REEVALUATING THE EVIDENCE FOR ANTICOMMONS IN TRANSITION RUSSIA

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Heller explains the underperformance and informality of retail in transition Russia as the consequence of botched privatization. He calls this outcome anticommons: too many people hold a veto, leading to underuse. Heller argues that the existence of too many overlapping property rights prevents entrepreneurs from opening brick-and-mortar shops in Russia. The ubiquity of kiosks, however, is better explained by other factors. Kiosks are smaller investments than storefronts, hence their ubiquity in a credit-constrained environment. In addition, taxes, corruption, organized crime, and favor-exchange networks all discourage scale. Retail is informal in Russia for the same reasons it is informal in other poor countries.

I. INTRODUCTION

The commons is an intellectual construct created by property scholars to frame discussions of entry and use. The commons is open to anyone and no one can restrict its use, which leads to its overuse.[1]

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Michael Heller proposes the existence of a novel property form he calls the "anticommons." As the name suggests, Heller argues that the anticommons is the opposite of the commons.[2] Many people have property rights over an anticommons, each rights holder can veto, leading to underuse. Heller's inspiration and central example of the anticommons is the underuse of commercial real estate in transition Moscow. He notes that sidewalk kiosks were common in Moscow in the 1990s, while many storefronts were empty—a situation he terms the "kiosk paradox." Heller identifies many government agencies and private actors empowered to delay or prevent the use of commercial real estate. Additionally, he argues that the relative success of residential real estate in transition Russia reflected the absence of anticommons problems in that sector.

Since then, scholars have applied the anticommons construct in over three hundred articles to a variety of legal problems, ranging from environmental law to intellectual property.[3] The theory of the anticommons is considered a major contribution to property law discourse. Despite the appeal of a novel explanation for the persistence of informality in transition Russia, there is almost no evidence to support Heller's claim. In contrast, there is substantial evidence to support a more conventional explanation of the kiosk paradox.

The weakness of Heller's thesis becomes obvious when one compares economies in transition and developing countries. If anticommons property were the dominant explanation for the kiosk paradox, then the paradox should be present in transition economies, but not in developing ones. Unlike transition economies, few developing countries have anticommons problems, at least in urban areas. But Moscow is hardly the only city where formal retail is dwarfed by the informal retail sector. In fact, the informal sector dominates retail in most low-income developing countries and plays a substantial role in middle-income ones as well.[4]

The ubiquity of the informal sector across the developing world lends credence to the argument that factors other than anticommons explain the kiosk paradox. If extant, anticommons problems are unique to privatization in transition. But, the supposed symptoms of anticommons are quite common across poor countries. In short, there is no kiosk paradox.

This paper argues that informality in Russia has the same causes as informality elsewhere: scarce credit and weak institutions. The economic transition in Russia was characterized by a persistent credit shortage, particularly for small businesses. Without access to credit, retail firms could not expand into empty commercial real estate. Additionally, corruption and tax avoidance encouraged firms to stay small

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[1] S*ee generally* H. Scott Gordon, *The Economics of a Common Property Resource: The Fishery*, 62 J. POL. ECON. 124 (1954); *see also* Garrett Hardin, *The Tragedy of the Commons*, 162 SCIENCE 1243 (1968).

[2] Michael Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Market*, 111 HARV. L. REV. 621 (1998).

[3] *See*, *e.g.,* Jonathan B. Wiener, *Global Environmental Regulation: Instrument Choice in Legal Context*, 108 YALE L. J. 677 (1998); Dan L. Burk & Mark A. Lemley, *Policy Levers in Patent Law*, 89 VA. L. REV. 1575 (2003); Teemu Ruskola, *Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective*, 52 STAN. L. REV. 1599 (2000).

[4] Kiosks are a response to the Russian climate, since informal vendors cannot leave their merchandise on a snowy sidewalk.

and mobile, to avoid governmental attention. Small firms better survive extortion from organized crime, further limiting the ability of firms to grow. Favor exchange networks[5] also excluded many small firms from access to resources and preferential government treatment, again discouraging scale. Both Heller's and this Article focus on Russia in the 1990s. The process of transition, however, is incomplete and the factors holding back private enterprise in the 1990s are still present in Russia.

The aim of this Article is to remind readers that a variety of factors contribute to and explain the economic underperformance of developing and transition countries. Correctly diagnosing the reasons for the underperformance of retail in transition Moscow is important to appropriately tailor the responses to this problem. If anticommons is the problem, then reforming property law will improve property use. If, however, undercapitalization, corruption, organized crime, and government extortion are the cause of private sector weakness, other solutions are in order.

II. COMMONS AND ANTICOMMONS

While commons and anticommons are intellectual constructs, real-life examples of both exist. True commons are rare,[6] while Heller and other scholars argue that anticommons are relatively common.

A. Commons

One of the more famous commons in this country, Boston Common, was set aside for public use as a common grazing area in 1634. The Massachusetts Bay Colony acquired the land from William Blaxton, the first European settler in the area. Overgrazing led first to regulation and ultimately to closure of the common in 1830.[7] As a theoretical matter, it is unclear whether Boston Common was a true commons since access was not open to everyone; cattle owned by Catholics, Jews, or Roger Williams were unwelcome. But, Catholics, Jews, and Roger Williams were not welcome anywhere in Massachusetts. For any polity sufficiently large, the exclusion of outsiders from use of the commons may be a distinction without a difference. Where a polity is small, however, a "commons" begins to look like a resource shared by a group. Resources controlled by small groups, such as families or clans, are common (shared), but are not commons. A true commons is rare because intricate codes govern most common-use property. After 1646, grazing on Boston Common was restricted to seventy milk cows, indicating it was no longer a true commons.[8]

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5 Favor exchange is the non-market trading of services and assistance, often disguised in the rhetoric of friendship, networking, or connections.

6 *See* Margaret A. McKean, *Success on the Commons: A Comparative Examination of Institutions for Common Property Resource Management*, 4 J. THEORETICAL POL. 247, 250–52 (1992) (arguing that the commons should be called unowned non-property to distinguish commons from shared property).

7 NATHANIEL BRADSTREET SHURTLEFF, A TOPOLOGICAL AND HISTORICAL DESCRIPTION OF BOSTON 294, 339 (1883). Today, the Common hosts theater and concerts (in season), ice skating, and hobos.

8 In addition, new settlers were denied any grazing rights. *Id.* at 303.

When describing the inevitable overuse that results from commons property, Hardin tells a parable of herders who relentlessly expand their flocks until all grazing land is destroyed. But Hardin ignores the prevalence of coordinated management of commonly-held resources.[9] (In poor countries, traditional resource management codes are invariably unwritten, so scholars often ignore them.) To address the perceived "tragedy of the commons," Hardin proposes privatization or government regulation, yet both strategies have failed in practice. In response, development scholars have looked to traditional land use practices and discovered that common property is often regulated informally. Recent scholarship on common property in the developing world distinguishes between open access (true commons) and common property regimes.[10] In fact, common property regimes are often quite successful in regulating resource use sustainably.[11]

B. Anticommons

While the commons grants no one a veto over use, the anticommons gives the veto to many.[12] This leads to the anticommons being underused whilst the commons is overused. Although commons and anticommons are meant to be parallel concepts, they are not. The commons is a positive classification; commons are defined by the absence of restrictions on their use. In contrast, the anticommons is a normative classification. While the existence of multiple parties with veto power is a positive predicate, the anticommons is not defined by the number of parties with the power of veto. If a commentator judges the resource underused (and the legal context grants several parties a veto), then an anticommons exists, "for the tree is known by [its] fruit."[13]

It should be emphasized, however, that questions of over- or under-use are inherently normative. Even if reference is made to an objective standard, the appropriateness of that standard is a normative question.

The concept of the anticommons has been applied to many different types of property, both tangible and intangible. Heller proposes several examples of anticommons, but his seminal example is the underuse of commercial real estate in Moscow. Heller argues that anticommons property was created by the botched privatization of real estate, stating that "even if the initial endowment of property rights were clearly defined, corruption held in check, and the rule of law respected, storefronts would remain empty because of the way governments are creating

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[9] It is not surprising that he was almost entirely wrong since Hardin's primary focus was population control, not common property. Hardin, *supra* note 1, at 1246 ("Freedom to breed is intolerable . . . . [H]ow shall we deal with the family, the religion, the race, or the class . . . that adopts overbreeding as a policy to secure its own aggrandizement?").

[10] Daniel W. Bromley & Michael M. Cernea, *The Management of Common Property Natural Resources: Some Conceptual and Operational Fallacies* 6 (World Bank, Discussion Paper No. 57, 1989).

[11] *See generally* ELINOR OSTROM, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION (1990).

[12] *Cf.* e-mail from Joseph Singer, Bussey Professor of Law, Harvard Law School, to author (Apr. 26, 2009) (on file with author) (arguing that the existence of "too many" vetoes is not a structural problem; instead anticommons property may be another form of communal property).

[13] *Matthew* 12:33.

property rights."[14] But, Heller's claim is not falsifiable because in Russia property rights are unclear, corruption rampant, and the rule of law nonexistent.

In the Soviet Union all land was owned by the state, which developed a complicated system of land use rights administered by government agencies.[15] Since many of these agencies retained some authority after the collapse of communism, the structure of Soviet law remains relevant. In the Soviet system, state property received the highest level of protection and personal property received the lowest. When two rights came into conflict, state property prevailed.

To protect higher forms of property, more bureaucrats needed to agree before land use decisions could be made. Heller identifies four types of interested parties in the Soviet regulatory scheme: owners, users, balance-sheet holders, and regulators.[16] Note, however, that state agencies, bureaucrats, firms, and workers had little individual autonomy in the Soviet Union, so the number of parties with a formal veto over property use had little practical effect. In transition, in contrast, parties with a veto could extract economic rents. In total, Heller identifies thirteen different governmental and quasi-governmental bodies with a role in determining the use of commercial property in transition Russia.[17]

Heller's thesis is that heightened protection of property under socialist law leads to anticommons problems. Greater use of property indicates marginal anticommons problems, while inefficient use and underutilization signal severe anticommons problems. In its strong form,[18] Heller's argument depends on underuse indicating anticommons problems, corresponding in turn to a point along the continuum of property protection under socialist law.

