Private Enterprise in Russia: 
An Approach to 
Alleviating Constraints

by

Marie Sheppard

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The contributions of all these individuals were much richer than the paper’s limited scope reflects, and, of course, none of them is responsible for the views expressed in the paper or for its flaws.
This paper identifies the constraints that inhibit the formation and growth of private enterprise in Russia. It then suggests a pragmatic approach for selecting constraints to address and for identifying ways to alleviate them. Specifically, the paper examines the relative roles of the public and private sectors in reducing business constraints. Most of these constraints are rooted in historical and institutional characteristics as well as in the recent Soviet past, and understanding these connections is essential when considering how to alleviate constraints. The paper profiles the priority constraints, as perceived by the Russian entrepreneur and examines how these inhibit business formation and growth. The main constraints addressed include taxation, sources of finance, commercial property, information, dispute resolution and business registration. The paper then proposes an approach for alleviating business constraints, including a framework for selecting constraints to target and parameters on how to intervene: who should be involved and what should they do? Finally, an attempt is made to derive specific implications for policy reform and program formulation, the result being some suggestions for reducing tax, commercial property and information-related constraints. This discussion and the conclusions are relevant, not only for Russia, but for most of the other countries of the former Soviet Union.
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INTRODUCTION

The purpose of this paper is to describe the constraints that restrict the formation and growth of private enterprise in Russia and to suggest an approach for alleviating them. When designing a strategy for private sector development (PSD), a prerequisite is to identify binding constraints. A PSD strategy also requires some method for deciding which constraints to target and what types of remedial programs are likely to be most cost-effective.

This paper is organized into four sections. The first reviews the recent development of private business in Russia. The next section proposes a typology of business constraints. The third section focuses on the most binding constraints to Russian businesses. The final section describes an approach for alleviating constraints and applies this approach to some binding constraints in Russia.
I. THE CONTEXT

Today's business environment is shaped by historical and institutional characteristics of Russian and Soviet life. This chapter describes how certain features in the current environment affect the development of the private sector. Although not explicitly stated in the paper, progress towards macroeconomic stability is an important prerequisite.

Count Witte, a Russian Imperial Prime Minister at the end of the last century, wrote that his country was different from the rest of the world: Russians had "no sense of property or legality". While the uncertainty regarding property rights is pre-revolutionary, the Soviet period reinforced this institutional characteristic by abolishing most forms of private property. Despite the collapse of the Party, ownership and property rights remain ambiguous. There is still no market infrastructure and few incentives (or penalties) which, in most western economies, encourage market-oriented behavior.

In order to distinguish between constraints that might be alleviated by external technical and financial assistance and those that would not, it is useful to understand their roots. Simply importing "missing" elements of a market system will have limited effect if there is no institutional infrastructure to support them. A sound body of contract law, for instance, will not lead to contractual compliance if conditions continue to make it more rational for entrepreneurs to renge on commitments and renegotiate the terms of trade at every step in the process. While enabling legislation is necessary, it is only effective if accompanied by other conditions, (such as penalties, enforcement practices or ethical codes of conduct) that render compliance a rational business decision. This chapter describes some of the existing conditions that most effect Russian businesses.

A. Property and Ownership

In the west, ownership provides a well-defined right to property; in Russia, this relationship has yet to be clarified and enforced. The current status vis-a-vis property rights increases risk, impedes investment and limits economic growth in both the private and public sectors.

During the Imperial period, private property was defined through the concept of eminent domain. The sovereign owned everything and his or her approval was required for all contracts. In the period prior to the revolution, property rights began to develop, albeit in a modified form, as the principle of eminent domain lingered on. After the revolution, private property was virtually abolished. This did not, however, make enterprises property of the state. Instead, the phrase "unproperty" is a more accurate description. State enterprises were legal entities that controlled assets, but the right to dispose of these assets and other concrete resources, even those directly "owned" by the enterprise, was never clearly defined. This left enterprise directors in an difficult position; even actions that clearly increased the efficiency could be used by a higher political authority as an example of misuse of "state property". Hence, enterprise directors had a disincentive to make resource-related decisions that might result in productivity gains.
In an effort to combat this dilemma and increase productivity, Perestroika introduced the first forms of non-state enterprise. Until 1987 the only legal forms of economic activity were state enterprises, collective farms (which were a different form of state enterprise), and agricultural production on family plots (usually less than 1 hectare). Gorbachev introduced two new management systems: cooperatives and leases. The Law on Cooperatives was enacted in 1988. Cooperatives were the first legal form of non-state enterprise, and because there was no other, all kinds of entrepreneurs flocked to register their businesses as "cooperatives".

The legal foundation for the current array of enterprise structures was essentially completed by 1990 when it became possible to have a 100 percent privately owned business. During this same period, market liberalization began. Thus Perestroika increased the autonomy of the public sector as well as opportunities for the private sector.

These reforms focused more on ownership than on property rights, and this has been characteristic of the reforms to date. While property can be owned, it can seldom be considered secure. Most enterprises - be they state or private - possess property titles that are less than absolute.

The uncertainty surrounding property rights is exacerbated by the political situation. The collapse of the Soviet and communist systems created a power vacuum that has largely been filled by local governments. The distribution of power varies widely across and within oblasts, and this layering of jurisdictions (often with overlapping mandates) creates confusion, ambiguity and opportunism amongst both officials and entrepreneurs.

While private enterprises appear more autonomous with regard to property than state enterprises, there is ample opportunity for outsiders to meddle in their operations. Leasing arrangements (primarily of premises) and continuing control over sources of supply (despite the apparent monetarization of some areas) guarantee that the directive features of the Soviet system continue to function in much the same way as they did before. Because the system continues to exercise control, business people continue to depend on it, and this reinforces the power of the old system. Entrepreneurs will not be willing to break these links until there is an alternative system for resource allocation - one in which property rights are clearly defined and enforced.

B. Institutions and Attitudes

Russians often refer to the private sector as the non-state sector, and this is very telling. From the 1920s to the 1980s virtually all of the most important resources - food, housing, health, education and work - were allocated through top-down decision making processes. Economic, political, and social forces intertwined to create a stable state system that provided for each member of society. Hence, a key attribute of the system was the sense of security it engendered.

