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“Evaluation of competitiveness and business environment of Russia’s economy”

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ABSTRACT

This report evaluates the competitiveness and business environment of the Russian economy by using the Global Competitiveness Index and the Ease of Doing Business Index, respectively. The analysis identifies the current positioning of the economy and shows that there is enough room for progress. In terms of competitiveness the main weaknesses concern institutions, financial and goods market efficiency. In terms of business environment the country lags in dealing with construction permits, getting credit, protecting minority investors and trading across borders whereas it scores high in registering property and enforcing contracts. Furthermore, a strong positive correlation between GCI and EDB indexes in the Russian economic environment, and a negative one between real GDP growth and GCI-EDB was identified. Last, recommendations are made for the improvement of institutions, financial and goods market, business climate, clusters and regional development, economic relations with neighbors and diversification of the economy.

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Athanasios Vrachinopoulos

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I. INTRODUCTION

BACKGROUND

The economy of a nation is a significant pillar of its national power. It supports and to a great extent defines its position on the international stage. It fuels also other factors of national power such as its military capability, available technology, education, morale and prosperity of the population. Economy deals with the production, acquisition, distribution and consumption of the national income and wealth. So great is its importance that it can cause dramatic consequences and even the dissolution of a country, as happened among Russia and the states of the former Soviet Union. In order to control and improve the economy, economists study the system and production factors, productivity and rate of growth, indexes of economic activities, the total value of products and services a society produces, prices of production factors, unemployment and its influence in the economic process, measures for development of the economy, function and role of enterprises and various other aspects of the economy.

PURPOSE

The purpose of this study is to evaluate the economy of Russia in terms of its competitiveness and business environment. It attempts to examine the current situation of the economy of the country and propose ways for further development of its competitiveness and the enhancement of its business environment.

RESEARCH QUESTIONS

For the implementation of this project research the following questions were established:

What is the level of competitiveness of Russia's economy? Why is that?

What should be done in order to improve the level of competitiveness?

What is the situation of business environment in Russia? Why is that?

What should be done in order to improve the business environment in Russia?

SCOPE AND LIMITATIONS

The evaluation of a country's economy is multileveled and multifaceted. The scope of the present study is limited to assessment of the economy of Russia as far as its competitiveness and its business environment are concerned.

BENEFITS OF STUDY

This study can be useful to policy makers and regulators in order to make informed decisions towards development of the competitiveness and improvement of the business environment of a country's economy from the respective findings of the situation of Russia's economy. In addition, it can be useful to people who have an entrepreneurial interest in Russia. Moreover, the concepts of competitiveness and business environment are of great interest because they include many factors the amelioration of which can boost a country's economy, helping it to achieve a respectful position on the international scene and prosperity for its citizens.

METHODOLOGY

The project first provides a background pertaining to the economy profile of Russia and the current situation of its economy. It continues focusing on the concepts of competitiveness and business environment. It then transitions to the international benchmarking indicators concentrating on those that measure competitiveness and business environment, particularly the Global Competitiveness Index (GCI) and the ease of doing business (EDB) index, respectively. By using these indexes and their breakdown indicators, it evaluates the economy of Russia in comparison with the respective performance of other countries. Based on the findings of the analysis relevant recommendations towards improvement are made followed by conclusions.

ORGANIZATION OF STUDY

Chapter I: Identifies the purpose of the project, its scope and limitations, the research questions, as well as methodology and benefits of the research.

Chapter II: Presents in general the economy profile of Russia, gives a brief description of the concepts of competitiveness and business environment as well as two indexes that measure these two concepts, the Global Competitiveness Index (GCI) and the ease of Doing Business Index (EDB) respectively.

Chapter III: Introduces in detail the GCI and EDB indexes for the evaluation of competitiveness and business environment respectively. It describes how well they gauge the above concepts of a country's economy, what their strengths and limitations are, what pillars they rely on and how they are calculated.

Chapter IV: Analyzes the competitiveness and business environment of Russia by using the above indexes and their breakdown indicators in comparison with the respective performance of other countries. It then transitions to an attempt of finding possible relationship between the performance of Russian economy in the aforementioned indexes and growth using correlation, as well as the underlying reasons.

Chapter V: Makes relevant recommendations based on the findings of the analysis concerning the policy and the measures towards improvement of competitiveness and business environment of Russia.

Chapter VI: Summarizes the conclusions from the analysis and identifies areas for further research.

II. LITERATURE REVIEW

A BRIEF HISTORY OF RUSSIA'S ECONOMY

Russia was the largest of the fifteen republics that made up the Soviet Union (USSR) after the dissolution of which in 1991, ended up in the establishment of the Russian Federation. On the verge of collapse of the USSR, radical market- oriented reforms were announced along the lines of Poland's 'big bang' also known as shock therapy. Since then many attempts have been made in Russia towards privatization, liberalization and stabilization and conversion of the world's largest state-controlled economy into a market-oriented one, which were difficult to pass during political and economic turmoil. This transition period was characterized by times of hyperinflation, unemployment, underemployment, poverty and economic inequality.[1]

The main reason that Russia passed through such a turbulent transition is that the country was remaking both its Soviet-era political and economic institutions simultaneously and, in parallel, was remaking itself as a new national state following the disintegration of the union. The first major obstacle which faced Russia was the legacy of the Soviet Union's huge commitment to the Cold War. The USSR, in the late 1980s, devoted a quarter of its gross economic output to the defense sector. After the end of the Cold War, production plants were severely hit by the cutback in military spending and it was often impossible for them to quickly retool equipment, retrain workers, and find new markets to adjust to the new post–Cold War and post-Soviet era. A second problem, which is related to the vastness and geographical diversity of the Russian landmass, was that the regional economies were dependent usually on a single industrial employer, a situation that Russia inherited from the Soviet Union. When the USSR collapsed and the economic ties between Soviet republics and regions were severed, the production in the whole country decreased by more than 50% which caused tremendous unemployment and underemployment. A third difficulty was the fact that, post-

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1 "History of Russia (1992–present)," *Wikipedia*, accessed September 10, 2015, www.wikidedia.org.

Soviet Russia did not inherit a system of state social security and welfare from the USSR which left industrial employees heavily dependent on their firms. Thus, since local governments were unable to take on responsibility for these functions, economic transformation created serious problems in maintaining social welfare. Last, there was a human capital dimension to the difficulty of post-Soviet reforms in Russia. The former Soviet Union's state enterprise managers were educated and highly skilled at coping with the demand under the Soviet system of planned production targets.The incentive system built into state institutions and industries during the Soviet era however, encouraged skills in coping with state-run planned economy, but discouraged the risk-and-reward centered behavior of market capitalism. Thus, Soviet managers or employees did not have experience with decision-making under the conditions of a market driven economy.[2]

By the mid-1990s, the best-connected former state entities leaders accumulated considerable financial resources, and the most successful entrepreneurs became acquainted with public politicians and government officials. The privatization of state enterprises was a unique opportunity for those who had gained wealth in the early 1990s to convert it into shares of privatized enterprises. Thus a relatively small group who used the connections built up during the last days of the Soviet Union benefited form Russia's vast resources during the privatizations era and the class of oligarchs emerged. In general, the Western world advocated a quick change of the state planned economy and the reforms towards the free-market, but later expressed frustration about the emergence of the new class of oligarchs and their subsequent corruption.

Russia's economy sank into deep depression by the mid 1990s and was hit further by the financial crash of 1998. It began to recover in 1999–2000. That economic decline was far more severe than the Great Depression of the United States in terms of Gross Domestic Product. The global recession of 1998, which started with the Asian financial crisis in July 1997, deteriorated Russia's economic predicament. The commodity prices fell, and countries which were heavily

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2 Ibid.

dependent on the export of raw materials such as oil were among those most severely hit. More than 80% of Russia's exports were raw materials (oil, natural gas, metals, and timber) which made the country vulnerable to world prices fluctuations. Oil is also a major source of government tax revenue and its sharp price decline had severe consequences for Russia's proceeds. The pressures on the ruble, reflecting the weakness of the economy, resulted in a catastrophic fall in the value of the currency. In addition the continued massive tax evasion rendered the government unable to service the big loans it had received or even to pay its employees. The IMF approved a $22.6 billion emergency loan but despite the bailout the situation was unsustainable. The ruble went into free fall, foreign investment rushed out of the country, Western creditors lost heavily, and a large part of Russia's banking sector was destroyed. Russia recovered eventually from that financial crash in 1999, when the oil prices rapidly rose, helping thus to a large trade surplus. What also helped the recovery was that domestic industries benefited from devaluation of the currency which caused a steep decrease in imported goods. In addition, Russia's economy was operating to a large extent on barter and other non monetary instruments which caused less damage to producers than it would, had the economy been heavily dependent on the banking products. Last, the economy was supported by cash influx derived from enterprises pay offs of arrears in taxes and wages which in turn increased the purchasing power, consumer demand and employment. Nevertheless, the economy remained vulnerable to downturn if the world oil prices fell at a dramatic pace. [3]

Thus, Russia was also severely hit by the global economic crisis of 2008 when global commodity prices dropped and so did Russia's GDP, which fell by more than 10% between mid-2008 and mid-2009.[4]

In 2014, the annexation of Crimea by Russia caused disappointment of the West which resulted in economic sanctions[5] against Russia. In addition, reduction

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3 Ibid.

4 Dmitri Trenin, "Russia Reborn. Reimagining Moscow's Foreign Policy," *Foreign Affairs* 88 No.6 (December 2009): p 67.

of oil prices, decrease of oil exports and devaluation of the ruble put Russia's economy in another spin of crisis.[6]

THE CURRENT SITUATION OF RUSSIA'S ECONOMY

According to a recent survey[7], the economic crisis in Russia affects a diverse range of factors and players and has an important impact on the business environment. There is a consensus view among both the business community and the general population about the possible duration of the crisis, but members of the former group are more optimistic about the speed of recovery. The current economic crisis is affecting the majority of Russia's population, with a decline in purchasing power for more than 90% of the population and with 53% of the population unable to gather any savings. Most Russians connect the crisis with increasing prices and unstable national currency. They consider that the crisis will be over only when their purchasing power improves and the Russian ruble (RUB) stabilizes versus the euro (EUR) and the US dollar (USD).

Actuals		Forecasts*			
2014	January – April 2015 (Y-o-Y)		2015	2016	2017
0.6%	-2.4%	World Bank	-2.7%	0.7%	2.5%
		IMF	-3.4%	0.2%	
		J.P. Morgan	-4.0%		
		S&P	-2.7%	1.9%	
		The Ministry of Economic Development of the Russian Federation	-2.8%	2.3%	2.5%
		HSE	-3.6%	0.7%	1.4%

Table1. Dynamics of real GDP of Russia (After: PwC, "Russia's Current Economic Downturn: A 360° View How to Adapt Today to Succeed Tomorrow," June 2015, www.pwc.ru/crisis360.p.6)

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5 Weaver Courtney, "Russia's Anatoly Motylyov: Rise, Fall, Repeat," *Financial Times*, September 6, 2015.

6 James Kynge and Jonathan Wheatley, "Emerging Markets: Fixing a Broken Model," *Financial Times*, August 31, 2015.

7 PwC, "Russia's Current Economic Downturn: A 360° View How to Adapt Today to Succeed Tomorrow," June 2015, www.pwc.ru/crisis360.

Although both average citizens and businesses expect the crisis to last about two more years, members of the business group expect to see some improvement by the end of the current year, showing a more positive sense concerning the speed of recovery. Most analysts predict moderate growth for the Russian economy in 2016 as is shown in Table 1.

People alter their shopping habits, in part permanently, which will radically change demand patterns. In an attempt to stretch their household budgets, many people are displaying thriftier behavior and adopting various money-saving strategies, such as choosing cheaper products, buying fewer items, or buying only items on promotion. It is believed that consumers will continue to exhibit most of these behaviors after the crisis as well. This factor will permanently change the nature of consumer demand and, given the fact that business customers are changing their behavior in a similar way, companies that are focused on business customers are being affected as well.

The traditional role of the middle class as a driver of economic growth seems to be diminishing. Due to the reduction of their real incomes a considerable number of people no longer qualify as middle class. But even those who still meet the income criteria are changing their shopping habits by delaying purchases of expensive items due to a general feeling of financial insecurity, spending less on leisure activities or limiting spending on everyday goods.

Period	Real incomes: Y-o-Y dynamics (to the same month of the previous year)
November 2014	-3.8%
December 2014	-6.2%
January 2015	-0.9%
February 2015	-1.7%
March 2015	-2.1%
April 2015	-4.0%
Average for the period November 2014 – April 2015	-3.1%

Table 2. Real incomes of Russian consumers are steadily declining (After: Ibid.,p.24)

The diminishing demand affects in turn the companies which see their profits shrinking and their ability to finance new projects diminishing. The majority

of companies report falling demand and rising input costs as the two main effects of the crisis which, in turn, are putting pressure on profit margins. Additionally, they report lack of ability to finance new projects as a critical issue. This weak point, given its close connection to compressed margins and the frequently short-term horizon of many shareholders, may well put in danger the development of many capabilities that are vital for longer-term growth. However, some companies with operations in Russia, especially consumer goods producers, compared to their competitors with a larger share of imports, are reporting a positive impact in terms of better relative price positions.

In order to better respond to the situation, companies are starting to apply tactical measures, such as cutting marketing budgets and direct spending. Most of the companies cut spending on input materials and marketing costs as their initial response to the crisis, although some of these cost reductions are unsustainable. Many companies also, without making any fundamental changes, have initiated a number of optimization measures in production and logistics, mostly within their current configurations.

Possibly, some of the changes companies have to make in the business environment in response to the crisis will be long term; therefore they need to make fundamental changes in how their businesses operate. It is highly likely that Russia will experience a period of low growth after the crisis. In essence, this will be the new normal situation, similar to what was seen in Europe after the 2009 crisis. To some extent, demographic factors will contribute to this. The shrinking of the working age population, mainly due to Russia's very low birth rate in the 1990s, is expected to accelerate considerably over the next several years. Thus, the consequences of the new normal situation, among other things, will be a surplus of supply due to falling demand, putting even more pressure on prices and a continuous change in consumers behavior with a greater emphasis on value.

This in turn, means that companies will have to adjust their value propositions to face the changing consumer behavior. In addition, they will need to reconsider the ways they create value, making thorough changes in business processes, systems and their operating models so as to remain profitable. By

doing this, they will be better prepared to adequately respond to structural changes in the economy.

Return on investment (RoE), which measures how much profit a company makes as a percentage of shareholders equity, has fallen for Russian companies[8] since 2008, from 23,2% to 7,1% following though a general export decrease tendency of commodity exporting emerging countries, as shown in Figure 1.