To support the strong form of his argument, Heller makes an astonishing series of assumptions. Heller asserts that "[t]he level of administrative corruption, judicial incapacity, and clarity of rights is reasonably consistent across types of real estate within any given national real property market."[19] Without these assumptions, there is no direct linkage between underperformance and anticommons. Unfortunately, there is no evidence to support any of these claims and much contradictory evidence.

Corruption is worse in Moscow than elsewhere in Russia, despite Heller's assumption that corruption in Russia is relatively uniform.[20] Further, commercial real estate provides more opportunity for graft than residential property. For example, private homes are not burdened with fire inspections, which are a recurring feature in the literature on corruption in Russia. Although the phenomenon is

[14] Heller, *supra* note 2, at 623. This "if" is big enough to swallow most of the scholarship on transition.

[15] *See id.* at 629.

[16] *Id.* at 636–37.

[17] *Id.* at 638 fig. 2.

[18] Strong or weak forms are terms of art in the economics literature. Acknowledging the strong form of a theory means that the theory is largely, or even actually, true. In contrast, the weak form of theory is largely untrue, but contains a kernel of explanatory power.

[19] Heller, *supra* note 2, at 631.

[20] Anna Smolchenko, *Small Businesses Slam Moscow*, MOSCOW TIMES, Apr. 21, 2005, at 1. Some Moscow businesses are registered elsewhere in Russia to reduce the corruption burden. Ruta Aidis & Yuko Adachi, *Russia: Firm Entry and Survival Barriers*, 31 ECON. SYS. 391, 407 (2007).

notoriously hard to measure, Rimsky estimates that Russian businesses pay roughly \$33 billion annually in bribes. In contrast, individuals pay a little less than \$3 billion—less than ten percent of the total.[21]

Additionally, the clarity of rights varies considerably. Heller himself shows that privatization created confusion over business assets by subjecting these assets to competing claims.[22] Workers, firms, government, and creditors all have claims on business assets. In contrast, only residents have claims on housing, enhancing the clarity of residential property rights.[23] Since judicial incapacity imposes a smaller cost when rights are clearer, commercial real estate is further burdened relative to residential property.

There is more evidence *undermining* the claim that corruption, judicial incompetence, and rights opacity are similar among different property types than there is supporting it. If these three burdens vary between different types of property rights, then the strong form of Heller's thesis is untenable.

The weak form of Heller's thesis, by contrast, is that anticommons problems may be one factor among many in explaining the informality of retail in transition Russia. The remainder of this Article will address the weak form—whether anticommons contribute to the kiosk paradox in Russia. This Article argues that even the weak form of Heller's thesis lacks explanatory power since the kiosk paradox is best explained by other factors. In particular, credit shortages, taxes, corruption, favor exchange practices, and organized crime all depress Russian retail and encourage kiosks over storefronts.

Each of the factors that create a hostile environment for private enterprise in Russia weighs more heavily on small businesses than large enterprises. *Among* small businesses, however, the effect is reversed: the burden falls hardest on medium-sized enterprises (as opposed to very small ones).[24] The smallest businesses can partially escape taxes, corruption, and organized crime, but growing larger is not a viable option. So, kiosks prosper at the expense of storefronts.

C. Housing and Automobiles

The kiosk paradox was Heller's primary example, but he also applied the anticommons theory to explain the relative success of private over shared apartments in Moscow, and also the success of private taxis.[25]

The Soviets converted large apartments in the city center into *komunalkas*, where several families shared a kitchen and a bathroom. While individual (unshared)

[21] Vladimir Rimsky, *Bureaucracy, Clientage, and Corruption in Russia*, SOC. SCI.: Q. J. RUSS. ACAD. SCI. 32, 32–33 (2005).

[22] Heller, *supra* note 2, at 635–38.

[23] No landlords or mortgage lenders existed in the Soviet Union. The state owned the land and buildings, but speedy transfer to the residents was the norm in Russia and other transition economies.

[24] This inverted "U" curve might be a species of Kuznets curve. Simon Kuznets, *Economic Growth and Income Inequality*, 45 AM. ECON. REV. 1 (1955) (asserting that income inequality initially rises, and then falls, with increasing per capita income). *See also* Gene M. Grossman & Alan B. Krueger, *Economic Growth and the Environment*, 110 Q. J. ECON. 353 (1995) (positing a similar relationship between per capita income and air and water quality).

[25] Heller, *supra* note 2, at 650–53.

private apartments were quickly and successfully privatized, it took much longer to reconvert *komunalkas* back into unified, luxury apartments. Delays in expelling several poor tenants in favor of a single rich tenant are not necessarily a problem of "too many vetoes."

Heller also notes that *perestroika* produced an abundance of private taxis.[26] Once it was legal to use personal property for private gain, many car owners became impromptu taxi drivers. Heller cites this as evidence of the inverse relationship between property protection under Soviet law and use in transition, since personal property received the lowest level of protection in the Soviet property scheme.[27]

The level of protection has little to do with the immediate appearance of private taxis, however. Informal taxis require no additional investment, so their immediate emergence is not surprising. Informal taxis are common in the developing world, often appearing simultaneously with private automobiles. In the United States, informal taxis (jitneys) emerged in 1914; by the following year, 62,000 jitneys operated nationwide and had spawned a trade journal.[28] Therefore, the emergence of informal taxis in Moscow indicates nothing more than the end of state restrictions on private enterprise with no relevance to anticommons.

III. THE KIOSK PARADOX

Heller argues that anticommons property problems are responsible for the kiosk paradox. While reports of empty storefronts are frequent in the literature on transition Moscow, a quantitative measure of empty commercial real estate is unfortunately not available.[29]

A. Kiosks in Moscow

Kiosks in Moscow date at least from the time of Ivan IV (1530–1584). Government hostility to kiosks appears to be persistent, but perhaps not as persistent as the kiosks themselves. Even Stalin was unable to remove all kiosks from Moscow.[30] The recent explosion in kiosk numbers dates to 1990 when the *Soyuzpechat*, the Soviet agency in charge of newspaper and magazine distribution, began to allow or tolerate the sale of other items, like cigarettes and liquor, from kiosks that had previously only sold periodicals.[31] Soon, almost any product was available from a kiosk. No accurate census of kiosks was taken, but the mayor of Moscow estimated that 16,000 kiosks existed in the city by 1993.[32]

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26 *Id.* at 631 n.53.

27 *Id.* at 631–32.

28 By 1916, lobbying by streetcar companies put the jitneys out of business. Jitneys continue to flourish in a few cities, including Atlantic City. *See* DANIEL KLEIN, ADRIAN MOORE, & BINYAM REJA, CURB RIGHTS: A FOUNDATION FOR FREE ENTERPRISE IN URBAN TRANSIT 33–36, 41–46 (1997). Formal taxis ("yellow cabs") are scarce in Harlem, but informal taxis called "gypsy cabs" are plentiful.

29 Heller, *supra* note 2, at 633 n.61.

30 *Kiosks Are as Russian as Borshch*, MOSCOW TIMES, Jan. 25, 1995.

31 Sergei Khrushchev, *Stands of Dirty Capitalism*, ASIA, INC., Mar. 1994, at 86.

32 Ellen Barry, *Kiosk Crackdown Yields Sidewalk Space, Bitterness*, MOSCOW TIMES, Feb. 14, 1995.

B. The Dearth of Business Entry

Heller's observation of empty storefronts in post-Soviet Moscow can be explained as a lack of business entry. Russia has a long tradition of hostility to entrepreneurial activity. Under the czar, entrepreneurial activity was largely limited to minority ethnic groups.[33] Private economic activity was criminalized under socialism except for a few legitimate private craftsmen, called *kustari* (artisans). Most artisans were elderly men who repaired shoes and boots on the street, and had disappeared by 1980.[34] While a few old men repairing shoes may have been tolerated, there was no legal entrepreneurial activity in the Soviet economy. Organized crime, however, did exist and flourish in the Soviet Union.

Transition increased the opportunities for small businesses, which had been until then nonexistent. Nevertheless, the business climate remained bleak. Economic and demographic collapse weakened the prospects for private enterprise. In addition, transition Russia was a poor country, limiting opportunities for profit. High inflation and the 1998 currency crisis further undermined the business climate. Three times between 1992 and 1999, annual inflation fell at least eight percentage points, only to rebound.[35] Even though high oil prices through 2007 boosted incomes, the effect on business entry was mixed. Some individuals profited from the rising petroleum prices, so sales of consumer and luxury goods increased. On the other hand, oil exports produced an appreciation of the ruble, driving up the costs of imports and making exports less competitive. Scholars of economics recognize this as the "Dutch disease," where oil exports lead to currency appreciation, strangling other sectors of the economy. But, poor macroeconomic conditions play only a small part in the underperformance of small and medium enterprise in Russia.

Nevertheless, the ubiquity of kiosks in Moscow indicates that some new businesses were formed. Although kiosks in Moscow may be registered businesses, kiosks are less formal than storefronts.[36] Pervasive informality is a feature of transition and developing countries. The informal sector was also present in planned economies: in the years leading up to Russia's economic transition, the informal sector was larger than in corresponding market economies.[37] Informal operations within larger, formal enterprises are believed to be unique to socialist and transition

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[33] Sheila M. Puffer & Daniel J. McCarthy, *Navigating the Hostile Maze: A Framework for Russian Entrepreneurship*, 15 ACAD. MGMT. EXECUTIVES 24, 29 (2001). Most entrepreneurs were Germans, Jews, and Old Believers (a Christian sect). William Blackwell, *The Russian Entrepreneur in the Tsarist Period*, *in* ENTREPRENEURSHIP IN IMPERIAL RUSSIA AND THE SOVIET UNION 17 (Gregory Guroff & Fred V. Carstensen eds., 1983). For a numerical summary, see Henning Hillmann & Brandy L. Aven, *Fragmented Networks and Entrepreneurship in Late Imperial Russia* 11 (Stan. U. Dep't of Soc., Working Paper, 2009).

