminal firms will impose protection under the threat of violence without discriminating whether their “clients” are legal or illegal enterprises.<sup>55</sup> In a manner reminiscent of the nascent development of “refined moral and ethical norms” under the auspices of monarchs following the medieval period, groups with a comparative advantage in coercion will delineate the “code by which members of various classes and social groups can organize their lives.”<sup>56</sup> The mafia in Sicily, for instance, served this crucial intermediary and arbitration role by regulating tensions between both government and landowners, and landowners and peasants. Intermediaries served in all sorts of business, from agriculture and marriage to international arms traffic and the housing market – areas not intrinsically “mafioso.”<sup>57</sup> Similarly, in the property rights boom in Japan after World War Two, social boundaries between the legitimate and illegitimate world began to blur in transition. Noting the vacuum of rules, organized crime groups helped rearrange individuals’ mutual expectations in markets by settling civil disputes and governing creditors’ committees. As they became more institutionalized and legitimized in the eyes of their clients, bandits slowly became formal businessmen, later moving past traditional protection to financing golf courses and resort hotels.<sup>58</sup> Where boundaries between rulers and ruled became indistinct, alternative intermediaries rose to fill the power vacuum. In a sense, supply met demand. Taken as a whole, the function of

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<sup>54</sup> Albin et al., “Russian Organized Crime,” 217.

<sup>55</sup> Gianluca Fiorentini, “Organized Crime and Illegal Markets,” *Dipartimento di Scienze Economiche*, Università di Bologna (1999): 437.

<sup>56</sup> Volkov, “The Political Economy,” 24-40.

<sup>57</sup> Gambetta, 17.

<sup>58</sup> Milhaupt and West, “The Dark Side.”

organized crime becomes manifest not in the provision of illicit goods, but in the structuring of market and sociopolitical relations and rule frameworks in an uncertain social world.

To this end, there are several crucial institutional requirements that tend to facilitate the emergence of organized crime. Most commonly cited among these is the lack of a central monopoly on coercion. Anderson argues that organized crime begins to compete with the state when it develops a comparative advantage in the production of military technology.<sup>59</sup> Criminal services are particularly demanded in cases of high regulation, irregular markets, the dissolution of resources, and high information asymmetry in the market. If a firm does not believe it will make a profit after paying costs of state regulation, it will avoid taxes and rely on alternative parties to define and enforce property relations. It seeks new rule enforcers to minimize the risks of opportunism. In their comparative analysis of criminal private ordering in Japan, Milhaupt and West stress that organized crime will flourish wherever property rights and enforcement institutions are misaligned. Detailing Japan's transition from an agrarian to a modern society in the Meiji period (1868-1911) and the aforementioned reconstruction following World War Two, the transplantation of a Western constitution, land tax system, and property rights regime did not match internal institutions in which court supervision over disputes was minimal, banks set extremely restrictive clearing levels, traditional legal documents favored the rights of tenants, and universities produced a minimal number of attorneys. As a result, Japan suffered a severe shortage of state-sanctioned "transaction cost engineers," automatically creating demand for extralegal enforcement mechanisms across virtually all "formal" business interactions. Similar to the North-Weber narrative, agents will tend to coalesce around a monopolist or hierarchical structure that will produce order. Best defined by Kasper and Streit, individuals seek to orient

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<sup>59</sup> A. Anderson, *The Business of Organized Crime: A Cosa Nostra Family* (Stanford: Hoover Institute Press, 1979), cited by Fiorentini, 440.

behavior around a “systematic, non-random and comprehensible pattern of actions and events.”<sup>60</sup>

In the Bloomington context, decision makers change their strategies as they re-conceptualize the meaning of social order. Market actors turn to rule enforcers outside of the state.

In the first stages of market correction, the “boss” will seek to simply thwart threats from competing coercive partners, monitor contract obligations, and repay debts by forcing his services onto an unprotected clientele. Private ordering will require intermediaries who possess the time, information and skill in rights enforcement. The organized crime group will have a visible comparative advantage in violence, which it must preserve in order to remain a reliable authority. What makes someone a Mafioso is his ability to protect himself and others against cheaters and competitors.<sup>61</sup> Initially, victims will often find it hard to hide themselves, and will become particularly vulnerable to racketeering threats if their profits are easily observable and assets are highly specific. At this point, protection resembles a private good. Using North’s conception of the exclusionary nature of property rights development, localized centers of violence will be in a position to limit their client base in order to reap economies of scale and maintain a sphere of legitimate trust. If a Mafioso accepts an infinite number of clients, for instance, he would not be able to collect tribute from all of them, and they may escape to the protection of rival competitors. Furthermore, if too many clients buy into the protection service, one client’s enjoyment of the service may decrease another’s enjoyment, as the Mafioso may lack the resources to expend his energy on the protection of the marginal client. Some firms will feel insufficiently protected and the Mafioso will lose his prestige as they exit the market. In this sense, the market for protection becomes both excludable and rival. The Mafioso develops a

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<sup>60</sup> Kasper and Streit, 24.

<sup>61</sup> Gambetta, 19.

sense of ownership over his limited client-base like a prince establishes sovereignty over his domain.

Over time, protection develops characteristics of a public good as localized extortion grows into an organized market. Facing an unpredictable environment in which he cannot easily recover debts from or prosecute cheaters for contract violations, a businessman will eventually profit from the imposition of a racket. In the Sicilian scenario, a market would simply not have evolved unless Mafiosi negotiated rules between buyers and sellers. For instance, if a buyer suspects he will be cheated, he will not enter into a transaction. Neither buyer nor seller benefit, and an opportunity to create capital is gone, resulting in a net deadweight loss to society. The seller, Gambetta notes, will choose to purchase protection “against himself” in an effort to quell his urge to cheat buyers. Incidentally, he develops an interest in gaining a reputation for honesty.<sup>62</sup> At the same time, the Mafioso may not always protect buyers from buying defective products or sellers from making contracts with unreliable customers: Mafiosi will have interest in making occasional injections of distrust into the market to increase demand for their protection services. As a result, distrust becomes endogenous to the market. As more and more clients buy into the protection market, those who are left out develop a bigger incentive to buy in as well. The Mafioso will tend to concentrate on extorting from this group to gain more clients. This causes a chain reaction in which everyone ends up buying protection simply because of peer pressure.<sup>63</sup> Buying protection becomes a positive externality for someone who also buys it and a negative externality for someone who does not. As buy-in increases, the Mafioso may find it easier to simply tax clients. As an intermediary, therefore, the Mafioso facilitates the crucial

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<sup>62</sup> Gambetta, 30.

<sup>63</sup> Ibid., 24-28.

development of market relations and trust, filling in the previous institutional void. Payment for the third-party arbiter (whether initially we call it tribute) ultimately becomes a tax for trust.

By the time large investments are sunk into protecting private property rights and enforcing contracts, organizations of protectors will have sufficient incentives to compete with the state to provide their services in above-ground legal markets.<sup>64</sup> As certain racketeers with a comparative advantage in violence and enforcement reap economics of scale and scope by expanding, larger client bases will become gathered in fewer hands. Similar to the rise of the state, there is a tendency towards monopoly. Buchanan writes that monopolies tend to reduce the opportunity costs of producing protection, requiring fewer resources per unit of output. He therefore argues that illegal monopolists eventually prefer lower levels of violence and corruption precisely because they internalize high costs.<sup>65</sup> Volkov stresses that the competitive advantage for enterprise is the “elimination of dangers” rather than the “application of physical force or security.”<sup>66</sup> As a result, an organized crime group will eventually focus not merely on thwarting away threats from other coercive partners, but takes on functions of issue-resolution with authorities in the *legal* realm, which can include anything from expediting licenses, using authorities to harm other legal firms, and much more. He defines this more sophisticated level of organization as an *enforcement partnership*.<sup>67</sup>

Extortion, therefore, is a purely predatory activity that may apply to any illicit practice. As crime becomes more organized, horizontally integrated, and implicated in the legal realm, it secures autonomous demand and becomes a positive supplier of trust to other firms. Organized crime becomes a governmental authority. In the early stages of racketeering, protection is not a

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<sup>64</sup> Fiorentini, 445.

<sup>65</sup> James M. Buchanan, “A Defense of Organized Crime” in *Economics of Crime*, Ed. Ralph Adreano and John J. Siegfried (Cambridge: 1973).

<sup>66</sup> Volkov. “The Political Economy,” 38.

<sup>67</sup> Volkov, *Violent Entrepreneurs*, 40-41.

service to be bought; freedom of action in the market is severely limited. Over time, however, institutionalization of force-backed protective services transforms *real* coercion into *potential* coercion, which restrains threats through the *nonapplication* of force.<sup>68</sup> The Mafioso's comparative advantage rests not in the sale of selective information to buyers and sellers, but in the sale of guarantees.<sup>69</sup>

The nature of organized crime eventually mirrors would-be functions of the state. In the ideal state-based model, taxes paid to the state will allow it to out-compete rackets as the legitimate means of protecting property rights.<sup>70</sup> Without a state monopoly on force, free entry of independent intermediaries will stimulate competition in the market for corporate control.<sup>71</sup> The legal and "illegal" markets become substitutes, in which supply and demand curves in one will create shifts in the other. An increase in the price of protection on the legal market (for instance, due to heavy regulation or non-enforcement of law) will decrease the price of protection in the extra-legal market. Organized crime, therefore, provides an alternative use of violence that differs in no substantial way from the state. While distrust is endogenous to private protection and therefore involves inter-gang violence and competition (making state-monopoly enforcement preferable), we can analyze the mafia phenomenon without an attendant moral analysis: organized crime is not necessarily a *dark* side to private protection as much as it is an *alternative* one.

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<sup>68</sup> Volkov, "The Political Economy," 25-27.

<sup>69</sup> Organized crime, in this sense, transcends corruption and intermarriage with the state. It encompasses the services of a separate, autonomous body that does not depend on the legal or public sector in order to function. Patrons, for instance, may be interested in supplying privileged information from authorities to clients, but their service depends on that connection.<sup>69</sup> In a client-patron relationship, there is no safeguard against cheating on market transactions. Organized criminals develop legitimacy endogenously by meeting market demand for trust and security through the application of potential coercion.

<sup>70</sup> Timothy Frye and Ekaterina Zhuravskaya, "Rackets, Regulation, and the Rule of Law," *Journal of Law, Economics, and Organization* 16 (2000): 482.

<sup>71</sup> Cheryl W. Gray, "In Search of Owners: Privatization and Corporate Governance in Transition Economies," *World Bank Res Obs* 11, no. 2 (1996): 179-197.

Within the neoinstitutional framework, optimal avenues of transition out of “private” enforcement into ideal Smith-Hume “public” rule of law require changes in market incentives. When Yeltsin admitted that crime was problem “number one,” common policy prescriptions to prosecute the underground sector ultimately misunderstood the nature of socioeconomic relations in the market for protection. In Japan, for instance, the cohesion and appeal of gang life was enhanced, rather than diminished, by criminal prosecution.<sup>72</sup> In the short run, Milhaupt and West note that the eradication of organized crime is an unrealistic goal. Schelling and Fiorentini comment that the first priority in transition is to legalize as many illegal markets as possible. This will shift the aforementioned public-private demand curves and reduce the rents available in illegal markets. Organized crime will therefore be outcompeted by the state as a legitimate governance structure. The inevitable gaps in state governance must be filled: the state must restore viable financial and legal intermediaries, workable structures for dispute resolution and rules for debt collection. Importantly, especially in the Japanese and Russian cases, the state must provide an adequate supply of sanctioned rights-enforcement agents (this may include outlets for legal professionals and police officers). The point, Milhaupt and West write, is to “set state incentives so that entrepreneurialism is channeled into outlets that reinforce rather than erode legal and social norms.”<sup>73</sup> Transition towards rule of law is not merely a demand for the state to re-capture control over its citizens or uproot the foundations of criminal society. Such a prescription will only obscure the emergence of rational order under alternative intermediaries. Scholarly openness to social context allows us to delve deeper into the process of social and cultural change as actors adapt to their institutional environment.

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<sup>72</sup> Milhaupt and West, 92-96.

<sup>73</sup> Ibid., 96.