1This system provides for the following legal forms: state, municipal, and individual enterprises, full and mixed partnerships, limited liability (closed stock) and open stock companies, and associated, subsidiary and leasing enterprises.
The collapse of this system invokes ambivalent reactions. On the one hand, market reforms have created countless opportunities for entrepreneurs who, quick to meet the suppressed demand, are providing services and better quality goods. They are quick to capitalize on money-making opportunities created by the transition process. Exploiting temporary features such as gaps between state and market prices (complemented by the fluid legal/regulatory environment) creates huge arbitrage rents and enables business people to generate vast profits in a short time.\footnote{Rent-seeking behavior has dangerous attitudinal implications. It seems that many Russians believe that businesses profit from working the system - as opposed to hard work. A poll undertaken by Russia’s Public Opinion Center in Autumn of 1992 is indicative. Roughly two thirds of the respondents believed that an business’ success is the result of swindling, fraud, and crime; 14% attributed this to luck, and 13% to persistence and hard work (Source: The Public Opinion Center of the Russian Federation, February 1993).}

On the other hand, market-driven forces cannot immediately fill the gaps left by the retreat of the state system. Individuals fear an immediate worsening of their living conditions. The widespread perception is that, even if goods and services were available, the most important services (e.g., housing, health and education) would not be affordable. Not surprisingly then, most of the population continues to depend on the old system for jobs and, more importantly, the accompanying package of housing, goods and services.

Most Russian families have ties to both the state and non-state sectors, with at least one member moonlighting or otherwise engaged in non-state economic activity. Official jobs are kept to access housing, goods and services, but many people earn more money in the non-state sector. Thus an engineer paints apartments on weekends, a research scientist dabbles in a small travel company, and an accountant at a state enterprise keeps the books for small companies. Because these people keep their jobs in the state sector, employment figures are relatively stable; meanwhile, the bulk of their income may be generated from private activity.

C. The Private Sector

As of mid-1993, the official non-state sector accounted for roughly one tenth of the economy in terms of resources and production. Roughly 950,000 new enterprises had been registered (see Table 1). Though imprecise, these figures indicate some growth in private economic activity and this reflects the impact of privatization.\footnote{These figures include those companies that have been privatized. Partnerships and individual private enterprises (accounting for 385,000 companies) reflect independent start ups and small scale privatization. Joint-stock companies includes companies privatized under the mass privatization program.} However, the pace of change is not enough to avoid the threat of serious social disruption should mass unemployment materialize. Nor is it sufficient to compensate for the drop in productivity in the state sector.
While an increasing share of Russian businesses are wholly private, their daily operations seldom reflect this.\(^4\) Commercial enterprises are dependent on state entities as customers and suppliers, but the level of dependence varies by ownership type and by line of business. Pure, privately owned companies depend less on the state (26 percent) than do other types of companies (47 percent). The greatest dependence is among manufacturers, of whom 60 percent declared themselves "largely dependent" on state enterprises for supplies.

The state sector wields control over rubles, resources, and information that is difficult to overestimate. Allocation of these resources is highly decentralized, and depends on individuals scattered throughout government and across state owned enterprises. As the old system crumbles, opportunities to capture value abound. In fact, a unique feature of the transition period is that these opportunities (usually in trading) far outnumber those for value creation.

There is a tendency amongst Russians to lump this "army of speculators" into a single category that can then be castigated for reaping benefits from Russia's hardship. In reality, many of these entrepreneurs are providing a useful function in commerce, manufacturing, or both. These business people share one trait that is common amongst entrepreneurs worldwide: a desire for independence. Strategies for achieving that independence fall into two general categories:

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\(^4\)This information was generated from a survey of 180 companies covering eight oblasts. The survey was conducted in 1992. Throughout this paper, any detailed information (i.e., percentage of firms responding) or reference to a survey refers to this one.
entrepreneurs for whom trading is their end business and entrepreneurs that use trade as a means to accumulate capital, market knowledge and other resources needed to build a sustainable production or service-oriented business.

Entrepreneurs in both categories are quick to exploit business opportunities created by the transition; the difference lies in their long term strategies. While both groups use trade to generate cash-flow, for one group, this is enough. Within this first group of traders, there are two subcategories. One is learning commerce and will continue to trade long after the market starts functioning and margins are squeezed. The other is the rent seeking opportunist, cashing in on connections and making a quick ruble while the opportunity lasts; once "rents" are no longer there to be captured, many of these traders will disappear.

The second group is equally quick to pounce on cash-rich opportunities, but these entrepreneurs are using cash-flow from trading to build an asset base. Manufacturing products are volatile and are driven by value added and by imbalances in prices of input/output markets. The latter is a transitional feature that creates both obstacles and opportunities for manufacturers. Valuable assets can be obtained from state enterprises and used to build manufacturing capacity for the future.

For instance, a common phenomenon is an imbalance between the cost of raw materials—world market—and the price for which finished goods can be sold—local market—that makes manufacturing seem a losing proposition. Many entrepreneurs innovate around this constraint by adopting complicated resource reallocation schemes with state enterprises. In essence, the private enterprise purchases inputs from state enterprises at subsidized prices, some portion of which is paid in cash. The subsidies received by state enterprises are only in credit, and because state owned enterprises (SOEs) cannot survive without cash, the SOE forgoes the potential profit it could theoretically make (by selling at a market price) in order to receive cash. The private trader then collects the difference between the subsidized price and the market price. If the company uses these inputs to manufacture a product, their margin might be squeezed, but they will be able to produce goods - something the company without access to the subsidized inputs cannot do at all.\(^3\)

Most companies, no matter the size, engage in several activities simultaneously. One characteristic of the transitional environment is the speed with which business opportunities emerge and evaporate. A common coping strategy is diversification. Most companies perform a combination of manufacturing, services and trading. By maintaining a flexible strategy, entrepreneurs try to: (i) keep enough of a presence in the industry to build on should an

\(^3\)In many of these cases firms manufacture goods in order to appear socially valuable, as this helps to satisfy eligibility requirements for purchasing inputs from state owned suppliers.
opportunity open up; and (ii) minimize exposure to any single activity. While this flexible strategy helps firms to survive, it also inhibits investment and growth.

In sum, black and white distinctions between the state and private sectors are of little use. A more practical approach is to view the economy as a continuum where degrees of "stateness" and "privateness" are present in all ventures. The task is to encourage businesses and individuals to behave in a more market-oriented manner. To do this, one needs to create and support conditions where market behavior is possible and rational—by removing constraints, creating incentives and providing means.

II. CONSTRAINTS TO RUSSIAN ENTERPRISE

This chapter describes how constraints restrict business growth and suggests a way to classify them that is useful when deciding whether/how to try to alleviate them. It then identifies the priority constraints in Russia, as perceived by the Russian entrepreneur. Finally, it examines the constraints identified and describes how these impede business formation and growth.

A. Constraints: A definition

Constraints inhibit economic activity by increasing the cost, whether actual or perceived, of starting or operating a company. They heighten business risk and are a disincentive to entrepreneurship and investment, unless complemented by a sufficiently attractive return. The greater the constraints, the slower the rate of enterprise formation, investment and growth.