[34] THANE GUSTAFSON, CAPITALISM RUSSIAN-STYLE 114 (1999).

[35] ANDREI SHLEIFER & DANIEL TREISMAN, WITHOUT A MAP: POLITICAL TACTICS AND ECONOMIC REFORM IN RUSSIA 40 (2001).

[36] The formal sector describes most businesses in developed countries. The informal sector includes a broad range of legal and illegal businesses, defined by tax evasion, legal noncompliance, and small scale. There are a variety of terms used to describe economic activity outside of the formal sector, including underground economy, subterranean, shadow, informal, hidden, parallel, clandestine, second, household, dual, and black (or gray) market. Klarita Gërxhani, *The Informal Sector in Developed and Less Developed Countries: A Literature Survey*, 120 PUB. CHOICE 267, 269–70 (2004).

[37] *Id.* at 280.

economies.[38] Some of this "third" economy informality was tolerated or even encouraged by officials obligated to meet planning targets.[39] Many commentators stress the continuity of the Soviet underground economy and the informal and criminal enterprise in transition Russia.[40]

By the end of the Soviet era, a vigorous and entirely illegal economy flourished side-by-side with the planned economy. The underground economy was characterized as *nalevo* (meaning "on the left") and grew as incomes grew in the 1960s.[41] By the 1980s, a third of household income and 10% of the Soviet labor force was *nalevo*.[42] In certain sectors, such as auto repair, construction, dockwork, and truck farming, the underground economy outgrew the official one.[43]

A common external perception is that private enterprise began with *perestroika*, indicating a break with earlier socialist enterprise. In fact, the expansion and new visibility of private enterprise constituted a continuous growth from the earlier, informal era.[44] Although difficult to measure accurately, the size of the Russian informal sector is substantial.[45] The World Bank estimates the shadow economy in Russia at 46% of GDP, more than twice the OECD average of 18%.[46]

Although not dispositive, the evidence on business entry does not support the narrow anticommons thesis. If anticommons drives the underperformance of Russian retail, then other sectors should see unsuppressed business entry. Yet business entry in Russia is consistently the lowest recorded worldwide.[47] Between 1998 and 2002, the number of new firms as a share of all firms fell from 2% to less than 1% in Russia.[48] Even this figure overstates the true pace of business entry. To reduce or evade taxation, managers often register multiple businesses, thus overstating official statistics on business formation.[49] Some small businesses exist solely to conduct "shadowy transactions" for larger enterprises.[50] Scholars believe that the majority of

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[38] *Id.* at 281.

[39] *Id.*

[40] *Cf.* VADIM VOLKOV, VIOLENT ENTREPRENEURS: THE USE OF FORCE IN THE MAKING OF RUSSIAN CAPITALISM 18–21 (2002) (arguing that privatization and the weak state created demand for private enforcement).

[41] GUSTAFSON, *supra* note 34, at 114.

[42] *Id.* at 114–15.

[43] *Id.* at 114.

[44] *Id.* at 115.

[45] Gërxhani, *supra* note 36, at 276.

[46] Aidis & Adachi, *supra* note 20, at 402. Using a different methodology, Schneider and Enste estimate the shadow economy makes up 25% of the GDP of the former Soviet Union, in contrast to 12% for the OECD. FRIEDRICH SCHNEIDER & DOMINIK H. ENSTE, THE SHADOW ECONOMY: AN INTERNATIONAL SURVEY 73 tbl.4.5 (2003).

[47] *Id.* at 393. The figures reported describe firms with more than fifty employees, so many new businesses will not be counted. Instead, the statistic does give a good measure of how many businesses grow beyond the smallest scale. Developed economies generally have business entry rates between 5 and 15%, while developing and transition economies have even higher rates, consistent with higher rates of growth and fewer existing firms.

[48] *Id.* at 394 tbl.1.

[49] Small businesses are taxed at a lower rate. *Id.* at 393–94.

[50] Leonid Polischuk, *Small Business in Russia: Institutional Environment* 4 (U. of Maryland, Iris Working Paper No. 240, 2001).

businesses are registered but conduct a portion of their activities off the books.[51] Estimates of the proportion of unreported business activity range widely, from 10% to 90%.[52]

Multiple registrations overstate the rate of new business formation, while the absence of completely unregistered businesses means that new business formation is unlikely to be understated. Further, a firm that closes its doors has no incentive to see the registration statistics corrected, contributing to an overstatement of the number of firms.[53] Polischuk reports that fully one third of registered businesses either never began operations or shut down without deregistering.[54]

In 1997, small businesses employed 72% of the workforce in the European Union. For every thousand people in the European Union, there were forty-five small businesses. In Russia, there were only 5.6 small businesses per thousand, employing only 13% of workers.[55] While the rate of business entry is already the lowest recorded worldwide, the actual rate is even lower, indicating an environment almost uniquely hostile to private enterprise.

Several explanations have been advanced for the size of the informal sector in Russia and elsewhere. One explanation holds that firms will hide their operations to minimize extortion by the mafia.[56] In Gaddy and Ickes' survey, 90% of Russian managers reported paying protection money to the mafia.[57] A second explanation is that firms remain informal to hide their operations from government extortion.[58] Gërxhani argues that businesses opt to stay small to avoid tax or criminal attention.[59] Friedman and his collaborators find that corruption (and over-regulation) is associated with a larger informal sector. By itself, high marginal tax rates do not appear to encourage informality, but governmental discretion (which permits corruption) pushes businesses into the informal sector.[60] In contrast, Schneider and Enste find that higher taxes, more regulation, and rigid labor markets encourage informality.[61] A broad consensus exists that over-regulation promotes informality.[62]

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51 Mehnaz S. Safavian et al., *Corruption and Microenterprises in Russia*, 29 WORLD DEV. 1215, 1215 (2001) ("the ubiquity of the regulatory environment makes working completely outside the formal economy a virtual impossibility").

52 Nonna Barkhtova, *Russian Small Business, Authorities and the State*, 52 EUR.-ASIA STUD. 657, 675 (2000).

53 It is unclear whether this effect would be greater in Russia than elsewhere, but it is fair to assume that weaker institutions produce weaker statistics. Aidis & Adachi, *supra* note 20, at 394.

54 Polischuk, *supra* note 50, at 3.

55 *Id.* at 5.

56 Ekaterina Zhuravskaya & Timothy Frye, The Rise of the Racket in Russia (1998) (unpublished report, cited in Simon Johnson et al., *Why Do Firms Hide? Bribes and Unofficial Activity after Communism*, 76 J. PUB. ECON. 495, 496 (2000) [hereinafter Johnson et al., *Why Do Firms Hide?*]).

57 Johnson et al., *Why Do Firms Hide?*, at 497.

58 Safavian et al., *supra* note 51, at 1215.

59 Gërxhani, *supra* note 36, at 282.

60 Eric Friedman et al., *Dodging the Grabbing Hand: The Determinants of Unofficial Activity in 69 Countries*, 76 J. PUB. ECON. 459, 481 (2000). *See also* Andrei Shleifer & Robert W. Vishny, *Corruption*, 108 Q. J. ECON. 599 (1993).

61 Friedrich Schneider & Dominik H. Enste, *Shadow Economies: Size, Causes, and Consequences*, 38 J. ECON. LIT. 77, 82 (2000) [hereinafter Schneider & Enste, *Shadow Economies*].

62 *See* Gërxhani, *supra* note 36, at 279. *See also* Simon Johnson, Daniel Kaufmann, & Andrei Shleifer, *The Unofficial Economy in Transition,* BROOKINGS PAPERS ON ECON. ACTIVITY 159 (1997)

Whatever the cause, Gaddy and Ickes note that small businesses in Russia have shown little sign of growth or expansion.[63] In an uncertain and hostile environment entrepreneurs will reduce fixed investments, and kiosks are smaller fixed investments than storefronts. Considering the climate that small businesses face in Russia, opting for a kiosk instead of a storefront is no surprise, and certainly no paradox.

C. *New Business Formation and Scale*

This Article argues that low rates of business entry are caused by many factors including credit constraints, *blat*,[64] tax policy, corruption, and organized crime. Credit in transition Russia will be discussed in some detail, both because of its importance to new businesses and its scarcity. Russian tax administration encourages businesses to stay small in two ways. Businesses stay informal and mobile both to avoid paying taxes and to escape the uncertainty of tax administration. *Blat*, corruption, and organized crime have significant effects on new business formation and scale. Unsurprisingly, information on extra-legal activity is scarce, limiting its treatment in this Article.

This Part addresses specific problems the entrepreneur must face at the moment of business formation. Kaufmann and Kaliberda argue that informal firms in transition economies face near-zero entry and exit costs.[65] The evidence, however, does not support this view.[66] In fact, the costs of new company registration in Russia are significant.

Formally, new business registration costs 4804 rubles,[67] which is roughly five times the average monthly salary, and should take about ten days.[68] The true cost is much higher. The simplest registrations require five examinations by the registration committee. In response, private firms have arisen for the sole purpose of negotiating the registration procedure. On average, brokers charge 1000 rubles, and new businesses can be registered in two to three weeks.[69] Without a facilitator, registration can take months.[70]

[hereinafter Johnson et al., *The Unofficial Economy*]; Simon Johnson, Daniel Kaufmann, & Pablo Zoido-Lobaton, *Corruption, Public Finances and the Unofficial Economy* (World Bank, Policy Research Working Paper No. 2169, 1999) [hereinafter Johnson et al., *Corruption*]; HERNANDO DE SOTO, THE OTHER PATH: THE INVISIBLE REVOLUTION IN THE THIRD WORLD (1989); Schneider & Enste, *Shadow Economies*, *supra* note 61.