#### IV. Russian Organized Crime in Context

##### *Institutional Pressures: The Post-Soviet Landscape*

To successfully chart the birth and functional trajectory of organized crime in Post-Soviet society, we must first explore the institutional framework that set the stage for organized crime in the early-mid 1990s. I will briefly discuss the legacy of Perestroika, privatization reforms, and the shortcomings of the legal-administrative state apparatus. These factors helped shape the transactional decision situations of new cooperative owners and market entrepreneurs. By examining the “big picture” structural landscape, I will later demonstrate how major gaps in state and legal institutions (inability to systematically enforce contracts, resolve repayment of debt, secure trade, minimize opportunism, and settle disputes) opened possibilities for violent entrepreneurs.

The breeding ground for bandits, mafia “kingpins” and other varieties of violent entrepreneurs was paved by Gorbachev’s failed domestic reform policies and continued with Yeltsin’s subsequent chaotic efforts at privatization. Vitaly Naishul’s insights on the time period offer a unique perspective on the creeping bouts of entrepreneurialism in the system; “there was no dictator!” he proclaims. Instead, “the whole bureaucratic planning system had become a strange, never ending undisciplined bazaar.”<sup>74</sup> In 1985, Gorbachev’s anti-alcohol policy and the following fight against “unearned income” in the summer of 1986 opened the levies for a nascent intermarriage between new informal entrepreneurship and violent entrepreneurship. Literaturnaya Gazeta published its infamous story on the “Criminal Tomato,” confronting the absurdity of police confiscation of street fruit and vegetable sales. “*Kooperator*” and “*chastnik*” became buzz words for criminals. Business activity effectively became an act of political

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<sup>74</sup> David Hoffman, *The Oligarchs* (New York: PublicAffairs, 2002), 26.



dissent.<sup>75</sup> The 1987 Law of State Enterprises and the 1988 Law of Cooperatives lent an unprecedented push for actors who took advantage of cleavages in the legal system to establish themselves along new lines in the legal and international realms. In the first months of 1992, the number of small and medium private enterprises jumped from 20,000 to over 50,000.<sup>76</sup> Of these, about 33,000 were small scale enterprises.<sup>77</sup> By 1993, the total number of privatized enterprises reached 82,000. Between January and April of 1993, 2.5 million apartments were privatized. The levies were unleashed.

Unfortunately, the legacy of privatization failed to nurture the requisites of a functioning market. The Gaidar-Chubais shock therapy program effectively freed prices from state control and broke the state monopoly on property. As technocrats who sought to destroy the Soviet past rather than foster a credible commitment to new market institutions, Gaidar and Chubais inadvertently transferred the reigns of economic control to the “underworld.” Pondering whether it was better to unleash the boxers first or build a boxing ring for them to fight in, Chubais was certain that the players themselves would build the ring once let loose.<sup>78</sup> Voucher privatization lead to a disastrous cycle of fraudulent advertising schemes in which about 600 funds collected forty-five million vouchers from naïve citizens without knowledge of investment practices; in effect, old factories and mines were sold for pittance to the select few while investors would never hear again from the promises of the so-called “market.” As the central bank began pumping massive subsidized credits to prop up nascent businesses (and particularly friendly Soviet “red directors”) while inflation raged at twenty-five percent per month, owners’ ruble savings became little more than figures on paper. Enterprise owners became interested in

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<sup>75</sup> Ibid., 38.

<sup>76</sup> Federico Varese, “Is Sicily the Future of Russia? Private Protection and the Rise of the Russian Mafia,” *Archives europeenes de sociologie* XXXV (1994): 239.

<sup>77</sup> Financial Times 1993.

<sup>78</sup> Hoffman, 180. Prophetically, he was correct, but not in a way amenable to his constructivist-technocratic senses.

handouts from the state rather than developing businesses, learning corporate management, or allocating resources to efficient ends. In essence, they simply began stripping assets, pilfering from cheaply-purchased industries, and pocketing wild profits in offshore accounts through currency speculation. New banks and foreign investors would not dare risk lending to infant business start-ups when their incentives were entirely perverse. Long-term investment and capital accumulation, the key facets to the production of wealth, were squeezed out of the picture and wrecked havoc on public confidence in the rhetorical promises of leaders. The state itself had no incentive to adopt the ideal Smith-Hume governing framework in which formal institutions would produce systematic, non-random and comprehensible rules.

These developments revolutionized the socioeconomic context in which Russians adapted to and changed their market environment. Entrepreneurship took a (familiar) turn towards self-government. Amidst rotting Soviet factory infrastructure, “everything was for the taking.”<sup>79</sup> Chronic nonpayment of wages, empty store shelves, and broken promises left no room for scruples among a disillusioned populace. The working class, Tanya Frisby writes, hates the state “for betraying them...” and “most of them would do almost anything to avoid poverty.”<sup>80</sup> Stealing carried no negative ethical implications in a shortage economy. In early 1980s, standard requisitions of crops from farms would be stored in decaying Moscow warehouses to which 20,000 Muscovites were drafted daily to pack, stack, and sort the putrid produce. Naturally, hundreds of thousands of people stole what they could.<sup>81</sup> Inspectors and party officials themselves took a part in the looting, simply taking the first and freshest pickings off the shelves. Similarly, the monstrous Avtovaz zhiguli-car manufacturer was taken apart from the inside out in

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<sup>79</sup> Hoffman, 139.

<sup>80</sup> Tanya Frisby, “The Rise of Organised Crime in Russia: Its Roots and Social Significance,” *Europe-Asia Studies* 50, no. 1 (1998): 29.

<sup>81</sup> Hoffman, 55.

a remarkably sophisticated scheme. Multiple groups of bandits gathered alongside the assembly line in quiet suspense and marked which line of cars they would appropriate under the noses of factory managers. On a regular basis, entrepreneurs with Soviet survival instincts met the demands of shortages in the market for cars by popping off clean windshields from parked street cars and selling them for profit. Many individuals supplemented nearly worthless incomes by stealing industrial resources, selling them to nascent criminal groups, most often in collusion with industrial security services themselves.<sup>82</sup>

Common tactics among burgeoning cooperatives involved a variety of arbitrage schemes in which hustlers with old party connections bought cheap oil, paid bribes to sell it on the world market for hard currency, purchased personal computers, and sold them for fantastic profits below the state managed prices at home.<sup>83</sup> Old time communists engrained in ideological tradition expected that the new businessmen would fail. When their expectations were overturned, they used their legal power either to arrest the businessmen or join them.<sup>84</sup> Under the auspices of Komsomol connections, the young Mikhail Khodorkovsky got his start by transferring state “non-cash” money into “cash” money and valuable hard currency. In essence, for select entrepreneurs who crossed the boundary between private and public market sectors, millions of dollars were made from arbitrage and speculation rather than from the competitive production of goods and services. Few distinctions between right and wrong existed in the throes of sudden freedom: “ourselves for ourselves!” was Khodorkovsky’s ringing slogan: “we are advocates of equality in the right to be rich.”<sup>85</sup> Indeed, young hustlers with a knack for entrepreneurship emerged into an unexplored market with a fresh self-righteousness and

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<sup>82</sup> Frisby, 31.

<sup>83</sup> A great live-interview of this process with Russia’s “first millionaire,” Artem Tarasov, can be found here: <http://www.fontanka.ru/2011/02/24/185/>

<sup>84</sup> Albin et al., 227.

<sup>85</sup> Hoffman, 121.

defensiveness against state power that could declare their actions criminal at any moment. A lack of commonly accepted enforcement mechanisms dissolved shared economic perceptions of limits set forth in the Soviet legal system. In this sense, a “failing polity,” writes Walter Williams, “ceases to be properly national, integrated, held together by shared values.”<sup>86</sup> Macro dissolution leads us to micro re-organization. The legacy of Perestroika can be characterized as the obsolescence of boundaries, a rush of adrenaline for new capital, fresh fear of the unknown: it was an altogether dramatic opening in the market for social order.

Compounding perverse and illiberal incentives in the financial sector were remarkable distortions in the legal and administrative sectors. State arbitration services held almost no significant sway over economic transactions in the early 1990s. The number of civil disputes in the court system decreased significantly from 1992-1994. The average case took three to four months to process, with thousands of cases stalled annually.<sup>87</sup> Typically, if a plaintiff won the case, the defendant would reimburse him. Attached to the sentence was an order by the court obliging the losing party to comply. Theoretically, the court would stop all financial and banking operations of the party in case of non-compliance. To make this happen, the petitioner had to obtain a bailiff’s signature and file a motion before the arbitration court. Effectively, enforcement of decisions had to be pursued at the victim’s own cost.<sup>88</sup> In case of nonpayment of debts, if a debtor claimed that the assets in question were not in his possession, court officials could only oblige him to dedicate half of his monthly salary towards repayment. Very little could be done to enforce compliance whatsoever. In the comparatively more well-protected market environment in Smolensk, twenty-six percent of shop owners who needed to use courts decided

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<sup>86</sup> William Walters, “Social Capital and Political Sociology: Re-Imagining Politics?” *SAGE Publications* 36, no. 2 (2002): 383.

<sup>87</sup> Volkov, *Violent Entrepreneurs*, 46-48.

<sup>88</sup> Varese, *The Russian Mafia*, 46.

against it. In contrast, more restrictive legal environments in Ulyanovsk and Moscow pushed those percentages to forty-percent and forty-nine percent, respectively.<sup>89</sup> In fact, shopkeepers in need of arbitration services who avoided courts were twenty-two percent more likely to have contact with a racket. By 1995, only half of all court decisions regarding property disputes were enforced.<sup>90</sup> When Russians were surveyed on whether they thought legal institutions protected the interests of all citizens equally by the Centre for Sociological Research at Moscow University in 1993, only 5.1 percent answered positively. The number fell to 4.4 percent in 1994.<sup>91</sup>

The state's instruments for self-financing were over-bureaucratized and broken. Until January of 1999, Russia had no official tax code, and depended on extraction by decree. Following one such decree in December of 1993, separate regions and cities were given leverage and control over local taxes. As a result, by 1995, Moscow companies were required to submit twenty-three different quarterly tax reports.<sup>92</sup> Until the end of the 1990s formal tax brackets could reach up to eighty percent of revenues (not including additional costs reportedly necessary for state bureaucracies). One Omsk businessman in Volkov's accounts faced an alternative between a ten percent racket charge and a ninety percent state tax.<sup>93</sup> In 1994, less than six percent of citizens in the labor market filed income tax statements; by 1996, that number rose to (an impressive?) sixteen percent. Fines ranged up to 500 percent of the amount concealed; authorities often conducted on-site visits to punish the taxpayer for appealing his fines in court.<sup>94</sup> Because the provision of public goods under socialism was an inherent aspect of central planning, few individuals understood the concept of taxation, causing a significant decay in tax

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<sup>89</sup>Frye and Zhuravskaya, 495-497.

<sup>90</sup> Volkov, *Violent Entrepreneurs*, 47.

<sup>91</sup> Varese, *The Russian Mafia*, 41.

<sup>92</sup> Ibid., 18.

<sup>93</sup> Volkov, *Violent Entrepreneurs*, 48.

<sup>94</sup> Varese, *The Russian Mafia*, 18.

morale between 1991 and 1995. A poll in the early transition years in Tambov indicates that a mere one-third of participants thought that paying taxes would provide a benefit to themselves.<sup>95</sup> Businesspeople tended to view local government primarily as an extractor of resources.<sup>96</sup> Until 1995, tax authorities were legally allowed to keep a percentage of collected fines to pay staff bonuses. After that was prohibited, they simply exaggerated fines to supplement for their own meager wages.

In a classic principal-agent problem, individuals simply had no incentive to keep tabs on reckless behavior among bureaucrats who effectively had no positive stake in their financial livelihoods. Simultaneously, therefore, the state was caught in a trap: it could not raise money to sustain an effective legal and administrative apparatus. To raise the money, the apparatus had to already exist. Instead of fostering an environment of capital accumulation, agents of the state faced extreme uncertainty over tax and bribe payments (implicating their personal livelihood), which made pilfering existing state coffers and extracting exorbitant funds from an alienated populace a dominant strategy. Non-accountability to citizens reproduced greater cycles of non-accountability, reinforcing the role of the state as an irrelevant source of protection and stability for the disillusioned citizen. A handicapped framework of rules set the stage for new rule makers. Post-perestroika conditions manifest Lachmann's open socioeconomic world, though without a fundamental legal basis to direct human action. In an effort to minimize risk and re-organize social life around new points of orientation, the new market for protection was an open book, a forum of tacit knowledge, to be transformed by acts of the entrepreneurial human imagination.