While there are many types of constraints, it is useful to classify them into two broad categories: systemic and operational constraints. Systemic constraints are features of the overall business environment that the entrepreneur has no control over. Operating constraints are those obstacles that a entrepreneur has some capacity to control. Product quality, for example, can be improved through a range of management decisions such as better inputs or processing techniques. Entrepreneurs can buy or build management skills, that are often missing in start up operations and, to that extent, act to alleviate an operating constraint.

This approach to classifying constraints to private enterprise is most useful (and practical) when thought of as a continuum (see Figure 1); at one end are systemic constraints and at the other, operational. While some constraints can cleanly be positioned at either end, others belong in the middle. For example, obtaining capital, whether through savings and friends (as most start up businesses do) or through financial institutions (as is common for established companies) depends on both the state of the financial markets and on the manager’s tenacity and performance.

Systemic constraints include those aspects of the political, macro, legal and regulatory context that cannot be controlled by a given business. A business can innovate around such obstacles, but it cannot
change them. For example, entrepreneurs can exploit tax loopholes and so reduce taxes payable, but Government is the entity responsible for setting tax rates and rules.

Systemic constraints increase uncontrollable risk. In environments such as Russia’s where systemic risks abound, entrepreneurs tend to increase the range of business activities (and reduce the depth) as a means of managing their exposure. In many market economies, Governments strive to improve the business environment by targeting systemic constraints; the underlying premise being that less systemic risk will enable entrepreneurs to take on more operational risk, which will yield higher returns. Clearly the technique varies depending on the country and the issue, but two common strategies are to (i) reduce the real cost (lower inflation, streamlined registration, efficient and equitable arbitration mechanisms etc...) and (ii) maintain a constant legal, regulatory and macro environment.

B. Constraints to Russian Enterprise

Of all the problems faced by Russian businesses, systemic constraints are the most acute. As illustrated in Figure 1, foremost amongst these is the volatile political and economic environment, particularly inflation. A businessman from Perm encapsulated the general sentiment: "inflation, rouble instability, and unpredictable price rises all lead to the absence of any idea of what tomorrow brings and an inability to plan for the future."

Regulatory constraints also rank high, and the most costly of these is taxation. Other binding constraints are sources of finance, commercial property, access to information, dispute resolution, and business registration. Interestingly, few entrepreneurs consider lack of management skills a constraint. When asked what type of assistance they would use (and pay for), consultants were mentioned, but not as a priority, and the skills sought were accounting and legal as opposed to other managerial skills.6

What follows is a brief description of the priority constraints as perceived by Russian entrepreneurs.7 These constraints include taxation, sources of finance, commercial property, information, dispute resolution and business registration.

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6While this is a common response of business people worldwide, it was somewhat surprising in Russia where many entrepreneurs seek out written material on managing in a market economy.

7This information was collected using the aforementioned survey of 180 companies and corroborated whilst working with companies during project preparation in 1993.
C. Taxation

Russia's tax system is a major impediment to business growth and to transparency of the private sector. Problems with the tax system are recognized by both the private and public sectors. For businesses, the cost of the tax system includes: (i) rubles paid for taxes and for "services" rendered to appease tax authorities; (ii) time taken to understand the complex system; and (iii) the uncertainty generated by constantly changing laws and inconsistent administration. At the same time, tax authorities are exploiting and/or overwhelmed by the complexity of the system. Government receives only a fraction of the revenue it is due, and this is caused by official graft, firms' ability to exploit ambiguities in the regulation and increased informal activity.

**Tax legislation.** Tax regulations are cumbersome and confusing. The average Russian company must comply with 14 federal, 4 oblast and up to 22 local taxes. The number of taxes is constantly changing, many new taxes are applied retroactively and reporting procedures are seldom standardized. Aside from confusion, this can result in duplication as is the case with the profits tax (at 32 percent) and the recently recommended enterprise income tax. Finally, while complaints of high taxes are common worldwide, it is less frequent that taxes add up to over two-thirds of profits. While we do not know the prevalence of this cumulative tax rate, many private businesses pay excessive rates, particularly in the manufacturing and agricultural sectors.
Private Enterprise in Russia

**Tax administration.** The administration of taxes is inefficient and frequently regarded as predatory. This is caused by: (i) the numerous and varied locations of tax authorities; and (ii) the control systems that demotivate and/or drive the behavior of tax authorities. The role of tax authorities is often unclear; they lack accountability and credibility. Few tax authorities have had training and most do not possess the information needed to administer taxes in accordance with the law. As already described, the law is rife with ambiguities that, in the absence of a clear and effective incentive system, many tax officials are quick to exploit. The widespread complaints of incompetent officials and their lack of integrity (e.g., often imposing penalties unless "services" were paid) is a manifestation of this broader problem.

Tax authorities are perceived as having broad discretionary powers and as using these powers quite frequently. However, the authorities are bound by their mandate and by the enforcement mechanisms available to them. It is therefore necessary to distinguish between the sheer exploitative behavior of individuals and the blunt instruments that the system requires them to use. Two examples are illustrative. Tax inspectors in Tomsk expected a Federal tax to be introduced on November 1, 1992. Although the tax was not enacted until February 1st, 1993, the authorities required that companies pay the tax from November 1. Those companies that protested were fined until they conformed.

The second example is the mechanism used to collect overdue taxes across the country. At the tax inspector's request, fines for late payment are automatically withdrawn from a company's bank account without even informing the company. This not only allows Government to impinge on property rights, but encourages the exploitative behavior of Government officials.

**Information gaps.** Most businesses lack the information they need to comply with the tax regulations. Frequently the tax authorities are also missing this information. For example, when some business people from Tomsk asked for clarification on how to comply with a recent change in tax codes, the local authorities were at a loss to provide answers. While admitting that they did not understand the new tax regulation, the tax authorities insisted that businesses comply and fined those that refused.

There is no streamlined communication between the federal, oblast, and municipal tax authorities or between the authorities and the business people. Due to the complexity and changeability of the tax code, it is often impossible for businesses to independently ascertain whether they are complying with the law. Many respondents claimed that tax authorities monopolize what information they have, and this enables them to interpret ambiguities to their own advantage and purposefully conceal information. No public body is accountable for providing taxation information to businesses on a timely basis, and while some tax consultants are taking on this role, few businesses are willing or able to purchase their services.

**The impact.** The dilemma for the Russian Government is how to increase tax revenue and simultaneously encourage investment? To a large extent, it seems that Government has adopted a short-term strategy of generating revenue by hiking up tax rates. While there have been some attempts to use tax policy to stimulate sectoral development, most of the tax breaks have been from the entrepreneur's
Just when it is critical to take a long term strategy that encourages business formation, fosters investment, and broadens the tax base, Government appears to be choking business development through high rates, a complicated code, and abusive enforcement.