[63] Clifford Gaddy & Barry W. Ickes, *To Restructure or Not to Restructure: Informal Activities and Enterprise Behavior in Transition* (World Bank, Working Paper No. 13, 1998).

[64] *Blat* is the Russian term for favor exchange practices. While *blat* is sometimes a cloak for corruption, favor exchange is not corruption *per se*. Russians responded to the inefficiencies of central planning by trading favors, many of which were innocent.

[65] Daniel Kaufmann & Aleksander Kaliberda, *Integrating the Unofficial Economy into the Dynamics of Post-Socialist Economies: A Framework of Analysis and Evidence* (World Bank, Policy Research Working Paper No. 1691, 1996).

[66] Gërxhani, *supra* note 36, at 281.

[67] Barkhtova, *supra* note 52, at 662–63.

[68] *Id.* at 662. On average, new business registration takes twenty-eight days, a little less than double the OECD average. Aidis & Adachi, *supra* note 20, at 397.

[69] Barkhtova, *supra* note 52, at 662–63.

[70] *Id.* at 662.

In addition to registration, new businesses often need licenses to enter particular sectors. Business licenses present a more expensive challenge, ranging from hundreds to millions of dollars.[71] In 2006, Russia ranked 163rd out of 175 nations in ease of acquiring business licenses.[72] On average, acquiring a business license involves twenty-two procedures, takes 531 days (about 18 months), and costs 275% of per capita GDP.[73] Despite daunting obstacles, there are 844,000 small businesses registered in Russia, producing 12% of GDP as of 1997.[74]

Small businesses report an adverse economic situation and falling output more often than larger firms.[75] Between 1991 and 1996, the number of self-employed Russians actually *fell*, from 1.7% to 1.4%.[76] After the 1998 financial crisis, 30 to 50% of small businesses closed their doors.[77]

One contributing factor is the limited ability of companies to organize for their own protection. Russian law restricts the ability of small business owners to organize across business types, thereby preventing the emergence of, for example, a small business lobby.[78] Thus, it would be illegal to form a Chamber of Commerce in Russia.

Aidis and Adachi assert that the greatest impediment to business entry in Russia is the weak legal system. Legal uncertainty allows government officials to interpret and apply the law selectively and arbitrarily.[79] Many Soviet laws and regulations remain in force, although they are enforced haphazardly. Legal uncertainty discourages business entry and encourages entrepreneurs to keep their ventures small to hedge their bets. Note that of all Russians, Muscovites report the lowest level of trust in the legal system.[80]

Another factor that often appears in discussions of economic transition is legal or regulatory uncertainty. While it is true that uncertainty discourages investment, the effects of legal uncertainty have two indirect, and significant, effects on private enterprise. Uncertainty about property (i.e. lack of quiet title) makes borrowing difficult or impossible. In addition, legal uncertainty creates opportunities for corruption, since government officials have more discretion in applying the law.

IV. UNDERCAPITALIZATION AND CREDIT MARKETS

There are several explanations for Heller's observation that Moscow had empty storefronts but many street kiosks. Perhaps the most obvious is undercapitalization.

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[71] *Id.* at 663.

[72] Aidis & Adachi, *supra* note 20, at 396.

[73] *Id.*

[74] Barkhtova, *supra* note 52, at 657.

[75] Daniel Berkowitz & Wei Li, *Tax Rights in Transition Economies: A Tragedy of the Commons?*, 76 J. PUB. ECON. 369, 390 (2000).

[76] Theodore P. Gerber & Michael Hout, *More Shock than Therapy: Market Transition, Employment, and Income in Russia, 1991–1995*, 104 AM. J. SOC. 1 (1998).

[77] Polischuk, *supra* note 50, at 5.

[78] Barkhtova, *supra* note 52, at 673–74.

[79] Aidis & Adachi, *supra* note 20, at 403; Vladimir Kontorovich, *Small Business and Putin's Federal Reform* (Haverford College, Working Paper No. 25, 2006).

[80] Aidis & Adachi, *supra* note 20, at 405.

The Soviet Union had no credit markets; indeed, markets in general were illegal. Credit *as such* did not exist in the Soviet Union.[81]

Although a financial system was not strictly necessary in a centrally planned economy, the Soviet Union did rely on a mono-bank system which combined the functions of a commercial and central bank. In its role as a commercial bank, the mono-bank had two strictly separate functions: distributing cash to firms for the payment of wages, and recording credit assigned for all expenditures approved under the plan. "Credit" was created by planners and could not be used without planning approval, so it was merely a means of account. The plan used credit to control which enterprises could expand, although this "credit" was nothing like credit in a market economy. Consequently, considerations like ability to repay (or opportunity cost) were irrelevant, and some state enterprises accumulated huge debts.[82]

Although no meaningful distinction can be made between fiscal and credit support in the mono-bank system, payments from the bank to enterprises were arbitrarily designated credit in transition Russia. In the early years of transition, enterprise loans (meaning loans to firms, not government) were transferred to newly created commercial banks. The loan portfolios transferred to new commercial banks were not stripped of non-performing loans. Additionally, the number of non-performing loans increased sharply in transition.[83]

In transition Russia, credit was limited for many reasons, including high lending costs caused by weak accounting and short credit histories, moral hazard caused by weak corporate governance, and alternative opportunities for profit caused by inflation.[84] Like other institutions, banks are subject to corruption. For example, bank employees may issue loans on easy terms or without the expectation of repayment in exchange for bribes.[85] One businessman described banks as "parasitical," and another reported that bank employees "always tried to get a bribe from us."[86]

Very little credit is available through formal channels in Russia. Bank credit as a share of GDP is only 13%, compared with 120% in developed economies.[87] Nor is the limited credit available distributed evenly. Large enterprises, particularly those with good political connections, valuable assets, or foreign exchange earnings, receive a disproportionate amount of credit. While this is true in other economies as

[81] In the 1930s, the Soviet Union had no interest rates. Several engineers wrote to Stalin asking to be allowed to use interest rates for planning purposes. Without interest rates, the engineers noted that it was impossible to decide whether to tunnel through a mountain (saving coal in the future) or lay track across it (costing less today). Stalin had the engineers sent to a gulag. Interview with Vladimir Treml, Prof. of Econ., Duke University (Oct. 1, 1998).

[82] Stephen M. Fries & Timothy D. Lane, *Financial and Enterprise Restructuring in Emerging Market Economies*, *in* BUILDING SOUND FINANCE IN EMERGING MARKET ECONOMIES 23 (Gerard Caprio, David Folkerts-Landau & Timothy D. Lane eds., 1993).

[83] Daniel C. Hardy & Ashok Kumar Lahiri, *Bank Insolvency and Stabilization in Eastern Europe*, 39 STAFF PAPERS—INT'L MONETARY FUND 778, 778–80 (1992).

[84] Anna Meyendorff, *Tax Avoidance and the Allocation of Credit*, *in* DESIGNING FINANCIAL SYSTEMS IN TRANSITION ECONOMIES: STRATEGIES FOR REFORM IN CENTRAL AND EASTERN EUROPE 101 (Anna Meyendorff & Anjan V. Thakor eds., 2002).

[85] *See* Barkhtova, *supra* note 52, at 667–68.

[86] *Id.*

[87] Meyendorff, *supra* note 84, at 101.

well, the imbalance is much greater in Russia. Weak accounting and short credit histories are a particular impediment for new and small businesses. While small business loans are often in short supply in developed countries, they are almost non-existent in transition Russia. Barkhtova reports that bank loans for less than $20,000 are practically unavailable.[88] According to World Bank estimates in 2006, Russia ranked 159th out of 175 countries surveyed in access to business credit.[89] External funding for small businesses is extremely limited,[90] and less than 16% of small businesses report receiving bank loans.[91]

In developed economies, credit for small businesses is often scarce. Yet, the scarcity that entrepreneurs faced in transition Russia was extreme. The economy suffered from an "[e]xtraordinary scarcity of all types of resources after the fall of the Soviet Union in 1991 . . . . With personal capital being the only source of financing for most Russian entrepreneurs, they were forced to be highly creative in developing other resources."[92] Some credit was available through informal channels, including loans from friends, family, and loan sharks. In fact, Barkhtova reports that for small companies informal credit is the largest source of credit.[93]

Russia's banks provide little credit to small business. To add insult to injury, the archaic banking system cannot adequately manage its other role of facilitating and clearing transactions. Even routine bank transfers are time-consuming and expensive in Russia. One businessman reports a simple $2000 transaction taking two hours.[94]

Credit shortages depress economic growth because firms cannot expand to an efficient scale. Undercapitalized firms are unable to invest, depressing labor productivity and restricting the gains from increasing economies of scale. Firms in transition economies are particularly dependent on credit, because these firms are generally new. Older firms can re-invest their profits; internal funds are the largest source of capital for firms in most countries.[95] Additionally, transition economies are not as wealthy as developed ones, so entrepreneurs have fewer resources to invest.

However, the effects of credit shortages are not felt uniformly throughout the economy. Some sectors are particularly reliant on credit.[96] New firms are more sensitive to credit shortages than older firms that may have other sources of capital, such as retained profits. In addition, small firms are more reliant on credit than big firms. Credit shortages are likely to deter entry, thus preserving the market dominance of existing and large firms.

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[88] Barkhtova, *supra* note 52, at 668.

[89] In comparison, Brazil ranked 83, China 101, and India 65. Aidis & Adichi, *supra* note 20, at 395–96.

[90] *Id.* at 407.

[91] *Id.* at 407 n.33.

[92] Puffer & McCarthy, *supra* note 33, at 30.

[93] Barkhtova, *supra* note 52, at 668.

[94] *Id.* at 669.

[95] Stephen D. Oliner & Glenn D. Rudebusch, *Sources of the Financing Hierarchy for Business Investment*, 74 REV. ECON. STAT. 643, 643 (1992).