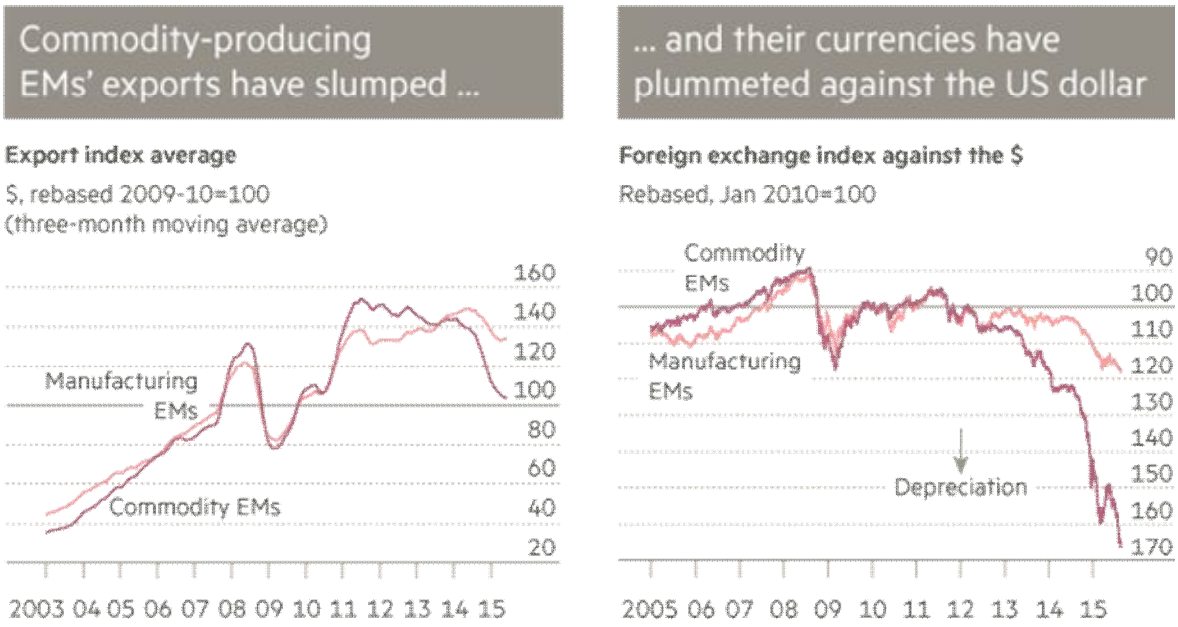

Figure 1: Export decrease of commodity-producing countries and currency depreciation. (After: James Kynge and Jonathan Wheatley, "Emerging Markets: Fixing a Broken Model," *Financial Times*, August 31, 2015)

Russia geographically belongs to the countries of the Black Sea area (BS-10) which consists of 10 countries: Armenia, Azerbaijan, Greece, Moldova, Bulgaria, Georgia, Romania, Turkey, Russia. It belongs also to the Black Sea Economic Cooperation (BSEC) which was established in 1992 after the collapse of the USSR, as a model of multilateral, economic and political initiative towards the interrelation and harmony among their members as well as to reassure peace,

8 Kynge and Wheatley, "Emerging Markets: Fixing a Broken Model."

stability and prosperity in the region encouraging good relations among the member countries.[9]

In addition, Russia is a member of the Commonwealth of Independent States (CIS), a regional organization among the former Soviet Union republics for the cooperation in economy, politics and the environment as well as in other sectors including humanitarian and cultural issues. As is shown in Figure 2, GDP per capita in Russia outstrips that of CIS over time.

Figure 2: GDP (PPP) per capita (int'l $).1990-2013 (After: "The Global Competitiveness Report 2014-2015" World Economic Forum, p. 320)

Russia is also a member of BRIC, a group whose name comes from a 2003 Goldman Sachs report that lumped together the then world's four largest emerging markets: Brazil, Russia, India and China.[10] In 2010, China invited South Africa to join the group even though South Africa lacked behind in development, comparatively to the other members and thus the group name changed to BRICS.

From 1997 Russia also belongs to G8, a group of the most industrialized countries (France, Germany, Italy, United Kingdom, Canada, USA, Japan and Russia) that hold a summit annually. The last two G8 summits however, took place without the participation of Russia due to its entanglement in the Ukraine crisis. Finally, Russia is a member of G20, a group consisting of the 20 largest and most advanced emerging economies which represent almost 2/3 of the global population, 85% of the global Gross Domestic Product and over 75% of the global

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9 Harry Papapanagos, "'International Economics Course' in International Relations & Security Postgraduate Program" (International Benchmarking Indicators, UOM, 1st_Semester 14-15).

10 Trenin, "Russia Reborn. Reimagining Moscow's Foreign Policy," p.73.

trade. G20 started as a meeting in 1999 and since then a summit is held annually.[11]

The population of Russia amounts to 142.9 millions. Its GDP in 2013, amounted to 2,118 billion US$, which accounted for the 2.94% of the world total in purchasing power parity (PPP), whereas the GDP per capita was 14,819 US$.[12] PPP regards the equivalent amount of money needed to purchase the same goods and services in two different countries and facilitates international comparisons of values taking into consideration the exchange rates and the differences in cost of living between countries.

COMPETITIVENESS - BUSINESS ENVIRONMENT

The performance of an economy is determined by various factors and characteristics, thus its assessment can be multileveled and multifaceted. For this reason a lot of indexes have been developed focusing on different aspects of an economy. Two ways of evaluating an economy is via the competitiveness and the business environment of a country.

The concept of competitiveness is a comprehensive one that includes many factors and has been approached in various ways. National competitiveness is a matter of considerable importance to both managers and public policy makers alike. Business scholars reflect this importance by their annual issuance of international indices of country competitiveness.

There is a view that the notion of national competitiveness is controversial and has both a narrow, concise conception that relates primarily to cost conditions as determined by exchange rates, and a broader, more complicated conception that comprises the institutional and systemic circumstances of an economy, such as governmental, legal, public policy and other factors framing a country's wider business environment. In practical terms, national competitiveness is a

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11 Papapanagos, "'International Economics Course' in International Relations & Security Postgraduate Program."

12 WEF, "The Global Competitiveness Report 2014-2015" (World Economic Forum, n.d.), p.320.

combination of both these narrow and broad conceptions. According to a study that investigated the contribution of these two conceptions to national competitiveness, the institutional circumstances are significantly more important than cost conditions to the competitiveness of an economy from a practical managerial viewpoint.[13]

Another view defines productivity as the only meaningful concept of competitiveness at the national level. According to that view the primary goal of a nation is to produce a high standard of living for its citizens. The ability to do so depends on the productivity with which a nation's capital and labor are employed. Productivity is the value of the output produced by a unit of capital or labor and depends on both the quality and features of products, and the efficiency with which they are produced. The quality and features of products in turn determine the prices they can command. Productivity is the prime determinant of a nation's long run standard of living and it is also the root cause of national per capita income. The productivity with which capital is employed determines the return it earns for its holders and the productivity of human resources determines employee wages. The standard of living of a country depends on the ability of its enterprises to achieve high levels of productivity and to increase it over time. Sustained productivity growth requires continuous upgrade of an economy. Enterprises must continuously improve productivity in existing industries by raising product service quality, improving product technology, adding desirable features, or boosting production efficiency. They must develop the necessary capabilities to compete in increasingly sophisticated industry segments, where productivity is generally high as well as to compete in entirely new, sophisticated industries.[14]

Foreign investment and International trade can improve a nation's productivity as well as threaten it. They support rising national productivity by allowing a nation to specialize in those industries where its companies are more

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13 E.R. Thompson, "National Competitiveness: A Question of Cost Conditions or Institutional Circumstances?," *British Journal of Management* 15(3) (2004): 197–218.

14 Michael E Porter, "The Competitive Advantage of Nations," Harvard Business Review, (April 1990), p.76.

productive and to import where its companies are less productive. However, international trade and foreign investment can also threaten the productivity growth since a nation's industry is exposed to international standards of productivity and industry will lose out if it is not sufficiently better than foreign rivals. If a nation can not compete in a range of high productivity and high wages industries its standard of living is threatened.

In the global competitive environment, nations try to provide a favorable home base for companies that compete internationally. The home base is the nation in which an enterprise creates and sustains the essential competitive advantages. It is a company's strategy to be located where the core product/s and process technology are created and maintained and where the most productive jobs and most advanced skills are found. The presence of the home base in a nation has great positive influence on other linked domestic industries and leads to other benefits in the nation's economy.[15]

Despite the widespread acceptance of its importance competitiveness remains relatively a nebulous concept. In order to clarify competitiveness, the starting point must be to understand the underpinnings of a nation's prosperity. The central economic goal of a nation is to improve its sustainable standard of living. Prosperity can be inherited or created. Inherited wealth comes from a country's natural resources such as oil, minerals, arable land, and the geographic location and has a positive direct effect on a nation's prosperity. Created wealth arises from the ability to create products and services that can be sold domestically and internationally at a profit. Created wealth can include products and services that use inherited resources, but is unlimited and enhances value only by the innovativeness and dynamism of the business enterprises operating in the country. Government cannot create wealth. Wealth can only be created by companies. However, government has an important role to establish the general framework and conditions which allow wealth creation.

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15 Ibid., p.77.

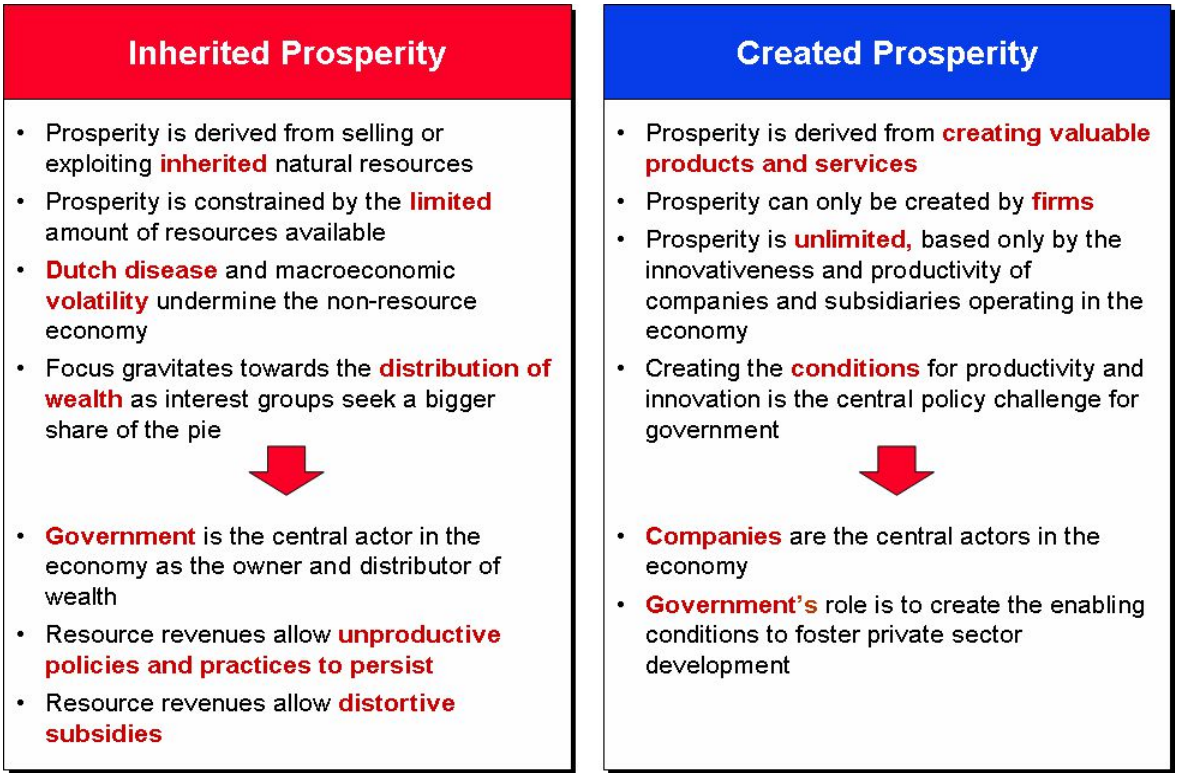

Figure 3 : Inherited versus created prosperity (After: Michael E. Porter and Christian Ketels, "Competitiveness at the Crossroads: Choosing the Future Direction of the Russian Economy," p.7)

Many countries rich in natural resources including Russia, have failed to achieve the level of prosperity of countries with far fewer inherited resources, because the availability of resources creates complexities in developing the non-resource economy. Abundant resources if not utilized properly, can lead to creation of governance structures and incentive structures that impede competitiveness. Their existence may permit governments to support non-economic policy choices, such as subsidies and unproductive employment, and often place governments' role in distributing wealth instead of incentivizing the private sector thus worsening the environment for wealth creation.[16]

A series of factors which increase productivity and upgrade the economy can also serve as intermediate indicators of competitiveness. These are: domestic investment, exports, imports, foreign direct investment (FDI) and domestic

16 Michael E. Porter and Christian Ketels, "Competitiveness at the Crossroads: Choosing the Future Direction of the Russian Economy," n.d., p.6,7.

innovation. Domestic investment is critical for the improvement of productivity and infrastructure. Inward FDI brings added capital and technology, market access, skills and competitive pressure whereas outward FDI enables international growth of local companies. Domestic innovation also fuels productivity growth. Exports allow a country to grow its most productive activities beyond the demand of the local market. Imports allow a country to access goods that it can't produce efficiently, provide access to foreign technology embedded in capital goods, and increase the level of rivalry on domestic markets. Each of these enablers depends, in turn, on existing competitiveness. Exports for example, cannot grow unless products have high quality and can be produced efficiently while investors will not invest unless the country offers an attractive environment compared to local wages. If at the same time, investments, exports, or patenting rates are due to direct subsidies, they will rather undermine productivity instead of improving it.[17]

It is supported that three broader influence factors,[18] which interact with each other, determine the level of competitiveness. These are: the endowments, the general context and the microeconomic competitiveness as illustrated in Figure 4.

Endowments include natural resources, geographic location, and historical legacy and are essentially 'given' and not the result of current policy choices. Natural resources can offer exports and affect productivity directly, however, they can also create risks of retarding competitiveness improvements, a challenge that especially emerging economies like Russia are struggling with. Location can also impact the productivity in terms of proximity to oceans, navigable waters, the related logistic costs as well as the neighboring countries in terms of their wealth, markets size, relations etc. The historical legacy of a country is embedded in the structure of government agencies, companies and beliefs. It is said that Russia's inefficient company structures and poor experience with privatization in the early stages of transition, inhibits further reforms towards competitiveness.

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17 Ibid., p.9.