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<sup>95</sup> James Alm, Jorge Martinez-Vasquez and Benno Torgler, "Russian Tax Morale in the 1990s," *National Tax Association – Tax Institute of America* (2005): 289.

<sup>96</sup> Frye and Zhuravskaya, 493.

Certainly, Elinor Ostrom writes, “it is more comforting to think...about the effects of using one particular rule out of context of the other rules simultaneously in effect.”<sup>97</sup> But judging a criminal outside of the crime scene tells us nothing about the nature of his culpability. From the mid-1980s until the late 1990s (indeed, from much deeper in Russian history), blurred rules led to blurred ethical conceptions of crime. Who, in the end, was a bandit? A woman on the street selling vegetables? A tax inspector? A mafia kingpin? Gorbachev himself? To reframe the discussion, I now focus on the supply-side and demand-side pressures in the market for protection among low-level entrepreneurs. This may help us understand the significance of violent entrepreneurs in an uncharted political and economic vacuum.

### *The Scope of Organized Crime*

The scope of organized crime falls between conservative and sensationalist accounts. Because no concrete estimate is possible due to limited press coverage or official data, we may still gather a general picture of the phenomenon by consulting existing sources. Dr. Pavel Ponomarev, professor and Director of the MVD Research Institute in 1996, states that “our economy has in fact become a zone of total criminal aggression... in many respects criminal activity has become one of the most important methods of regulating the present-day economy and a method for solving economic problems.”<sup>98</sup> J. Serio estimates an average of 4,000-5,000 criminal groups during the Soviet period, a number which expanded to 12,000 in 1987, with about 400 groups in Uzbekistan and Ukraine, 119 in Krasnodar, and twenty-nine in Moscow.<sup>99</sup> Varese cites that there were more than 6000 cases of racketeering in 1988. By 1992, there were

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<sup>97</sup> Larry Kiser and Elinor Ostrom, “The Three Worlds of Action: Metatheoretical Synthesis of Institutional Approaches,” In *Polycentric Games and Institutions: Readings from the Workshop in Political Theory and Policy Analysis*, ed. Michael McGinnis, 101 (Ann Arbor: University of Michigan Press, 2000).

<sup>98</sup> “Chtoby Prognoz ne Opravdalsia,” *Militsiia* (1996): 8.

<sup>99</sup> Quoted in Varese, “Is Sicily,” 232.

some 80 organized crime groups in Moscow and St Petersburg alone. Tanya Frisby estimates that 30,000 individuals actively participated in organized crime by the end of 1995, with over 3000 criminal leaders directing their activity. 1011 of those established inter-regional links, and 300 international links.<sup>100</sup> According to a *Finansovye Izvestiya* article dated February 18, 1997, approximately 41,000 industrial companies and over eighty percent of joint ventures have criminal connections. That same year a report by Anatolii Kulikov cites that 100,000 members belong to 9000 organized crime groups.<sup>101</sup> The most serious jumps in OC activity occurred in 1989, when it was estimated that the average Soviet citizen was four-to-five times more likely to die a violent death than a Briton, Frenchman, or Japanese.<sup>102</sup> Businesspeople operating in Moscow and other major Russian cities were reported as having appealed to foreign police for assistance.<sup>103</sup> In choosing an interpretive framework, we may view this unprecedented phenomenon as evidence of an emergent market for order in which suppliers and clients maximize welfare and restructure relationships by responding to incentives. Boxers, once let loose, began to build their own boxing rings.

### *Demand-side Pressures*

In light of early-Perestroika criminalization of entrepreneurship, many of the first cooperatives were obliged to bribe, lie to authorities, and hire goon squads to stay in business.<sup>104</sup> After price deregulation in 1992, private farmers in the Kemerovo region of Siberia faced massive theft of cattle and poultry by armed visitors to their farmsteads. One owner of significant

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<sup>100</sup> Frisby, 31-32.

<sup>101</sup> Ibid.

<sup>102</sup> *Izvestiia* 26/11/1990 and *New Times* no 35, 1989.

<sup>103</sup> Louise Shelley, "Post-Soviet Organized Crime: Implications for Economic, Social and Political Development," *Demokratizatsiya*, 2 (1994): 350-4.

<sup>104</sup> Kelly et al., 261.



acreage in Russia's southern Penza region decided to hire private police to protect his fields against encroaching state farmers and racketeers. After lobbying local police, farmers in Cheliabinsk were allowed to carry shotguns to guard their territories. MVD data reports the illegal possession of 1.5 million firearms in 1993.<sup>105</sup>

Meanwhile, entrepreneurs faced remarkable barriers to the legal market. In their 1997 survey, Frye and Zhuravskaya find that in order to open business, shopkeepers needed an average of over two months to register, almost four months to receive necessary permits, and permission from more than five agencies. The average shop was inspected eighteen times annually, and eighty-three percent of shopkeepers reported paying fines within the year prior to the survey.<sup>106</sup> Oftentimes, business people would not even voluntarily accept police services out of fear that they would be caught selling stolen goods (which, we recall, was a generally accepted means of subsistence) or otherwise harassed and accused of non-compliance with non-existent administrative rules. Bottles of paralyzing gas against thieves and intruders could be bought everywhere in Moscow in 1992. At this time, Handelman and Sterling write that “virtually every small business across Russia pays protection money to some gang.”<sup>107</sup>

Federico Varese cites an elementary and non-violent form of racketeering originally reported in a 1992 article of the *Moscow News*, describing the story of young entrepreneurs Zhenya Belova and Nadya Nekrasova, aged 12 and 13. Setting up outside of Moscow's Kropotkinskaya metro station, the two girls decided to make a business out of washing car windshields while drivers waited at the red light. The girls note, “We have to pay protection money to bigger boys.” One of those boys, identified in the story as “Dude,” collects the

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<sup>105</sup> Varese cites here Kommersant-Daily 16/II/1993.

<sup>106</sup> We may compare this data to Warsaw, where shopkeepers could register shop in three weeks, faced inspection only 9 times per year, and were fined in only 46% of cases.

<sup>107</sup> Cited in Kelly et al., 261.

payment and in turn makes sure that adults won't take the girls' money or that other youngsters begin to compete with them. Down the street, Dude pays off traffic police twenty-five rubles for every hundred he earns. The police, in turn, leave the girls alone. Dude's role in this scenario is critical for allowing market transactions to occur. Without him, the girls could be at risk of police investigation, robbery, and sexual predation from drivers.<sup>108</sup> The same insurance-driven mindset dominated general economic decision-making. One businessman in Volkov's study states,

“Every day we expected the bandits to turn up. You know, this anticipation was the worst thing. So when they indeed came, it was kind of a relief. We were lucky the problem was resolved in a civilized way.”<sup>109</sup>

And in Varese's interviews, kiosk owners responded,

“If I go to the mafia, it will take one day to get my merchandise back: the person who stole it from me will come to me on his knees, return everything and also compensate me for the loss of the working day.”<sup>110</sup>

“If the racket were not present, my business would collapse.”<sup>111</sup>

“Bandits, bandits, bandits!” was the ringing outcry of Vladimir Gusinsky in his interview with David Hoffman when describing his early years remodeling Moscow city block apartments in a partnership with then-Mayor Luzhkov: “I would hire the Devil himself if he could provide us with security.”<sup>112</sup> Indeed, racketeers began to infuse distrust into a void without rules to enhance demand for their services. A police officer in Varese's accounts mentions, “now every respectable man from the business world deems it necessary to hire several armed bodyguards or at least to buy a weapon on the black market.”<sup>113</sup> Sergei Goncharov, a fifteen-year KGB veteran, explains that businessmen simply did not trust the state: “If they relied on the state,” he says,

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<sup>108</sup> Varese, “Is Sicily,” 254-256.

<sup>109</sup> Volkov, *Violent Entrepreneurs*, 32.

<sup>110</sup> Varese, *The Russian Mafia*, Interview of Anvar, 111.

<sup>111</sup> Ibid.

<sup>112</sup> Hoffman, 165.

<sup>113</sup> Varese, “Is Sicily,” 251.

“you wouldn’t see them riding around Moscow in a convoy. I laugh when I see five businessmen: they usually have 25 bodyguards.”<sup>114</sup> For the later Gusinsky, this actually became a private thousand-man security service.<sup>115</sup>

In a larger perspective, shop-keepers with small businesses and no private security forces tended to view private protection organizations as a relatively minor problem. In the early stages of Soviet break-up, tax rates, shortage of capital, rent, legal vulnerability, and corruption were more significant problems than rackets.<sup>116</sup> In Perm, “informal” racketeers became a part of genuine “formal” market practices. The most successful small businesses and kiosk owners would in fact arrange for roofs *before* opening up shops. In this sense, they could shop around for valid “roof” protection and avoid settling in an area marked by a criminal group that would force unfavorable conditions on their trade. Perm shop owners identified Komsomolskii Prospekt as prime real estate for business, where racketeering “roofs” gained respectable reputations and became very interested in protecting their name and establishments. Some respondents described the rackets as “gentlemen’s agreements” and “long-term exchange[s] of favors.”<sup>117</sup> From the perspective of Fedor, a bakery owner interviewed in 1994, “You should not get the wrong impression: not all these people are dangerous criminals. Some may be of great help – decent, honest people.”<sup>118</sup>

In Gambetta’s framework, property in the late 1980s became an exchangeable commodity. Hoffman writes, “the very essence of the state – authority to set the rules of the game- was simply privatized by the new capitalism.”<sup>119</sup> Given a vacuum of rules, high

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<sup>114</sup> David Hoffman, “Banditry Threatens the New Russia,” *The Washington Post*, 12 May 1997: A01.

<sup>115</sup> Hoffman, *The Oligarchs*, 165.

<sup>116</sup> Frye and Zhuravskaya.

<sup>117</sup> Varese, *The Russian Mafia*, 100.

<sup>118</sup> *Ibid.*, 98.

<sup>119</sup> Hoffman, 234.

asymmetries of information between business owners and competitors and the surrounding legal transaction costs, market actors sought new means of enforcing contracts, settling disputes, securing private capital, and providing for an orderly exchange of goods and services. Strategies for minimizing risk and uncertainty included an expansion of clientelist networks, private security forces, or appeals to friendly connections with the state. For those without favorable connections, widespread infusion of “bandit” authorities into street markets effectively raised the cost of opportunism between contracting parties. As long as profits exceeded costs of protection, businesspeople could still reap gains from trade. In an interview with *Literaturnaya Gazeta* in January 1993, Deputy Chief of Police for combating organized crime Gennadii Chebotarev stated that most contracts for “hits” were initiated by businessmen themselves.<sup>120</sup> The protection operation, Albin et al write, “often originates out of a symbiotic need created by the social conditions themselves.” Therefore, he concludes,

“It is not the criminal that forces protection on the businessman, but, instead, the businessman who, recognizing the need for protection in an environment where theft is so rampant, will often seek and agree to be protected for a price.”<sup>121</sup>

Containing the threat of rampant uncertainty in this scenario requires dealing with a rapidly dynamic society in which knowledge production takes place continuously. For the average shop owner, new possibilities manifested themselves in new relationships (whether wanted or not) with violent entrepreneurs. To successfully anticipate the future actions of their competitors and customers (and thereby create an assurance that opportunistic behavior would be contained), shop and kiosk owners began to orient their shared understanding of new rules around the criminal domains of their protectors. Assessing alternative possibilities in their particular decision situations, businessmen and women developed strategies to minimize

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<sup>120</sup> Varese, *The Russian Mafia*, 70.

<sup>121</sup> Albin et al., 233.

vulnerability and uncertainty in the marketplace. Unintentionally, bandits changed the landscape of prescriptions “commonly known and used by a set of participants to order repetitive, interdependent relationships.”<sup>122</sup>

To understand the mechanisms of violent entrepreneurship, I now turn to the specific circumstances that helped produce the missing transaction cost “engineers” in the Russian scenario. The market for protection did not automatically produce extra-legal mechanisms to meet shop owners’ demands. Rather, it developed from a series of simultaneous events that linked together vulnerable cooperative and kiosk owners with new suppliers of protection.