[96] For example, professional services firms need very little capital and hence are less affected by credit shortages.

This lack of credit restricts entrepreneurial activity, encouraging smaller scale retail operations at the expense of medium-scale ones. Entrepreneurs may be able to scrape together enough cash to stock a kiosk, but not a store. In addition, where judicial systems are underdeveloped, the lenders themselves must repossess collateral for nonperforming loans, without judicial support. Repossessing a portable kiosk is much easier than taking over a lease: a creditor relying on self-help can seize and move a kiosk, and therefore be more willing to provide credit for one. Even where entrepreneurs have access to capital, the lack of formal credit markets encourages the spread of kiosks and discourages the use of storefronts.

Meyendorff argues that businesses also avoid formal credit to avoid discovery by government officials. Many firms feel that disclosing information to banks "is equivalent to disclosing to . . . organized extortion rackets."[97] Since the mechanisms for collecting public revenue are weak and underdeveloped, the state relies heavily on the banking system. Applying for formal credit increases the likelihood of notice by government officials and hence the demand for both legal and illegal payments.[98] In the Russian context, applying for formal credit erases the possibility of tax evasion.[99] Perversely, firms that are more profitable are less likely to apply for credit since the potential for extortion is greater,[100] and entrepreneurs are less likely to apply for credit for less risky projects for the same reason.[101] For small firms, the benefit of avoiding state attention outweighs the benefit of credit.[102] Consequently, the overall level of lending is lower than in rich countries, where an application for credit does not result in legal and illegal payments to state and private organizations.[103]

In addition, credit shortages stunt the growth of firms because Russia suffers from "a general cash shortage"[104] related to its credit shortage. Firms cannot pay suppliers with cash, so instead firms trade output with each other. Barter is inefficient compared with currency since each transaction requires a double coincidence of wants. Barter is also time-consuming.[105] Another effect is that existing firms (with output to barter) have the upper hand over newly formed businesses with no inventory.

A final constraint on lending is the legal ambiguity created by transition. The Soviet legal system did not recognize property rights in land.[106] Thus, property records were simply not kept. As a consequence, the process of determining property

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97 Meyendorff, *supra* note 84, at 102.

98 *Id.*

99 *Id.*

100 *Id.* at 103, 107–08.

101 *Id.*

102 *Id.* at 102.

103 *Id.* at 107.

104 Merritt B. Fox & Michael A. Heller, *Corporate Governance Lessons from Russian Enterprise Fiascos*, 75 N.Y.U. L. REV. 1720, 1729 (2000). Credit constraints would not encourage barter if firms have cash on hand.

105 SHLEIFER & TREISMAN, *supra* note 35, at 98.

106 In fact, the term "real estate" first appears in the Law of the Russian Federation on Basic Principles of the Federal Housing Policy (Dec. 24, 1992) (translation on file with the Harvard Law School Library).

boundaries and recording them has been slow,[107] while industrialization and urbanization have compounded the uncertainty. When cities expanded outward into the countryside during Soviet times, factories and residential developments were built without any subdivision or recording. Hence, many property owners cannot say with any confidence what the metes and bounds of their land are. The lack of clear title makes it difficult to use real estate as collateral for loans. By contrast, since kiosks are mobile and not tied to a specific piece of real estate, the kiosk itself can easily be used as collateral.

Both credit and cash shortages favor existing firms, discourage the formation of new firms, and limit their expansion. The net effect of the dual cash and credit shortages is stunted growth and pervasive informality. Credit shortages characterize both developing and transition economies, both of which have informal retail, whether street vendors or kiosks.

V. TAXES

While Russia's statutory tax rates are moderate, its tax administration is corrupt. The burden on private enterprise is large and so "many of them choose to go underground."[108] The Russian tax system discourages formality and scale in several ways. The effective tax burden is high, so firms remain small and informal in order to avoid collection. Second, the application of tax laws is arbitrary, creating additional incentives for small-scale firms—especially profitable ones—to hide from the authorities.

A survey in 1998 found that "[e]ntrepreneurs in retail trade pointed to the high tax burden more often than any other factor (81% of respondents) to explain the limited development in small businesses."[109] Entrepreneurs reported a "bewildering" number of taxes, with a cumulative impact of nearly 100% of profit or even gross revenues.[110]

Barkhtova reports that entrepreneurs have a "strong feeling that the main goal of all state tax policy is suffocation of small business."[111] To defend themselves from the state, business owners keep two sets of books, termed "white" and "black."[112] Duplicative bookkeeping is expensive and limits the ability of entrepreneurs to expand. While it may be possible to keep two sets of books for a small shop or kiosk, the cost of deception and duplication increases along with scale. Without a single set of accounts, it is difficult for large enterprises to track profitability and, more importantly, prevent their employees from stealing. The effect of "white" and

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[107] Many socialist countries are struggling with similar problems. For example, in Slovenia, deed records date to the time of Empress Maria Theresa's cadastral survey. After 1945, careful recordkeeping was abandoned, producing considerable problems today. In many cases, no one can tell where the boundary between two properties should be. Interview with Urška Velikonja, Attorney, in Ljubljana, Slovenia (Aug. 30, 2005).

[108] Friedman et al., *supra* note 60, at 481.

[109] SHLEIFER & TREISMAN, *supra* note 35, at 98.

[110] *Id.* at 95.

[111] Barkhtova, *supra* note 52, at 666.

[112] *Id.* at 665–66.

"black" accounting is to discourage scale and formality in favor of entrepreneurial minimalism and informality.

In addition to duplicative accounting, firms engage in a wide variety of sham transactions to reduce their tax liability and free up *chernaya nalichnost*, or "black cash." This "black cash" can be kept as profit or used to pay bribes, extortion, or (untaxed) salaries. One common variation uses an *odnodnevki* (one-day firm) which operates for only a couple of months for the sole purpose of issuing false invoices. Firms pay these sham invoices and receive 97% of the payment back in cash.[113] False invoices inflate reported expenses, thus inflating tax write-offs and reducing tax liability. In the *obeznalichivani* scheme favored by retailers, a series of sham transactions provides the shop with undocumented inventory, which can be sold for (unreported) cash.[114] All of these transactions are more important for small firms than for large ones who can afford to play by the official system (with its own network of bribes and extortion).[115]

Another response to high tax rates is barter. Although awkward, barter facilitates tax evasion. Between 1992 and 1996, barter increased from 5% to 40% of total sales in one survey.[116] Barter hides transactions and output, and inventory is more difficult for government to seize than money held in a bank account.[117] As noted above, new firms cannot barter because they do not have output yet. Tax-fueled barter thus further discourages entrepreneurship and scale.

Since banks require disclosure from borrowers before extending credit, the Russian state has placed on banks the legal obligation to act as agents of the tax authorities.[118] The tax authorities (and government utilities) can withdraw funds from a private account without prior permission or even notice, further discouraging business activity conducted through the banking system.[119] This is compounded by the fact that "mistakes" by the tax authorities remain mostly uncorrected.[120]

As if that did not seem arbitrary enough, tax payments are due *in advance.* The tax authorities will refuse to register a new business or even a self-employed person unless taxes are paid in advance and *in full* based on *anticipated* income. In addition, changes to the tax system are generally published several months after becoming effective. Tax inspectors have essentially unlimited authority to assess tax and penalties. Not surprisingly, Barkhtova reports a tax advisor as admitting that often "[instead of paying] absolutely all taxes, it is better to close the company down."[121]

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[113] Andrei Yakovlev, *"Black Cash" Tax Evasion in Russia: Its Forms, Incentives and Consequences at Firm Level*, 53 EUR.-ASIA STUD. 33, 38 (2001).

[114] *Id.* at 40–42.

[115] *Id.* at 52.

[116] CLIFFORD GADDY & BARRY W. ICKES, RUSSIA'S VIRTUAL ECONOMY 26 (2002).

[117] SHLEIFER & TREISMAN, *supra* note 35, at 97.

[118] Meyendorff, *supra* note 84, at 102.

[119] Michael Ellman, *The Russian Economy Under El'tsin*, 52 EUR.-ASIA STUD. 1419 (2000); Barkhtova, *supra* note 52, at 666.

[120] Barkhtova, *supra* note 52, at 666.

[121] *Id.* at 665.

Entrepreneurs report that tax inspectors use conflicting and unpredictable methods to assess tax, even in identical situations.[122] In addition to discouraging entrepreneurship in general, unpredictable tax collection encourages businesses to remain small and mobile. Small, mobile businesses are better able to evade taxes, insulating the entrepreneur from unpredictable tax collection. If the entrepreneur is unlucky and the tax authorities find him, his loss is limited because his operations are small. A medium-sized business in a fixed location, such as a retail store, thus faces much greater risk of an adverse tax outcome than a small, mobile business such as a kiosk.[123]

Even if tax inspectors did their jobs faithfully, the paperwork involved in tax administration would be enough to smother most businesses. In 1995, Moscow businesses were required to submit twenty-three different tax forms each quarter.[124] In 1994 alone, local and regional governments introduced over one hundred different taxes and fees.[125] Every factor that complicates compliance with regulations also discourages small-scale, informal businesses such as kiosks from expanding into medium-scale, official enterprises such as retail stores.

To reduce taxes, many businesses conduct informal operations in addition to their formal operations.[126] As much as 40% of corporate profits in Russia avoid taxation.[127] A survey of 1700 small businesses in 1994 found that a third concealed at least a quarter of transactions, almost as many masked half their business, and an astonishing 18% hid all of their activities.[128] Another survey found that unreported sales composed 29% of total sales.[129] One manager reported only 1% of his actual revenue to the tax authorities.[130]

Most developing and transition countries suffer from kleptocratic tax authorities, but the evidence suggests that persecution of Russian businesses is particularly severe. The structure of tax administration may explain why tax collection is such a burden. Berkowitz and Li argue that the private sector suffers from a tragedy of the commons caused by the existence of multiple, independent tax agencies. Like multiple herds grazing over the same commons, the private sector is "over-grazed" by tax agencies competing to extract maximum revenue. Firms face excessive taxation, while the state receives less (since each tax authority keeps a share of what it collects, both through corruption and to finance its operations); public services and investment consequently suffer.[131]

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[122] *Id.*

[123] Yakovlev, *supra* note 113, at 39 ("Thus the tax inspector finds it much easier to pay regular visits to 'stationary' enterprises, regardless of their size, than to run about in search of 'flying' firms.").