18 Ibid., p.10.

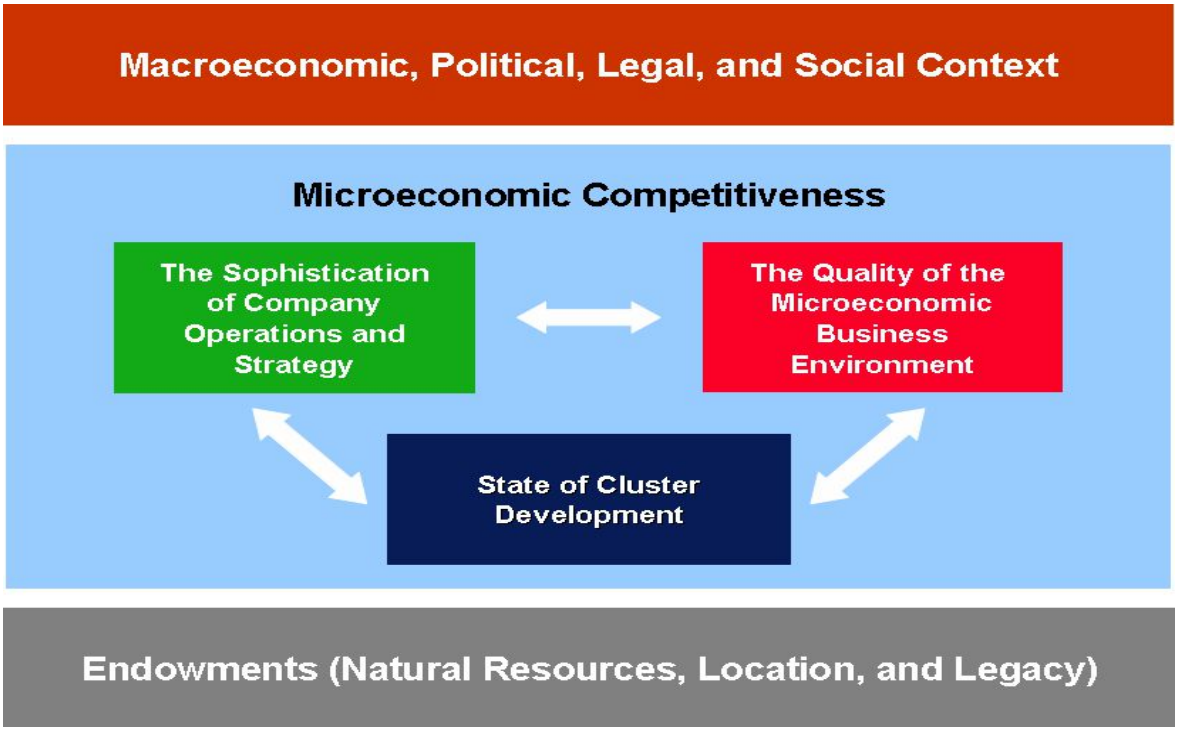

Figure 4: Determinants of Competitiveness (After: Michael E. Porter and Christian Ketels, "Competitiveness at the Crossroads: Choosing the Future Direction of the Russian Economy," p.10)

The second important determinant of national competitiveness in which citizens, companies, and government operate, is the macroeconomic, legal, political, and social context. A sound overall context of policies and institutions creates the potential for prosperity, but does not itself create prosperity. Policies especially in the areas of macroeconomics and governance, have dominated the literature on economic development. However, although they are necessary, they are not by themselves sufficient. Wealth is actually created at the microeconomic level and lies in the ability of firms to create valuable goods and services using efficient methods. Government or other societal institutions cannot create wealth whereas firms can. That is why the most important level of influences on productivity is considered to be the microeconomic competitiveness of the economy (the third determinant). This comprises three areas: the quality of the business environment, the state of cluster development, and the sophistication of company operations. The business environment includes all the inputs, incentives, rules, and supporting entities that directly influence productivity and innovativeness of company competition. The state of cluster development captures the linkages and externalities that occur among co-located firms, service

providers, supporting industries, and associated institutions in a particular field. The sophistication of company operations refers to its strategy, capabilities, operating practices and management choices. Regardless of how good the business environment or the strength of the cluster may be, it is eventually companies that actually fail or achieve productivity depending on their own abilities.

The microeconomic business environment consists of four interrelated areas as shown in Figure 7,

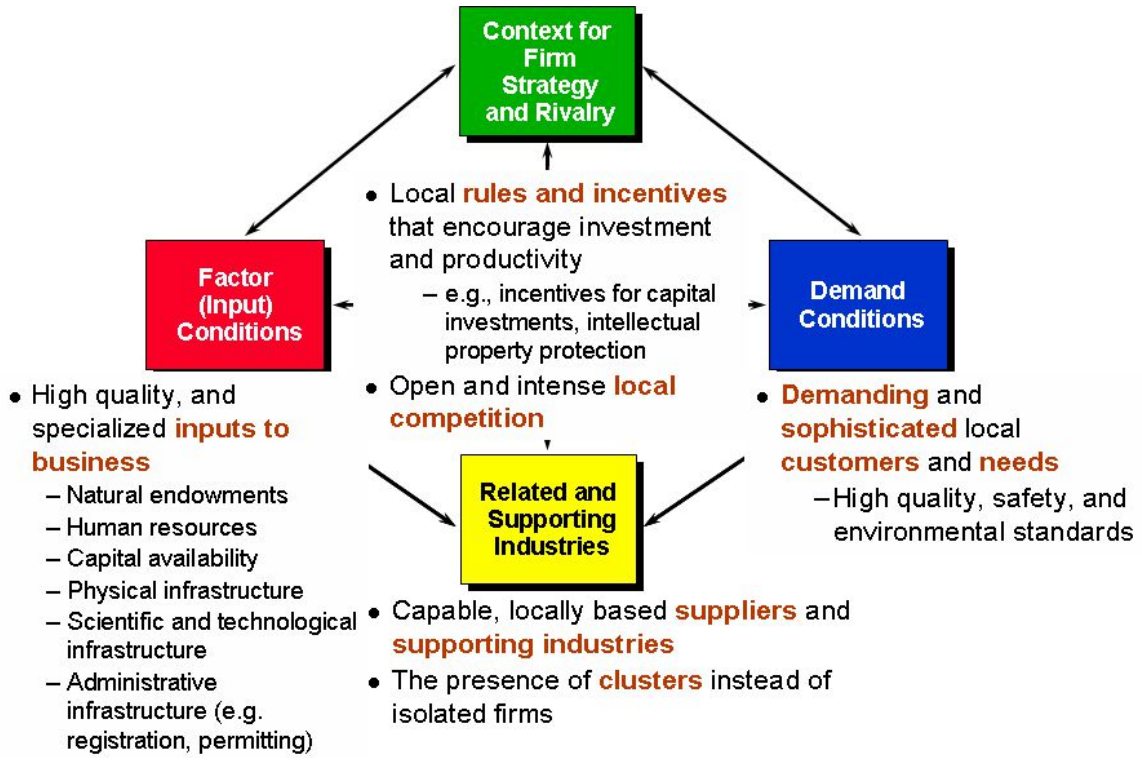

Figure 5: Quality of the Business Environment (After : Michael E. Porter and Christian Ketels, "Competitiveness at the Crossroads: Choosing the Future Direction of the Russian Economy," p.12.)

Factor conditions refer to the quality and availability of factor inputs, including government services and public infrastructure. The context for firm strategy and rivalry comprises the rules and incentives governing the nature of competition in the country. Related and supporting industries capture the presence of services providers, suppliers, and collaboration partners that create opportunities to specialize activities. Demand conditions are the needs and pressures derived from domestic customers to design products, improve

productivity, and innovate which can be influenced by consumer protection laws and government safety and environmental standards.[19]

Another factor that affects competitiveness is the influence of sub-national regions and the economic coordination with neighboring countries. Policies and circumstances at all geographical levels (national, regional, local), affect the quality of the business environment and the development of clusters. The differences at regional level create added complexity for governments to set appropriate policies that distinguish the needs of individual regions, especially for large countries and is particularly challenging if there is no strong legacy of independent regional governments as is the case in Russia. Productivity is also affected by the nature of economic relations with neighboring countries. Economic cooperation among neighbors is important for expanding trade and investment, linking clusters with complementary strengths and improving the business environment.[20]

ASSESSMENT APROACH

One way of assessing an economy is by using international benchmarking indicators. Benchmarking is a methodology of measuring the quality of decision making units (e.g. enterprises, organizations, countries) regarding programs, policies, strategies, products and performance metrics and comparing them with standard measurements or similar measurements of the best-in-class. With regard to enterprises the evaluation is made by comparing one's business processes and performance metrics to the bests of the industry or to best practices from other industries. Concerning countries, the assessment is conducted by comparing a country's policies, reforms and performance metrics to a group of participating economies in order to reveal the best practice economies and classify them in a ranking order according to a score gained, based on a methodological framework. Benchmarking can be useful in stimulating debate about policy by identifying weaknesses and areas where policy makers might look for good practices. The

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19 Ibid., p.12.

20 Ibid., p.18,19.

quantitative data used by the indicators, provide also a basis for analyzing how different policy approaches and reforms contribute to desired outcomes in terms of higher competitiveness, higher employment, growth, incomes etc.[21]

Some of the international benchmarking indicators most commonly used for the evaluation of a country's economy are:

a. The Corruption Perception Index (CPI) which scores and ranks countries based on how corrupted a country's public sector is perceived to be and the Global Corruption Barometer (GCB) which gauges public opinion on corruption in both public and private sectors.

b. The Index of Economic Freedom (IEF) which measures the economic freedom from different perspectives.

c. The Global Competitiveness Index (GCI) which captures many of the determinants that drive a country's competitiveness by including a weighted average of many different components, each measuring a different aspect of competitiveness.

d. The Ease of Doing Business (EDB) index which measures the business environment of countries and ranks them according to their scores.

In this study the evaluation of the competitiveness and business environment of the economy of Russia will be approached by the use of the last two aforementioned indexes (GCI and EDB) which are presented and analyzed in the next chapter.

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21 Papapanagos, "'International Economics Course' in International Relations & Security Postgraduate Program."

III. METHODOLOGY AND DATA

THE GLOBAL COMPETITIVENESS INDEX (GCI)

As analyzed in the previous chapter competitiveness is a comprehensive concept that includes many factors and aspects of an economy. According to the World Economic Forum (WEF) competitiveness is defined as “the set of institutions, policies, and factors that determine the level of productivity of a country”. The level of productivity, on one hand sets the level of prosperity that en economy can reach and sustain, and on the other hand determines the rates of return obtained by investments (physical, human, and technological) in an economy, which in turn determines its growth rate. Thus a more competitive economy can sustain a high level of income for its citizens and is the one that is likely to grow faster in the medium and longer term.[22]

Productivity can be defined as the ratio of output (goods and services) produced per unit of input (productive resources) over a period of time.[23] However, apart from the growth of an economy there are rising concerns about the income inequality within societies, the access of population to job opportunities and created wealth, as well as the consequences of growth to the environment. Policymakers, citizens and businesses, increasingly recognize the need for economic growth to be balanced and the need for a holistic approach by providing opportunities and benefits for all segments of the population and by being respectful to the environment. Thus, the social and environmental dimensions of an economy need also to be considered.

There are many determinants that drive productivity and competitiveness and there is an interrelation among many of them. Since 2005, the World Economic Forum has based its competitiveness measurement on a comprehensive tool that measures the macroeconomic and microeconomic

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22 WEF, “The Global Competitiveness Report 2014-2015,” p.4.

23 *Outline of the U.S Economy* (Office of International Information Programs U.S Department of State, n.d.), p.151, http://usinfo.state.gov.

foundations of national competitiveness called Global Competitiveness Index (GCI). GCI captures many of these determinants by including a weighted average of many different components, each measuring a different aspect of competitiveness.

These components are grouped into 12 pillars and each one of them is analyzed to thematic topics. The 12 pillars capture a variety of micro and macro economic factors that affect economic competitiveness and, as the determinants they attempt to capture, they are also interdependent thus weaknesses in one area may have negative impact on others.

THE PILLARS OF GCI INDEX

Below are presented the 12 pillars of GCI according to WEF[24]:

1st pillar: Institutions

The institutional environment is determined by the legal and administrative framework within which governments, companies and individuals interact to generate wealth. The recent financial crisis highlighted the importance of fair and sound institutions especially as the role of the state is becoming more increasing at the international level.

The quality of institutions influences significantly competitiveness and growth and affects investment decisions. For instance, owners of land, corporate shares, or intellectual property are not willing to invest in improvements and keep their property if their rights as owners are not protected. The institutional environment also goes far beyond the legal framework since the proper management of public finance and the government attitude towards markets and economic freedom plays a significant role in the economy. A situation characterized by corruption, bureaucracy, lack of transparency, overregulation, and dishonesty in dealing with public contracts and political dependence of the judicial system causes important costs and obstacles to businesses and retards

24 WEF, “The Global Competitiveness Report 2014-2015,” p.4–9.

the development of the economy. On the other hand, not only public but also private institutions are essential to reassure the correct functioning of the businesses as it seems from the recent global financial crisis along with the numerous corporate scandals. Sound accounting and reporting standards and transparency for preventing fraud and mismanagement are essential in good governance and establishing investors trust.

2nd pillar: Infrastructure

Extensive and efficient infrastructure is critical for the effective functioning of the economy. Well-developed infrastructure reduces the negative effect of distance among regions, integrates the national market and connects it at low cost to markets of other countries and regions. Quality roads, railroads, ports, and air transport, enable entrepreneurs to reach markets and transport their goods and services in a timely and secure manner as well as facilitate the movement of employees to jobs.

Economies also depend on uninterrupted electricity supplies so that businesses can work unimpeded. An extensive and reliable telecommunications network also allows for free and rapid flow of information, increasing the overall economic and business efficiency.

3rd pillar: Macroeconomic environment

This pillar evaluates the stability of the macroeconomic environment which is important for business and for the overall competitiveness of a country. Although macroeconomic stability alone cannot reassure the productivity of a nation, it is widely recognized that macroeconomic instability can harm the economy. A macroeconomic environment characterized by high interest-rate government payments for its past debts, running fiscal deficits and high volatile inflation does not constitute a favorable situation for the state to provide prosperity for its citizens and for the businesses to operate efficiently. Thus if the macroeconomic environment is not stable, an economy cannot function in a sustainable manner.

4th pillar: Health and primary education

Investment in health services is critical for economic and moral considerations. Workers who are ill cannot work efficiently, will be often absent and less productive causing increasing costs to businesses. Thus a healthy workforce is essential to a country's competitiveness and productivity as is also the basic education which increases the efficiency of workers. Lack or inadequate formal education can limit the performance of a worker only to simple manual tasks restricting him from adapting more advanced production processes and techniques having thus a negative effect towards devising innovations. In other words, inadequate primary education constitutes a constraint on business development and production of more sophisticated products.

5th pillar: Higher education and training

The globalizing economy requires employees with higher education and training, who are able to perform complex tasks and adapt quickly to the changing environment and its evolving needs. This pillar measures secondary and tertiary enrollment rates, the quality of education as evaluated by business community and takes also into consideration the extent of staff training. Higher education and training is important for economies that want to move up the value chain beyond simple production processes.

6th pillar: Goods market efficiency

Goods market efficiency means that the market is able to produce the right mix of products and services driven by the particular supply-and-demand conditions, and that ensures their effective trading in the economy. Market efficiency is driven by healthy market competition, both domestic and foreign, which ensures that the businesses that thrive are the most effective ones. The efficiency of goods market is also influenced by the government intervention that must be limited to the necessary extent in order not to distort the exchange of goods and impede the business activity. Foreign direct investment (FDI) for example can be hindered by discriminatory rules and heavy taxes. Protectionist measures also are counterproductive as they reduce aggregate economic activity.

The conditions of demand such as buyer sophistication and customer orientation can also drive the efficiency of the market by forcing companies towards innovation and the creation of competitive advantage.