### *Supply-Side Pressures*

To meet rising demand for contract negotiation and rule enforcement, a number of key conditions helped produce entrepreneurs with comparative advantages wielding force. Following the late Perestroika market reforms, three million people lost jobs in industry, only about twenty-percent of whom were offered suitable alternative employment.<sup>123</sup> Within the first six months of 1990, over 100 skilled law enforcement experts in Khabarovsk Territory quit their jobs due to low salaries. According to proceedings from a closed conference on organized crime, Russian Internal Minister Victor Yerin reported that 63,000 professionals left the militsia in 1992, one in five going “over to the enemy.”<sup>124</sup> In 1993, four officers ranging in rank from major to colonel (later additionally including the commander and deputy commander of the tenth Air Defense Army) were arrested in Moscow for selling weapons. The chief of the Smolensk Federal counterintelligence Service Directorate reported that dozens of guns and grenades were

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<sup>122</sup> Reference to Ostrom (see above).

<sup>123</sup> Varese, *The Russian Mafia*, 55-58.

<sup>124</sup> *Ibid.*, 198.

confiscated by security personnel from “the mafia in uniform.”<sup>125</sup> In 1996 Russia had disposed of eleven separate intelligence and security organizations, 344,000 paramilitary and security troops, a force that effectively represents twenty-percent of the regular military.<sup>126</sup> By February of 1997, Galeotti cites the existence of more than 6500 private security agencies, each employing over 800,000 people, about seventy percent of whom were ex-KGB officers who left the service before retirement. *Most-Bank* had a private army of 2500 armed officers in Moscow alone (equivalent to a regiment of the Kremlin Guard). Gazprom boasted a security service of 20,000, and LUKoil protected one Novorossiisk oil terminal with an army of its own.<sup>127</sup>

The rule-framework behind this phenomenon has contributed remarkably to these findings. Even under Gorbachev, the Interior ministry had issued orders allowing local Soviet policemen to enter into contracts with new cooperatives to provide security services for commercial establishments. In 1989, 600,000 rubles-worth of contracts were signed by the militia in Moscow. A new law in April 1992 allowed security firms and detective agencies to buy arms.<sup>128</sup> In his attempt to regain state monopoly control over arms sales, President Yeltsin issued an edict in November of 1993 ordering the merging of several key military suppliers with the state Rosvooruzheniye company.<sup>129</sup> Because of new opportunities to obtain hard currency profits in this venture, security force personnel took advantage of major arms import-export sales, only contributing to the redistribution of instruments of protection among the various coercive interests in the market.

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<sup>125</sup> Graham H. Turbiville, “Weapons Proliferation and Organized Crime: The Russian Military and Security Force,” *USAF Institute For National Security Studies* (1996).

<sup>126</sup> Mark Galeotti, “The Mafiya and the New Russia,” *Australian Journal of Politics and History* 44 (1998): 420.

<sup>127</sup> *Ibid.*, 422.

<sup>128</sup> Varese, *The Russian Mafia*, 62.

<sup>129</sup> Turbiville (1996).

In the Gambetta framework, as more clients bought into the protection market, those left out would quickly become targets of lower-level bandits. Violent entrepreneurs were initially deterred from stealing from police-protected enterprises and focused on the unprotected. The informal division of territory among competing coercive parties slowly became evident in everyday public spaces. Varese describes how invisible traffic agents “rented out” space near the major Moscow McDonalds in 1992: the agent assured sellers that no one would trespass on the street, creating a bubble of market safety. As a result, a nearby street became bustling with vendors, while the space directly in front of the McDonalds, naturally more expensive and lucrative for foreign visitors, remained mostly free of sellers.<sup>130</sup> Gangs, simply because they were adept at using intimidation and force, “worked” the protection and extortion schemes without police or state protection. Varese notes,

“The rights that people have over assets-or places- are not constant in the streets of Moscow; they are a function of their own direct effort at protection, of the competition posed by other people’s attempts to capture those assets, and of police or other agents’ protection.”<sup>131</sup>

Ownership over the private means of production, therefore, is heavily contingent upon a system of rules that can guarantee commonly-accepted boundaries across which others cannot trespass. The orderly arrangement of relationships in the *public* sphere is similarly a function of *private* boundaries. The various social agents – state-backed security forces, militsia, and racketeers – simultaneously assume public and private roles, affecting commonly-held understandings of “how things work” in the economy by redrawing streets and market spaces into new organizational arrangements. Identifying gaps in enforcement structures, they were alerted to the opportunity to profit from the discovery of wholly new knowledge: how to physically pin down

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<sup>130</sup> Varese, *The Russian Mafia*, 203.

<sup>131</sup> Ibid.

new points of orientation for the tumultuous market. Without a central monopoly on the use of coercion, multiple users of coercion created micro-orders.

### *The Practices of Violent Entrepreneurs*

By adapting to changing conditions, racketeers managed to transform the socioeconomic landscape of the transition era in less than ten years. Typical early racketeering practices followed a trajectory outlined by Vadim Volkov, the most important of which included *Probivka*, *Naezd*, *Strelka*, and *Razborka*.<sup>132</sup> In the first stage, or *probivka*, a usually polite, athletic gentleman in business attire will approach the business, ask “whom does this business pay?” and announce that his boss, or the brigadier, requires a conference with the shop owner. A meeting with the brigadier transpires fairly quickly, usually at night in the brigadier’s car. There, the owner and brigadier settle on a monthly protection fee and the owner is given the group name and phone number, which can be used to thwart other possible racketeers and, naturally, to solicit protection services. On agreed dates, a *boevik* visits the shop and collects fees, which usually reach between twenty and thirty percent of the client’s business. Sanctions for failing to pay are extremely severe. In Varese’s accounts, several Perm kiosks were burned down for non-compliance.<sup>133</sup> The use of coercion, in this case, minimizes the client’s opportunistic temptation to renege on the relationship, thereby creating a predictable framework of rules and sanctions.

In the early stages of racketeering, brigadiers are not symmetrically bound to follow through on their promises to clients. During *naezd*, the brigadier demonstrates his coercive powers to solicit compliance, which could include a visit by brigades to crush office equipment, threaten businesses with arson, use handcuffs and soldering irons, and lock people in cellars. In a popular move, the brigade may take a businessman to a forest and make him dig his own grave

<sup>132</sup> Volkov, *Violent Entrepreneurs*, 87-94; Varese, *The Russian Mafia*, 105-108.

<sup>133</sup> Varese, *The Russian Mafia*, 109.



until he succumbs to extortion demands. Usually, these tactics are used to enforce compliance, speed up repayment of debt on behalf of a client, or put pressure on a client's intruder.

*Strelkas* are usually used to verify the client's claim to a "roof." In one of Handelman's interviews with a powerful Armenian boss in Moscow in 1993, a group of hoodlums visited the boss' client: When the stammering shop owner insisted that he had already paid proper tribute to his boss, the hoodlums didn't believe it. After calling on the Armenian, a *strelka* ensued. Both parties arrived to meet in black limousine with armed bodyguards; "everyone was well dressed and extremely polite." After a brief discussion, the hoodlums conceded on a positive note: "Shopkeepers will say anything to save their skins, but who believes them? Don't worry; the place is yours."<sup>134</sup> Sometimes a *strelka* could end in a *razborka* involving a violent elimination contest. In the early 1990s, raids on saunas and restaurants where big-name bosses often negotiated deals became commonplace.<sup>135</sup> Albin and Volkov make mention of an extraordinary *razborka* in August of 1993 in Nizhnii Taigil, when members of an Afghan crime group hijacked a T-90 tank and drove through the city to settle a score with an Azeri group that had been attempting to monopolize a local market.<sup>136</sup>

We may make two main observations concerning these procedures. First, these processes successfully precluded post-contractual opportunism. Shop owners would not be able to exploit loopholes in their agreements with brigadiers by lying about existing protection or later risk non compliance. *Strelkas*, in this sense, were a form of monitoring to check potential moral hazard. Demonstrations of coercion enforced accountability among clients. Furthermore, *Strelkas* and *razborkas* were crucial processes in the territorialization of socioeconomic space: "The only rule was not to assault or rob each other's kommersanty," noted one leader at the Deviatkino market

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<sup>134</sup> Handelman, *Comrade Criminal*, 15.

<sup>135</sup> Hoffman, 147.

<sup>136</sup> Volkov, *Violent Entrepreneurs*, 93.

in St Petersburg.<sup>137</sup> Mutual recognition of coercive capabilities among organized criminal groups interestingly created a type of coexistence in which powers could be tested through violent contestation and manifestation of force at the same time that it reinforced a more predictable set of rules for clients within each group's territory.

Before we proceed, however, we must note that while brigadiers had less incentive to be accountable to their clients due to their coercive capacities, they were ultimately suppliers in the market for protection rather than merely forces of economic oppression. As in all markets, the supplier is bounded by the demand curve. Brigadiers realized that they could not simply terrorize or extort full incomes from clients. Doing so could lead clients to seek retribution by turning to competing criminal groups. Alternatively, the brigadier could face all-out elimination by other groups that desired to tap into his client base and offer more amenable terms of agreement. Indeed, in 1988, in over 6000 reported racketeering cases, almost half of the clients faced a fee of 500 rubles, slightly less than half were charged 1000 rubles, and in 928 cases the charge was over 1000 rubles.<sup>138</sup> On the whole, racketeering demands were on the sensible side. To outperform conditions of extraction offered by the state, rackets had to serve as a corrective mechanism; they seldom extracted over thirty percent of business profits. Interestingly, this figure matches Laffer curve estimates in which the revenue-maximizing rate is estimated between approximately 32-35 percent.<sup>139</sup> Constraints on suppliers therefore *did* exist in early racketeering stages, and grew more formal as rackets evolved into enforcement partnerships.

Volkov emphasizes that violent entrepreneurs are simultaneously sources of threat and protection. Arguably, this case can be made for the modern state, which exhibits the same

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<sup>137</sup> Ibid., 15.

<sup>138</sup> Varese, *The Russian Mafia*, 106-107.

<sup>139</sup> Yu Hsing, "Estimating the laffer curve and policy implications," *Journal of Socio-Economics* 25, no. 3 (1996): 395-401.

properties in a more sophisticated stage of development. As early racketeering and extortion practices evolved into full-fledged enforcement partnerships in the “above ground” markets and became recognized as formal institutions, they began to resemble a peaceful relation of exchange. The conditions of the partnership, or “silovoe partnerstvo,” transcend purely force-backed transactions and create consciously driven institutional structures for businesses to flourish. Instead of just thwarting competition, enforcement partnerships (EPs) involve themselves in settlement agreements, debt recovery, formal contract enforcement, and extended physical protection. EPs may selectively organize scams to purposefully increase the common businessman’s risks of acting alone. Each criminal group then profits by becoming a source of “preventive insurance.”<sup>140</sup> In one of Varese’s cases, kiosk owner Maksim came into conflict with neighboring competitors when he began selling alcohol at lower prices and refused to collude. His competitors approached his EP, who eventually persuaded Maksim to raise the price of alcohol and resume trade peacefully.<sup>141</sup> Galeotti writes, “criminals do not just prey on entrepreneurs”: they provide funds through banks, match investment partners, expedite business through bureaucratic red tape, manage bribery flows, and fend off demands of other gangs.<sup>142</sup> Settlement of debt often involves a type of *strelka* in which the creditor produces documentary proof of debt, and his EP pressures the debtor to pay up or come forth with his own EP. In the latter case, a *razborka* between the two EPs may follow. Other forms of intimidation and physical force are at the disposal of the creditor’s EP. Eventually, criminal groups organized entire subdivisions in their growing domains to handle debt settlement.

The burgeoning organizational sophistication within these satellites of power resembles a version of organic, polycentric order outlined by the Ostrows. In her study of the governance of

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<sup>140</sup> Volkov, *Violent Entrepreneurs*, 42.

<sup>141</sup> Varese, *The Russian Mafia*, 116.