[124] SHLEIFER & TREISMAN, *supra* note 35, at 96.

[125] Alexander Morozov, *Tax Administration in Russia*, 5 E. EUR. CONST. REV. 39, 43 (1996).

[126] Vladimir Kontorovich, *Has New Business Creation in Russia Come to a Halt?* 14 J. BUS. VENTURING 451, 455–56 (1999). *See also* Meyendorff, *supra* note 84, at 102.

[127] Meyendorff, *supra* note 84, at 104.

[128] Morozov, *supra* note 125, at 45.

[129] In contrast, the corresponding figure for Poland was 5%. Johnson et al., *Why Do Firms Hide?*, *supra* note 56, at 497.

[130] Yakovlev, *supra* note 113, at 38.

[131] Berkowitz & Li, *supra* note 75, at 371. *See also* SHLEIFER & TREISMAN, *supra* note 35, at 113.

VI. CORRUPTION, *BLAT*, AND ORGANIZED CRIME

Blat and corruption are distinct but related phenomena. Both practices are responses to the inefficiency of a centrally-planned economy. While *blat* may include innocent favor-trading between individuals, the actual practice of *blat* in transition Russia has an effect on small and medium businesses similar to that of corruption. Corruption, *blat*, and organized crime spring from a common source: the planned economy. Since firms did not respond to demand, shortages created opportunities for people willing to work outside the official system. In addition, managers were often under intense pressure to meet planning targets and so turned to black markets when shortages arose.

A. Corruption

Corruption is one of the largest obstacles facing post-Communist countries.[132] Corruption developed into an everyday phenomenon in response to the low wages and persistent shortages caused by the planned economy, not just in the Soviet Union but throughout socialist economies.[133]

In a market economy, the supply of goods and services expands or contracts in response to price signals. Increases in demand lead to higher prices, which cause suppliers to increase production. In contrast, supply does not respond to price signals in a planned economy. The insensitivity of supply to price signals is the root cause of corruption.[134]

The development model developed in the Soviet Union and exported to Soviet bloc economies placed a heavy emphasis on investment and little emphasis on consumption, which created persistent shortages of consumer goods and services. But there were probably even more desperate shortages of producers' goods (raw materials and tools). Shortages were caused by excessively aggressive plan targets and the criminalization of failure to achieve those targets. Managers often had little choice but to turn to criminals to find necessary inputs (spare parts, for example) in order to keep factories running: *No questions. Don't tell me how you got it. Here's the rubles, I need the spark plug by tomorrow morning.* Managers often produced a little more than the plan required as insurance (in case of occasional shortfalls) and

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[132] *See* Andrei Shleifer, *Government in Transition*, 41 EUR. ECON. REV. 385 (1997). Andrei Shleifer is quite the expert on corruption. He paid $2 million to settle a suit under the False Claims Act for conspiring to defraud the federal government by investing in Russia while advising its government. Zachary M. Seward, *Harvard To Pay $26.5 Million in HIID Settlement*, HARV. CRIMSON, Jul. 29, 2005; Marcella Bombardieri, *Harvard Professor Loses Honorary Title in Ethics Violation: Economist Will Retain His Tenure*, BOSTON GLOBE, Oct. 14, 2006.

[133] Peter Galasi & Gabor Kertesi, *The Spread of Bribery in a Centrally Planned Economy*, 38 ACTA OECONOMICA 371 (1987) [hereinafter Galasi & Kertesi, *The Spread of Bribery*]. *See also* Peter Galasi & Gabor Kertesi, *Rat Race and Equilibria in Markets with Side Payments Under Socialism*, 41 ACTA OECONOMICA 267 (1989).

[134] Galasi & Kertesi, *The Spread of Bribery*, *supra* note 133, at 387.

for sale on the black market.[135] Corruption, organized crime, and Soviet planning were joined at the hip from the beginning.

Models of consumer behavior suggest that corruption will spread in a planned economy even where only one consumer offers a bribe initially.[136] As bribery becomes entrenched, consumers develop a "corruption psychosis."[137] Where sellers have control over the product, weak coffee, small portions, diluted wine, and broken bricks become the (depressing) norm. Bribes were particularly pervasive in the service economy, because sellers had more control over the product; lawyers, doctors, nurses, repairmen, and even kindergarten teachers have their hands out for a "tip" or "thank-you money."[138]

The legacy of central planning is corruption. Several other factors contribute to Russia's high level of corruption however. Tanzi and Davoodi found that 80% of the variation among countries in levels of perceived corruption can be explained (in a statistical sense) by differences in economic growth, measured by changes in real GDP per capita.[139] Russia's real GDP per capita fell 21% between 1992 and 1998.[140] But falling incomes were only one factor contributing to corruption in Russia. Treisman found that Russia's corruption can be explained by its underdevelopment, federal structure, short history of democracy, and small degree of openness to trade.[141]

Corruption imposes costs on every part of society, including business.[142] As usual, small businesses bear a disproportionate burden. "Small business is the worst affected and suffers more than others from corruption and organized criminals."[143] Small entrepreneurs pay an estimated $6 billion in bribes, roughly 10% of total revenue.[144] The corruption burden will lead to companies being smaller than otherwise. Although illegal, corruption operates like a tax, reducing the output of whatever is taxed. Since businesses face sharply increasing corruption burdens as they grow from small- to medium-scale, they face incentives to stay small.

Corruption does more than discourage economic activity; it distorts the form and scale of that activity. In order to avoid extortion by government officials, entrepreneurs will choose businesses that minimize the cost of corruption. Permits and visibility both encourage government extortion. Instead, an entrepreneur might

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[135] If managers exceeded the plan, planners would then increase the plan quota, so there was no incentive to report excess output. Arye L. Hillman & Adi Schnytzer, *Illegal Economic Activities and Purges in a Soviet-Type Economy: A Rent-Seeking Perspective*, 6 INT. REV. L & ECON. 87, 89 (1986).

[136] *Id.* at 385.

[137] *Id.* at 372.

[138] *Id.* at 385–86. For a detailed description of corruption in a food shop, *see id.* at 92–93, 96.

[139] Vito Tanzi & Hamid R. Davoodi, *Corruption, Growth and Public Finances* 4 (Int'l Monetary Fund, Working Paper No. 00/182, 2000).

[140] International Monetary Fund statistics are available at http://www.imf.org.

[141] Since Russia's corruption was so well-predicted by these four factors, Treisman rejects culture as an explanation. Daniel Treisman, *The Causes of Corruption: A Cross-National Study*, 76 J. PUB. ECON. 399, 437 (2000).

[142] Corruption reduces private investment which reduces economic growth. Paolo Mauro, *Corruption and Growth*, 110 Q. J. ECON. 681 (1995).

[143] Barkhtova, *supra* note 52, at 673.

[144] Mark Levin & Georgy Satarov, *Corruption and Institutions in Russia*, 16 EUR. J. POL. ECON. 113, 115 (2000). This figure does not include payments to "roofs"—see Part IV.B.

choose to operate out of a kiosk or a van, which bear less risk of discovery and extortion.

Officials in Russia are generally not held accountable for arbitrary or capricious behavior.[145] Hence, there is little reason to forgo graft and act lawfully. In addition, since government salaries are generally low, officials make up the difference with bribes – just as waiters are paid low base salaries, but can expect to make up the difference in tips. Comparing the reported incomes of government officials with the property they own and their spending suggests that bribes are the "principal part" of their disposable income.[146]

Although it is very difficult to measure, it appears that real estate and business licenses are the two areas with the highest corruption demands.[147] One survey found that over 90% of Russian managers reported unofficial payments (bribes) in exchange for government licenses.[148] Unsurprisingly, when government officials were surveyed, the power to issue licenses topped the wish list of administrative changes.[149]

While anticommons problems may explain some of the excess corruption associated with real estate, many of the corruption opportunities are unrelated to the distribution of property rights. For example, fire inspectors do not hold a property right in commercial real estate but are a persistent source of demands for bribes.[150] Whether or not an actual fire safety hazard exists, the fire inspector can close a business if refused a bribe.

Moscow, along with St. Petersburg, is one of the most hostile environments for small businesses.[151] Business owners in Moscow report spending 11.5% of their monthly income on bribes.[152] The situation has prompted some businesses to register elsewhere in Russia, even though they operate in Moscow.[153]

Heller argues that kiosks are equally subject to extortion by government officials as commercial space, but there are two reasons why kiosks present less exposure to corruption. Firstly, government officials calibrate their demands to the perceived resources of the victim.[154] Kiosks present a smaller target than storefronts.[155] Since profits (and, to a lesser extent, revenues) are hard to gauge, corrupt officials may rely on inventories to judge potential revenue. Thus, a kiosk with its much smaller inventory is better positioned to survive governmental

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145 Barkhtova, *supra* note 52, at 671.

146 Rimsky, *supra* note 21, at 41. "May you be made to live off your official salary" is a Russian curse. Hillman & Schnytzer, *supra* note 135, at 89.

147 Barkhtova, *supra* note 52, at 671.

148 Johnson et al., *Why Do Firms Hide?*, *supra* note 56, at 503.

149 Levin & Satarov, *supra* note 144, at 121.

150 Barkhtova, *supra* note 52, at 671. Similarly, sanitary inspectors do not own the kitchen they inspect, but constitute a large burden on Moscow businesses. Aidis & Adachi, *supra* note 20, at 407.