7th pillar: Labor market efficiency

Labor market efficiency refers to the allocation of the workers ensuring their most efficient use and the existence of incentives to motivate them to perform their best. It refers also to the flexibility of a market with which it can change rapidly employees from one economic activity to another at a low cost and its resilience to wage fluctuations without great social disruption. Meritocracy and a clear relation between efforts and incentives, as well as equity between women and men in the business environment also count towards the efficiency of the labor market and attract talents.

8th pillar: Financial market development

An efficient financial sector allocates the economy resources to their most productive uses. It channels them to investment projects and entrepreneurial schemes with the highest expected rates of return rather than to those politically connected. A thorough and proper assessment of risk is therefore a key ingredient of a sound financial market.

Efficient financial markets presuppose also capital access to private- sector investments with appropriate financial products such as loans from a well-functioning banking sector, well-regulated security exchanges, venture capital etc under conditions of trustworthiness and transparency, as highlighted by the recent liquidity crunch that affected both businesses and public sector.

9th pillar: Technological readiness

The technological readiness pillar measures the agility with which an economy adopts existing technologies with specific emphasis on the use of information and communication technologies (ICTs) in daily activities and production processes for increased efficiency and innovation that in turn enhance competitiveness. ICT access and usage have become key enablers of countries'

overall technological readiness and infrastructure since it has a spill over effect to other economic sectors.

The ability of a society to absorb the existing technology is regardless of whether that technology has been developed abroad or within the country. Among the sources of foreign technology, FDI plays a key role, especially for countries at a less advanced stage. A distinction, however, needs to be made between the absorption of the existing technology which is available to firms from a country's ability to conduct research and develop new technologies for innovation that expand the frontiers of knowledge and are captured in the 12th pillar.

10th pillar: Market size

Market size allows firms to exploit economies of scale and affects productivity positively. Empirical evidence shows also that trade openness is positively associated with growth. Globalization and open trade have expanded the borders of markets thus international markets can be considered as an extension of domestic markets. International markets have become a substitute for domestic markets, especially for small countries and exports can be considered as a substitute for domestic demand in determining the size of the market for the firms of a country. This pillar includes both domestic and foreign markets giving thus credits to export driven economies and entities, such as the European Union, that are divided into many countries but have a single common market.

11th pillar: Business sophistication

Sophisticated business practices are contributing to higher efficiency in the production of goods and services, higher productivity and thus enhanced competitiveness. Business sophistication refers to two elements: the quality of a country's overall business networks and the quality of individual firms' operations and strategies. This is especially important for countries that are at an advanced stage of development when the more basic sources of productivity improvements have been virtually exhausted. This pillar measures the quantity and quality of local suppliers and the extent of their interaction. In other words, it refers to clusters which are interconnected companies and suppliers from a particular sector located in geographically proximate areas. Clusters, as said in the previous

chapter, increase the efficiency and create greater opportunities for innovation in processes and products. However, it is companies that produce wealth and this depends on the individual firms' advanced operations and strategies as far as marketing, distribution, branding, production processes, production of unique and sophisticated products are concerned. This in turn has a spill over effect to other companies and leads to sophisticated and modern business processes across the country's business sectors. Operations and strategy of a company belong to the microeconomic environment as shown if Figure 5 and 6 (Chapter II) and attempt to be captured by this pillar is made in part by relative questions of the WEF, Global Competitiveness Report 2014-2015," p.544 Executive opinion survey.

12th pillar: Innovation

Improving all the factors that are captured by the previous pillars such as institutions, infrastructure, macroeconomic stability, human capital, labor, financial, and goods markets can yield substantial gains but eventually will run into diminishing returns. From this level and on, only technological innovation can enhance the standards of living in the long run. Although less-advanced countries can still improve their productivity by adopting existing technologies or making improvements in other areas, for those that have reached the innovation stage of development this is no longer sufficient for increasing productivity. For economies that approach the frontiers of knowledge and the possibility of integrating and adapting exogenous technologies tends to be limited, Innovation is becoming particularly important. It must be clarified though that this pillar captures only technological innovation, whereas innovation in other areas such as production, processes etc is captured in the eleventh pillar. Technological innovation requires an environment that is conducive to innovative activity, supported by both the public and the private sectors with sufficient investment in research and development (R&D), the presence of high-quality scientific research institutions, extensive collaboration in research between universities and industry and the protection of intellectual property as well as access to venture capital and financing.

STAGES OF DEVELOPMENT

The above pillars are classified in three sub indexes as shown in Figure 6: a) Basic requirements, b) Efficiency enhancers c) Innovation and sophisticated factors.

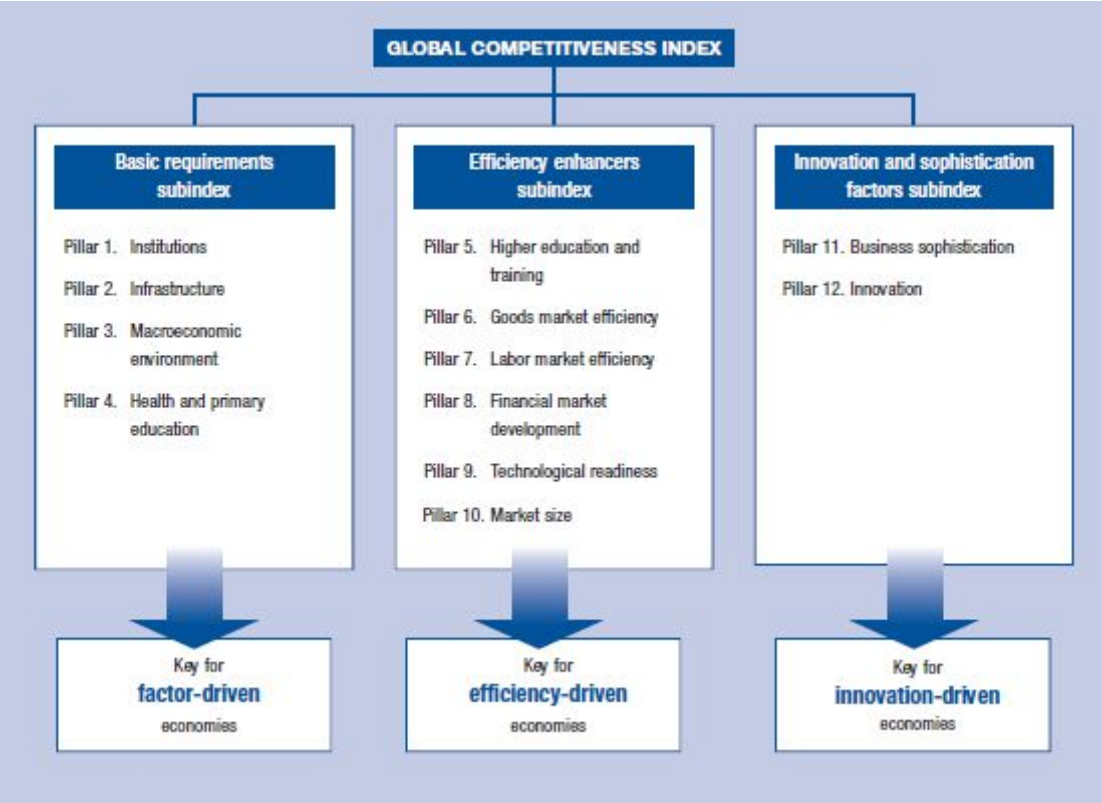

Figure 6 : The Global Competitiveness Index framework (After: "The Global Competitiveness Report 2014–2015," WEF, p.9).

Each one of the above sub indexes represents a stage of development. According to the economic theory of stages of development, the GCI assumes that economies in the first stage are mainly factor-driven and compete based on their factor endowments - mainly natural resources and unskilled labor. Companies compete on the basis of price and sell commodities or basic products at this stage, productivity is low, driven by pillars 1,2,3,4 and is reflected in low wages. As the country moves to the second stage its productivity and wages will increase as well as product quality and production processes efficiency. Its competitiveness then is becoming efficiency-driven and it increasingly depends on pillars 5,6,7,8,9, and 10. Finally, as countries move into the innovation-driven stage, standard of living and wages will have risen by so much that they can be sustainable only if their

businesses are able to compete with new and unique products, services, and processes. The production of new products with sophisticated processes is captured by pillar 11 and the innovation of new ones by pillar 12; that is why these two pillars are more critical for the competitiveness of an economy at this stage.[25]

The GCI index is the weighted average of the 12 pillars and the attributed weight to each sub index (and to the pillars they include) depends on the development stage of the economy. The concept is that higher weight is given to those pillars that are more critical for an economy according to the stage it belongs. The weights attributed to each sub index in every stage of development are shown in Table 3.

	STAGE OF DEVELOPMENT				
	Stage 1: Factor-driven	Transition from stage 1 to stage 2	Stage 2: Efficiency-driven	Transition from stage 2 to stage 3	Stage 3: Innovation-driven
GDP per capita (US$) thresholds*	<2,000	2,000–2,999	3,000–8,999	9,000–17,000	>17,000
Weight for basic requirements	60%	40–60%	40%	20–40%	20%
Weight for efficiency enhancers	35%	35–50%	50%	50%	50%
Weight for innovation and sophistication factors	5%	5–10%	10%	10–30%	30%

Table 3: Sub index weights and income thresholds for stages of development (After: WEF, "The Global Competitiveness Report 2014-2015," p.10)

For the purpose of allocation of countries into the stages of development two criteria are used: a) the level of GDP per capita at market exchange rates and b) the share of exports of mineral goods in total exports (goods and services). The second criterion is used to adjust for countries that are wealthy, but where prosperity is based on the extraction of resources and assumes that countries which export mineral products accounting for more than 70% of their total exports are to a large extent factor driven. Some resource-based economies, however, that have reached very high levels of income and are significantly wealthier than economies at the technological frontier, can afford to invest in innovation and are classified within the innovation-driven stage.

25 Ibid., p.10.

Countries that fall in between two of the aforementioned stages are considered to be “in transition’’, as is the economy of Russia which falls between 2nd and 3rd stage. As shown in Table 3, the attributed weights change smoothly as countries develop and move to the next stage, putting more weight on those areas that are becoming more important for the country’s competitiveness, and ‘’penalizing’’ gradually those countries that are not preparing for the next stage. The weight coefficients for Russia are: 25,5% for basic requirements sub index, 50% for efficiency enhancers sub index and 24.5% for innovation and sophistication sub index.[26]

For the estimation of GCI each pillar gets a score from 1,00 (reflecting worst performance) to 7,00 (reflecting the best) and then the weighted average is calculated according to the stage of development a country is at, using the respective weight coefficients. This overall score depicts the overall performance of the economy in terms of competitiveness. The closer the GCI index is to 7, the higher the competitiveness of a country and vice versa.[27]

DATA SOURCES

To measure the relevant concepts, the GCI uses statistical data obtained from internationally recognized agencies, particularly the United Nations Educational, Scientific and Cultural Organization (UNESCO), the World Health Organization (WHO) and the International Monetary Fund (IMF). Furthermore, to capture concepts that require a more qualitative assessment or for which internationally comparable statistical data are not available for the entire set of economies, the GCI uses data from the World Economic Forum’s annual Executive Opinion Survey (the Survey). The GCI scores and ranks of the participating countries is displayed in the Global Competitiveness Report which for the current year covers 144 economies.[28]

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26 Ibid., p.320.

27 Ibid., p.10.

28 Ibid., p.11.

REVIEW OF THE GCI

The GCI index has become widely recognized as an important tool for the assessment of competitiveness and has been used by policy makers of many countries. As the concepts it attempts to capture though, are evolving and partially vague, a review of the index is necessary in order for the required adjustments to be made. The WEF has already started this endeavor in 2013 to identify potential new measures and to include them in the index in order for it to remain a useful tool for policymakers, society and business leaders to measure and benchmark the drivers of competitiveness and prosperity of an economy, and identify the needed reforms and productive investments.[29]

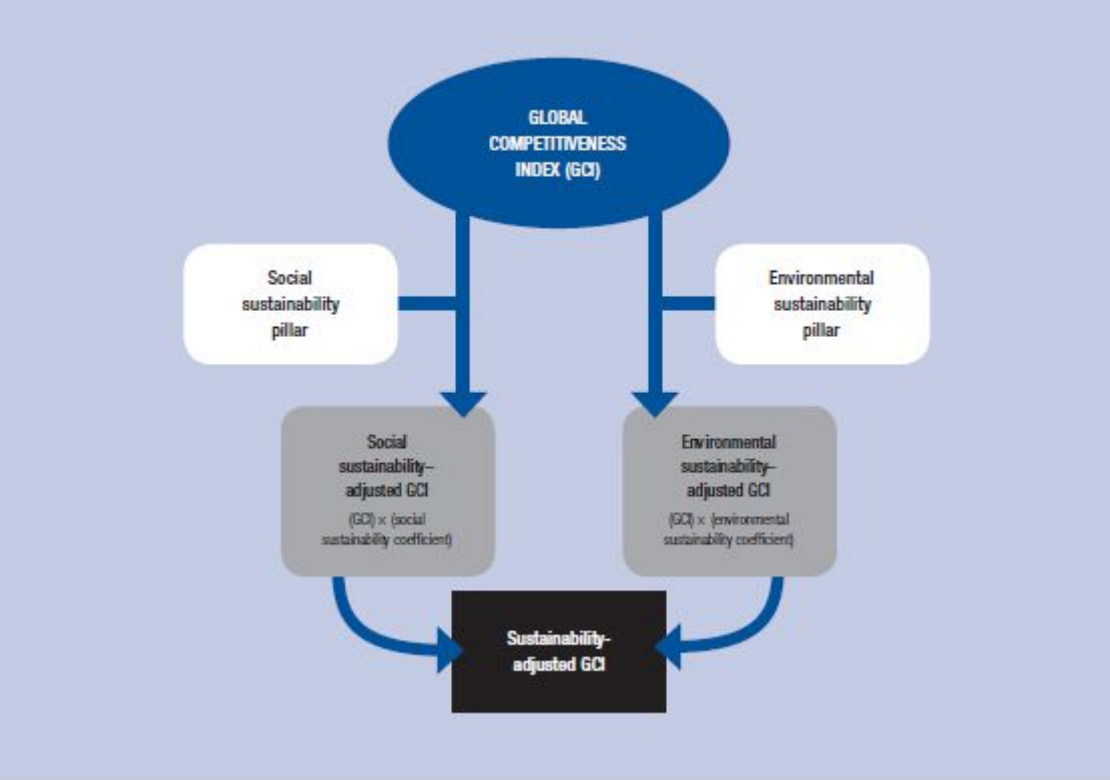

Figure 7: The structure of the sustainability-adjusted GCI (After: WEF, "The Global Competitiveness Report 2014-2015," p.64)

Towards that direction is the consideration of sustainable prosperity and competitiveness with the inclusion of the social and the environmental dimensions. Many attempts are being made to measure these two additional dimensions since

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29 Ibid., p.12.

it is increasingly understood that without social cohesion and environmental protection any achieved prosperity can not be long lasting. In order to address this issue, the WEF uses the simplified model displayed in Figure 7 and estimates the sustainability adjusted GCI by adding two pillars: the social sustainability pillar and the environmental sustainability one. These pillars are included in the calculation of the GCI in the form of coefficients, taking values from 0.8 to 1.2, and are each driven by three factors: the social sustainability pillar by access to basic necessities, vulnerability to economic exclusion and social cohesion, and the environmental pillar by the environmental policy, use of renewable resources and degradation of the environment.[30]

EASE OF DOING BUSINESS (EDB) INDEX

Economic activity requires sensible rules that encourage start ups and growth avoiding distortions in the market. The Doing Business project, which was initiated by the World Bank in 2003, attempts to measure the rules and regulations that can help the private sector thrive. Private sector creates wealth and without it no economy can provide a high and sustainable standard of living. The Doing Business data highlight the important role of the government and its policies concerning the domestic small and medium-size firms that conduce to growth and job creation for most economies, and measure the efficiency, accessibility and simplicity in the implementation of regulations. Doing Business promotes rules that facilitate the entrepreneurial activity by clarifying property rights, increasing the predictability of economic interactions, minimizing the cost of resolving disputes and providing protection against abuse. [31]

WHAT DOES EDB MEASURE

Doing Business attempts to measure several essential dimensions of the regulatory environment of the local firms and provides 2 main types of indicators:

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30 Ibid., p.65,66.