<sup>142</sup> Mark Galeotti, “The Mafiya and the New Russia,” *Australian Journal of Politics and History* 44 (1998): 424.

common metropolitan space, Elinor Ostrom uncovered a critical misperception in common public policy that attempts to centralize districts and neighborhoods under ever greater monocentric government control. A multiplicity of ordered relationships within cities highly fragmented by overlapping jurisdictions was (and often continues to be) commonly viewed as “chaotic,” and therefore highly problematic. Though formal political instincts fail to recognize order out of apparent chaos, polycentric centers of decision-making are in fact crucially tailored to the interests of diverse populations in a condensed geographical area. Public entrepreneurs undertake the task of structuring the provision of public goods and services in ways amenable to localities. This analysis indicates a number of clear parallels to the Russian case study, which witnessed a division of territories into criminal spheres of influence in the absence of monocentric governance. Violent entrepreneurs undertook the provision of public goods in their own backyards. While Ostrom notes that polycentric order in metropolitan space requires a legal framework and functioning public safety and enforcement institutions, I will nevertheless extend the parallel by arguing that polycentrism is an endogenous and spontaneous phenomenon that reproduces itself in greater layers of sophistication and organization. Criminals ultimately created the polycentric “pulsating currents” that transformed crucial decision situations in Russia’s emergent markets.<sup>143</sup>

## **V. Socio-Economic and Political Implications of Russian Criminality**

### *Territorialization of Economic Space*

The nature of this transformation straddled the political and cultural fabric permeating everyday life. De facto claims on territory by bandit groups became the locus of legitimate socioeconomic activity. Major “criminal” groups organized themselves around territories of

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<sup>143</sup> Aligica and Boettke, 26.

origin (*Tambovskie, Murmanskie, Vorkutinskie, Permskie, Kazanskie*), names of leaders (*Malyshevskie, Kudriashevskie, Komarovskie*), ethnicities (*Azerbaidzhantsy, Chechentsy*), veterans' groups (*Afgantsy*), sports affiliations, industry connections, and geographic placement in cities.<sup>144</sup> By 1996, six large groups controlled Moscow (three Chechen – *Tsentralnaya, Ostankinskaya, Avtomobilnaya*, each with about 1500 members; the others including *Solntsevskaya, Podolskaya*, and the twenty-first century association). Four major groups dominated in St Petersburg, two in Yekaterinburg (*Uralmashevskaya, Tsentralnaya*), and nine in Vladivostok.<sup>145</sup> Phil Williams describes measures of role specialization, whereby Chechens dominated the petroleum trade, Azeris dominated drug businesses, and Georgians dominated local burglaries.<sup>146</sup> Division of territory based on local specialization allowed groups with claims on a particular name or space to reap economies of scale in a limited market where they could maintain prestige and establish a sphere of enterprises both excludable and rival. Rites of initiation into a group often required standing up “under a flag,” similarly to pledging allegiance to a military association.<sup>147</sup> Many kiosks and shops in fact displayed homemade plates (“security provided by A. I Malyshev”) in shop windows and used official adhesive labels with the name and telephone number of their protector. Territorialization in this manner follows Gambetta’s analysis, whereby a group will establish a common trademark with recognizable features, which allows competing protectors to recognize each other’s domains and prevent unauthorized trespassing into each other’s private rule systems. Internally, pledges also served to limit post-contractual opportunism among members of the group by reducing their incentive to renege on enforcement duties.

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<sup>144</sup> Volkov, *Violent Entrepreneurs*, 67-69.

<sup>145</sup> Phil Williams, “Hysteria, Complacency and Russian Organized Crime,” *PSBF Briefing* 8 (1996): 3.

<sup>146</sup> Ibid.

<sup>147</sup> Volkov, *Violent Entrepreneurs*, 69.

Small racketeers usually emerged with brigades of no more than ten members and eventually joined larger, more established groups. Within the central hierarchy, one (and sometimes several) *Avtoritets*(s) governs *brigadiri* under his command, who specialize in the provision of mobility, firepower, and coordination.<sup>148</sup> We may view this as a form of multidivisional organization, whereby a firm decides to create satellite companies within its hierarchy that would specialize in particular products, markets, regions, or technologies. As racketeers evolved into multi-functional enforcement partnerships, vertical integration could minimize the costs of communication and information transfer within the group. When client buy-in increased and the market for protection began to resemble the provision of a public rather than a private good, “criminal” authorities could additionally profit from horizontal integration by extending their “roofs” and reputations across a variety of industries. Domination over a street could turn into domination over an entire city – and even region – as a supplier of protection becomes a supplier of trust. A. Gurov, head of the USSR Interior Ministry Department stated at the time,

“Everyone lives by his own laws and instructions... a veritable war of sovereignties is on. Almost every neighborhood or block has proclaimed its sovereignty. All this contributes to the increasing legal nihilism and anarchy.”<sup>149</sup>

While Gurov’s description of sovereignty struggles is accurate, his diagnosis of the problem is flawed. If racketeers do not fight to establish pockets of order, what alternatives do shop owners face when in an environment of blanket opportunism? As rational actors without contract enforcement mechanisms, shop owners would choose to cheat on contracts as a dominant strategy. The costs of self protection would likely exceed the benefits of trade. Without protection, owners may choose not to transact at all, causing net deadweight loss for society.

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<sup>148</sup> Ibid.

<sup>149</sup> Varese, “Is Sicily,” 246.

Contrary to shock-filled attributions of anarchy, therefore, emergent “sovereignities” alert us to a significant phenomenon in organic institution-building.

The Armenian boss in Handelman’s case study, for instance, had always been “unabashedly proud of his diplomacy” in settling territorial boundaries with competing bosses. After the breakup of the Soviet Union, the boss remarks, “there were too many thugs running around this city on their own, and the police couldn’t do a thing. We had to clean up this situation.” By making a point to consolidate and coordinate his group’s activities better, he notes that they managed to keep the peace. “Without our leaders, it would have been even worse,” he concluded.<sup>150</sup> In the slow evolution of the Russian underground, violent entrepreneurs realized their role as forces of *de facto* law enforcement. Rather than resorting to crude and violent means of intimidation, they transformed their use of real coercion into potential coercion: as local stationary bandits, they benefited by governing through the non-application of force. Market entrepreneurs treated them as pillars of stability; bandits profited from the sale of guarantees.

A local understanding of the need for order stimulated a much more massive system of coercive organization. One of the largest syndicates, Ekaterinburg’s *uralmashevskie*, got their start by racketeering over small shops and producing alcohol illegally.<sup>151</sup> When the mining *Uralmash* plant hit major deficits following massive inflation in 1991, the gang began buying out sectors of the industry. Between 1992 and 1993 a series of brutal elimination contests ensued with the competing *Tsentrāl’naya* group in which both parties would kill each other’s and middle-ranking leaders (and sometimes clients). Eventually, the *uralmashevskie* ambushed *Tsentrāl’naya*’s key brokers and leaders and became the new rule-makers. Taking over copper, energy and communications industries, the *uralmashevskie* began conducting charity campaigns,

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<sup>150</sup> Handelman, *Comrade Criminal*, 15-17.

<sup>151</sup> A more detailed story on Uralmash is detailed in Volkov, *Violent Entrepreneurs*, 116-121.

supporting local youth sport clubs and subsidizing public transportation. When police arrested big “boss” Konstantin Tsyganov in 1993, public protests ensued and one leading entrepreneur spoke in defense of the group at a press conference: “Uralmash is a financial group, not an organized criminal society.” Eventually, Volkov notes, the group established over two hundred companies, twelve banks, and held shares in ninety other companies. By 1996, group members had sponsored local election campaigns and were getting elected to the regional legislature themselves. By May of 1999, the gang was officially registered as a Social-Political Union. In the fall of 1995, Interior Minister Anatoly Kulikov identified some eighty-five criminals running for Parliament. His report also mentioned 1,600 linkages between criminals and high government officials. By 1996, Frisby cites that fifty-five percent of capital in the entire economy and eighty percent of voting shares were in the hands of criminal clans.<sup>152</sup>

Graham Turbiville (1996) writes,

“At one fine point, two lines – the power ministries and the criminal world- intersected...these still-evolving relationships have...undermined law enforcement efforts at every level, contributed to the ‘criminal resource base,’ and generated variations of organized crime as it appears in the region and beyond.”

While it is certainly true that many highly organized groups undermined formal police efforts, it is less arguable that they undermined *law enforcement*. Contextually, in an environment where criminal groups redrew the boxing ring according to their own “laws,” we must reevaluate whether pinning the “underground” against continually decrepit formal institutions is useful to the Russian socioeconomic reality. Indeed, Alena Ledeneva notes, at “some point” (perhaps the same point of intersection mentioned by Turbiville), the “underground” life loses its specific ideology, and “with wealth comes a need for legitimacy, respect, and security for those who will

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<sup>152</sup> Frisby, 35.



inherit the wealth.”<sup>153</sup> As “criminal” elements established themselves in ever greater spheres of economic and political influence, separating them from (the usually state-dominated and “formal”) public sphere – indeed, criminalizing them - becomes incomprehensible and unjustifiable.

The notion of territory and “space” further carries strains of much deeper socio-cultural and political significance for a society in rapid transition. A market, writes Virgil Sorr, “is more than simply a locus of competition and exchange: it is also a ‘social space’ where in addition to economic transactions, social relations whose reach extends beyond the narrowly commercial are forged and maintained.”<sup>154</sup> Perhaps this key point has no greater tangible relevance than in the market for order and protection. Chamlee-Wright and Myers make no ostensible reference to organized crime, but conclude in theoretical terms that non-priced social networks will develop feedback mechanisms that encourage the “type of social learning that takes place in markets in which benefits of social exchange routinely spill over to unknown others.”<sup>155</sup> Enforcement partnerships evolve into much more organized and formal institutions as benefits of protection become positive externalities. The market, Lavoie adds, “is not so much a physical objective thing” as “a text which is open to several possible readings.” It is the job of an entrepreneur, in turn, to read the text. Violent entrepreneurship differs no less in the market for protection. The relationship between shop owners and bandits is a sociocultural conversation in which both parties eventually find mutual and peaceful interdependence highly beneficial. Shop owners who are initially coerced or who buy into the services eventually constrain the racketeer’s violent behavior by imposing social costs and introducing reputation mechanisms. In a call-and-response

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<sup>153</sup> Alena Ledeneva, “Organized Crime in Russia Today,” *Jamestown Foundation Prism* 17 April (1998): 14.

<sup>154</sup> Quoted by Paul Lewis and Emily Chamlee-Wright, “Social Embeddedness, Social Capital and the Market Process: An Introduction to the Special Issue on Austrian Economics, Economic Sociology and Social Capital,” *Review of Austrian Economics* 21 no. 2-3 (2008): 113.

<sup>155</sup> *Ibid.*, 114.

strategic game, small street-level public spheres grew into greater territorial spheres, orienting activities around an increasingly benign local monopoly on force.

In a state of flux, V. Ostrom notes,

“the exigencies to which rules apply are themselves subject to change. Applying language to changing configurations of development increases the ambiguities and threatens the shared criteria of choice with erosion of their appropriate meaning.”<sup>156</sup>

Dynamic market change tempers commonly understood social, cultural, and political prescriptions of human action. The evolution of enforcement partnerships is not merely an economically expedient response to increased demand: it is a locus of commonly understood *meanings*. Changes in the meaning of private property and law over time affect community relations as contestants “resolve existing discrepancies and inconsistencies” in the market.<sup>157</sup> Just as institutional optimists within transition studies rely too much on an undersocialized rational actor model, cultural pessimists rely too much on an oversocialized model in which individuals cannot overcome structural handicaps to effectively change institutions. Culture, however, is inherently “shaped by and in turn shapes the pervasive meanings, dispositions, and images that are inscribed in it through the metaphors we use and the stories we tell.”<sup>158</sup> It is hardly a unidirectional or static concept.

Drawing from the rich contributions in cultural studies, Lavoie and Chamlee-Wright identify culture as a “framework of meaning that provides the context within which people understand the world around them.” This definition, in turn, is inevitably couched in Kiser and Ostrom’s discussion of institutional change as a process that affects “the shared understandings

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<sup>156</sup> V. Ostrom 1980, 1, quoted by Kiser and Ostrom, 73.

<sup>157</sup> Sanford Ikeda, “The Meaning of Social Capital as it Relates to the Market Process,” *The Review of Austrian Economics* 21 no.2-3 (2008): 177.

