Russia’s Transition to a Market Economy: A Permanent Redistribution?

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Reviews are coming in on the first ten years of transition to a market economy in Russia. The occasion has reopened debates about the pace of liberalization and the wisdom of mass privatization. Despite differences, the reviewers tend to share a surprisingly similar diagnosis of Russia’s current problems. Russia, they say, lacks “institutions”—a catch-all phrase to connotate all the supporting organizations, structures, and practices that make a market function well. Courts, tax inspectors, regulatory agencies, financial intermediaries, among others—these are the institutions that are claimed to have been neglected in the obsession with prices and property that dominated the thinking of the reformers and their advisers in the early stages of the transition. This resulted in a market without the institutional prerequisites for the rule of law—the Achilles heel of the Russian transition. However, it is important to reexamine the initial thinking and underlying assumptions about the development of market-supporting institutions to better understand the current obstacles to reform.

Did the “radical” reformers in Russia ignore the importance of institutions in their rush to liberalize and privatize? The extensive written record of their thinking at the time suggests otherwise. Indeed, rapid liberalization and mass privatization were both strategies designed to create a critical mass of market actors who would not only defend the reforms once introduced but
also demand further reforms to create and improve the institutions necessary to support the market economy. Property owners would seek protection for their property and contract rights. Businesses would demand banks to provide a range of financial instruments and services. Taxpayers would want to ensure that unfair exemptions and advantages are not provided to favored firms or individuals. The radical reformers had no plans to impose these institutions from above on the basis of Western models. They believed that liberalization and privatization would generate the demand for effective institutions. They believed that once property rights were established, markets would evolve toward the establishment of more efficient institutions.

This view was particularly prominent in the early thinking about privatization. The overriding imperative of privatization was to "depoliticize" property or, more simply, to get property out of the control of politicians and state bureaucrats. Although the initial privatization plans envisioned transferring ownership to a broad range of the public to create a large constituency with a personal stake in the reform process, it quickly became clear such plans were not politically feasible. Enterprise insiders got the upper hand in the privatization process and forced the reformers to accept privatization options that effectively concentrated property rights and control to existing managers in collusion with workers. Such a compromise, though not ideal from the reformers' point of view, was justified largely because of their beliefs that private ownership generates the incentives for efficiency-enhancing institutions over time. Once a critical mass of private owners had been created, they would, regardless of their past, demand the necessary institutions to protect their newly acquired rights and to create a favorable environment for investment and growth. Even if these new owners did not initially respond to such incentives, they would soon be replaced by those who would, through a liquid secondary market for enterprise shares and an active market for managers.

Paradoxically, the radical reformers behind mass privatization in Russia held an evolutionary approach toward the development of efficient market-supporting institutions. Indeed, their belief in this evolutionary approach was so strong that it shaped their assumptions about the initial distribution of property rights. Far from ignoring the importance of market-supporting institutions, the reformers' decisions about privatization were, in part, driven by their desire to create a structure of incentives that would create a constituency for further institutional reforms. While mass privatization—and, in particular, the decision to skew the process toward enterprise insiders—has become a lightning rod for criticism over the past ten years, the critiques have largely bypassed the assumptions about institutions that shaped the early thinking of the reformers. In reviewing the past decade, we need to go beyond the recognition that Russia lacks adequate market-supporting institutions and ask why the initial assumptions about the evolution toward efficiency-enhancing institutions have not proven valid to date.

In hindsight, several problems with the notion of an evolution toward efficient institutions can be raised. First, reformers assumed that the new stakeholders in the reform process would demand institutions to provide the classic market-supporting public goods—stability, the rule of law, infrastructure, and so on—that bring benefits to the entire society. But was that the only option? Why would the initial beneficiaries of privatization and liberalization not seek to create redistributive institutions to enhance and protect their own interests in the emerging market economy at the expense of other groups in society? Institutions that build barriers to entry into the market, secure individualized protection of property rights, preserve advantageous price distortions, and limit the capacity of the state to collect taxes could be far more advantageous to the initial beneficiaries of reform than those providing classic public goods. Although it is true that the early winners of liberalization and privatization did demand institutions to protect and secure their gains, the notion that such institutions would by definition also be ones that further supported the development of a competitive market economy is certainly questionable.

