

## The Transition of Russian Business and the Potential for Economic Development

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Reality of 1990s: poor institutional environment and lack of necessary skills and knowledge for operations in market economy, rent-seeking and vested interest lead to huge state capture (Hellman et al, 2003), assets stripping and mass violation of property rights (Black et al, 2000), barter, non-payments and tax arrears (Gaddy & Ickes, 1998), deep economic decline and fiscal crisis.

August 1998 financial crisis was the consequence of rent-seeking strategies of 1990s. However it was not only financial but also political crisis – first time after 1991 prominent communists came to the government. This threat created preconditions for dialog between main groups in the elite – with search for more adequate economic policy.

Liberal reforms of early 2000s – radical tax reform, lowering of custom tariffs, simplification of SME regulation – can be considered as ‘negotiated institutional change’ according to Luong & Weinthal (2004). Peak business associations – RSPB, Delovaya Rossiya, OPORTA – played important role in these state-business negotiations.

‘Yukos affair’ and increase of oil prices changed the balance between state and business but nevertheless social and political stability of 2000s provided opportunities for economic growth. As a result we could observe in 2000s development of ‘new business’ – successful medium-size companies that managed to take advantage of the opportunities provided by the high growth in domestic demand. About five thousand medium-size firms with an average annual turnover per company exceeding \$10 million were operating in the Russian economy before the crisis of 2008, steadily maintaining average annual rates of sales growth at the level of 20 percent and more (Vin'kov et al., 2008). These companies were particularly active in construction and trade, but were in fact represented in all economic sectors.

At the same time, owners of these firms understood that they could attain a high social status only in Russia. Therefore such companies became involved in collective action to change the investment climate, first of all through the Delovaya Rossiya association after the 2008-2009 crisis. Such companies, familiar with the Russian market, disposing of financial resources and management teams, could become the basis for the new model of economic growth (Yasin et al, 2014). However, in order to succeed they should be sufficiently motivated to invest.

Crisis 2008-2009 led to new dialogue between government and business. Introduction of Regulatory impact assessment (RIA), liberal amendments to Criminal code, creation of Agency for Strategic Initiatives (ASI), launch of National entrepreneurial initiative were political results of this dialogue. However contrary to improvement of Russia's position in DB ranking there were no real changes in economic trends: lower economic growth, capital flight, decline in investments. Key factors here were contradictions in economic policy and very high uncertainty for economic actors after 2011.

The series of revolutions in Arab countries in the spring of 2011 became a strong ‘external shock’ for the Russian political elite. A fear of possible developments in Russia along the Egyptian or Libyan scenario within the context of mass political protests in Moscow in December 2011 triggered strong conservative reaction. This reaction took various forms: fight against corruption (with much stronger pressure on bureaucracy); pressure on political opposition (arrests of activists, law against ‘foreign agents’ etc.); anti-Western political rhetoric and increase in military spending and expenses on law enforcement

activities (see Yakovlev (2016) for details) as well as continuation of efforts to improve the business climate; increase of salaries in public sector (May 2012 decrees). But it was mostly 'defensive reaction' – without any new clear vision of future.

Key problem of this policy were contradictory signals for economic actors – because it was clear already in 2012 that the government had no resources to afford an increase in public sector financing, simultaneously pursuing with an accelerated build-up of military expenditure. Persistent declaration of these goals generated doubts in the overall adequacy of economic policy and the maintenance of macroeconomic sustainability. This contributed to increased capital flight from the country. Increased pressure on the bureaucratic machine for anticorruption purposes in conditions of excessive and inconsistent regulation increased the risks for officials in displaying any sort of initiative and in fact reduced incentives for creating an adequate environment conducive to economic development (Yakovlev, 2015).

The crisis in Ukraine accompanied by accession of Crimea to Russia and international sanctions against Russia as well as Russian food embargo only increased the uncertainty on economic policy. Recent events (military operation in Syria and new tensions with Turkey) showed again that economic policy is subordinated now to foreign policy targets. At the same time current crisis created new opportunities for some sectors like agriculture, chemical industry, metallurgy. More broadly in long-term perspective foreign investors continue to consider Russia as attractive destination. Among the advantages of Russian market they named the following:

- Availability of various natural resources (including, in addition to oil, also metals, timber, agricultural lands, etc.). In contrast to sceptic reflections about a 'resource curse' typical of the Russian liberal experts, business representatives unambiguously regard rich supplies of natural resources as a serious potential advantage of Russia.
- Significant structural distortions in the economy (inherited from the Soviet plan system and not overcome during last 25 years). For many companies these distortions mean the existence of market niches with opportunities for sales growth for many years to come.
- Educated labour force. The qualification of workers in Russia, in the estimates of foreign companies, is still higher on average than in other developing countries, which offers the opportunity for locating high-tech production facilities in Russia.
- High urbanization level. A considerable part of the urban population, combined with a high level of education and increased level of incomes, creates mass-scale demand for consumer goods of high and medium quality.

In respondents' opinion, the combination of all these factors before 2014 provided opportunities for sustainable long-term growth of the Russian economy at a pace of 5-6% a year. According to respondents this potential has not been realized due to inadequacy of economic policy and mistrust of business toward the state. However, even now, regardless of the inevitable tension in relations with developed countries in the coming years, Russian companies' restricted access to capital and technologies, and decline of oil prices, the effect of the aforementioned factors has not disappeared. Russia still has potential for development. However, its practical implementation requires the settlement of the systemic internal conflicts and development of new agreements between key groups within the elite, as well as the formation of a new 'social contract' between the elite and society. These processes are impossible without formulating a new national development strategy shared by elites and masses.