The net effect is that the tax base is eroded and fraud is rampant. Many enterprises evade taxes or remain informal, thereby narrowing the tax base. Some "companies" do not register, have no official bank account, and conduct all transactions in cash. This activity is not limited to kiosk traders or the government stores that now have "commercial sections" running similar operations. Other "companies" appear and disappear quickly, usually by agreement with the authorities that are supposed to control them. This practice gave rise to the cliche: "paying taxes is stupid, but paying bribes is vital".

Most companies use legal and semi-legal means to avoid taxes, and some use tax authorities as a weapon against competitors. Avoidance is not limited to trading groups, but extends right through the economy. "Underground" production companies have been operating for years. Most had started to become legal, but were driven back underground by the tax regime. Now, they employ various means to evade taxes, including creating unprofitable subsidiaries and false charitable funds. Government experts estimate the undelivered revenues at more than a trillion rubles, hamstringing investment programs and fueling inflation.

D. Sources of Finance

Entrepreneurs across the board were quick to articulate their financing constraints, and the list of finance related problems was extensive - ranging from the cost of credit to corrupt bankers. However, when ranked against other constraints, finance was not the highest priority.

Whereas most western start-ups are financed from personal savings, in Russia inflation has eroded this option. The dominant source of funds is trading activity, which generated more than 60 percent of total financing (see Figure 2). This was true for start-ups and established companies, but wide trading margins are a transitionary feature. As markets develop and margins are squeezed, this financing option will become less viable.

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8For example, the profits tax for manufacturing firms with fewer than 200 employees is reduced from 32% to 16%; meanwhile the inventory tax penalizes companies that stock large inventories. The underlying premise being that "socially valuable" activities deserve tax breaks whereas socially exploitative activities should pay more (the profit tax for brokers is 45%).
The banking system. From slow payments to poor administration, the banking system is rife with problems. In fact, carefully selecting a bank seems to be the most efficient way that firms can alleviate bank-related constraints and source credit. The primary reason for this is institutional. Government uses banks to control private businesses. For instance, a 1992 decree obliges all enterprises to deposit money at a bank and use that bank for all transactions (exceptions only if previously agreed upon by the bank). Government can also withdrawal tax fines from a company’s bank account and banks can restrict use of deposits when a client is considered behind on accounts payable.

Because bank managers have much discretion over these matters, the most important criteria in choosing a bank is the entrepreneur’s relationship with bank management and staff. Given the importance of good banking connections, it is not surprising that entrepreneurs using bank credit were more likely to have been managers of state owned enterprises (46 percent) and less likely to be women (35 percent).

Bank finance. Compared to past practices (for example, restrictions on multiple bank accounts), it now seems relatively easy for entrepreneurs to open bank accounts. Those companies that wanted bank credit appeared able to get it. However, bank credit does not seem to finance investments.

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*Roughly 41 percent of enterprises surveyed had used bank credit, of which 34 percent had outstanding loans.*
Approximately 24 percent of loan recipients reported up-to-date equipment, compared to 26 percent overall.\textsuperscript{10}

With bank financing averaging 15 percent of total financing, most entrepreneurs did not want credit at the present terms. Although complaints of short terms (averaging 2-3 months) and exorbitant rates (150-200 percent) lose their force when one considers that rates are negative in real terms, credit terms are clearly considered unattractive by most entrepreneurs. The group most interested in credit was existing bank borrowers; 57 percent of bank borrowers plan to finance expansion with bank credit, whereas only 17 percent of non-users have similar plans.

If bank credit is not attractive to most private companies, the question then becomes what type of finance is there demand for? Equity would seem a better fit for the average Russian entrepreneur. Cash-flow would remain untouched, the red tape associated with banks avoided, and inflation-related uncertainty reduced.

\textit{Equity finance}. Because relationships are so crucial to Russian businesses, equity partners and cross shareholdings would seem a natural next step. Russia has no tradition of the independent entrepreneur. Most businesses are jointly owned by three - five partners. Entrepreneurs should, therefore, be more amenable to taking on partners. However, formal equity financing is discouraged in the present environment. There is no established means for investment in or exit from the market. Concerns with contractual performance limit the potential for mutually acceptable partnerships. Hence it is not surprisingly that capital markets are underdeveloped, and there are no venture capital nor investment banking industries.

\textbf{E. Commercial Premises}

Finding appropriate commercial property and obtaining secure tenure is "the problem of all problems" for many Russian entrepreneurs. This reflects the lack of a functioning commercial real estate market and the legislative and administrative underpinnings to support it. There is a shortage of retail space, and this situation is exacerbated by a rigid system of property administration that often misallocates existing space (e.g. ground floors are used as flats instead of shops, and shops are located outside of pedestrian traffic areas). Russia's property markets (such as they are) are dominated by the state as owner and regulator.

\textit{Legislation}. Current laws (and lack thereof) make it difficult for entrepreneurs to find, secure, and use the property they require. As yet, there is no law on private property or land and little economic stimulus for the state to release these rapidly appreciating assets. Even where ownership has been clarified, control is fragmented. As described by the chairman of Novosibirsk's property fund, "the property fund owns the property, but districts will not provide information about the vacant premises.

\textsuperscript{10}An alternative explanation is that companies are using credit to finance investment, but that investment is the purchase second hand equipment.
If any of them become vacant, nobody will let us know, and if an organization collapses, they will not get out of the premises they used to rent." Hardly surprising, many premises are under utilized.

The defining characteristic of Russia's property markets is the dominant presence of the state as owner and regulator. Property is often underutilized, and there are bottlenecks to both selling and leasing. As "owners", SOEs and local governments are reluctant to sell property and seem to feel little pressure or incentive to do so. Leasing is more common, particularly informal lease arrangements between acquaintances.

Lessors. Landlords are a heterogeneous group, ranging from oblast and municipal GKIs and MKIs to technical institutes and SOEs. The incentives to rent property vary amongst landlords. Some are keen on facilitating "socially valuable" businesses, whereas others are after a quick kickback. Despite these differences, landlords across the board saw "no reason for advertising". Demand for premises overwhelms accessible supply, and there were no groups - public or private - that disseminated information on available premises. Instead, this information (spotty though it is) is passed on to the ever growing circle of "friends" of the property fund; roughly 90 percent of the entrepreneurs found their premises through personal connections. Of these, half spent more than a year searching for property.

Rent also varies depending on the goals of the landlord and the extent to which landlords seek to control property use. Official agencies, such as the MKIs and GKIs use formulas to determine rent. While the components of these formulas are similar, the weightings attached to them vary across (and within) oblasts. There is a common base rate, and coefficients are assigned for: (i) location; (ii) the type of building; (iii) the quality of the building; and (iv) the term of rent. This amount is then topped up by a usage fee, which allows the landlord to promote or penalize activities. For example, in June of 1993 the Voronezh MKI charged R2,000 per sq meter for "socially valued" uses (such as retail clothes or manufacturing food) versus R3,000-5000 for other purposes (such as retail cigarettes or producing vodka).