151 Smolchenko, *supra* note 20, at 1.

152 *Id.*

153 Aidis & Adachi, *supra* note 20, at 407.

154 Similarly, drivers of nicer cars pay three times as much to avoid punishment for drunk driving. Levin & Satarov, *supra* note 144, at 123.

155 *See* Adam Tanner, *City to Cut Kiosks, Urges Move to Stores*, MOSCOW TIMES, July 16, 1994, at 32.

attention. Secondly, street kiosks are likely to face fewer government inspections, meaning fewer opportunities for extortion.

Perhaps the greatest difference between commercial real estate and kiosks is that kiosks are movable, allowing entrepreneurs to relocate to escape government extortion. Unlike a store, a kiosk can simply move to escape a particularly demanding government official. The possibility of flight provides downward pressure on the level of government extortion.[156] As a government crackdown drove kiosks from certain Moscow districts, the kiosks reappeared in others.[157]

Kiosks are by no means immune from extortion from multiple government agencies. For example, a kiosk owner needs to bribe tax inspectors, firefighters, electricians, architects, and the business license office, as well as pay protection money to organized crime.[158] Barkhtova reports that kiosks need approval from forty different government agencies. The license alone costs 40,000 rubles, but the true cost is higher because government bureaucrats artificially complicate the process in order to demand more bribes.[159] Business owners report "unlimited arbitrariness . . . [permitting] an absolutely wild racket as [the bureaucrats'] power is unlimited."[160] Barkhtova reports a businessman saying that local authorities find it "very easy . . . to destroy any small company."[161]

Multiple inspections constitute a major burden for small business, both in money and time.[162] The frequency of inspection is actually a sign of regulatory weakness rather than strength. Small firms face seven inspections per year; in comparison, small enterprises in Sweden face one inspection every two years.[163] In surveys, Russian managers report spending a fifth of their time dealing with government.[164] In one survey, the few managers who reported paying no bribes reported hiding between 85 and 98% of their business activities.[165]

While corruption increases the cost of doing business for all firms, the impact is greatest on small businesses. Bribes tend to be regressive—the proportional burden falls as firm size increases.[166] Large firms often have specialized departments that deal with government bureaucracy, or can afford specialized "facilitators" to deal with the government. In addition, large firms have greater resources and political

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[156] Heller addresses this difference in a single sentence buried in note 67. Heller, *supra* note 2, at 634 n.67.

[157] Tanner, *supra* note 155, at 32.

[158] Margaret Shapiro, *Perils of Kiosk Capitalism: Russia's New Entrepreneurs Pay for Permits and Protection*, WASH. POST, Aug. 28, 1993, at A15.

[159] Creating red tape to extract bribes is common. State employees resisted general incorporation in New York in order to preserve graft. With little graft to protect, New Jersey introduced general incorporation to attract businesses. Lincoln Steffens, *New Jersey: A Traitor State*, MCCLURE'S MAG., May 1905, at 41, 41–42.

[160] Barkhtova, *supra* note 52, at 663.

[161] *Id.* at 672.

[162] Aidis & Adachi, *supra* note 20, at 408.

[163] *Id.* In fact, excessive regulation and bureaucracy themselves produce corruption. Simeon Djankov et al., *The Regulation of Entry*, 117 Q. J. ECON. 1, 3 (2002).

[164] Johnson et al., *Why Do Firms Hide?*, *supra* note 56, at 502.

[165] *Id.* at 509.

[166] Safavian et al., *supra* note 51, at 1216.

power and can lobby for protection or rent seeking,[167] which provide the firms a benefit from corruption.[168]

Even very small firms routinely pay bribes.[169] Since new firms do not begin large, corruption deters both small business formation and growth. The businesses that do survive will be either very large or smaller than in economies with less corruption.

The fiscal structure of Russian federalism does little to encourage honest administration or private enterprise. In the United States, for example, new business formation and existing business expansion increase the tax base, generating public revenue. As business activity grows, city officials can reduce tax rates or increase spending, including their own salaries. In contrast, increases in municipal revenue in Russia are almost entirely offset by decreases in revenue sharing. The central government equalizes tax revenue between Russian towns, so that richer towns subsidize poorer ones. Thus, revenue sharing removes the incentive to expand the local tax base or provide public goods such as better infrastructure. With no countervailing incentive, Russian local governments are prone to overregulation because red tape provides opportunities for graft and extortion.[170]

Different government agencies do not coordinate their graft. Instead, each agency, ministry, or level of government sets its own bribes in order to maximize its own revenue.[171] The effect is similar to the "overgrazed" commons described by Berkowitz and Li. The result is that transition Russia has been characterized by "excessive proliferation of regulations and red tape."[172] Unfortunately, Russia is becoming more corrupt: the average bribe tripled between 2006 and 2007, reaching 27,000 rubles (roughly $1000).[173]

B. Blat

The inefficiency of socialism created informal networks between and within firms that persist in Russia. These networks provide economic advantages to insiders at the expense of most Russians. Party members, managers, and *apparatchiks* have useful connections and enjoy advantages over ordinary Russians, even after the official collapse of socialism. Exclusion from these networks discourages economic activity, which helps explain the shortage of new retail firms. Operating a retail store is a bigger undertaking than running a kiosk, and entrepreneurs excluded from these informal networks find the scale of their operations restricted. Entrepreneurship is

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167 Vito Tanzi, *Corruption Around the World: Causes, Consequence, Scope, and Cure*, *in* GOVERNANCE, CORRUPTION & ECON. PERFORMANCE 47 (George T. Abed & Sanjeev Gupta eds., 2002). Economists use the term "rent seeking" to refer to non-productive activity that enriches.

168 *Id.*

169 Tanzi, *supra* note 167, at 46–47.

170 Ekaterina V. Zhuravskaya, *Incentives to Provide Local Public Goods: Fiscal Federalism, Russian Style*, 76 J. PUB. ECON. 337 (2000).

171 In contrast, corruption was pervasive in the Soviet Union, but organized. Multiple bribes were not required and excess demands were penalized by the party bureaucracy. Shleifer & Vishny, *supra* note 60, at 600, 605.

172 Puffer & McCarthy, *supra* note 33, at 30.

173 Richard Pipes, *Pride and Power*, WALL ST. J., Aug. 22, 2009, at W1.

restricted to people with "high levels of social and cultural capital,"[174] unlike other developing economies where business entry is more widespread.

Persistent shortages in the Soviet economy encouraged the development of *blat*, the Russian word for favor-exchange practices.[175] Most frequently, *blat* was cloaked in the rhetoric of friendship,[176] but when dealing with strangers *blat* became nothing more than bribery.[177] The rhetoric of *blat* distinguished between "friends" (*svoi lyudi*, literally "our people") and "useful people" (*nuzhnye lyudi*).[178] Dealing with "friends" is relatively easy since the *svoi lyudi* can trust each other. Transacting with "useful people" is more difficult, since they are strangers. Restricting transactions to personal connections because others cannot be trusted limits the reach of *blat* networks.

Blat, like corruption, appears to be a direct result of the planned economy.[179] Reports of the importance of *blat* date back to the 1930s. By the 1940s, Russians complained that it was impossible to get an apartment, buy a train ticket, or even shop for the few goods available without *blat*.[180] Since *blat* undermined the planned economy, the practice was discouraged and the term avoided in polite conversation.[181]

Since *blat* operated as a mechanism for distributing scarce resources, money (as a scarce resource itself) became an increasingly important part of the practice. Money changed hands more frequently with "useful people" since on-going personal relationships were lacking. Favor exchange "devolved . . . into bribery and corruption."[182] After the market replaced the plan as the means of distributing resources, the rationale for *blat* should have disappeared.[183] Yet, shrunken *blat* networks persist. In transition, government officials were not replaced wholesale, although some with marketable skills did leave. The remaining *apparatchiks* depend on corruption and *blat* to adjust to, and prosper in, the new market economy.[184]

Firms find that dealing with a small number of friends is more predictable than dealing with strangers.[185] Even when firms confined their dealings to a narrow

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[174] Carolyn L. Hsu, *Capitalism Without Contracts Versus Capitalists Without Capitalism: Comparing the Influence of Chinese* Guanxi *and Russian* Blat *on Marketization*, 38 COMMUNIST & POST-COMMUNIST STUD. 309, 322 (2005).

[175] The parallel in Chinese, *guanxi*, may be more familiar. *Id.* at 311.

[176] *Id.* at 312; SHEILA FITZPATRICK, EVERYDAY STALINISM: ORDINARY LIFE IN EXTRAORDINARY TIMES: SOVIET RUSSIA IN THE 1930'S, at 63 (1999).

[177] ALENA V. LEDENEVA, RUSSIA'S ECONOMY OF FAVORS: *BLAT*, NETWORKING AND INFORMAL EXCHANGE 41 (1998).

[178] *Id.* at 121.

[179] While the term *blat* can be traced to pre-Soviet criminal slang, its use was not widespread until the advent of the planned economy. In fact, it is a common misapprehension that the term first appeared after the October Revolution. *Id.* at 11–13. In 1940, a concerned citizen described *blat* in a letter to the deputy chairman of the Council of Ministers as follows: "swindling, cheating, stealing, speculation, slipshod practices." FITZPATRICK, *supra* note 176, at 62.

[180] FITZPATRICK, *supra* note 176, at 62.

[181] *Id.* at 62–63; LEDENEVA, *supra* note 177, at 13.

[182] Hsu, *supra* note 174, at 320.

[183] In fact, *blat* has regained some of its pre-Soviet connotations of criminality. *Id.* at 320–21.

[184] Levin & Satarov, *supra* note 144, at 117.