Second, if enterprise insiders and budding oligarchs were powerful enough to skew the initial distribution of property rights to their own advantage, they would also be powerful enough to skew the further development of market-supporting institutions in a similar direction. Indeed, privatization only strengthened the position of enterprise insiders and the new oligarchs, by turning their initial political influence into economic power. Once property—and the attendant wealth and income—became concentrated in their hands, they had no incentive to support institutions such as liquid secondary markets or minority shareholder protection that threatened to weaken their power and control in the future. By turning their newly acquired wealth into even greater political influence, especially in the absence of any other well-organized collective interests, enterprise insiders and oligarchs had the capacity to tailor the design of new institutions to their own advantage.
Third, it had been assumed that once property rights were redistributed, the new owners would have strong incentives to seek a stable environment and the supporting institutions necessary to protect their newly acquired rights. But what if the opportunities to redistribute state property do not have a clear end point? Reformers were among the first to recognize that the types of political institutions and tactics necessary to redistribute property in transition economies are different from those necessary to protect property rights. Reforms such as mass privatization required a state with considerable discretionary powers that would not necessarily be appropriate once property rights had been fully distributed. Reformers often discussed the need for periods of “extraordinary politics” in which the standard constraints of democratic competition would be temporarily suspended to push through contentious policy choices that face strong opposition from an entrenched status quo. As long as there is valuable property to redistribute, powerful groups will have an interest in preserving the conditions that provide them advantages in the redistributive process, even at the expense of creating the conditions necessary to maximize the value of their previously acquired property rights. This paradox is critical to understanding Russia’s transition.

Alternative Approach

In contrast to a theory of transition that relies on the gradual evolution over time of increasingly efficient market-supporting institutions, the Russian transition suggests an alternative approach, which could be called a theory of “permanent redistribution”—with apologies to Trotsky’s famous theory of “permanent revolution.” This alternative approach explains why the initial successes of liberalization and mass privatization in Russia did not generate the expected demand for more efficient institutions, but instead resulted in the transition being stalled by the very groups that benefited most from liberalization and privatization. There are five main features of a transition of permanent redistribution.

First, the basic distribution of property rights is incomplete and subject to constant renegotiation. In contrast to the view that mass privatization is a one-off redistribution of state-owned property following which private owners seek to protect their newly acquired rights, this approach suggests that there is no clear, finite end to the redistribution of formerly state-owned property. Even after mass privatization and the infamous “loans-for-shares” deals in Russia, the state continued to maintain substantial holdings of industrial assets that would eventually be subject to some form of privatization. These stakes encompassed both minority and majority blocs of some of the most valuable assets in the country, including energy and natural resources, banking, and real estate. Though continued state ownership of key assets is a standard feature of most market economies, the key difference is that in Russia it is widely assumed by market actors that many of these valuable state-owned assets will eventually be privatized in some form. As a result, potentially substantial payoffs are still possible by taking advantage of opportunities in the privatization of remaining state assets.

More important, a theory of permanent redistribution suggests that even assets that have been privatized are subject to renegotiation. This does not mean that there is a lively resale market for privatized assets, which would be a natural and welcome feature of any transition economy. Instead, permanent redistribution presumes that the initial privatization of assets is open to constant contestation through such methods as legal challenges to the legitimacy of the initial privatization deal, expropriation of rival stakeholders, tunneling of assets, or political interference in the disposition of privatized property. In Russia, such contestation over previously privatized assets is a permanent feature of the transition landscape. Courts in far-flung regions overturn earlier privatizations by the Federal State Property Committee. Minority shareholders turn up at annual meetings only to find the location suddenly changed to a remote city and their voting rights diluted by new share issues. Assets from companies with continued large state holdings are systematically shifted to offshore companies controlled by management through transfer pricing schemes, asset stripping, and other nontransparent procedures. And most prominently, the threat constantly hovers over the loans-for-shares deals that the state will reopen these cases and, in so doing, start a new scramble for some of Russia’s most prized assets.