31 “Doing Business 2015 Going Beyond Efficiency 12th Edition,” Flagship Report (World Bank, n.d.), p.15.

those that broadly measure the complexity and cost of regulatory processes and those that measure the strength of legal institutions as shown in Table 4. Indicators of the first type promote efficiency in transactions handled by the government whereas indicators of the second type reflect better institutions for private sector development. Although labor market regulation is a topic of measurements by Doing Business, this year's report does not present that topic in the ranking of economies neither does it include it in the aggregate distance to frontier score.

Complexity and cost of regulatory processes	
Starting a business	Procedures, time, cost and paid-in minimum capital to start a limited liability company
Dealing with construction permits	Procedures, time and cost to complete all formalities to build a warehouse
Getting electricity	Procedures, time and cost to get connected to the electrical grid
Registering property	Procedures, time and cost to transfer a property
Paying taxes	Payments, time and total tax rate for a firm to comply with all tax regulations
Trading across borders	Documents, time and cost to export and import by seaport
Strength of legal institutions	
Getting credit	Movable collateral laws and credit information systems
Protecting minority investors	Minority shareholders' rights in related-party transactions and in corporate governance
Enforcing contracts	Procedures, time and cost to resolve a commercial dispute
Resolving insolvency	Time, cost, outcome and recovery rate for a commercial insolvency and the strength of the insolvency legal framework
Labor market regulation	Flexibility in employment regulation, benefits for workers and labor dispute resolution

Table 4: What Doing Business measures (After: Doing Business 2015 Going Beyond Efficiency 12th Edition," World Bank, p.15)

The choice of the Doing Business indicators has been guided by economic research and data, particularly from the World Bank Enterprise Surveys that highlight the main obstacles to business activity as reported by entrepreneurs in more than 120 economies. Doing business presents a ranking of participating economies and their distance to frontier score. The ranking of countries is a relative measure of regulatory performance since the total number of participating countries is fluctuating each year, but the distance to frontier (DTF) score aids in assessing the absolute level of a country's performance. DTF shows the distance of each economy to the "frontier," which represents the best performance observed on each of the indicators across all economies in the Doing Business sample. DTF allows users to see the gap between a particular economy's

performance and the best one, as well as to assess the absolute change in the economy's regulatory environment over time.[32]

Each indicator of Doing Business covers a different aspect of the regulatory environment. The rankings and DTF scores of each economy vary, often substantially across topics, showing thus that strong performance by an economy in one area of regulation does not necessarily mean similar performance also in other areas.

The data used for the purpose of this index are based on domestic laws, regulations and administrative requirements and cover 189 economies. They are collected through several rounds of interaction with expert respondents from private sector as well as government officials, through responses to questionnaires, written correspondence, conference calls and visits by the team of designated specialists. There are four main sources of information: the relevant laws and regulations, the Doing Business respondents, the governments of the economies and the World Bank Group regional staff.[33]

STRENGTHS AND LIMITATIONS

The Doing Business offers an easily replicable way of benchmarking business regulation and enables the comparability across a global set of economies. However, although it captures the key dimensions of regulatory framework it does not cover many important policy areas, and even within the areas it covers its scope is narrow. It does not measure all the factors, institutions and policies that affect an economy's business environment. It does not capture, for example, corruption and bribery, market size, macroeconomic stability or the strength of its financial system, the security of property from theft and looting, skills and training of the labor force or the strength of underlying institutions. Thus it should be complemented with other sources of information.

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32 Ibid., p.16.

33 Ibid., p.20.

In addition, it uses standardized case scenarios with specific assumptions which constitute part of its limitations. One such assumption is the location of a notional business in the largest city of the country, though in reality business regulations and their enforcement may differ, particularly in federal states and large countries, as is the case in Russia[34]. To address this limitation, this year's report covers also the second largest city in countries with more that 100 million population. Thus EDB measurements for Russia take into consideration Moscow and Saint Petersburg. Another assumption that limits the generalization measurements is that the standardized case scenario usually involves a limited liability company or its legal equivalent. In addition, there is the underlying assumption that entrepreneurs have full knowledge and comply with the applicable regulations though in practice they may not know what needs to be done resulting thus in loss of valuable time trying to find it out.

Despite the limitations due to the assumptions, the EDB index constitutes a tool that ensures comparability of data. Limiting assumptions are also common in many other economic indicators such as inflation or GDP without preventing the widespread use of these indicators. Another strength of the index is that it not only identifies where problems exist in the regulatory framework but also points to specific regulations or procedures that needs reform. This is a significant contribution to the policy makers in order to change the incentives under which businesses operate.

THE PILLARS OF EDB INDEX

The Ease of Doing Business Index is based upon 10 pillars that are briefly described below. The ranking of each pillar is calculated as the average of the percentile rankings of its respective component indicators:[35]

1st pillar: Starting a business

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34 Evgeny Yakovlev and Ekaterina Zhuravskaya, "The Unequal Enforcement of Liberalization: Evidence from Russia's Reform of Business Regulation," October 23, 2011, p.135, http://ssrn.com/abstract=965838.

35 "Doing Business 2015 Going Beyond Efficiency 12th Edition," p.117–144.

This pillar measures the ease of starting a business in an economy by recording all procedures required by an entrepreneur to start up and operate an industrial or commercial business (SME). This includes obtaining all necessary permits and licenses and completing all required inscriptions, verifications and notifications with authorities to enable the company to formally operate. It also records the time and cost required to complete these procedures as well as the minimum capital that must be deposited before registration (or within 3 months). Cost and paid in capital is expressed as percentage of income per capita. The ranking of economies on the ease of starting a business is the average of the percentile rankings on each of the above components (procedures, time, cost, minimum paid in capital).

2nd pillar: Dealing with construction permits

This pillar records all the procedures required for an entrepreneur in the construction industry to build a warehouse in the largest business city. These include submitting all relevant project documents to the authorities, obtaining all necessary clearances and permits, submitting all required notifications and receiving all necessary inspections. Procedures for obtaining utility connections for water and sewage water and sewerage are included, as well as the time and cost required to complete each procedure. The ranking for an economy for this pillar is the average of the percentile rankings for each of the aforementioned components of the pillar (procedures, time, and cost).

3rd Pillar: Getting Electricity

This pillar records all procedures required for a local business to obtain a permanent electricity connection for a standardized warehouse, as well as the required time in days and the respective cost as a percentage of income per capita. These procedures include applications and contracts with electricity utilities, clearances from other agencies and the external and final connection works. It is assumed that the warehouse is located in the largest business city, in an area where electricity is most easily available.

4rth Pillar: Registering Property

This pillar records the procedures necessary for a business to purchase property from another business and transfer the property title to the buyer's name, as well as the required time in days and the respective cost expressed as a percentage of the property value. The transaction is considered complete when the buyer can use the property, sell it or use it as collateral for a bank loan.

5th Pillar: Getting credit

This pillar assesses the sharing of credit information and the legal rights of borrowers and lenders concerning to secured transactions through 2 sets of indicators. The depth of credit information index that refers to rules and practices that affect the coverage and accessibility of credit information available through a credit registry or bureau, and the strength of legal rights index which measures whether rights of borrowers and lenders and protection of secured creditor's rights exist within the collateral and bankruptcy laws. The ranking for this pillar derives from the average of the ranking of the aforementioned component indexes.

6th Pillar: Protecting Minority investors

This indicator measures the strength of protection of minority investors from conflicts of interest related to mismanagement of the corporate. The score is the average of scores for the extent of conflict of interest regulation index and the extent of shareholder governance index. Protecting minority investors affects the ability of companies to raise the capital they need to grow, innovate and compete.

7th Pillar: Paying Taxes

This pillar measures the number of taxes and mandatory contributions that a local medium-sized company must pay in a given year, the administrative burden of paying taxes and contributions as a percentage of a company's profit before taxes, as well as the required time in hours per year to comply with tax laws.

8th Pillar: Trading Across borders

This pillar measures the number of documents necessary to export and import a standard shipment of goods by sea transport, as well as the time and cost

associated with it, excluding tariffs, and the time and cost for sea transport. The indicators cover predefined stages such as documentation requirements and procedures at customs and other regulatory agencies as well as at the port. They also cover trade logistics, including cost and time of inland transport to the largest business city.

9th Pillar: Enforcing Contracts

This pillar measures the efficiency of the judicial system in resolving a commercial dispute in the local courts. It has three component indicators: The number of procedures to enforce a contract through courts, the required time in days and the total associated cost as a percentage of the claim.

10th Pillar: Resolving insolvency

This pillar refers to the time, cost and outcome of insolvency proceedings involving domestic legal entities. These variables are used to calculate the recovery rate for creditors, which is expressed as cents on the dollar recovered by secured creditors through reorganization, liquidation or foreclosure proceedings.

In addition, this pillar evaluates the adequacy of the legal framework that is applied to liquidation and reorganization proceedings through the strength of insolvency framework index. The index tests if the economies adopted good practices in four areas: commencement of proceedings, management of debtor's assets, reorganization proceedings and creditor participation. The ranking of this pillar is based on the recovery rate and the total score of the strength of insolvency framework index.

11th Pillar: Labor Market Regulation

This pillar measures the flexibility in the regulation of employment and especially how it affects the hiring and redundancy of workers and the rigidity of working hours. This year's report does not include rankings of economies on this topic, neither is this considered in their aggregate DTF score or ranking on the EDB index, but presents the data for the labor market regulation indicators in an annex.

COMPUTATION OF EDB

The overall EDB index averages the country's percentile rankings on the first 10 pillars described above, which as shown are made up of a variety of indicators, giving equal weight to each pillar and ranks the participating economies. If a country attains a high ranking on the EDB index it means that its regulatory environment is more conducive to start ups and operations of local firms.

Governments have increasingly focused on reforming business regulations to maintain competitiveness in an increasingly globalized economy and Doing Business provides one source of objective data that give useful insights into good practices worldwide. Since 2003 more than 600 regulatory reforms have been implemented that had been highlighted by Doing Business.[36]

RELATIONSHIP BETWEEN VARIABLES

In order to approach the relationship between two variables the statistical concept of coefficient of correlation (r) will be used. Coefficient of correlation takes values between -1 and +1. The positive sign (+) means that there is a similar trend between two variables in increase or decrease, whereas the negative (-) implies the existence of the opposite trend. When the coefficient equals to 1 it means that there is a perfect linear relationship between the two variables and when it equals to 0 it means that there is no linear relationship. All other values are judged according to the proximity to 1 or 0. Thus, the closer the value of coefficient to 1, the stronger the linear relationship between the two variables is and vice versa. Furthermore, in order to see the trend line through the points of a scatter diagram, the method of least squares will be used which produces a straight line so that the sum of squared deviations between the points and the line is minimized.[37]

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36 Ibid., p.21.

37 Gerald Keller and Brian Warrack, *Statistics for Management and Economics*, 6th ed. (USA: THOMSON BROOKS/COLE, 2003), p.118,124.

IV. EVALUATION OF COMPETITIVENESS AND BUSINESS ENVIRONMENT

As mentioned in Chapter II, the evaluation of Russia's economy will be approached with the use of GCI and EDB benchmarking indicators which are analyzed in the previous chapter. For the purpose of this analysis, a consideration of the relative groups (BRIC, CIS, BS-10) Russia belongs to is made, focusing though more on the BS-10 due to geographic proximity of Russia and the historic, social, economic and cultural binds and similarities. China is also taken into consideration due to the magnitude of its economy and the neighboring with Russia. Comparisons are also made with EU and USA since the latter is currently considered to be a superpower and has the largest economy in the world in terms of GDP.

BS-10 is generally characterized by a high level of corruption and bureaucracy, the former is almost double comparing to the EU-28, which constitutes a serious barrier to establishment of new enterprises and attraction of FDI. Most economies of the region are also transition economies. The service sector contributes with a rate of 59,5% to the total GDP of the region, which is relatively low in comparison with the advanced economies where it exceeds 70%. The tertiary sector in Russia contributes 58,3% to its GDP. The secondary sector (Industry) contributes to the total GDP at 31,7% (in Russia 37,5%) which is very high in comparison to EU and USA with rates at 26% and 19,5%, respectively. Last, the participation of the primary sector in BS-10 is very high, amounting to 8,9% (4,2% in Russia), due to the ecosystem of the region.

Russia, which was a centrally planned economy, is in the broader process of transition to a market economy based upon the rules of supply and demand. Economies that are under this transition are subject to an economic liberalization where the forces of the market, not the Government, drive prices and trade barriers are lifted. Transition economies facilitate the privatization of state owned enterprises and resources, as well as the creation of a financial system which supports the movement of the labor force and capital from the public to the private sector of the economy.

The transition process includes liberalization of the economic activity, effective redistribution of resources, development of the required tools a market economy uses, fiscal constraints for macroeconomic stability and economic effectiveness. It includes also the creation of transparent rules for the entrance of new enterprises in the market as well as development of an institutional and legal context for the protection of intellectual property.

EVALUATION OF COMPETITIVENESS

In order to position Russia in the broader international economic environment, we see (in Table 5) that over the time Russia's GCI score increased from 3,6 points in 2002/3 to 4,4 points in 2014/15 with intermediate fluctuations. It's score though, is constantly below the EU-28, USA and China and slightly above the BS-10 from 2006/7 and on.

	2002/3	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
EU-28 av.	4,4	4,6	4,8	4,7	4,9	4,7	4,7	4,7	4,5	4,7	4,7	4,7	
USA	5,9	5,8	5,8	5,8	5,6	5,7	5,7	5,6	5,4	5,5	5,5	5,5	5,6
China	4,4	4,2	4,3	4,1	4,2	4,6	4,7	4,7	4,8	4,7	4,8	4,8	4,9
BS-10 av.	3,6	3,7	3,8	3,6	4	4	4	4	4	4,1	4,1	4,2	4,2
Russia	3,6	3,5	3,7	3,5	4,1	4,2	4,3	4,2	4,2	4,2	4,2	4,3	4,4

Table 5: GCI scores, BS-10 region, 2002/3-2014/15. (After: WEF, "The Global Competitiveness Report 2014-15 and Harry Papapanagos, "'International Economics Course' in International Relations & Security Postgraduate Program" (International Benchmarking Indicators, UOM, 1st_Semester 14-15).