Many government and commercial organizations sub-let property to private firms, and 50 percent of the renters' revenue is taxed by the mayor's office. Businesses renting from non-government organizations pay a flat fee, plus goods, services or a percentage of the firms' revenues. For example, a Voronezh company found office space through an electrician who also worked for a state owned hotel that ran into hardship and began renting rooms on the first two floors. Hotel rooms are attractive as offices for two reasons: space and utilities (most important, a telephone). Most hotel rooms have direct outside lines, and given the state of telecommunications, this is a valuable service. The tenants' rent includes rubles plus an in-kind component (linens, mattresses or other furniture as required by the hotel's managers).

Leases. Rent agreements, whether with government, state owned enterprises or private firms, are usually for one year, but full-term tenancy is seldom secure. "Although guarantees exist on paper, practically they are meaningless. Everyone who rents can find themselves out of doors at any moment." And while arbitration courts exist, they are "effectively useless". Businesses leasing premises and small "privatized" enterprises are also burdened by profile restrictions on the type and/or volume of goods to be sold/manufactured as well as minimum employment. For each municipality, there is usually a department of finance and tax policy that controls the legitimacy of rights on premises. Sanctions are
strict, and if the property is not used for the purposes designated, the lessors must pay the city a share of profits.

Leased enterprises represent a different form of property transfer. As described earlier, the opportunity to lease an enterprise was introduced under Perestroika. According to the Voronezh oblast MKI, many enterprises continue to operate on a leasehold basis, under which lessees have generous buy-out options at the end of the lease. Most of these lessees intend to exercise this right in the near future.

**Impact on lessees.** Most private companies hold one year leases for their premises, and those that own property have purchased it via auctions. The only means of locating premises is through informal relationships with officials as opposed to advertisements or another type of clearinghouse. Examples are illustrative. One small consulting company has two offices: one at a friend's travel agency and the other at a city government building. Another company is hidden in a SOE, using their premises (and equipment) in exchange for channeling funds (and resources) to the SOE director. While the arrangements vary, the denominators are common: high cost and low security.

F. Information

The lack of accessible, accurate information is a serious constraint. It increases the cost and uncertainty of starting or expanding a business. Effective collection and dissemination does not exist, and the cause of this information gap is deep rooted. Under communism, the information collected was a function of administrative, not market, needs, and there were powerful incentives to distort it. The Party sought to regulate and channel information, making it available on a need-to-know basis to a select audience.

**Information needs.** Identifying profitable business opportunities depends on information - knowledge of existing laws and regulations, sources of credit and other inputs, and markets for outputs, as well as commercial know-how. Businesses lack the most basic information (telephone books and transportation schedules) and more advanced (data on standards, competitors, potential buyers...). There is no credit rating service and no reliable way to check the history of a potential partner/buyer/supplier. Ironically, while a few computerized databanks have emerged (on legislation and enterprise directories), these are beyond the means of most private businesses. In most markets, the best source of commercial information is other businesses. In Russia, businesses are so fragmented and information so precious, that such networks are not functioning.

The information gap is also costly to Government. Without accurate data on the private sector, Government cannot monitor private economic activity, and this impedes their capacity to develop and adjust policies accordingly. Also, the lack of descriptive data allows negative myths to persist; often used to quash (or slow) market reforms, these myths would be less powerful were it possible to quantitatively refute them.

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11 Such services require that the client have appropriate hardware, and most private businesses are not yet computerized.
Information collection and dissemination. Despite the dearth of information on the private sector, enterprises are required to present mountains of data to various state agencies. Russian companies resent providing statistical data, particularly when there is seldom any return (meaning that little of it is returned to them in a useful form) and frequently a very high cost.

While the pattern is similar to that in the west, the concerns of Russian businesses are more valid. First, information collection is decentralized. Every firm must provide data to the bureau of statistics, tax authorities, pension funds, employment funds, registration bodies and banks. Not only is this time consuming, but widespread disclosure of proprietary information increases the demands for bribes and the probability of racketeering. Every bit of information is regarded as a commercial secret. "Society does nothing to protect businesses, it is better to keep a low profile." "Tax authorities want detailed reports not for evaluation of taxes, but for future blackmail." As corruption and mafia-related activities increase, there is growing secrecy in company operations and a tendency to provide inaccurate data. This fuels the information shortage and preempts the development of an information industry - which will be the most effective means of meeting companies' information needs.

G. Dispute Resolution

The lack of efficient, reliable ways to resolve commercial disputes substantially increases the risk of doing business. Russian business people have two options when trying to resolve a dispute: formal and informal. Most entrepreneurs choose the latter, preferring to resolve differences amongst themselves than to bring cases to court for arbitration.

"It is futile to try to settle disputes through the court system", and this belief seems to be the consensus. Arbitration is considered a "theoretical possibility" and "more of a moral punishment than a way to get compensated." Arbitration courts are overloaded, queues average at one and a half years, and plaintiffs pay an advance equivalent to 10 percent of the suit. Even if the case is won, legislation makes no provision for compensation for damages (contractual sanctions for state enterprises cannot exceed 8 percent of the claim's value) and settlements are not indexed for inflation.

While informal settlements are seldom satisfactory, this method is more attractive than the arbitration system. Most entrepreneurs adopted a matter-of-fact approach: "try and sort out the problem and, if this fails, never do business with the person again." Although considered less expensive than arbitration, the informal route is costly. It limits contractual options, drives up transaction costs and provides no certainty - thereby driving up risk.

H. Business Registration

For tenacious entrepreneurs, registration is more of a nuisance than a binding constraint. However, tortuous registration sends a strong signal to would-be entrepreneurs and to the population. While registering a business is significantly less difficult than it was in 1991, roughly 50 percent of the businesses surveyed had trouble registering. The process varies widely amongst regions, but in many the registration process is complicated and time consuming.
The process. Most requirements are leftover from the previous regime (i.e. certificates of property ownership, legal - as opposed to personal - addresses, and permission from the police for use of a seal.) Requirements such as these drive byzantine vicious circles that slow registration, increase its cost, and seem to serve no good purpose.

Many municipal authorities recognize that the registration process is "badly organized and too complicated." When the law on entrepreneurship was adopted, it was assumed there would be one state register for all registered and liquidated companies. This project did not happen, and even municipal authorities developed their own registers. Registration procedures often differ, even amongst districts. In Stavropol, for example, each district administration has different registration procedures. Not only does the list of required signatures vary, but it tends to be long. Entrepreneurs often spend days racing around in search of a sanitary-epidemiological station, environment protection committee, lawyer, tax official, fire-control inspector, and finance inspector to get the necessary signatures. Few of these organizations bear responsibility for the activity of the enterprise, and even if they do, few pursue it. Instead, most documents are signed shortly after bribes have been paid.