Second, new market actors are primarily focused on the accumulation and redistribution of property rather than other maximizing strategies. This suggests that in the environment of permanent redistribution, the returns to acquisition of new property rights over additional assets exceed those of investment in existing privatized assets. This is particularly true if the new property can be acquired not in a liquid and competitive secondary market for assets, but through nonmarket means such as political intervention, manipulation of the court system, or nontransparent forms of tunneling through which property can be acquired at below-market prices. Especially
after the 1998 financial crisis in Russia, when foreign investors largely abandoned the market and numerous potential domestic competitors were eliminated, the opportunities to acquire assets in a noncompetitive environment were enormous. The financial-industrial groups that survived the crash have tended to gobble up assets indiscriminately through both market and nonmarket means. Indeed, it has been the most dynamic entrepreneurs in Russia who have invested their talents in acquisition of new assets over investment in existing assets, thus setting the standard for innovation in the Russian market.

Third, the permanent redistribution of property relies heavily on the capacity of economic actors to influence the state. As discussed above, permanent redistribution in Russia has not been largely market-driven. Instead, economic actors seeking to acquire existing state-owned assets or previously privatized assets are often reliant on state intervention. Firms “convince” local or regional governments to challenge prior privatizations. Regional courts uphold various schemes to expropriate minority shareholders. Privatizations of remaining state holdings in attractive enterprises have been structured to the advantage of particular firms. What distinguishes an environment of permanent redistribution from a normal secondary market for assets is the extent to which the redistributions are a function of nonmarket interventions. The insecurity of property rights underlying permanent redistribution is a function of the state’s willingness to intervene in the disposition of privatized assets.

Fourth, economic actors who can capture state institutions have substantial advantages in the constant renegotiation over property rights. In the game of permanent redistribution, the main currency is influence over the state. Though influence is largely dependent on economic resources, as in any political system, it also relies on personal ties and networks—some inherited from the past, others newly sprung from the transition. Economic actors that can utilize wealth and influence to “capture” politicians and even entire state institutions will be able to use the state to shape the process of permanent redistribution to their own advantage. Moreover, in Russia, as in many post-Soviet systems, there are few collective actors who can serve as countervailing interests to powerful oligarchs and firms with the capacity to capture the state. Political parties, trade unions, consumer groups, and nongovernmental organizations are extremely weak. In such an environment, politicians are dependent on large firms and wealthy businessmen to fund their campaigns, to provide an organizational network of support, and, in many cases, to provide a range of private benefits as well. What these businesses get in return is an opportunity to use the state to enhance their capacity to acquire additional assets.

And, finally, permanent redistribution is not contained within Russia’s borders. In his theory of permanent revolution, Trotsky recognized that the success of Russia’s essentially peasant revolution depended on the spark it would generate for revolutions around the world. Similarly, the imperative for permanent redistribution appears to be driven from outside Russia. As the stock of available assets to acquire or redistribute goes down, the interest in acquiring assets through similar means in other transition countries increases. As a result, Russian firms seek to export their redistributive strategies abroad in countries where the state is highly susceptible to capture, and property rights can be easily manipulated by political intervention.

In recent years, Russian firms have been particularly active in acquiring assets in neighboring transition countries. In many cases, these acquisitions are the result not of competitive international tenders but of negotiations between governments in the form of debt-for-equity swaps or other barter-equity deals. Again, these deals rely on state intervention and are often structured to benefit private firms as opposed to state entities.