After China, Russia ranks higher though in 2014/15 among the other countries of the BRIC, as shown in Table 6.

With regard to CIS group, Russia has a similar or higher score by pillar than the average of CIS as shown in Figure 8, except institutions, financial market development and goods market efficiency where it scores slightly lower, indicating that these sectors are among its weaker areas.

In the same sectors (viz. institutions, financial market development, goods market efficiency) Russia scores lower as well comparing to BS-10 average, as shown in Figure 9. Additionally, it scores lower in technological readiness.

The Global Competitiveness Index 2014-2015	Global rank*
China	28
Russian Federation	53
South Africa	56
Brazil	57
India	71

Source: The Global Competitiveness Report 2014-2015
Note: * 2014-2015 rank out of 144 economies

Table 6: BRICS, GCI index rank, 2014-2015.

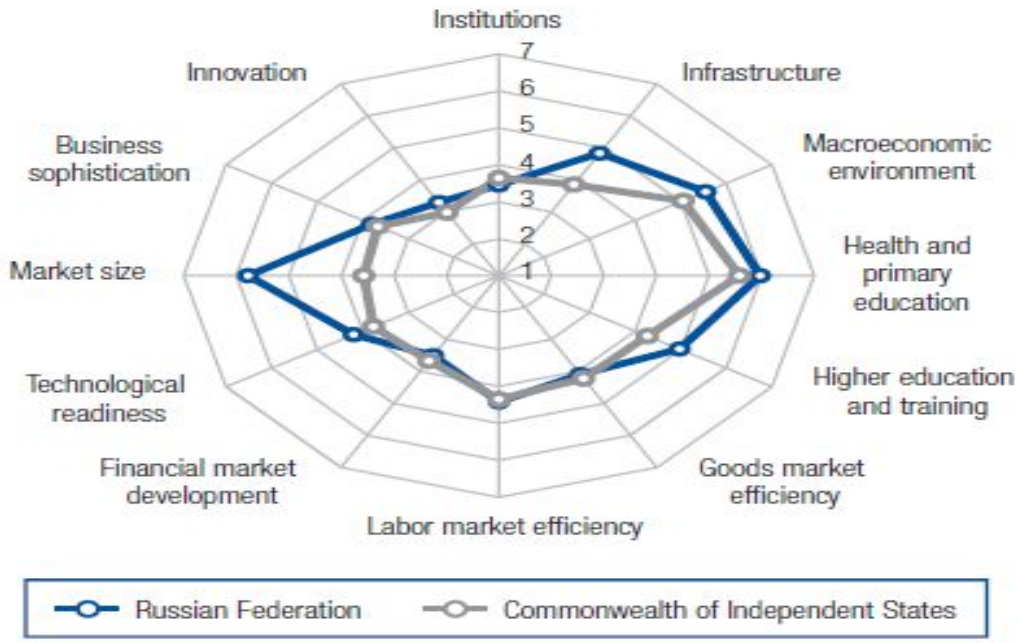

Figure 8: Russia-CIS, GCI index score by pillar 2014-15. (After: WEF, "The Global Competitiveness Report 2014-15,p.320)

As shown in Table 7, among the BS-10 countries Russia has gained 11 positions in the total GCI ranking over the period from 2002 (64th) to

2014/15(53rd), after Azerbaijan (31 positions up), Turkey (24 positions up) and Georgia (25 positions up), while Azerbaijan and Turkey stand also higher in the 2014-15 GCI ranking. Green and blue highlighted countries stands for the best and worst performers, respectively. Except 2008/09 Russia was never the best performer of the region. Total ranking though over the time, must be considered as a relative gauge since the total number of participating countries differs each year.

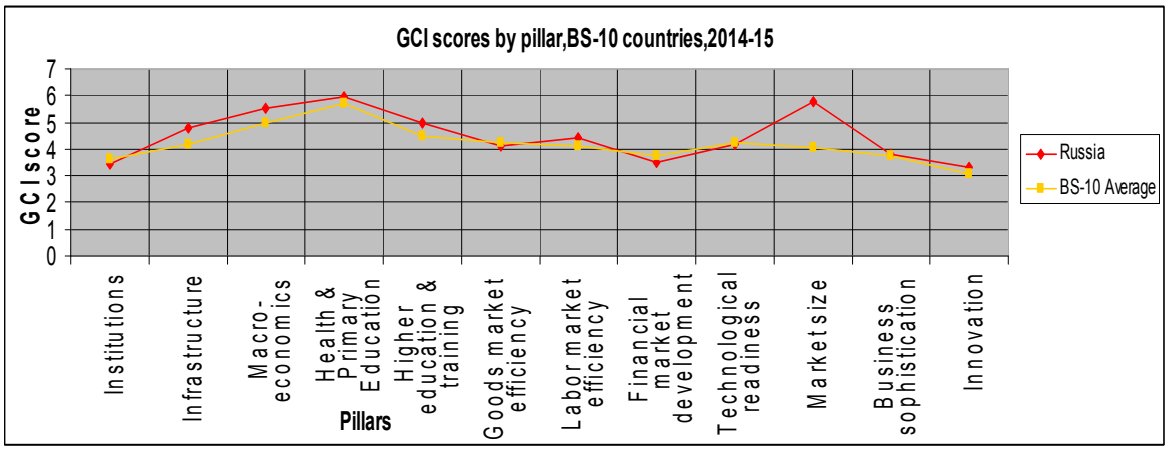

Figure 9: GCI scores by pillar, BS-10 countries, 2014-15

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2002-15
Armenia	-	-	-	79	82	93	97	97	98	92	82	79	85	-6
Azerbaijan	-	-	-	69	64	66	69	51	57	55	46	39	38	31
Bulgaria	62	64	59	58	72	79	76	76	71	74	62	57	54	8
Georgia	-	-	94	86	85	90	90	90	93	88	77	72	69	25
Greece	38	35	37	46	47	65	67	71	83	90	96	91	81	-43
Moldova	-	-	-	82	86	97	95	-	94	93	87	89	82	0
Romania	66	75	63	67	68	74	68	64	67	77	78	76	59	7
Russia	64	70	70	75	62	58	51	63	63	66	67	64	53	11
Turkey	69	65	66	66	59	53	63	61	61	59	43	44	45	24
Ukraine	77	84	86	84	78	73	72	82	89	82	73	84	76	2
Countries	80	102	104	117	125	131	134	133	139	142	144	148	144	

Table 7: GCI Rank, BS-10 countries, 2002/3-2014/15. (After: Ibid.Papapanagos, "'International Economics Course' presentation in 'International Relations & Security" Postgraduate Program. 2014-15"

	Basic Requirements				Efficiency Enhancers						Innovation	
Pillars	Institutions	Infrastructure	Macro-economics	Health & Primary Education	Higher education & training	Goods market efficiency	Labor market efficiency	Financial market development	Technological readiness	Market Size	Business sophistication	Innovation
Armenia	72	78	77	99	75	64	74	97	71	118	93	104
Azerbaijan	60	70	9	104	90	72	33	89	56	72	80	59
Bulgaria	112	74	36	51	63	63	67	60	41	63	105	105
Georgia	48	59	48	63	92	60	41	76	67	103	113	121
Greece	85	35	135	41	44	85	118	130	39	49	74	79
Moldova	98	112	125	65	68	81	42	124	81	120	115	106
Romania	88	85	46	88	58	89	90	64	47	45	90	66
Russia	97	39	31	56	39	99	45	110	59	7	86	65
Turkey	64	51	58	69	50	43	131	58	55	16	50	56
Ukraine	130	68	105	43	40	112	80	107	85	38	99	81
USA	**30**	**12**	**113**	**49**	**7**	**16**	**4**	**9**	**16**	**1**	**4**	**5**
CHINA	**47**	**46**	**10**	**46**	**65**	**56**	**37**	**54**	**83**	**2**	**43**	**32**

Table 8: GCI Pillar rank out of 144 countries, BS-10 countries, 2014-15 (After: WEF, "The Global Competitiveness Report 2014-15")

		Basic Requirements				Efficiency Enhancers						Innovation	
Pillars	GCI Overall Score	Institutions	Infrastructure	Macro-economics	Health & Primary Education	Higher education & training	Goods market efficiency	Labor market efficiency	Financial market development	Technological readiness	Market size	Business sophistication	Innovation
Armenia	**4,01**	3,82	3,83	4,62	5,33	4,2	4,37	4,2	3,71	3,72	2,75	3,73	2,95
Azerbaijan	**4,5**	3,96	4,12	6,41	5,24	3,9	4,31	4,59	3,77	4,26	3,66	3,86	3,33
Bulgaria	**4,37**	3,32	4,06	5,45	6,03	4,49	4,37	4,24	4,17	4,73	3,87	3,61	2,94
Georgia	**4,22**	4,21	4,31	5,14	5,84	3,89	4,4	4,49	3,9	3,85	2,98	3,49	2,71
Greece	**4,04**	3,64	4,88	3,31	6,15	4,84	4,2	3,74	2,97	4,79	4,34	3,91	3,18
Moldova	**4,03**	3,22	3,68	4,91	5,4	4,08	4,07	4,11	3,7	4,38	2,6	3,35	2,53
Romania	**4,3**	3,56	3,65	5,2	5,51	4,63	4,18	4,04	4,12	4,49	4,44	3,77	3,28
Russia	**4,37**	3,45	4,82	5,54	5,97	4,96	4,09	4,42	3,5	4,19	5,77	3,79	3,29
Turkey	**4,46**	3,9	4,55	4,83	5,75	4,69	4,6	3,48	4,21	4,27	5,31	4,31	3,42
Ukraine	**4,14**	2,98	4,16	4,14	6,14	4,93	3,99	4,12	3,54	3,5	4,58	3,66	3,16
BS-10	**4,24**	**3,61**	**4,21**	**4,96**	**5,74**	**4,46**	**4,26**	**4,14**	**3,76**	**4,22**	**4,03**	**3,75**	**3,08**
USA	**5,54**	**4,69**	**5,82**	**4,01**	**6,06**	**5,82**	**5,05**	**5,3**	**5,35**	**5,78**	**6,94**	**5,58**	**5,49**
CHINA	**4,89**	**4,22**	**4,66**	**6,41**	**6,08**	**4,42**	**4,42**	**4,55**	**4,3**	**3,53**	**6,86**	**4,38**	**3,91**

Table 9: GCI Pillar score, BS-10 countries, 2014-15 (After: Ibid.)

At a closer look by pillar, as shown in Table 8 and Table 9 , it seems that Russia is the outperformer of BS-10 in higher education and market size, whereas it lags in all the other pillars. This implies that there is room for progress with comparison even to the countries of its geographic neighborhood. In comparison with USA, Russia ranks lower in all pillars except macroeconomic sector where USA has exceeded the debt limit of 100% of its GDP.

More specifically, Russia ranks 97th out of 144 countries in the institution pillar which is a very low position reflecting the existing problem with its institutional framework. It scores 3,45, below its overall GCI score of 4,37 and also below the average of the BS-10 (3,61). The ranks and the respective scores in the sub indexes of this pillar are disappointing. Starting from the protection rights, the protection of intellectual property, the judicial interdependence, the bribes, the efficiency of legal framework in setting disputes, the reliability of police services, the organized crime, the protection of minority shareholders interest where it ranks over 100th place, to public trust in politicians, favoritism in decisions of government officials and wastefulness of government spending, it seems that corruption has penetrated broadly in the institutional context and there is much room that has to be covered for the improvement of the overall competitiveness. Institutions affect many other sectors and it seems that this is the root problem of Russia's competitiveness, a legacy from its centralized planned economy.

Infrastructure of Russia is in a relatively good condition since it scores 4,82, higher than its overall GCI score, as well as higher than the BS-10 average which amounts to 4,21. Its strong points are the sufficient fixed lines, mobile subscriptions and available airline seats but it needs improvement in the quality of electricity supply, port and airport infrastructure and especially in the road network.

Russia has a very low debt (13,4% of GDP) and deficit (-1,3% of GDP) but a slightly increased inflation (6,8%) that has to be taken care of. Its overall macroeconomic situation is strong.

In health and primary education Russia scores 5,97 - slightly higher than the average of BS-10 (5,74) but lower than China (6,08). With regard to health, Russia does not present a good situation since the 91 tuberculosis cases/100.000

population and the 1,1% HIV prevalence of adult population ranks her at the 89th and 110th position respectively, and 95th as far as life expectancy is concerned. These numbers imply a problematic health and social security system. The situation in primary education appears better, since its quality and the 96,2% of enrollments classifies the country at the 57th and 54th position respectively. In higher education and training Russia ranks much higher (39th), being first in the BS-10 region and surpasses also China (65th). Its 76,1% tertiary enrollment classifies her high at the 19th position; it has sufficient internet access at schools but lags in quality of management schools (104th).

The country ranks very low in goods market efficiency (99th), lower than the average of BS-10, and China (56th). It presents insufficient local competition (74th) and anti monopoly policy (102nd), high tax rate (50,7%) which has a very negative effect on incentives for investments (122nd). The disappointing situation completes the prevalence on trade barriers (111th) and tariffs (102nd) which along with the business rules has a negative impact on FDIs (118th) and the existence of foreign ownership (124th). The 22,1% imports of its GDP are also very high classifying the country at the 133rd position. In essence, Russia seems to intentionally apply this policy in favor of particular domestic enterprises.

In terms of labor market efficiency the country has a relatively good position (45th) presenting flexibility in wage determination (28th) and good connection with productivity (24th), sufficient ratio of women to men in labor force (41st) and hiring-firing practices (41st). The heavy taxation, however, has a negative effect on incentives to work (115th), the cooperation of employers with employees is not satisfactory (89th) and the country faces serious difficulty in attracting (92nd) and retain (103rd) talents.

Financial market development is the weakest pillar of the country, since it ranks 110th, lower than any other of its pillars, below the BS-10 average which implies a problematic financial sector. Financing through local equity market is not effective, banks do not function well (118th), and the legal rights are very weak.

With respect to technological readiness Russia stands in the 59th position, having sufficient mobile and fixed broadband subscriptions and usage of internet

by individuals but lags in availability of latest technologies (108th), FDI and technology transfer (123rd) and absorption by local firms (98th).

Market size is the strongest pillar of Russia. It achieves the best score in the BS-10 and ranks 7th due to its 142,9 million population and the 2.556,2 US$ billion GDP (PPP). The large market enables the creation of economies of scale and constitutes an important comparative advantage of the country. However, its 27,8 % exports to GDP is low, ranking the country 104th.

The weakness of the country in terms of goods market efficiency (99th) and financial market development (110th), contributes highly to the degradation of its overall GCI ranking, since the two relative pillars that are included in the efficiency enhancers sub index, participate with a weight of 50% in the computation of GCI. Thus Russia, is “penalized” because it is not prepared enough in the aforementioned sectors according to its stage of development.