<sup>158</sup> Don Lavoie and Emily Chamlee-Wright, *Culture and Enterprise: The Development, Representation and Morality of Business* (New York: Routledge, 2000), 15.

of individuals making choices within decision situations affected by the rules.”<sup>159</sup> A community’s perception of rules is an inextricably cultural process: institutions become legitimated through a cognitive film, a process of reading signals. Indeed, by 1993, as armed Mafiosi began strutting in the centers of large cities without fear of repercussions from government law enforcement, public opinion duly took note of new norms of action. One poll in the summer of 1992 indicated that one-third of residents in the Russian Far East believed that “criminal structures determined the course of events in their region.” In line with the development of Uralmash’s regional sovereignty, three-quarters of residents in Yekaterinburg believed their city was ruled by the mafiya. In fact, so did fourteen percent of the city’s police.<sup>160</sup> Most Russians easily distinguished between organized and unorganized crime. Gangsters “kill each other,” but “they certainly have no quarrel with the muzhik, the ordinary guy,” explained MVD investigator Anatoli Zhoglo in one of Handelman’s interviews. In consequence, he concluded, “A lot of people see them as their protectors from the hoodlums on the street.” Even all the attractive girls “want[ed] mafiya boys.”<sup>161</sup> In the Russian environment, feedback between individuals and their underlying environment thereby tempered the constantly evolving domain of shared meanings in the collective. New rule frameworks dominated community imaginations. The market text read by violent entrepreneurs is simultaneously a cultural one, an open book to the community: within its structural boundaries, “the culture being read is a process of mutual reading and re-reading by its participants.”<sup>162</sup>

New de-facto social boundaries furthermore fundamentally redefine commonly “read” perceptions of power relations and ethical life. Drawing on Hegelian conceptions, Albrecht

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<sup>159</sup> Kiser and Ostrom, 56.

<sup>160</sup> Handelman, *Comrade Criminal*, 22.

<sup>161</sup> *Ibid.*, 26.

<sup>162</sup> Lavoie and Chamlee-Wright, 19.

Wellmer writes that the “ethical life of people...is inseparable from its institutions, its collective interpretations of the world, its ways of self-understanding, its customs, traditions, and values.”<sup>163</sup> Implicated in the domain of shared and conflicting meanings is an underlying *political* discourse. When head of MVD A. Gurov discusses the war of “sovereignities” split between blocks and neighborhoods, it is not a matter of anarchy: it is a matter of the reorganization of power relations. The state was by far no longer the commonly perceived locus of control. In place of the standard dichotomy between the “above ground” state and “underground” organized crime, Walters helps shift the dialogue towards a Foucauldian conception of governmentality. Rather than conceptualizing “government” as the sovereign domain of a prince or autocrat, we can re-frame it as a measure of power relations that concerns men in their “links, their imbrications with those things that are wealth, resources, means of subsistence, the territory with its specific qualities... men in their relation to...customs, habits, ways of acting and thinking.”<sup>164</sup> In the Russian case, local communities under the auspices of criminal influence were not inherently under attack by a viral threat to civil order: as individuals who come to negotiate their terms of agreement, actors in the market place, violent entrepreneurs and local populations renegotiate their own political imaginations to a fluid economic, cultural *and* political text.<sup>165</sup> Governmentality as a means of managing human relations effectively shifts into the domain of multiple sovereigns: it becomes an ethical politics on the streets and in the minds of their occupants.

F.A. Hayek uses the term “catallaxy” to describe economics as a dynamic science of exchange, or the spontaneous order generated by the mutual adjustment of many individual

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<sup>163</sup> Albrecht Wellmer, “Models of Freedom in the Modern World,” in *Hermeneutics and Critical Theory in Ethics and Politics*, ed. Michael Kelly (Cambridge, MA: The MIT Press), 232.

<sup>164</sup> Michel Foucault, “Governmentality,” in *Power*, ed. James D. Faubion (New York: The New Press, 2000), 209.

<sup>165</sup> Walters, 393.

economies in a market. Deriving the word from its Greek original, it is translated to mean “to change from an enemy into a friend” and “to admit into the community.”<sup>166</sup> In world of ever-expanding knowledge and possibilities of action, social change is an inherently catallactic process of learning and adjustment. Human beings are no less economic actors than they are social and political ones. The evolution of extortion into public enforcement partnerships demonstrates Russia’s social transition from privatized force into a form of localized provision of public goods and de facto community borders. The process is not forestalled by supposedly predetermined structural hindrances, nor is it determined by the rhetorical reforms of the country’s leaders. It is a call and response negotiated through the exchange of gunfire, meetings behind tinted car windows, and eventually through meetings in sophisticated offices. As *multiple* bandits eliminate each other in vying to become the *stationary* bandit, they travel the path from enemy to friend among their client base. The evolution of individual actions into institutions and collective arrangements turns yesterday’s bandits into today’s business partners.

### *The Criminal Ties That Bind*

To re-conceptualize violent entrepreneurship as a catallactic process, it is useful to view ties between enterprises and bandits and enforcement partners as sources of social capital. Gathering from a variety of contested definitions of the phenomenon, Portes notes that a growing consensus within the literature identifies social capital as “the ability of actors to secure benefits by virtue of membership in social networks or other social structures.”<sup>167</sup> In line with Coleman’s definition, we may understand social capital as a productive asset that “inheres in the structure of

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<sup>166</sup> Morley Leonard Evans, “Wordplay: Man, Markets and Language,” *St. Lawrence Institute for the Advancement of Learning*.

<sup>167</sup> Alejandro Portes, “Social Capital: Its Origins and Applications in Modern Sociology,” *Annual Review of Sociology* 24 (1998): 6.

relations between persons and among persons.”<sup>168</sup> As a productive asset, it helps individuals achieve goals that would otherwise have not been achieved in its absence. Other social actors become the source of an individual’s advantage. Ikeda treats social capital as an unspoken context that enables agreements among strangers, which consists of “obligations, information that may flow over ties originally created as obligations, or of norms that support those ties.”<sup>169</sup> Most generally, it may consist of “any link among individuals that can produce value for someone at a particular place and time.”<sup>170</sup> Social capital, therefore, consists of the catallactic links that bind social actors within the social market place. By virtue of its ability to connect individuals in a productive manner, it becomes the active agent in each individual’s decision situation. Whether individuals reap benefits by virtue of orienting themselves around a predictable state-enforced rule framework or around a local bandit, social capital relations are an integral part of constantly evolving socioeconomic realities.

To summarize the empirical findings in this study within the theoretical social-capital framework, I use a “roof” model to demonstrate social change through violent entrepreneurship in Figures 1-3. Figure 1 outlines the contractual social-capital relations within a rule-of-law system. Figure 2 illustrates the absence of these ties in the post-Soviet institutional context. Figure 3 illustrates the recreation of social-capital contractual relations between violent entrepreneurs and their clients.

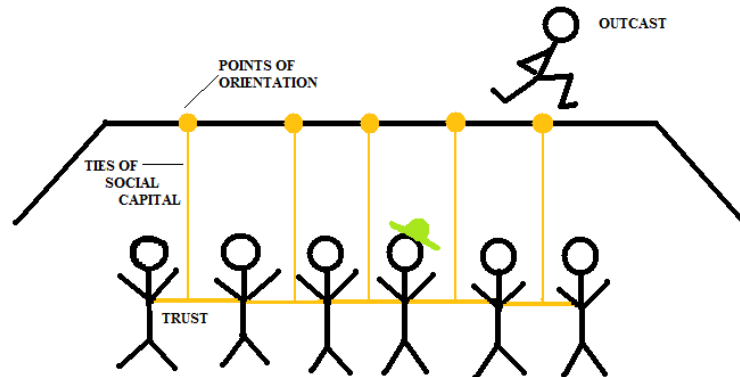
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<sup>168</sup> Ikeda, 169.

<sup>169</sup> Ibid, 176.

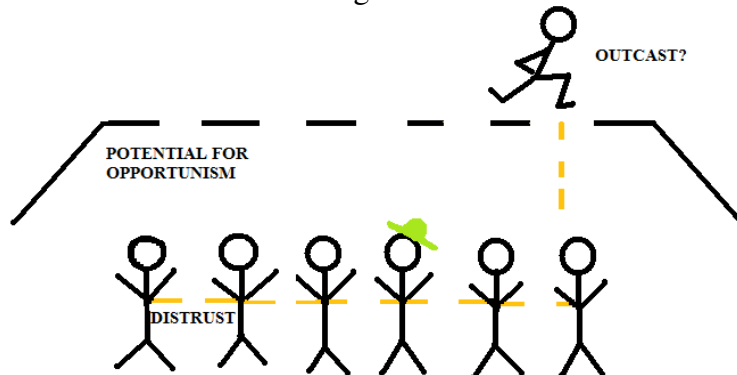
<sup>170</sup> Ibid.

Figure 1



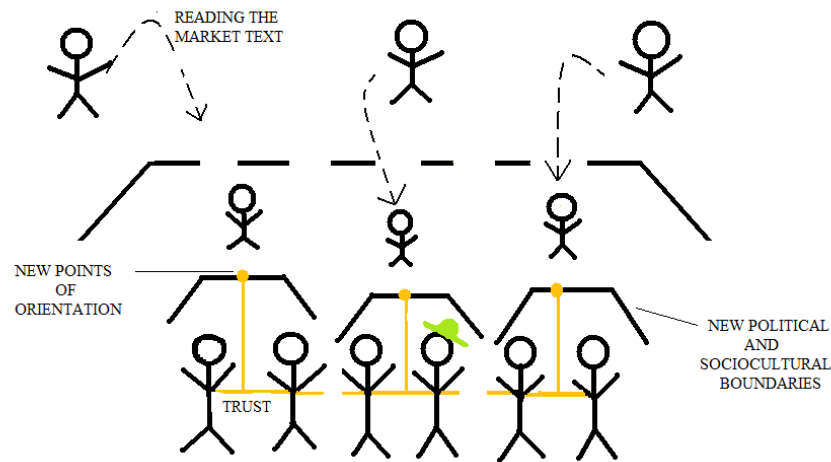
State enforcement mechanisms through rule of law facilitate the production of value by providing points of orientation for social actors to constrain opportunism in the market place. Rule of law is a commonly understood mechanism of enforcement, clear in meaning and equally applied. There are clear boundaries between agents within the system and agents outside (outlaws). Agents carry out daily practices and transactions within the rule system. Trust becomes an endogenous outcome of those shared understandings. Social capital inheres in the structure of contractual relations. Political culture is often delineated in terms of a healthy polity and civil order on a macro public or “national” scale.

Figure 2



State enforcement mechanisms are extremely weak and offer no coherent points of orientation for social actors. There are unsanctioned pockets for opportunism. Mechanisms of authority are not widely delineated or commonly understood. Agents do not carry out transactions due to extreme uncertainty and vulnerability. There are no clear boundaries between agents within the system and agents outside. Normative understandings of “outlaws” become tenuous and malleable. Distrust is an endogenous outcome of weak mechanisms of enforcement. Political culture is often delineated on a macro scale as a sick polity, encompassing general malaise, distrust of public institutions, and an unproductive market system.

Figure 3



Alternative enforcement mechanisms recreate coherent points of orientation for social actors to constrain opportunism in the market place. Boundaries between agents become clearer on a micro level (streets, blocks, public market spaces, cities, regions). Mechanisms of enforcement become commonly understood as violent entrepreneurs claim local monopolies on violence. Normative understandings of “outlaws” are still malleable due to a lack of shared understanding of a single monopoly on force. Distrust is an endogenous outcome in the early stages of racketeering as enforcers purposefully generate unfavorable outcomes to attract a larger client base. Once they appropriate a bigger domain and social stature, relations of trust evolve through mutual feedback between enterprises and protectors. Provision of public goods is more clearly restored as racketeers become enforcement partners. In the process of catallactic development towards local order, social capital inheres in the relationship between violent entrepreneurs and their client bases. Political culture is still delineated as ailing on a macro scale, but commonly shared understandings of real power relations shift to the level of local monopolies on force. The real process of governance occurs in the de facto domains constructed by violent entrepreneurs.

In place of traditional state and society (macro and micro) analytical dichotomies, the point, Walters writes, “is to interrogate the discourse of social capital as a practice with the potential to be constitutive of the social.”<sup>171</sup> By abandoning statist-led conceptions of social capital that deem it to be contingent solely upon formal institutions or Robert Putnam’s conception that treats politics as derivative from networks of social association, we develop a much richer and more accurate understanding of social order in which political relations operate endogenously in socioeconomic space. Through the lens of social capital theory, violent entrepreneurship becomes a crucial governmental project that resolves macro-level crises of governance. At any given moment, contributes Walters, “political texts are associated with

<sup>171</sup> Walters, 388.



particular political imaginations.”<sup>172</sup> In the context of an unstable and broken public safety enforcement system, one’s political imagination becomes contingent upon his ability to act in an uncertain future. To return full circle, we revisit Ludwig Lachmann’s analysis of the open social system. In the midst of uncertainty, the formation of expectations is “an act of our mind by means of which we try to catch a glimpse of the unknown.” As the market for protection becomes transformed by acts of the entrepreneurial human imagination, our political imaginations flow in sync to the rhythm of social learning between new arbiters of power and their clients. New polycentric organizational systems become possible.