The proponents of mass privatization believed that the distribution of formerly state-owned property would have a number of “lock-in” effects. It would shift control over assets away from state bureaucrats to private owners who would not easily cede these control rights back to the state, thus locking in a constituency with an interest in making economic reforms irreversible. It would create a new set of stakeholders with an interest in defending their assets from encroachments, thus locking in a constituency for the rule of law. At the same time, by spreading property rights to the public through vouchers, the reformers believed that they were building the foundation of a liquid and competitive secondary market for assets that would prevent the initial recipients from locking in any permanent advantages in the new market economy. This was especially important, as political considerations had compelled them to give preferences to enterprise insiders who were not the best suited to making the most productive use of those assets, given their previous track record in the command economy. Once the rounds of mass privatization had been completed, the reformers immediately turned their attention to the development of the securities market to ensure that assets would eventually flow to the most efficient users.
But what the reformers did not anticipate was that mass privatization by itself would not be sufficient to prevent the state from intervening in the disposition of assets, that is, to achieve the depoliticization of property in the reformers' own terms. The same constituencies that compelled the reformers to skew the initial distribution of state property to their advantage also influenced the state to continue intervening in the dispensation of property rights. Instead of a liquid secondary market, mass privatization launched a process of constant renegotiation of property rights in which the state continued to play a critical role. As key assets in the economy remained up for grabs, new market actors had strong incentives to focus on further acquisitions to lock in advantaged positions in the emerging market economy. These acquisitions largely depended on one's capacity to capture politicians and bureaucrats. The most dynamic entrepreneurs who thrived in this environment were driven to invest their resources and talents in capturing the state to use the state's power to acquire more and more resources.

Demand for Institutions

The reformers correctly assumed that mass privatization would generate a demand for institutions. But what type of institutions? What are the consequences of permanent redistribution on the demand for market-supporting institutions and for further reforms in Russia? In an environment of permanent redistribution, demand for the rule of law is weak. The most powerful actors in the new market economy have a strong interest in minimizing any legal constraints on their capacity to acquire additional assets through methods such as tunneling, expropriation of minority shareholders, and other forms of asset stripping. If property rights were properly protected, then the opportunities for redistributing already privatized assets would be limited to legitimate market mechanisms. Because permanent redistribution depends on conflict intervention by the state or, at the very least, tacit agreement by relevant legal and regulatory authorities, an environment that adequately curbed corruption and other forms of illicit influence on public officials would seriously undermine the capacity to redistribute property. In contrast to the initial hopes of the reformers, privatization created a powerful constituency that gains from the absence of a rule of law. Such a constituency prefers state institutions that maintain a high degree of discretionary power, that are susceptible to influence through corruption, and that are incapable of enforcing secure property rights for all.

The World Bank and the European Bank for Reconstruction and Development (EBRD) recently conducted a survey of firms in twenty-two transition countries called the Business Environment and Enterprise Performance Survey, or BEEPS. The survey provides evidence of the concentrated advantages that selected firms can gain from engaging in various forms of grand corruption at the highest levels of the political system. The survey is able to identify those firms that engage in "state capture," defined as paying bribes to public officials to influence the content of laws, regulations, or decrees. Then the performance of these "captor" firms can be compared with the performance of ordinary firms without such influence. Figure 5.1 compares the average reported growth in revenues over a three-year period (from 1997 to 1999) for captor firms and ordinary firms in Poland and Russia. In Poland, where privatization progressed gradually and the perils of permanent redistribution were largely avoided, firms that engage in this form of grand corruption show little systematic benefit from this activity in comparison with other firms. In Russia, the captor firms grow at more than twice the rate of ordinary firms. This suggests a substantial payoff in terms of growth to the firms that can manipulate the instruments of the state through grand corruption. Such firms will seek to preserve these advantages for as long as possible.