The impact. The cost and time required to register a business varies across districts. Total costs include: (i) time spent preparing the application; (ii) registration fee (and bribes); and (iii) cost of the delay. In Novosibirsk for example, 45 percent of the respondents took 2 weeks to register, 45 percent, 2-3 months, and 10 percent, 6 months. Most of these firms paid between R2-4,000, except businesses in retail trade or joint ventures, which paid R15,000 and R40,000 respectively.

Many organizations have been formed to help businesses register. Most of these companies are associated with the local executive committee (responsible for registration) or other government agencies. For example, one such company in St. Petersburg cooperates closely with the Mayor's Department for the Promotion of Entrepreneurial Activity. The firm provides the entrepreneur with a legal address, opens a bank account, prepares seals and completes required documents. In mid-1992, the cost of a complete package (including approval from the executive committee) was R25,000-70,000; services that did not require networking were less expensive (R2,000 for preparing statutory documents). Entrepreneurs that filed documents independently usually faced delays of up to 6 months.

III. AN APPROACH TO ALLEVIATING CONSTRAINTS

This chapter describes an approach to alleviating business constraints and applies this approach to three of the most binding constraints in Russia. The first section provides a framework for selecting constraints to target. The next section suggests some parameters on how to intervene: who should be involved and what should they do? Finally, an attempt is made to ground this discussion in Russian reality, the result being some suggestions for reducing tax, commercial property and information-related constraints.
A. Which Constraints to Target?

In a complex, constraint-ridden environment such as Russia, it is difficult to decide where to start when trying to reduce obstacles to PSD. Given the breadth of problems, the difficulty of tackling them and the importance of making substantive and speedy progress, the approach must be selective.

**Cost of constraints.** The first step is to identify those obstacles that are absolutely binding or are the most costly for the average entrepreneur to overcome. Cost refers to the ruble, time, and/or opportunity cost to a firm of overcoming a given constraint. For example, to send freight by rail in the Central Black Soil region, entrepreneurs have to pay a standard fee plus a percentage of their revenue (or goods) to the local manager of the state owned rail company. Likewise, a tailor in St Petersburg is only able to register after he promised free clothes to a local official and his family for an indefinite period. Quantifying the cost subjective, so the key is to determine whether the cost is a nuisance or a serious impediment to profitability. To the extent that the most costly constraints hold constant across firms, interventions that address these constraints should have the most impact on private sector development.

**Potential to alleviate.** The second step is to determine whether the constraint can be eliminated or overcome. While the former is most ideal, the latter is often more realistic. Either way, this requires identifying who can alleviate the constraint and evaluating their potential to do so.

When considering who might alleviate a constraint, the universe of potential agents is broad and should include those able to wield a direct and an indirect effect. Depending on the constraint, these parties might include: (i) different layers of government; (ii) domestic business associations, educational institutes or private providers of business services; and/or (iii) aid agencies. The evaluative dimension of the analysis should focus on the incentives, capacity and authority that each agent has to alleviate the constraint. While alleviation need not imply direct intervention, the more indirect the delivery (or distanced a given agency is from responsibility for a constraint), the more dependent that agency becomes on those downstream/upstream in the process. For example, donor conditionality might spur a change in regulation, but the donor cannot control the regulation nor how it is enforced.

**Targeting a constraint.** The outcome of steps one and two provide the basis for deciding where to intervene. An organization’s interventions should target those constraints that (i) are the most costly to most firms; and (ii) that it has a high potential to influence (i.e., alleviate). For any organization considering an intervention, constraints that meet these criterion should be targeted first. Obviously, the targets will vary depending on the type of organization.

How should a local government in Russia decide where to intervene? Government will be most effective if they try to alleviate constraints that impose high costs on enterprises and that government is in a strong position to influence (see Figure 3). Hence, in this example a priority for local Government is access to real estate.
Government should exhaust their potential to intervene in the high cost/high impact quadrant before considering others. If, having addressed all the constraints in this quadrant, Government has some spare capacity, it should then consider the other quadrants. At this stage, Government should weigh the trade-offs between the cost of a constraint and Government's ability to alleviate it. In most cases, Government should target those constraints it can control, even if these are less binding to firms than others might be. Thus, having addressed the priority quadrant, Government might turn to business registration or other constraints in the high potential/low cost quadrant.

The mapping process also identifies constraints that an organization should not target. If the constraint is not costly and the agency is unlikely to alleviate it, it makes little sense to try. In this example, Government should not focus on labor regulations.

Mapping out constraints should be completed on an ongoing basis. Not only will the environment change, but as bottlenecks ease, new ones will emerge. Likewise, the capacity of organizations to intervene will also change.

B. Alleviating Constraints

Having chosen where to intervene and who should intervene, the question then becomes what to do. Quite often these three questions are blurred or one ends up driving the others. Returning to the systematic/operating constraint continuum described in Chapter 3, it might be assumed that government should only intervene to alleviate systematic constraints or that systemic constraints can only be alleviated.
by government. Based on this assumption, Government should focus on creating an enabling business environment. Hence, tools to intervene should be limited to passive interventions. Passive interventions include policy, regulatory and investment decisions that promote entry and competition without targeting specific activities or enterprises for support. This type of intervention tends to target the systemic constraints described in Chapter 3.

Conversely, it could be argued that operating constraints are best alleviated by companies either formally (through markets) or informally (through networks). Either way, the private sector is the most effective delivery mechanism for active interventions. Active interventions are activities (such as financial and advisory services) that provide services directly to firms. These interventions are designed to alleviate operational constraints.

Many Governments' experiences using active interventions to promote private business would seem to reinforce this approach. Governments often use positive social or economic externalities (such as small enterprises or minority owned companies) to justify active interventions. Despite often laudable objectives, the interventions are seldom a cost effective means of developing a sustainable private sector. The reasons for this are more complicated than those proposed above.

Government efforts to use active measures in constraint alleviation tend to share three characteristics. First, most have multiple, conflicting objective. For example, Government's interest in short-term employment creation is often at odds with long-term growth of value-adding enterprises. Second, the structure of the intervention is often poorly designed and delivered; this is usually caused by government's involvement in the intervention past the initiation stage (extending to design or delivery of the service). Finally, the strategy of the intervention is seldom consistent with the principles of a market economy. Ideally, operating constraints would be eradicated by functioning markets. Active interventions should encourage, not displace, these markets and should work within (or minimize distortion of) market principles.

Unfortunately, many active interventions are often delivered by agents that lack appropriate incentive systems and have cost-inefficient operations. These interventions often provide direct subsidies to enterprises, and this leads to distortions, rationing, and rent-seeking. Such mechanisms tend to send the wrong signals to private providers of services and their clients, thereby stifling the industry. Customers receive variable service, which is often taken for granted as subsidies continue. Poor performers are rewarded and potential competitors are crowded out.