### *Social Origins of the Russian “Underground”*

The analytical dialectic between formal and informal institutions dominates Russian and Soviet history. It often gives rise to theoretical constructs in which we separate Russian politics and economics from society and culture, or the legitimate world from the “underground.” Often, individuals are treated as victims of sweeping historical or political misfortune rather than as significant decision-makers who shape their ethical and political communities in response to systems of rules. Ultimately, given neoinstitutional analytical breakthroughs, the landscape of social change is a significantly more complex aggregation of millions of decisions that do not easily conform to predetermined theoretical molds.

Until late its history, “Russia knew only duties, not rights,” explains Richard Pipes.<sup>173</sup> Documenting the history of property rights in the country, he notes that once Moscow princes emancipated themselves from the Mongol yoke, they began to restrict and abolish rights to land-ownership. Russian nobles served the monarch and held land only as long as their actions pleased the Czar. As a Patrimonial regime, the Monarchy had no institutional incentive to

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<sup>172</sup> Ibid.

<sup>173</sup> Richard Pipes, “Private Property, Freedom, and the Rule of Law,” *Hoover Digest* 2 (2001).

concede rights to individuals. Indeed, that would dismantle czar's *raison d'être* because the owner of property is a "co-sovereign: his assets limit the power of the state, partly because they are outside the reach of the ruler's authority and partly because the ruler depends on them for fiscal solvency."<sup>174</sup> In essence, however, though individuals possessed few *de jure* (i.e. legally bound) property rights, they naturally retained *de facto* control over the use of resources.

*Governance* thrived alongside and despite of *government*. Because Russians could rarely count on enforceable laws or an impartial legal system, they reorganized their social relations through the self-governing *mir*, "*samosud*," *krugovaya poruka*, and many other extra-legal institutions.

N.G. Chernyshevsky speaks of Russia as a land "rich in bribetakers... since time immemorial."<sup>175</sup> There is arguably no clear origin of "criminality" in Russia, though illegal and mutually supportive organizations existed throughout Czarist and Soviet history, spanning nineteenth-century beggars' guilds or *artels*, the *vorovskoi mir* made of *vory-v-zakone* in Gulag prisons, and the shadow businessmen and *akuly* of the 1970s black markets. Extra-legal activity was a corrective mechanism allowing individuals to fill institutional gaps or slip past formal barriers to carry out transactions and to survive. In Gulag camps, thieves were in fact known as *dukhariki* – those who possess *dukh*, or spirit - not for any explicitly religious purpose, but to demonstrate that their survival depended on their ability to keep their spirits alive. Thieves believed they had exclusive rights to being human.<sup>176</sup> In the general socialist economy, "underground" practices were similarly a means of reinforcing natural *human* instincts in the face of the non-human expectations of the party. Lydia Rosner notes, "The ordinary Soviet citizen knew that to be honest and truthful means to die of hunger."<sup>177</sup> A divergence between

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<sup>174</sup> Ibid.

<sup>175</sup> Quoted by Albini et al., 222.

<sup>176</sup> Yuri Glazov, "Thieves in the USSR – A Social Phenomenon," *Survey* 22 (1976): 147.

<sup>177</sup> Quoted by Galeotti, 417.

market and administrative sectors naturally led to the pre-eminence of “the underground” as the legitimate realm of social cohesion and capital accumulation. Alena Ledeneva aptly terms Soviet social life an “economy of favors.”<sup>178</sup> Ultimately, if we assume that the Soviet state was truly the controller of all aspects of Soviet life, we would have to criminalize the entire Soviet population – and indeed most of the Party apparatus – for failing to fit into a system that attempted to erase human nature. Albini et al write,

“Since many people, if they could, were stealing goods from the state and wheeling and dealing in the game of exchanging goods and services, it is ludicrous to argue that criminal syndicates were established to provide illicit goods to those who desired them. Why? Because this entire system of citizen’s and governmental agents’ obtaining goods and services was so widespread as to have become, itself, the social norm.”<sup>179</sup>

Kelly, Schatzberg and Ryan take this theoretical inversion to the next level, describing the entire Soviet structure as a primitive racket that attempted to use terror and intimidation to “appropriate the entire economic mechanism of a vast empire.”<sup>180</sup> In Arkadi Vaksberg’s study of the Soviet mafia, several criminal groups in Azerbaijan – the Caspian Sea caviar mafia, the Sumbgait oil mafia, and a variety of fruit, vegetable, customs and transport mafias – reported to the party chief to enrich him in return for his agreement not to report their rackets. P. Boettke and G. Anderson compare the Soviet structure to a mercantilist system in which the autocrat – or party cohorts – used power to transfer wealth to themselves. In their study of rent seeking and socialist “venality,” they conclude that central planning authorities had little real power to manage the economy, challenging the assumption that the central planner was genuinely publicly

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<sup>178</sup> Alena Ledeneva, *Russia’s Economy of Favours: Blat, Networking, and Informal Exchange* (Cambridge: Cambridge University Press, 1998).

<sup>179</sup> Albini et al, 226.

<sup>180</sup> Kelly et al., 258.

interested.<sup>181</sup> Steven Solnick corroborates this theoretical understanding by stressing that individual bureaucrats were in fact very self-interested and opportunistic; following Gorbachev's reforms, bureaucrats actively began extracting any fungible assets, ultimately stealing the state itself.<sup>182</sup> Albini et al ask the critical question: "if the corruptor is simultaneously the corrupted, where are the boundaries for establishing the definition and essence of the legal system itself?"<sup>183</sup>

Soviet social reality ran contrary to its dictates. It disappoints our theoretical reliance on state and public institutions as primary sources of order and social capital. In Marx's framework, central planning was an attempt to resolve the inherent contradiction between the public and private spheres of society. In Don Lavoie's brilliant analysis of Marx's theoretical program, the problem with the status quo was that democratic institutions were confined to a "tiny part of social life," leaving the bulk of economic activity "to the unplanned outcome of non-democratic private struggles for wealth in the market."<sup>184</sup> The solution, therefore, was to "eradicate competitive market relations and replace them with a broadening of the democratically based public sphere to encompass all of social life."<sup>185</sup> As a result, production would no longer be a private act of war; commonly owned means of production would allow for the "defetishization of economic life and the transcendence of man's alienated social existence."<sup>186</sup> The attempted implementation of this ideal led to the complete inversion of social categories and theoretical dialectics.<sup>187</sup> In the process of creating an objective, harmonious public sphere, the Soviet regime merely instigated a reversion to private property exchanges in non-market conditions. The

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<sup>181</sup> Peter J. Boettke, "The Political Economy of Utopia: Communism in Soviet Russia, 1918-21," in *Calculation and Coordination: Essays on Socialism and Transitional Political Economy* (New York: Routledge, 2001).

<sup>182</sup> Steven Solnick, *Stealing the State: Control and Collapse in Soviet Institutions* (Cambridge: Harvard University Press, 1998).

<sup>183</sup> Albini et al., 226.

<sup>184</sup> Quoted by Boettke, "The Political Economy," 113.

<sup>185</sup> Ibid.

<sup>186</sup> Ibid., 127.

<sup>187</sup> Granting that there is much scholarly debate on the ideological origins of the Bolshevik revolution, I take the position in this paper that the Soviet regime was indeed an attempt to implement Marxist ideology.

“public” in itself became a commonly accepted myth in the face of full-fledged “fetishization” of economic laws within state and society alike. The foregone promise of a proletarian dictatorship fostered a dramatic loss of trust in formal institutions and in public spaces, where opportunism became a rule of survival. In *The Anti-Communist Manifesto*, Lev Timofeyev writes,

“No violence or brainwashing, however intensive, could make man forego the basic relations of supply and demand. Apparently, nature has not provided any other mechanism for supporting the social life of homosapiens.”<sup>188</sup>

Individuals - whether bureaucrats, gulag thieves, or citizens - were rational actors responding to a broken rule book. Normative conceptions of “right” and “wrong,” “honest” and “dishonest,” “criminal” and “righteous” became obsolete. For teenagers growing up in the early 1990s, the appeal of organized crime carried a hint of “spirituality based on immoral behavior” similar to its predecessor culture. For such a state of affairs, Colonel Zhoglo from Handelman’s study noted, “We have to blame ourselves. The old system had nothing to offer except hypocrisy.”<sup>189</sup>

Organization separate from the state remained an integral, commonly understood part of life. Within the bounds of a discursive cultural and sociopolitical catallaxy, we may understand that a justice system, for instance, cannot function without a “commonly held notion...of what constitutes justice.”<sup>190</sup> Without a common notion of “public” or “private,” the divisions become myths. In fact, circumventing the dichotomy allows us to treat markets as “important public institutions in generating common knowledge about prices as a measure of value.”<sup>191</sup> In the Soviet context, in which there were no market institutions to channel human instincts in a peaceful and prosperous direction, alternative non-state institutions, whether we call them “public” or “private,” emerged to cope with the burden of reality. The same lessons apply to the

<sup>188</sup> Lev Timofeyev, *The Anti-Communist Manifesto: Whom to Help in Russia* (Free Enterprise Press, 1990), 58.

<sup>189</sup> Handelman, *Comrade Criminal*, 27.

<sup>190</sup> Lavoie and Chamlee-Wright, 15.

<sup>191</sup> V. Ostrom, cited by Aligica and Boettke, 69.

post-Soviet transition. The grains of social order ultimately rested neither in the soil of the moldering Soviet state, nor in that of a weak Yeltsin-governed state. The break-up of the Soviet Union was not a transition from a bulwark of security to a vacuum of chaos; it was an opening for alternative institutions – not least of which included violent entrepreneurs – to carry out the ever-wieldy task of governance.

## Part VI. Conclusions

Traditional theoretical obstacles to a catallactic theory of social change hail from a variety of ideological perspectives. I will broaden the conversation to identify my main theoretical challenges and place the neoinstitutional perspective in context as it relates to the Russian case study and beyond.

### *The Problems of Theoretical Dichotomies*

Traditional divisions within social science literature thrive on generalized dichotomies, the most pervasive of which separate the state from society and culture, the state from markets, and markets from society and culture.

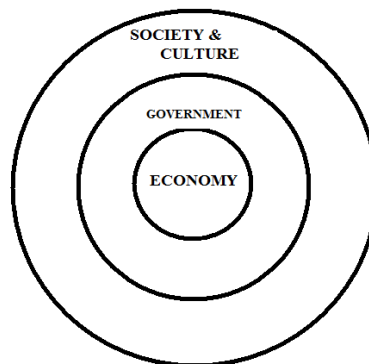
The economy, particularly following post-World War Two reconstruction, was treated as a distinct domain from “the social.” Communitarian critics treated the relationship between markets and social capital as parasitical in nature with the presupposition that markets actively undermined traditional social institutions and relationships were debased through individuals’ massive pursuit of self-gratification. Government intervention was therefore required to counter the “corrosive effects of markets and to ensure that society had an appropriate level of social capital.”<sup>192</sup> An alienated society plagued by crass consumerism had to be saved by public

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<sup>192</sup> Lewis and Chamlee-Wright, 111.

servants interested in maintaining a healthy civil and national order. Cultural studies in the 1960s made similar conclusions, treating commercial culture as unidirectional and consumers as helpless victims. Scholars viewed culture as a static, homogenous unit rather than as a fluid and discursive process. These particular conclusions echo Marxist aims to “de-fetishize” economic life and transcend alienated social existence in the capitalist world. Because the state was regarded as a bulwark of stability, this school of thought precluded the suggestion that polycentric orders could thrive within apparent chaos, or that individuals are significant actors in the production of their social realities. Within transition studies, the cultural argument tends towards an “oversocialized” conception of social order. The belief that a healthy economy and polity cannot thrive without a historically entrenched civic culture assumes a model of socio-cultural embeddedness that we may model in Figure 4.<sup>193</sup>

Figure 4



*Sociocultural Embeddedness:* Successful governance and market relations depend on the predominating sociocultural landscape. This model rests on the assumption that individuals are shaped by their surrounding environment. Culture is treated as unidirectional; individuals are not significant actors in the creation of their social realities.

<sup>193</sup> The circle-diagram models in this section are an adaptation of ones used by P.J. Boettke and V. H. Storr in “Post-classical Political Economy: Polity, Society and Economy in Weber, Mises and Hayek.” *American Journal of Economics and Sociology* 61 (2002), 169 and 177. They use circle diagrams to describe Granovetter’s conception of economic life as embedded in concrete, ongoing social relations. For the purposes of this section, I use the model to resemble an “oversocialized” cultural argument.