Of course, those who gain from the process of permanent redistribution have an interest in protecting their own property rights even as they seek ways to expropriate the property of others. The reformers, however, were mistaken in believing that such an interest would lead to the demand for institutions that protect property rights as a public good. Instead, those who benefit from the permanent redistribution seek to purchase protection of their own property rights à la carte from the state. In other words, they seek individualized protection for their own property rights usually through the provision of some form of private payment to individual state officials. But this de facto privatization of the provision of a key public good weakens the security of property rights for everyone else. If public officials can extract private payments from the firms for selected guarantees of security, why should they provide this good to everyone else?

The BEEPS provides direct evidence of the selective provision of security of property rights for powerful firms in transition economies.
Figure 5.1 Gains to State Capture

![Chart showing gains to state capture in Poland and Russia]


Figure 5.2 compares the responses of firms across countries on the extent to which they are confident in the security of their property and contract rights. In Russia, more than 70 percent of the firms interviewed reported doubts about the security of their property rights. Yet if we examine how the security of property rights has changed over time, an interesting pattern emerges. In all countries, firms that engage in state capture and other forms of grand corruption are much more likely to have reported gains in the security of property rights than are other firms. As the level of grand corruption increases in the country, the difference becomes more stark. In countries such as Russia, where the state is highly susceptible to capture, the captor firms were more than five times more likely than other firms to have reported improvements in the security of their property rights over time. In these countries, powerful firms have been able to buy individualized security from the state, while at the same time weakening the security of property rights for everyone else.

For those who benefit from permanent redistribution, the ideal state is weak at home but strong abroad. In a weak state, individual public officials generally have considerable discretionary authority, while the state itself cannot effectively enforce laws. This makes the state particularly susceptible to capture and other forms of illicit influence by powerful firms. A strong state at home might be less willing to undertake policies that give advantages to particular firms while imposing substantial social costs. Moreover, a strong state might be tempted to reclaim property rights for itself, thus threatening existing private owners. Weak states are generally unable to exercise effective control over their own holdings, thus opening up lucrative opportunities for acquiring nominally state-owned assets through a variety of illicit or informal methods.

However, if the process of permanent redistribution can be extended beyond Russia's borders, then it generates a preference for a strong state abroad. Most efforts by Russian firms to acquire assets in other transition countries depend not on competitive market tenders but on bilateral deals between Russia and the respective governments. Assets are acquired through debt-for-equity swaps, in barter deals for state-provided services (such as border control), and by other political agreements between states that are then channeled to selected firms. Such deals depend on the strength of the Russian state to enter into and enforce agreements in its relationships with other transition countries. In particular, Russia's increasing assertion of authority in the so-called near abroad (a term sometimes used by Russian officials to refer to the new independent states that occupy former Soviet territory) has netted a wide range of asset acquisitions for important Russian firms.
The BEEPS adds to the growing anecdotal evidence of efforts by Russian firms to expand the process of permanent redistribution to other transition countries. The survey included nearly five hundred foreign direct investors in the transition countries. When investing in other transition countries outside of Russia, Russian-owned firms are more likely than any other foreign direct investors to use illicit methods of influence at the highest levels of the political system to promote their activities. Figure 5.3 shows the share of all foreign investors that engage in state capture sorted by origin of the firms’ capital. Nearly a quarter of all Russian firms investing in other transition countries resort to capturing the state in building their investment portfolios. As the Russian state under President Putin has begun to play a much stronger role in the near abroad, Russian firms have been more aggressive in expanding their holdings in other transition countries. This has created vast new opportunities for acquisition of assets, thus further prolonging the dynamics of permanent redistribution in Russia and across the region.