[185] Hsu, *supra* note 174, at 322.

group, "they still reported constant problems with broken contracts."[186] Broken contracts generally meant broken friendships and shrinking *blat* circles. In Russia, the "reliance on winks and nods among friends" has created a business culture dominated by "poor management and sharp practice."[187]

As many entrepreneurs came from the shadow economy, the lack of personal connections creates another barrier to firm entry.[188] Paying bribes may be necessary for entrepreneurs in Russia, but it is not sufficient to ensure business survival and growth.[189] Personal connections with government officials are extremely important. In fact, the *blat* culture is so pervasive that one official cheerfully reported that "[i]nformal contacts are more reliable . . . . It is our Russian tradition to work with our own people."[190]

The literature on favor-exchange practices is often quite neutral. In fact, some have argued that favor-exchange practices in China (called *guanxi*) have contributed to, rather than hindered, economic development.[191] In the context of Russia, however, there is less reason for optimism. Without strong social limits, favor-exchange practices easily devolve into corruption.

C. Organized Crime

In transition, organized crime in Russia expanded in size, scope, and sophistication and the term *mafiya* became common in Russia and abroad. Many kiosk owners report a better relationship with organized crime than with the government.[192] One scholar notes that "Russian entrepreneurs fear bureaucrats more than criminals."[193] "[O]rganized crime is both a symptom and a cause" of the chaos in transition Russia that discourages productive investment.[194]

Between the 1920s and the 1950s, with a revival in the 1970s, a Russian mafia criminal organization flourished called *vory-v-zakone*, literally "thieves-with-a-code-of-honor [or law]."[195] In transition, many of the original criminal organizations were formed by athletes who lost their once-generous state support. Many sports, especially wrestling and martial arts, were supported by the military or law enforcement in the Soviet era.[196] In addition, the Afghan war created a large number

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[186] *Id.*

[187] GUSTAFSON, *supra* note 34, at 115.

[188] Aidis & Adachi, *supra* note 20, at 405–06.

[189] *Id.* at 405–06.

[190] Barkhtova, *supra* note 52, at 670.

[191] Hsu, *supra* note 174, at 324–25.

[192] For a discussion of competition between organized crime and the government to extract the maximum resources from productive activities, see Herschel I. Grossman, *Rival Kleptocrats: The Mafia Versus the State*, *in* THE ECONOMICS OF ORGANISED CRIME (Gianluca Fiorentina & Sam Peltzman eds., 1995). Volkov argues the mafia outcompetes the state in providing security at cost. VOLKOV, *supra* note 40, at 19.

[193] Smolchenko, *supra* note 20, at 1–2.

[194] VOLKOV, *supra* note 40, at 17.

[195] FEDERICO VARESE, THE RUSSIAN MAFIA: PRIVATE PROTECTION IN A NEW MARKET ECONOMY 8 (2001).

[196] Oddly, karate was banned in 1981, and several karate teachers were sent to prison. VOLKOV, *supra* note 40, at 6–11.

of maladjusted veterans accustomed to violence.[197] Former police, KGB, and GRU (military intelligence) also found work within organized crime.[198]

The government in Russia is involved with organized crime to an extent not seen elsewhere. In 1992, units within the Ministry of Internal Affairs were authorized to offer "extradepartmental protection," i.e. private protection services. Protection was available for both legitimate and criminal organizations, so law enforcement provided muscle for the mob.[199]

Private entrepreneurs rely on a *krysha* (literally "roof") for protection; current parlance does not distinguish between legal and illegal *krysha* providers.[200] Both criminals and retailers report receiving services in exchange for protection. For example, small traders would be provided retail space in exchange for a fee.[201]

In some cases, organized crime has created a system akin to tax farming. In exchange for large bribes, the local government gave organized crime total control over parts of Moscow. In other areas, bundlers can provide all the necessary permits for as little as $100.[202] In contrast to dealing with the government, kiosk owners praise organized crime, saying "[t]he mafia is the easiest of all to deal with. They don't charge too much, they tell you exactly what they want up front, and when an agreement is made, they live up to it. They don't come back later asking for more."[203] Organized crime provides a veritable bargain, charging 5 to 10% of profits, rather than the 50% (or more) demanded by the state.[204]

Neither is there any strict separation between the two. Anecdotal evidence suggests that the mafia receives information from government bureaucrats and documents.[205] *Krysha* that combine government and organized crime outcompete purely criminal "roofs." By 1998, 90 percent of *krysha* in St. Petersburg involved both government and organized crime.[206] Corruption in the security services also strengthens organized crime.[207]

Nevertheless, the protection fee paid to organized crime is a kind of tax levied by an extra-governmental entity, and, like any tax, reduces the incentive to expand operations. The possibility that businesses will be subject to additional extortion provides further incentive to remain small and informal.

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[197] *Id.* at 11–13.
[198] *Id.* at 61–62.
[199] *Id.*
[200] *Id.* at 22.
[201] *Id.* at 15.
[202] Khrushchev, *supra* note 31, at 86.
[203] James P. Gallagher, *Russia's Kiosk Capitalists Keep Wary Eye on Hard-Line Premier*, CHI. TRIB., Jan. 5, 1993, at 1.
[204] Khrushchev, *supra* note 31, at 86.
[205] GUSTAFSON, *supra* note 34, at 136–37.
[206] VOLKOV, *supra* note 40, at 169–70.
[207] Levin & Satarov, *supra* note 144, at 116. Corruption is pervasive in Russian law enforcement: 98% of drivers report bribing traffic police. *Id.* at 123.

VII. KIOSKS IN TRANSITION: COMPARING RUSSIA AND POLAND

Heller notes that kiosks also appeared in other transition countries, including Poland. Kiosks disappeared in Poland within a year, as entrepreneurs expanded into vacant storefronts.[208] In the kiosk stage of development, new businesses are somewhat immune from the institutional environment since there are many opportunities for arbitrage or otherwise taking advantage of transition rents.[209] In the storefront stage of development, by contrast, businesses grow and the institutional environment becomes very important. In Poland and other Central European countries, small businesses absorbed layoffs from state enterprises and contributed to continued economic growth.[210] By contrast, in Russia, after an initial explosion of small business formation the number of firms plateaued, and small business employment actually fell sharply in the late 1990s.[211]

Kiosks persist in Russia for the same reasons that kiosks disappeared in Poland. Credit is more readily available in Poland. The share of bank credit to GDP was 20% in Poland, as compared to 13% in Russia in the 1990s.[212] In addition, Poland is much less corrupt than Russia.[213] Frye and Shleifer found that shopkeepers in Warsaw suffered fewer inspections, paid fewer bribes, and paid fewer fines than their counterparts in Moscow.[214] In 1997, Johnson and his collaborators found that entrepreneurs in Russia faced higher taxes, more corruption, weaker courts, and more mafia extortion than in Poland. Managers reported taxes 50% higher (as a share of sales) in Russia.[215] In fact, 90% of managers in Russia report that it is "normal" to pay bribes, while only 20% of Polish managers reported paying bribes at all.[216] Only half of Russian managers believe they can rely on the courts to enforce a contract, in contrast to 73% of Polish managers.[217] While 90% of Russian managers report mafia extortion, only 8% of Polish managers report paying protection to the mafia.[218] The result is that in 1995, the informal economy was estimated to be 13% of GDP in Poland, but 42% in Russia.[219]

If the Soviet Union dominated Poland (and its neighbors), why is Russia more corrupt and backward than Poland today? Russia was poorer and less developed than

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[208] Grzegorz Wojtowicz, *World Bank Assignment: Poles' Retail Privatization Outstrips Region's*, WARSAW VOICE, Apr. 2, 1995. Like any city, Warsaw still has newsstands.

[209] Transition rents are the excess profits (beyond what is necessary to encourage business activity) possible in an atmosphere of economic dislocation.

[210] Polischuk, *supra* note 50, at 2.

[211] *Id.* at 4.

[212] Anna Meyendorff, *Tax Avoidance and the Allocation of Credit*, *in* DESIGNING FINANCIAL SYSTEMS IN TRANSITION ECONOMIES: STRATEGIES FOR REFORM IN CENTRAL AND EASTERN EUROPE 101, 101 (Anna Meyendorff & Anjan Thakor eds., 2002).

[213] In May 2004, Poland acceded to the European Union. Accession requires meeting benchmarks for governance, including corruption. Russia could not have met those benchmarks in 2004 or even today.

[214] Timothy Frye & Andrei Shleifer, *The Invisible Hand and the Grabbing Hand*, 87 AMER. ECON. R. PAPERS & PROCEEDINGS 354 (1997).

[215] Johnson et al., *Why Do Firms Hide?*, *supra* note 56, at 503 tbl.2.

[216] *Id.* at 497.

[217] *Id.* at 503 tbl.2.

[218] *Id.* at 497.

[219] Johnson et al., *The Unofficial Economy*, *supra* note 62, at 182 tbl. 1.

its neighbors to the west before socialism. More importantly, central planning and Soviet control had a shorter and more limited tenure in Poland, which escaped collectivization and the full force of Stalinism. Additionally, socialism lasted a full generation less in Poland. In 1991, no one in Russia could remember with much clarity the days before the Soviet Union. In Poland, however, many could remember the institutions and habits of democracy and a market economy even in 1989.[220]

VIII. CONCLUSION

This Article argues that conventional explanations in development literature well account for the experience of transition Russia, particularly in light of the paucity of evidence for anticommons problems. The large number of kiosks and the corresponding lack of storefront retail present a familiar question: why do poor countries have such vibrant outdoor markets?

Entrepreneurs in poor countries face capital shortages because the credit markets are underdeveloped. With little access to capital, businesses are small and find expansion difficult. Compared with firm revenues, taxes are high and unpredictable: Russia's tax system further discourages formal businesses or expansion. Corruption encourages businesses to stay small, informal, and mobile since size, formality, and a fixed location attract predatory officials. The culture of *blat* limits the number of people with the connections necessary to start and maintain a business in Russia's hostile climate. Organized crime provides additional discouragement for Russia's small entrepreneurs.

While entrepreneurs might benefit from simpler property regimes, improved access to credit and fewer dishonest government inspectors will likely have a much greater impact.

[220] In 1989, someone who was twenty years old in 1945 would have been just sixty-four.