Last, in terms of business sophistication and innovation, which are two interrelated sectors the country presents a rather medium performance (86th and 65th respectively) above the BS-10 average. As far as business sophistication is concerned, it ranks low in production processes (92nd) , the quality and quantity of local suppliers is not sufficient, as well as their networking, resulting in a low score at cluster development (118th) which is a very important factor for the competitiveness of the country. The nature of competitive advantage score is also low as it is based on the natural resources and not on sophisticated methods. Concerning innovation, the research institutions of the country are not among the best, not a lot of funds are spent in research and development and the collaboration between universities and industry is not strong. The availability of scientists and engineers also is not high, since as mentioned above the country lacks behind in retaining and attracting talents.

In addition, concerning the sustainability adjusted GCI index Russia faces also difficulties. Especially in the environmental area, the country attains an intermediate performance in both pillars for second consecutive year. In terms of social sustainability, it is still characterized by high and increasing inequality, a relatively weak social safety net and limited social mobility. Concerning

environmental sustainability, regulations are still weakly enforced and only a low percentage of the water (21%) drawn is treated. Although today Russia is endowed with one of the largest water reserves in the world, this low treatment rate could be a reason of water stress in the future. The country has high emissions, especially CO2, and fish stocks are diminishing. As a result, to ensure prosperity in the long run the country should better manage its natural environment. 38

EVALUATION OF BUSINESS ENVIRONMENT

With respect to ease of doing business, Russian Federation followed a downward route, as shown in table 10, from 2006 to 2011 and then an upward one gaining 35 positions totally since 2006. In the 2015 EDB report, Russia stands at the 62nd position among 189 countries with Georgia being the champion among the BS-10 countries for 8 consecutive years from 2008.

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2006-15
Armenia	37	34	39	39	43	61	55	32	37	45	-8
Azerbaij.	100	99	96	96	38	69	66	67	70	80	20
Bulgaria	59	54	46	46	44	57	59	66	58	38	21
Georgia	112	37	18	18	11	17	16	9	8	15	97
Greece	111	109	100	100	109	101	100	78	72	61	50
Moldova	88	103	92	92	94	99	81	83	78	63	25
Romania	71	49	48	48	55	65	72	72	73	48	23
Russia	97	96	106	106	120	124	120	112	92	62	35
Turkey	84	91	57	57	73	73	71	71	69	55	29
Ukraine	132	128	139	139	142	149	152	137	112	96	36
Countries	178	178	181	183	183	183	185	185	189	189	

Table 10: EDB, country rank, BS-10, 2006-2015. (After: Papapanagos, "'International Economics Course' in International Relations & Security Postgraduate Program." 2014-15)

According to the same report, Russia also surpasses in general rank the other BRIC countries as shown in Figure 10, with China following at the 90th position, but

38 WEF, "The Global Competitiveness Report 2014-2015," p.71.

it lags behind EU (36th) and USA (7th) as shown in Table 12.

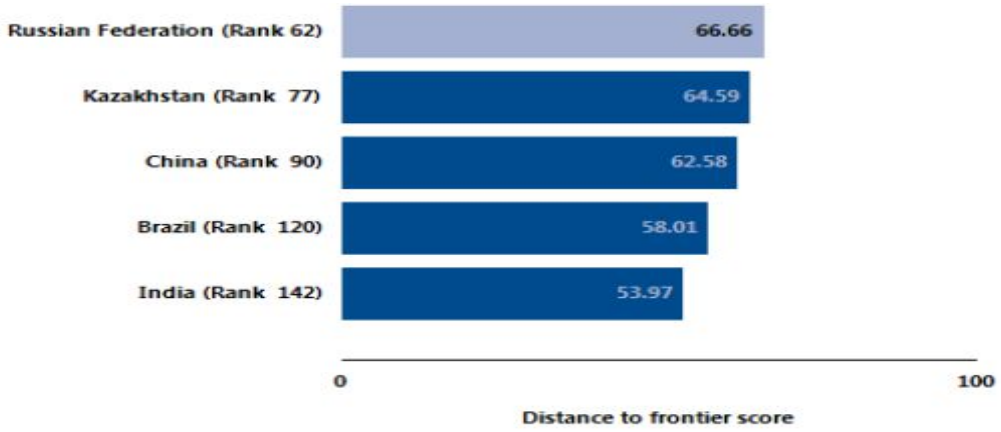

Figure 10: Russia and comparator economies, EDB rank and DTF.(After: Doing Business 2015, Going Beyond Efficiency, Economy Profile 2015, Russian Federation,12th Edition, p.8)

Within the BS-10 region, the country presents a mixed picture as shown in Figure 11, lagging behind in dealing with construction permits, getting credit, protecting investors and trading across borders, resulting in an overall EDB DTF score of 66,66 (Table 11), below the average of the region which amounts to 68,63.

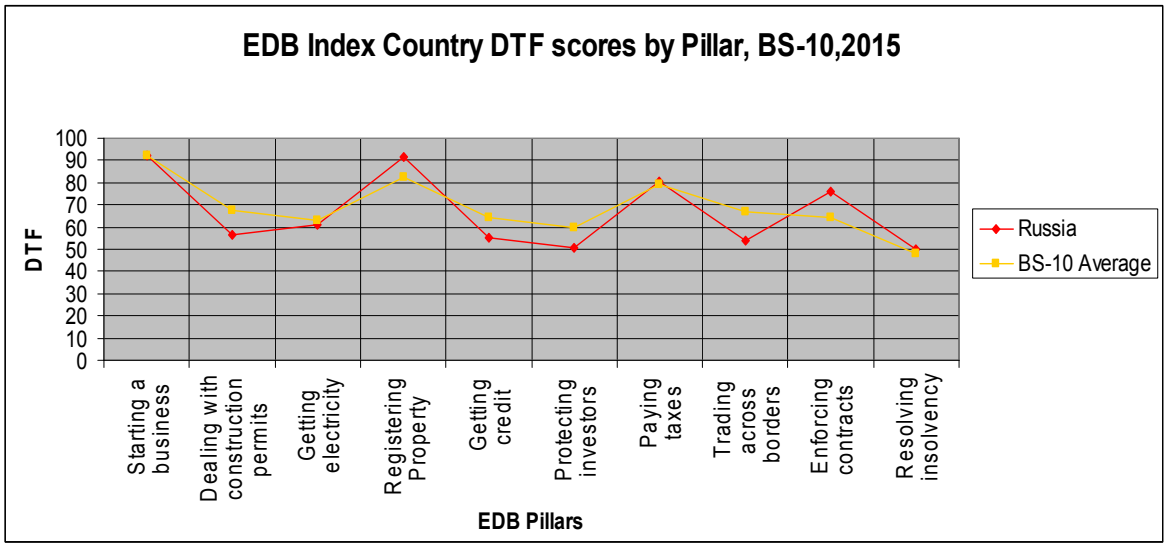

Figure 11: EDB, Russia-BS10, DTF scores by pillar, 2015

	EDB Overall DTF Score	Starting a business	Dealing with construction permits	Getting electricity	Registering Property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency
Armenia	70,6	97,77	73,78	64,02	93,03	65	60	82,1	68,81	53,33	48,14
Azerbaijan	64,08	95,54	59,89	55,69	92,3	40	59,19	83,77	42,37	69,02	43,02
Bulgaria	71,8	91,09	69,85	65,78	75,36	70	68,33	73,18	78,34	61,27	64,75
Georgia	79,46	97,73	91,44	84,69	99,88	85	60,83	82,76	84,02	71,82	36,48
Greece	66,7	90,71	72,31	76,67	61,16	50	57.50	78,3	80,8	43,6	55,98
Moldova	66,6	92,16	48,11	59,73	86,1	70	58,33	76.57	54,97	66,68	53,32
Romania	70,22	91,93	62,17	46,03	74,39	85	61,67	80,09	77,23	64,95	58,7
Russia	66,66	92,17	56,7	60,89	91,27	55	50,83	80,63	53,58	75,85	49,69
Turkey	68,66	86,86	63,1	85,12	76,38	45	69,17	79,8	73,26	67,92	40
Ukraine	61,52	87,35	75,29	32,65	74,82	75	48,33	70,33	53,96	66,25	31,17
BS-10 Av	68,63	92,33	67,26	63,13	82,47	64,00	59,63	79,00	66,73	64,07	48,13
EU	73,57	89,91	72,82	76,36	75,16	58,21	60,98	80,02	84,52	67,91	69,81
USA	81,98	91,22	78,87	79,52	89,92	95	65,83	80,84	88,25	67,26	90,12
CHINA	62,58	77,43	43,75	66,35	80,67	50	45	67,44	71,68	68,21	55,31

Table 11: EDB Index, country DTF scores by pillar, BS-10, 2015. (After: World Bank, Ease of Doing Business, Report 2015).

Looking at the EDB ranking by pillar in Figure 12, it seems that apart from the 4 aforementioned weaknesses, Russia also lags behind in getting electricity which puts her in the very low position of 143.

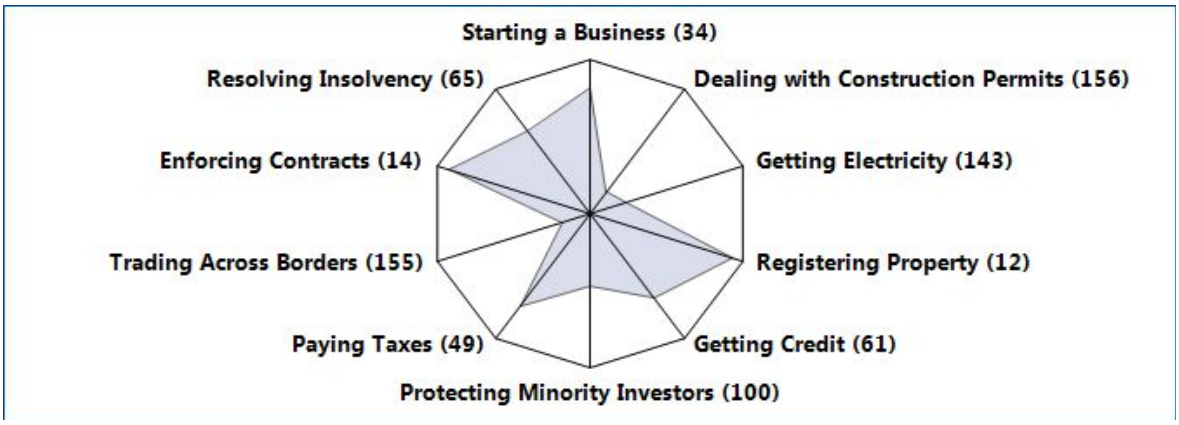

Figure 12: Russia, EDB Rank by pillar. 2015 (After: World Bank, Ease of Doing Business, Report 2015, Economy Profile, Russian Federation.p.9).

	EDB Index Rank (out of 189)	Starting a business	Dealing with construction permits	Getting electricity	Registering Property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency
Armenia	45	4	81	131	7	36	49	41	110	119	69
Azerbaijan	80	12	150	159	10	104	51	33	166	31	94
Bulgaria	38	49	101	125	57	23	14	89	57	75	38
Georgia	15	5	3	37	1	7	43	38	33	23	122
Greece	61	52	88	80	116	71	62	59	48	155	52
Moldova	63	35	175	149	22	23	56	70	152	42	58
Romania	48	38	140	171	63	7	40	52	65	51	46
Russia	62	34	156	143	12	61	100	49	155	14	65
Turkey	55	72	136	34	54	89	13	56	90	38	109
Ukraine	96	76	70	185	59	17	109	108	154	43	142
EU	36	53	82	78	62	55	48	56	34	48	33
USA	7	46	41	61	29	2	25	47	16	41	4
CHINA	90	128	179	124	37	71	132	120	98	35	53

Table 12: EDB rank by pillar, BS-10, 2015. (After: World Bank, Ease of Doing Business, Report 2015).

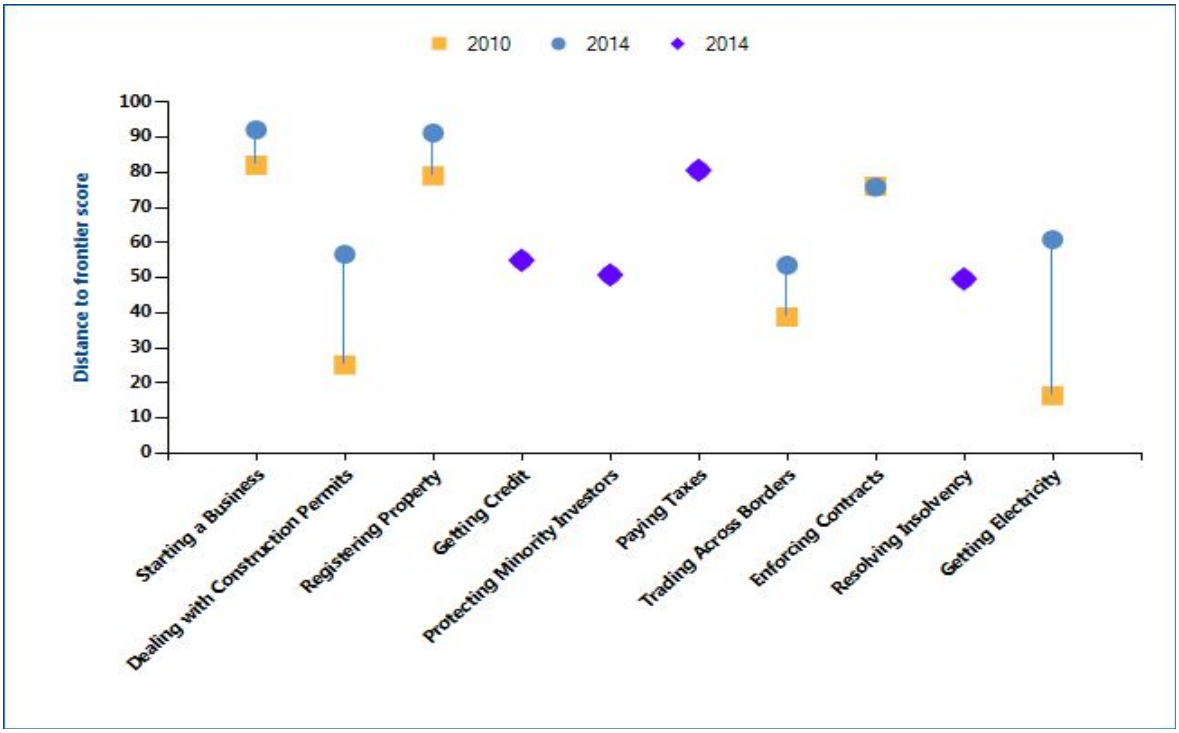

Figure 13: Russia, DTF score improvement by pillar. (After: World Bank, Ease of Doing Business, Report 2015, Economy Profile, Russian Federation.p.10).

However, no matter where it stands, Russia has proceeded also to implement reforms that improved the situation of its economy in starting a business, dealing with construction permits, registering property, trading across borders and getting electricity, as shown in Figure 13.

At a closer look, starting a business in Russia requires 4,4 procedures, takes 11,2 days, costs 1,2% of income per capita and does not require paid in minimum capital, which ranks the country at a relatively good position (34th), above China(128th), USA(46th) and EU(53rd). To achieve this score, Russia made starting a business easier in the last two years by abolishing the requirement to have the bank signature card notarized before opening a company bank account and eliminated the requirement to deposit the charter capital before company registration as well as the requirement to notify tax authorities of the opening of a bank account.