The first ten years of Russia’s transition have shown that the belief of reformers that liberalization and mass privatization would create demand for institutions to provide key public goods necessary for a well-functioning market economy rested on a number of assumptions about the incentives of the new market actors that ultimately proved inaccurate or incomplete. Although it is clear that society as a whole would have gained from the development of market-supporting institutions, what few reformers recognized at the time was that some would also lose as a result of such institutions. Periods of uncertainty, instability, and discretion can be very conducive for some groups to rapidly accumulate resources and power. An environment of insecure property rights creates opportunities for some to expropriate the assets of others. A weak state unable to enforce the rule of law generates opportunities for grand corruption that can aid in the building of future economic empires. Such distortions in the emerging market economy impose high costs on society, but they also can bring extraordinary gains to those in a position to take advantage of them through close ties with politicians and state bureaucrats. Institutions that reduce these distortions eliminate opportunities for those who can make the most out of periods of uncertainty. As long as there are valuable assets that can be acquired through nonmarket means (and hence at below-market prices), there will be powerful groups that oppose any institutions that reduce these distortions. These are the groups that gain from prolonging the process of permanent redistribution.

In an environment of permanent redistribution, the most dynamic and successful entrepreneurs invest their talent and resources in capturing politicians and bureaucrats to use their discretionary authority and the absence of countervailing restraints to acquire more assets. For such entrepreneurs, this environment constitutes a real window of opportunity that they seek to prop open for as long as possible. Although the weaknesses in the functioning of the market economy also impose costs on the entrepreneurs themselves, the costs are far outweighed by the potential gains generated by the additional accumulation of assets. Eventually the balance of costs and benefits will shift, but in large, natural resource-rich economies such as Russia, with plenty of “jewels in the crown” to redistribute, this could be a long time coming.
Some Thoughts for the Next Ten Years

The social costs of this permanent redistribution over the past ten years are well known. Although Russia has finally returned to growth, much of the economic contraction of the last decade can be attributed to asset stripping and theft, capital flight, declining investment rates, barriers to new market entry, deteriorating physical and human capital, and other problems generated by the process of permanent redistribution. This has pulled many people into poverty. The pattern of redistribution has concentrated gains to a narrow constituency while imposing high costs on the rest of society, bringing the inequality rate in Russia close to that of the most unequal countries in the world. Comparisons between the present and the pretransition past are futile in Russia, given the vastly different political, social, and economic context of the former communist system; however, it is clear that permanent redistribution has substantially constrained the potential inherent in the reform process.

The return to growth, the increasing investment rate, and the newfound political and economic stability that have followed the Russian financial crisis in 1998 are signs that the worst excesses of permanent redistribution may be abating, although constant renegotiation over property rights continues. Those financial-industrial groups that survived the crisis have been on hyperactive acquisition mode. While some of this acquisition has come through legitimate market mechanisms, there remain daily stories of political and legal challenges to past privatizations, expropriations of existing stakeholders, systematic tunneling and asset stripping, and other unchecked violations of property rights. New voices within the business community have been raised to demand that institutions provide the key public goods still lacking in Russia’s emerging market economy. Recently proposed reforms to strengthen the judiciary, to reduce regulatory obstacles, and to improve the quality of public administration are encouraging signs. But these developments are still in their infancy, and implementation has always been one of the key weak spots in Russia’s transition.

When looking toward the next ten years of transition, few have considered what might be the most important legacy of this process of permanent redistribution—the potential illegitimacy of the initial distribution of property rights in Russia. If the dominant financial-industrial groups in Russia were forged in questionable privatization deals, in acquisitions tainted by political interference and corruption, and in an environment marked by lawlessness, how will they stand up to challenge in the future? Will every future anticorruption campaign threaten forcibly to redistribute previously acquired assets? As the state gains strength, will it seek to reclaim its stakeholdings in key assets frittered away by previous governments? If populism ever takes hold in Russia, will the earlier distributions of property rights have enough legitimacy to withstand any potential backlash? No one has considered, in the context of the transition, the implications of a market economy built on an initial distribution (and redistribution) of property rights whose legitimacy is open to challenge. Of course, similar questions could be raised about the origins of most modern market economies, but the compressed time frame of the transition—in which developments over generations have been squeezed into a decade—makes these risks seem far more relevant.