It is not surprising that Governments' experiences with active interventions are often used to preempt repeat occurrences - and so they should. However, the lessons learned often fuel the more sweeping (and questionable) generalization that Government should keep clear of all active interventions. Even if this were desirable, it is not particularly useful because Governments worldwide have (and will continue to have) active interventions. To the extent that these initiatives go forward, it makes sense to optimize them and to avoid the costly mistakes made elsewhere.

Government should not be limited to passive interventions, nor should the private sector be limited to active ones. Instead, interventions should be segmented into three phases: initiation, design and implementation. Different players can take responsibility for different stages of the intervention.
Government might be the catalyst for an active intervention such as a directed credit program (see Figure 4). However, Government could subcontract the program's design and implementation to private companies that would operate the program on a cost-effective basis. In this example, Government is the catalyst for an active intervention, but the private sector is the implementing agent. Another example is self regulation. In this case, the private sector might initiate and design the intervention, but this will require Government approval. These examples demonstrate how both the public and private sectors contribute to alleviating a constraint.

Figure 4: Interventions by the Public and Private Sectors

<table>
<thead>
<tr>
<th>Passive Measures</th>
<th>Active Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Sector</td>
<td>Self Regulation</td>
</tr>
<tr>
<td>Public Sector</td>
<td>Infrastructure</td>
</tr>
</tbody>
</table>

In Russia, the capacity of both the public and private sectors to pursue passive and active interventions is limited. Government is highly decentralized and, to a large extent, lacks the resources and incentives to alleviate business constraints of any kind. It might be argued that Government should focus on its comparative advantage and not get embroiled in active measures. But the private sector also lacks capacity to initiate active measures. By default, federal and regional Governments are initiating (in part as channels for external assistance) interventions to alleviate operational constraints, and it makes sense to optimize these efforts.

A practical application of these ideas is the most effective means of explaining them. The following section illustrates what the role of government might be in alleviating three constraints. This section assumes that the mapping process described in Figure 3 has identified three priority constraints for Government; these include the tax system, commercial property, and information.

C. The Role of Government in Taxation

Costs incurred by the current tax system stem from three primary sources: the content of the law, the way this information is disseminated, and how taxes are administered. Together they amount to a
Private Enterprise in Russia

major constraint to business operations. While efforts to alleviate this constraint are predominantly passive, they are not exclusively so.

**Tax law.** Content includes the tax base, the number of taxes and the rates. While businesses worldwide complain of high tax rates, Russian businesses engaged in manufacturing or agriculture seem to have some justification as, on a cumulative basis, these companies can pay up to 65 percent revenue in taxes. Of almost equal importance is the complexity and changeability of tax regulation. Business people spend hours every day poring over newspapers to learn the latest changes in tax policy.

While tax rates should be determined by fiscal and other considerations, there are five principles that, if used to guide tax reform, would greatly alleviate the constraints that taxation systems impose on Russian businesses. First, simplify taxes. Reduce the number of taxes, the ambiguity, and the contradictions that currently enable disparate interpretations. Second, provide some stability. Keep changes to a minimum, prohibit retroactive application of laws, and establish fixed buffer terms for corrections to laws or instructions. Third, give priority to rules that preempt administrative decision making and minimize windows for discretionary behavior by tax officials. Fourth, reduce the amount of information required by taxation bodies and provide guarantees for the secrecy of commercial information. Finally, develop accounting definitions for taxation that consistently encourage investment instead of relying on tax holidays and other distortionary and/or discretionary investment promotion schemes.

Dissemination of tax legislation is slow, often spotty, and frequently inaccurate. The lack of information keeps administrators from enforcing and businesses from complying with new legislation. Government should ensure that businesses have access to timely, accurate information. While it might seem that Government (whichever level is responsible) is in the best position to distribute information, this should not be assumed. Given its resources, the size of the country and growing level of decentralization, Government might contract out this service to business associations or private firms that would distribute information on a user pays basis. Some private firms have already sprung up, but the accuracy of their material is questionable and the cost of their service prohibitively high.

Improving the quality of the tax inspectorate would be easier if the first two recommendations had been enforced, but given the time frame involved, this should not be a prerequisite. In fact, because most taxes are enforced by oblast and municipal governments, tax administration (on a pilot basis) is an attractive and urgent target. The tax inspectorate should be reorganized, control systems imposed, and equipment updated. Tax administrators should be trained and incentive (and penalty) systems introduced; non-performers should be dismissed after appropriate warnings. A streamlined appeal mechanism should be established, where complaints are resolved before fines are collected.

D. The Role of Government in Commercial Property

Access to real estate is a critical bottleneck to business formation and growth. Because commercial property is essentially under control of the state, it is a clear case where the public sector must initiate passive and active measures to encourage a commercial property market. Either the assets are under *de jure* control of bodies of state administration, or they are *de facto* subject to the control of public property administration policy because of the way ownership distribution has been determined.
Other than Government agencies, entities with marketable real estate tend to be SOEs or firms that were recently privatized. Most have not faced hard budget constraints and other incentives that could otherwise force them to restructure and divest assets. Hence, the property markets now tend to be dominated by public agencies, and efforts to develop them are largely subject to the explicit policies and operating practices of these bodies.12

For these reasons, development of a commercial real estate market requires both passive and active measures. The required passive measures are largely legislative (including enforcement). Laws on land and private property should be enacted, and an appropriate public property administration policy should be established in all of the relevant jurisdictions. Profile restrictions on leased/sold businesses should be eliminated.

A complicating factor is that there are often several jurisdictions with a role in property management policy: federal, regional, and local government. This layering of government administrations makes it difficult to define a framework for property administration at the regional level. Therefore, it is necessary to understand the existing composition of assets held by state and local government entities and the reasons for this allocation. Different public sector property management policy may be followed by each public sector "owner." While the challenges of addressing this complex structure are daunting and beyond the scope of this document, substantive work has been done in this area.

City and oblast governments have the legal authority to allocate property within a given region, but it seems that none have pursued this opportunity to its full potential. So far, the accent has been on privatization of enterprises as going concerns, with distribution of shares to workers and management and voucher auctions being the predominant forms of privatization. Often this has the ironic result of re-orienting the demand for fixed assets around sales of enterprise shares. The Chairman of the Voronezh Oblast Committee for State Property Management articulated an increasingly common belief, that as the initial stage of privatization nears completion, the emphasis will shift towards bankruptcy, and asset sales in liquidation could facilitate emergence of property markets. Under law, the management of the asset liquidation would be a prerogative of the arbitration court and the MKI.

Most of these agencies have missed opportunities for piecemeal asset sales and transparent, market-determined leases. This is not due to a lack of vision or energy on the part of Government officials. Similar to the tax inspectors, property administrators have a vested interest in maintaining the current system in which property (or information on property) is passed onto colleagues. Transparency has a high price, particularly when the officials involved do not see a viable alternative and will soon lose their justification for existence (as privatization winds down).