Perhaps the most classical of traditional theoretical dichotomies is defined along a Hobbesian and Smithian fault line. Whereas Adam Smith's contributions offered a social model in which the independent actions of individuals pursuing self-interest within a framework of rules would create spontaneous order, Hobbes' model described the general pursuit of self-interest as chaotic, ultimately necessitating the imposition of order from a central Leviathan. Boettke and Aligica write that this fundamental debate set the tradition for separating the market from the state. William Walters writes that politics has traditionally been imagined in terms of its hierarchical nature, where elites govern and society is governed. Following a Hobbesian conception, political culture, in turn, has been understood as a "national community" in which people's values are measured in terms of the extent to which they bind to the public concerns.<sup>194</sup>

The Russian transition is still regarded as a case of "biz-czarism" in need of a heavy hand to restore law and order in society. We may understand the rise of the Putin state and a dictatorship of the laws as the coming of a new leviathan in the face of apparent chaos. The state, in accordance with public policy logic, is the savior of society from the dangers of unimpeded markets. In Hobbesian terms, the presumption that peace and prosperity is derived from a unity of law and power implies that any instrument of coercive power not wielded by the center is illegal and therefore illegitimate. V. Ostrom stresses, however, that centralization of power fails to adhere to the assumption that human beings are fallible creatures of limited comprehension. Indeed, monocentric and state-based arguments for reform in society, whether proposing a dictatorship of laws or a version of institutional optimism, presume to be "omniscient observers capable of comprehending society as a whole where...national legislation is presumed to be applicable to all forms of collective action," "law is viewed as command" and "good citizens are

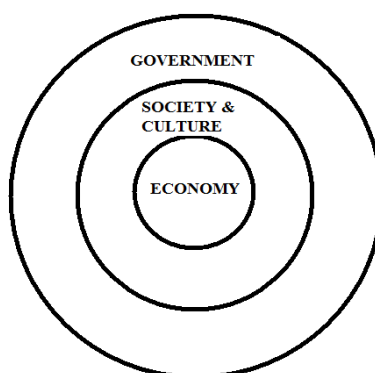
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<sup>194</sup> Walters, 383.



viewed as obedient subjects.”<sup>195</sup> This division within transition studies positions itself in the political-embeddedness model indicated in Figure 5.

Figure 5



*Political Embeddedness:* Successful governance, market relations and “national culture” depend on the unity of law and power originating in the monocentric state. This model rests on the assumption that individuals can actively construct their environment through enforcement of institutions irrespective of socio-cultural influences. State power is treated as unidirectional: the sovereign can shape social reality, and citizens are obedient.

In principle, both models make bold assumptions about human beings as predictable automata. In the sociocultural embeddedness model, humans are assumed to have no power to controvert their destinies: environment shapes all. In the political embeddedness model, certain humans have all power to change others’ destinies. Rational actors automatically respond to institutional changes enacted by holders of power: rationality shapes all.

In the case of Russian transition, the institutional-cultural debate is an anachronism in the face of the socioeconomic and political reality of life on the street level. The evolution of institutions is implicated in the interweaving imaginations of entrepreneurs both violent and peaceful, not in the designs of a benevolent planner or a cultural prison. This project ultimately

<sup>195</sup> Vincent Ostrom, “Problems of Cognition as a Challenge to Policy Analysts and Democratic Societies,” in *Polycentric Governance and Development*, ed. Michael McGinnis (Ann Arbor: University of Michigan Press, 1999), 404.

aims to re-conceptualize the broader theoretical framework of social change in the study of institutional transitions using a Smithian lens. V. Ostrom quotes Smith in his *Theory of Moral Sentiments* when he warns against those who imagine they can arrange “the different members of a great society with as much ease as the hand that arranges the different pieces on a chessboard.”<sup>196</sup> To counteract such “men of system,” Smith proposes that human societies actually consist of pieces that are capable of thinking and acting on their own in the “great chessboard of human society.”<sup>197</sup> Only legislation that fashions compatible institutional arrangements with these various points of motion will yield harmonious and happy results. The popular belief in a “strong man,” writes Hannah Arendt, is based on

“the delusion that we can ‘make something in the realm of human affairs – ‘make’ institutions or laws, for instance, as we make tables and chairs, or make men ‘better’ or ‘worse’ – or it is conscious despair of all action, political and non-political, coupled with the utopian hope that it may be possible to treat men as one treats other ‘material’”<sup>198</sup>

To avoid falling into the traps of political embeddedness and sociocultural embeddedness, we must reconcile purposive human action with cultural and environmental factors. Lachmann uses a “sculptor” model to describe the evolution of order: just as a sculptor fashions a product from the materials available to him, so social actors depend on a pre-existing social environment to order their actions and expectations. Structure, however, cannot initiate activity; people remain the “prime movers in society.”<sup>199</sup> Organizations are “works of art in which human beings function both as their designers and creators and as their principal ingredient”<sup>200</sup> In the Bloomington context, learning, innovation and choice are crucial in the

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<sup>196</sup> Adam Smith, *Theory of Moral Sentiments*, 380-381, quoted by V. Ostrom, “Problems of Cognition,” 406.

<sup>197</sup> Ibid.

<sup>198</sup> Hannah Arendt, *The Human Condition* (Chicago: University of Chicago Press, 1958), 188.

<sup>199</sup> Quoted by Lewis and Runde.

<sup>200</sup> Aligica and Boettke, 72.

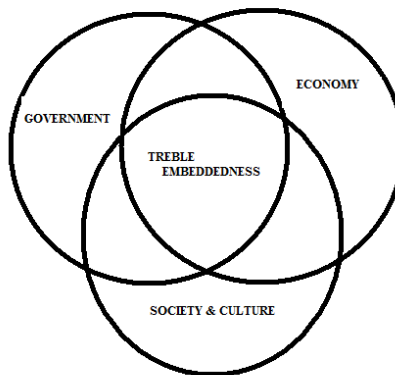
development of social order. Beginning with the assumption of uncertainty, Lavoie and Chamlee-Wright quote Barbara Hernstein Smith in their discussion on enterprise and culture:

“It is perhaps just as well for ‘our society’ that its norms are a ‘melange,’ that they constantly multiply, collide, and transform each other, that conflicts of judgment are negotiated ad hoc, and that normative authority itself is multiple and recurrently changes hands, variously strengthening and becoming diffuse.”<sup>201</sup>

Social change remains inextricably associated with *normative* and *catallactic* cultural, economic, and political discourses. Boettke and Storr maintain similar conclusions in their conception of post-classical political economy and the Weberian actor. What ultimately distinguishes social from political and economic phenomena “is only the meaning that actors attach to them, and the context within which actions are attributed this meaning.”<sup>202</sup> Bypassing oversocialized and undersocialized notions of social order, they propose a model of treble embeddedness, which I modify to the transition studies debate, illustrated in Figure 6.

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Figure 6



*Treble Embeddedness:* Human beings function as both designers and principal ingredients of their institutional environment. Neither action nor structure is privileged in the conception of social change. Sociocultural interactions, market processes and political relations are part of a greater catallactic give-and-take in an environment where humans are presumed to be fallible and non-omniscient beings.

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<sup>201</sup> Barbara Hernstein Smith, *Contingencies of Value: Alternative Perspectives for Critical Theory* (Cambridge: Harvard University Press, 1988), cited by Lavoie and Chamlee-Wright, 35.

<sup>202</sup> Boettke and Storr, 177.

*Social Order and the Putin State*

The follow-up to Russia's bandit era is a story of the state's conscious re-cooptation of coercive authority. The Russian institutional landscape and socio-cultural evolution since the rise of Putin requires serious investigation that extends outside of the immediate objectives of this capstone. The neoinstitutional perspective, however, offers cogent lessons for our understanding of Russian power relations since the late 1990s.

Localized bandits that were critical to the re-organization of socioeconomic orientation in the immediate-Post Soviet environment were eventually either wiped out in elimination contests, incorporated into formal legal and economic space, prosecuted by the state, or actively taken over by conglomerate political-economic interests. The state has combined strategies of neutralization, integration and pacification of organized crime groups, which has involved intensified MVD enforcement activity, the delegation of state functions to enforcement partners, and severely coercive financial audits of private companies (applying mostly to oligarch-owned enterprises).<sup>203</sup> From 1998 until 2002, a series of extensive hostile enterprise takeovers signified the return of the state as the stationary bandit. By manipulating new bankruptcy legislation, assembling impressive networks of coercive power structures in the MVD, bribing court officials and tampering with Procuracy investigation of fraud cases, large private businesses colluded with the state to forcefully strip ownership and consolidate assets of major industries from mid-to-large size companies.<sup>204</sup> While deregulation of intense registration and licensing restrictions and the implementation of a flat tax in 2001 have significantly leveled the playing field for the development of small to mid-level enterprise, the Russian state "roof" is still not sealed with respect to major players and oligarchs. Rule *by* law has disguised itself in rule *of* law rhetoric.

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<sup>203</sup> Volkov, *Violent Entrepreneurs*, 186-190.

<sup>204</sup> Vadim Volkov, "Hostile Enterprise Takeovers: Russia's Economy in 1998-2002," *Review of Central and East European Law* 29, no. 4 (2004): 527-548.

U.S. Secretary of State Colin Powell defended Putin following the seizure of Yukos and the arrest of Mikhail Khodorkovsky in 2004:

“The Russian people came out of the post-Soviet Union era in a state of total chaos- a great deal of freedom, but it was freedom to steal from the state and President Putin took over and restored a sense of order in the country and moved in a democratic way.”<sup>205</sup>

Out of the shock-tastic analyses of the 1990s was born the classic Leviathan, a sovereign who took seriously advice to uproot the criminal state that had so threatened social order on Russian streets. Putin’s approval rating hovered at a steady seventy-percent on the eve of his accession into power in 2000.<sup>206</sup> The conclusion, therefore, was that Russia was receding into its culturally-predetermined authoritarian system of governance. Aside from macro-level assumptions, however, have we witnessed the return of a healthy civic and national polity in post-Soviet Russia? At the same time that Putin’s popularity surged, from the early to mid 2000s, an absolute majority of citizens expressed deep distrust in courts, police and other law enforcement agencies. In 2006, from a sample of 1500 citizens, forty-seven percent of Russians denied the very idea that party competition existed.<sup>207</sup> Trust in public institutions in Russia was – and continues to be – among the lowest in the world.<sup>208</sup> The trajectory of post-Soviet politics has proven to be largely the work of elite reconfiguration. Gel’man offers the “resigned acceptance model,” arguing that the top-down regime has survived simply by default due to the inaction of citizens who see no valuable alternatives to the status quo.<sup>209</sup> In effect, Russians continue to find themselves estranged from the political process. To what extent, then, can public policy rely on macro-level

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<sup>205</sup> “Interview with the USA Today Editorial Board,” October 18, 2004, US Department of State website, [www.state.gov](http://www.state.gov). Cited by Anders Aslund, *Russia’s Capitalist Revolution*, 240.

<sup>206</sup> Anders Aslund, *Russia’s Capitalist Revolution: Why Market Reform Succeeded and Democracy Failed* (Washington, DC: Peterson Institute for International Economics, 2007), 207.

<sup>207</sup> Vladimir Gel’man, “Regime Changes Despite Legitimacy Crises: Exit, Voice, and Loyalty in Post-Communist Russia,” *Journal of Eurasian Studies* 1, no. 1 (2010): 59.

<sup>208</sup> Ibid.

<sup>209</sup> Ibid., 61.

assumptions ala Powell? Does social order primarily manifest itself in the state, or in the extralegal norms of community and market politics? Is the Russian Leviathan a *de facto* myth?

Peter Boettke writes that transitional political economy cannot simply be content with getting the prices or institutions right.<sup>210</sup> Understanding social order asks us to switch our macro lenses for micro ones in a way that our analytical conclusions on the grand processes of social order must correspond with the rich and constantly evolving perceptions of the social world by individuals on the ground level. Social change is not a function of state-society, society-economy, or public-private relations: it is a temporal measure of real life, real streets, in real circumstances. It is a puzzle of what constitutes commonly held meanings about the surrounding world and the attendant culture of governance. It always seeks fresh re-conceptualization.

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<sup>210</sup> Boettke and Storr, 180.

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