As long as such questions remain, the security of property rights in Russia will be compromised, with negative consequences for investment and growth. Recognizing this problem, some voices within Russia are already calling for blanket amnesties or other methods to secure ex post facto legitimization for the frenzied redistribution of property rights in the first decade of transition. But perhaps more important are the potential political consequences. In the quest to make reforms irreversible, the reformers may have unintentionally planted the seeds for future political challenges in the very structure of property rights in the new market economy.

Notes

1. The views presented here are those of the author and do not necessarily reflect the views of the World Bank.


4. For an interesting ex post explanation of the political tactics of economic reform in Russia, see Daniel Trensa and Andrei Shleifer, Without a Map: Political Tactics and Economic Reform in Russia (Cambridge, Mass.: MIT Press, 1999).
3. This is a rather broad generalization of what was a wide divergence of views at the time. For an approach to privatization that started with recognition of the potential pitfalls inherent in this approach, see the work of Roman Frydman and Andrezej Rapaczynski. For an example, see Roman Frydman, Andrezej Rapaczynski, and John Earle, *Privatization in the Transition to a Market Economy* (Budapest: Central European University Press, 1993).

4. At the same time, however, the evolutionary approach was used primarily to argue against rapid privatization. See in particular the work of Peter Murrell, including *Conservative Political Philosophy and the Strategy of Economic Transition,* *East European Politics and Societies,* vol. 6, no. 1 (1992), pp. 3–16.


6. This was the underlying political theory that motivated the shock therapy approach. One of the clearest statements of this approach is Leszek Balcerowicz, *Understanding Postcommunist Transitions,* *Journal of Democracy,* vol. 5, no. 4 (October 1994), pp. 75–89. Such views also came out in many of Jeffrey Sachs' statements of the period. For an example, see *Life in the Economic Emergency Room,* in *The Political Economy of Policy Reform,* ed. John Williamson (Washington, D.C.: Institute for International Economics, 1994).

7. Although he did not write about Russia and the transition, such a theory of institutional development must prominently associated with the work of Douglass North. In particular, see his *Institutional Change and Economic Performance* (Cambridge, U.K.: Cambridge University Press, 1990).

8. Trotsky's theory of permanent revolution, though initially welcomed as a major contribution to Marxist thinking, ultimately became the object upon which his fall was based. The theory simply stressed that Russia, at the time of revolution still largely a peasant country, needed to go through a bourgeois phase before reaching the socialist phase of development. As a result, Trotsky argued that the survival of the Russian revolution depended upon its success in sparking proletarian revolution in the more advanced capitalist countries around the world. See the classic work of Isaac Deutscher, *The Prophet Unarmed, Trotsky: 1921–1929* (Oxford, U.K.: Oxford University Press, 1959). One could argue that Trotsky's warning that Russia cannot simply skip key phases of development remains relevant to the development of a market economy as well.

9. This was an arrangement by which many of Russia's oligarchs made loans to the government with shares in government-owned enterprises as collateral. When the federal government was unable to repay the businessmen, they gained control of key state enterprises as a result of the government's default.

10. One need only refer to existing valuable state stakes in Gazprom, United Energy Systems of Russia (UES), Lukoil, Sberbank, Vneshtorgbank, and extensive real estate holdings, particularly at the regional and municipal levels.


14. For a much more detailed statistical test of this relationship controlling for all the other variables that might affect firm performance, see Hellman, Jones, and Kaufmann, "Seize the State."

15. It is important to recognize that the performance indicator is sales growth and not profits (which are notoriously underreported in transition economies and therefore unreliable)." As sales growth is a rough measure of the size of the firm, and as additional evidence in the survey shows no greater productivity gains for captive firms in comparison with ordinary firms, it may be assumed that one possible explanation of this growth is increasing accumulation of assets through gains associated with the process of permanent redistribution.

16. For a more extensive discussion of this concept, see Hellman, Jones, and Kaufmann, "Seize the State."

17. A standard answer to this question would be to maximize the collection of tax revenue. But while this would be collectively rational for the state as a whole, it is unlikely to be rational for the individual bureaucrat in an environment of considerable uncertainty about the future.