One approach, in the grey area between active and passive measures, is to help these administrators transform into brokerages for commercial property. Agencies could provide an information

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12Federal agencies also wield considerable influence, specifically in their capacity to (i) reduce the flow of subsidies and thereby create incentives to sell assets; and (ii) provide a regulatory framework that enables SOEs, local authorities and privatized firms to sell/lease assets.
One approach, in the grey area between active and passive measures, is to help these administrators transform into brokerages for commercial property. Agencies could provide an information clearinghouse for buyers and sellers, lessors and lessees. This activity could: (i) increase accessibility of real estate to "unconnected" business people; (ii) encourage SOEs to spin off assets; and (iii) shift the profitable part of the MKI and GKI's property management functions to the private sector, thereby reducing their resistance to change. Such brokerages could facilitate the development of a transparent, price-determined market for commercial property.

An illustration of an active measure that could be adopted by local authorities concerns retail space. Even if all existing retail outlets were privatized, there would still be a shortage of space. Semi-permanent street markets could offer a temporary solution. While kiosks are increasingly widespread, these are relatively expensive (high cost and high risk), and a great many goods are still sold helter skelter by street vendors. Crackdowns on street markets are frequent and the cost to businesses is high (hefty fines, confiscated goods and sometimes prison). Regular open markets would provide vendors with a stable (meaning the locale would not change) outlet for their goods and possibly some protection from racketeers. In exchange, government could regulate the market, contribute to their tax take and try to keep out the mafia.

Active measures that promote a leasing industry might also be effective. Private property management companies could lease a building from an SOE or local authority, retrofit the building as appropriate, and on-lease the office, manufacturing or retail sites to local businesses on a for-profit basis. The concept is similar to executive leasing services used throughout the west, and some additional services, such as utilities or secretarial support, might also be included in the package.

Representatives of the state sector seemed attracted by this proposal because they would maintain ownership over the property and receive rental fees, adjusted for inflation, for a fixed term. In exchange, they would relinquish all control over property use. An agreement on the type of construction to be undertaken (which would increase the value of the property) would also be required.

Leasing centers would provide a direct benefit to the numerous private businesses that struggle to secure and maintain rental agreements. The centers would also encourage the development of a commercial real estate market by: (i) rewarding the release of under-utilized buildings; (ii) demonstrating that real estate transactions can be conducted transparently; and (iii) providing an opportunity for private firms to be active in the real estate market.

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13The Board might (i) provide the database for a Multiple Listing System of assets; (ii) license brokers; (iii) provide training courses to existing/future brokers; and (iv) advise government on real estate related issues.

14Leasing facilities differ from traditional incubators, which tend to provide a broad range of support services and seldom operate on a for-profit basis.
E. The Role of Government in Information

The goal here is to shift from information rationing to information markets, in which information is accurate, delivery transparent and organizations generate/access data at a minimum cost. Achieving this goal depends on both the public and private sectors, as each will play an important role in the collection, analysis and dissemination of different types of data.

The most costly information-related constraints to businesses fall into two categories: description of current legislation and information on private firms (input/output markets and competitors). Similarly, Government needs solid information on which to base policies that affect the private sector.

In many countries, Government is responsible for collecting and disseminating various types of information - ranging from data on private businesses to updates on regulation and schedules for public services. The Russian Government has traditionally collected copious information but was not inclined to disseminate it. Hence, the first step is for Government to recognize the value of open information policies. Targeting first that information which is most useful to businesses and to Government, Government should focus its data gathering efforts and process the ensuing information in an accessible way.

Information on Legislation

The information most needed by entrepreneurs is accurate descriptions of regulation. Dissemination is haphazard and largely dependent on the press, whose information is incomplete and, often, inaccurate. Agencies responsible for formulating laws and regulations will not suddenly start disseminating them widely - nor would such a step be cost efficient. A possible solution would be to adopt the practice (used in many countries) where legislation is not effective until it has been published in a gazette. Hence, at the origin, there is no gap between information and legislation. The gazette should be widely accessible to individuals, private firms, and public agencies who interpret and use it accordingly.

In a functioning market economy, it might be argued that dissemination of information should be left to private firms who could do this efficiently, profitably, and at a cost reasonable to clients. In Russia, this will not happen for a long time; meanwhile the cost of waiting is high. Why not compromise? Stimulate an information industry and simultaneously deliver useful information to companies.

One active measure could be to contract out regional business information clearinghouses, that would collect, codify, archive, and disseminate information on a fee basis. The clearinghouse would prioritize information most valued by customers and then target this for collection and disbursement. This would be an iterative cycle; information gaps will close as the information industry evolves. Government subsidies would be weaned over time, until the clearinghouses become self sufficient. Granted, establishing a clearinghouse network would be a resource intensive task, and, given that it is unproven, a pilot program might be appropriate. Because of Russia's size and its unreliable postal system, an oblast network might be the place to start. One oblast clearinghouse would serve as the hub for local libraries or library vans (which would make a circuit throughout the oblast, disseminating material directly).
As the private sector develops, some clearinghouses would target specialized niches and others would continue to focus on more general material. Such a program could provide a jump start to the emerging information industry.

Information on the Private Sector

With regard to general data on the private sector, the Federal Government is in the strongest position to improve the quality and flow of information. Government should review its current collection practices and consolidate them as appropriate, given the tradeoff between the value of information and the cost of collection, compliance, analysis and dissemination.

In terms of passive measures, Government might: (i) reduce the number of collection agencies and encourage coordination amongst those that survive (Goskomstat and the Ministry of Finance are in the process of being linked); (ii) minimize the number of forms and the frequency of collection (some forms are required on a monthly basis); and (iii) simplify forms and cull repetitive questions.

Efforts to improve collection will not be effective until the risk/reward of disclosing information is reduced/increased. Most businesses are penalized for being visible and need encouragement as well as prodding to change their behavior. Confidentiality must be respected, and administrators that violate this ethos should be punished. Publicizing these transgressions and the penalties imposed is one way for authorities to demonstrate that they value confidentiality. If effective, the perceived risk of information disclosure will wane and there will be less resistance to divulging "commercial secrets". Clearly, this idea will be difficult to implement, particularly given the limited resources of most local governments.

An alternative is the carrot. After collecting and analyzing the data, administrators could ensure that some of the results are delivered to those firms that complied. For example, given how desperate businesses are for the most basic types of information, a general profile of local companies or open access to registration information would be invaluable. It would also demonstrate that the information disclosed is actually put to good use. Another idea might be to link up information collection with the clearinghouses. Companies that disclose requested material might receive a fixed credit at the local clearinghouse.