In dealing with construction permits the country has the worst ranking (156th) in comparison with its other pillars, obtaining a very low DTF score of 56,7 below the BS-10 average, USA and EU. This score is due to the big number of required procedures (19,8) and the long time of 238,4 required days, as well as their respective cost of 1,9% of an assumed warehouse value to be build. However, the situation was even worse in the past, as shown in Figure13, and the current standing point is the result of reforms Russia made by implementing a single window for all procedures related to land use (DB 2011), eliminating requirements for several preconstruction approvals (DB 2013) and other requirements for project approvals from government agencies as well as reducing the time required to register a new building (DB 2014).

The situation is also disappointing in getting electricity as the country ranks 143rd, obtaining a DTF score of 60,89- below BS-10 average (63,37), China (66,35), USA (79,52) and EU(76,36). The situation was much worse in 2010, as shown in Figure 13, and the current situation is the outcome of reforms implemented making the process less costly by revising the tariffs for connection (DB 2012), setting standard connection tariffs and eliminating many procedures (DB 2014). According to the Doing Business report 2015, getting electricity requires 5,6 procedures, takes 179.1 days and costs 321% of income per capita.

In registering a property, however, Russia attains the best ranking (12th) among its other pillars, surpassing the BS-10 average as well as China (37th), USA (29th) and EU (62nd). Completing the whole process requires 3 procedures, 19 days and costs 0,1% of the property value. The country made registering a property easier by reducing the required time introducing cadastral passports in place of the previous inventory documents and cadastral maps (DB 2010). It eased also the property transfers by eliminating the requirement to obtain cadastral passport on land plots (DB 2012), streamlining procedures and implementing effective time limits for processing transfer applications (DB 2014). In addition, it eliminated the requirement for notarization and introduced tighter time limits for completing the property registration (DB 2015).

In getting credit the country ranks 61st - below EU (55th), USA (2nd) and BS-10 average but above China. The economy has a score of 7 on the depth of credit information index and a score of 4 on the strength of legal rights index which are generally weak results. These results are also connected with the inefficiency of financial system that was identified in the analysis of the GCI index above.

Protection of minority investors is also weak since it ranks 100th, much below USA (25th), EU (48th) and the BS-10 average. This is mainly due to low liability of directors and weakness in governance structure.

In paying taxes though Russia presents a relatively good performance since it stands at 49th place - surpassing EU (56th), China (120th) and a little behind USA (47th). It's DTF score (80,63) is also higher than that of the BDS-10 average (79). On average, firms make 7,0 tax payments a year spending 168 hours for filing, preparing and paying taxes and the total tax rate amounts to 48,9% of profit. The country implemented reforms in the recent years, reducing the corporate income tax rate (DB 2010), increasing the social security contribution rate for employers (2012) which had a negative impact, eased the administrative burden of taxes for companies by simplifying compliance procedures for value added tax and by promoting the use of tax accounting software and electronic services (DB 2013).

Trading across borders is the second worst ranking (155th) EDB pillar of Russia's economy. The country stands much below the EU (34th), USA (16th),

China (98th) as well as the BS-10 average. This is due to the fact that exporting a standard container of goods in Russia requires 9 documents, takes 21,1 days and costs $2400,5 while importing the same container requires 10 documents, takes 19,4 days and costs $2594,5. The numbers imply that the whole process of importing or exporting is cumbersome despite the relative reforms made, reducing the number of documents needed for export/ import transactions, lowering the associated cost (DB 2012) and implementing an electronic system for submitting export/ import documents as well as reducing the number of physical inspections (DB 2014) which resulted in a small improvement over time as shown in Figure 13.

In enforcing contracts, however, the country has the best DTF score (75,85) within the BS-10 region ranking 14th out 189 economies, outstripping also EU(48th) USA(41st) and China(35th). Contract enforcement in Russia requires 35 procedures, takes 267 days and costs 14,9% of the value of the claim, which implies an efficient process of resolving a commercial dispute. The country made filing a commercial case easier by introducing an electronic case filing system (DB 2012).

In resolving insolvency Russia has a mediocre position (65th) - below EU (33rd), USA (4th) and China (53rd) but above the BS-10 average. The whole process takes 2 years on average and costs 9% of the debtor's estate, with the most likely outcome being that the company will be sold as piecemeal sale and the recovery rate is 43 cents on the dollar. Relative reforms have been made by introducing several changes to the country's insolvency law to speed up the liquidation procedure and strengthen the legal status of secured creditors (DB 2010) as well as by a series of legislative measures in 2009 to improve creditor rights and the insolvency system (DB 2011).

FINDINGS - DEFICIENCIES

From the above benchmarking analysis, with the use of GCI and EDB indexes, a series of weaknesses were identified that hold up the Russian economy and constitute comparative disadvantages.

In terms of competitiveness, institutional framework seems to be the main problem since it affects many other areas and has a spillover effect. A major

overhaul will be needed in order to eradicate corruption and favoritism and establish trust in the judiciary. The weak financial market contributes negatively to the situation and a stronger and more stable financial system is needed. Goods market inefficiency is also highlighted. Reinforcement of SME's, cluster development and diversification of the economy is needed in order to boost the market, and further the business sophistication and innovation. Technological readiness is also not sufficient enough. These challenges prevent the country from taking advantage of its competitive strengths, which are based on a well-educated population, high levels of ICT use, and its potential for innovation. Furthermore, the impact of the Ukraine conflict, the economic sanctions imposed by certain countries, the potential disruptions to the gas trade, the weakening domestic demand and the uncertainty regarding future prices for mineral commodities could further affect the country's competitiveness. Given the reliance of the education and innovation sectors on public funding which will become more limited, these implications could be especially serious. Access to technology developed abroad will also be negatively affected by the inefficient funding.

More less the same deficiencies are identified in the lately published GCI report 2015-16, though some improvements have been marked in the regulatory business environment, domestic competition and import tariffs, reflecting the government's attempt to ameliorate the domestic conditions for doing business. This latest report places Russian economy a little higher (45th) than the previous one, but this improvement is mostly due to the revision of PPP estimate by the IMF, which automatically increases Russia's GDP about 40% valued at PPP. However, structural deficiencies in institutions, financial market development as well as goods market efficiency remain the sticky points that Russia has to overcome in order to achieve higher prosperity.[39]

As for ease of doing business in Russia, the EDB benchmarking analysis identified also a series of weaknesses. Dealing with construction permits and getting electricity seem to hold back the construction of premises for the purposes

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39 WEF, "The Global Competitiveness Report 2015-2016" (World Economic Forum, n.d.), p.30.

of a new company. Weaknesses in sharing of credit information and legal entrenchment between lenders and borrowers retard also startups. In addition, the cumbersome trade across borders contributes negatively to the development of entrepreneurship.

Apart from the above findings, according to a related survey, among the most problematic factors for doing business in Russia is corruption, high tax rates, access to financing, tax regulations and inefficient government bureaucracy (Figure14).

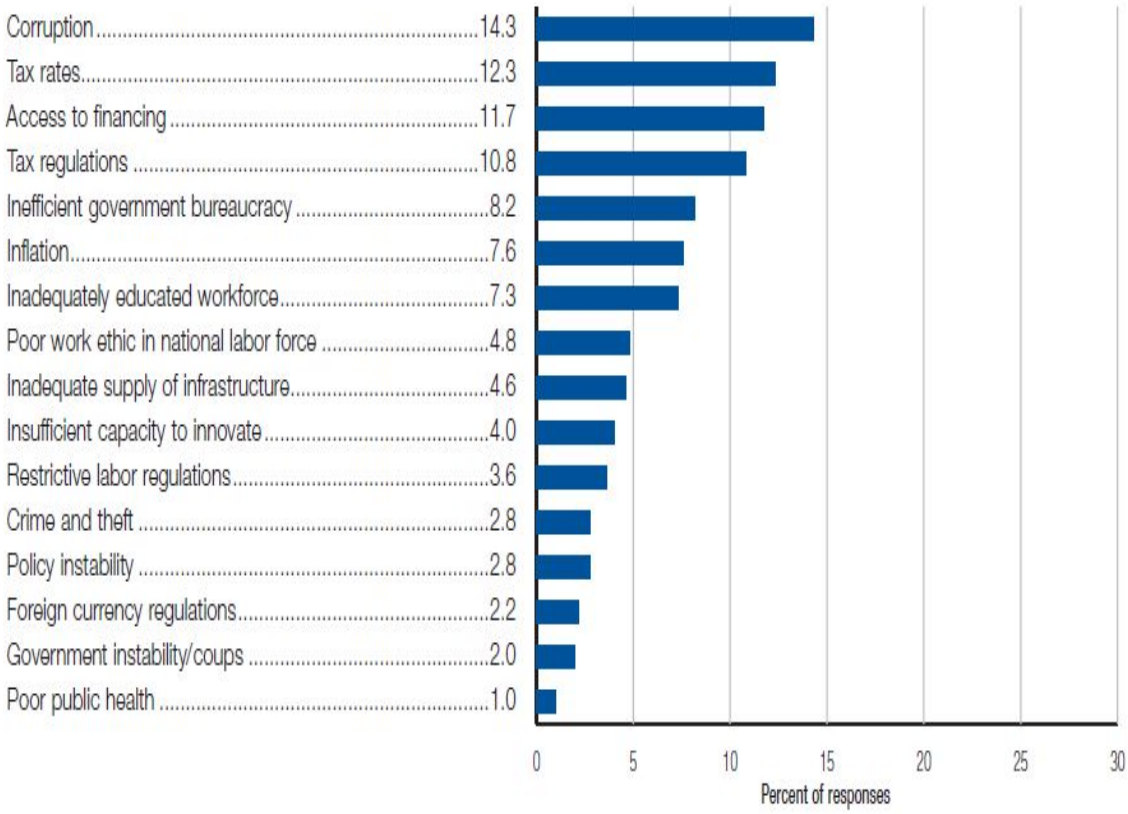

Figure 14: The most problematic factors for doing Business in Russia. (After: WEF, The Global Competitiveness Report 2014-15,p.320)

GDP- GCI - EDB RELATIONSHIP

In order to further analyze Russia's economy in terms of competitiveness, and business environment, we examine the possible relationship between these concepts and growth. As mentioned in the two previous chapters of this paper, competitiveness is considered to be the set of institutions, policies and factors that determine the level of productivity, which in turn sets the level of prosperity an economy can sustain as well as the rates of return obtained by investments in that

economy, which sets the drivers of its growth rate. Thus, high competitiveness is likely to be the fundamental driver for a faster growing economy in the long term. Furthermore, a well regulated and established business environment is likely to attract new businesses and increase the entrepreneurial activity resulting thus in higher growth rates. In order to measure the growth of the economy, we use the real GDP growth rate which is a widely acceptable indicator and measures the GDP change rhythm taking into account the inflation rate.

For the purpose of this comparison, Table 13 was created. As country ranking is a relative measure of where an economy stands, we use the GCI scores and EDB DTF scores in order to approach the real performance of the economy and how it evolved over time.

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Real GDP Growth rate (%)	4,7	7,3	7,2	6,4	8,2	8,5	5,2	-7,8	4,5	4,3	3,4	1,3	1,3
GCI	3,64	3,46	3,68	3,53	4,08	4,19	4,31	4,15	4,24	4,21	4,2	4,25	4,4
EDB									54,84	54,25	56,65	58,63	65,04

Table 13: Russian Economy, Real GDP growth rate, GCI scores, EDB DTF scores. (After: Papapanagos, Section I & III "'International Economics Course' presentation, International Relations & Security Postgraduate Program." 2014-15 & www.doingbusiness.org/custom-query).

Examining initially the possible relationship between GCI and EDB for the Russian economy we find that the sample correlation coefficient amounts to + 0, 93 as we see in Table 14, which implies a strong positive linear relationship.

	2010	2011	2012	2013	2014
EDB	54,84	54,25	56,65	58,63	65,04
GCI	4,24	4,21	4,2	4,25	4,4

Correlation	EDB	GCI
EDB	1	
GCI	0,930537	1

Table 14: Russian Economy, GCI scores - EDB DTF scores, Correlation

This is a logical outcome, because as seen from the description of the pillars of these two indexes in chapter III, they have some overlapping areas (they both deal with the issue of taxes for example) and capture different facets of the economy aiming though both at the amelioration of it. Thus, they can be used complementary to each other in order to have a better picture of the economic environment.

Furthermore, with the use of least squares method we estimate the trend line (Figure 15) and the respective linear equation (y= 0,017 x + 3,2584) which best fits the points drawn from the sample data concerning GCI and EDB of table 14. It can be seen that for every 1 point increase in EDB DTF score, Russia's GCI score increases about 0,017 points, or for every 10 points increase in EDB DTF score an increase of 0,17 points in GCI score is expected for the Russian economy.

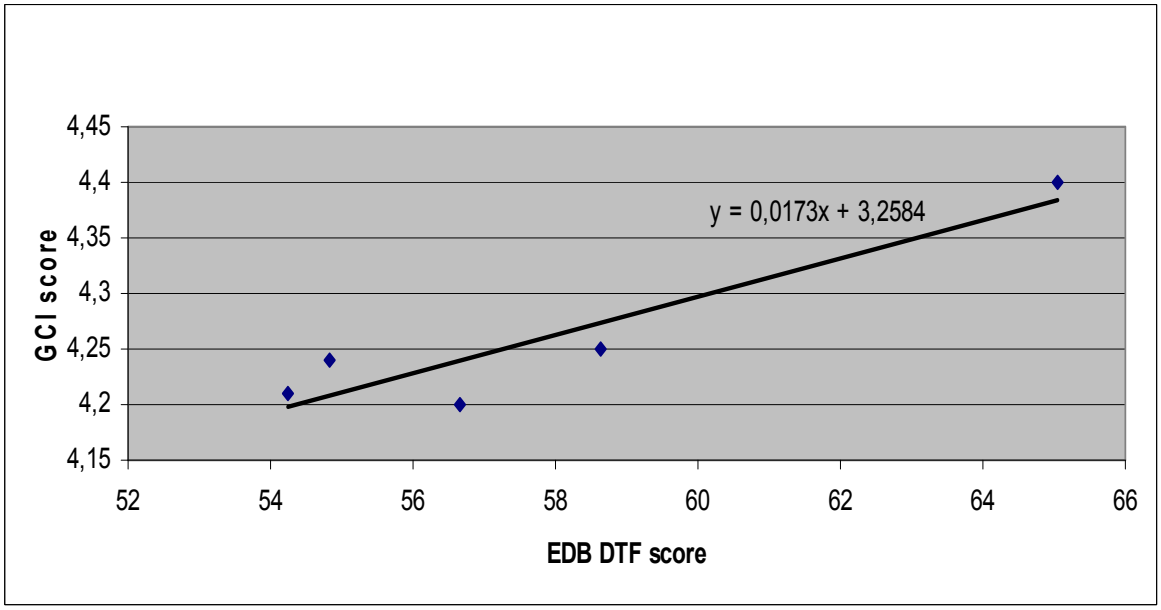

Figure 15: Russian Economy, EDB-GCI relationship.

In other words, improving the business environment by increasing the efficiency, accessibility and simplicity of regulations applying to the domestic SME's through their life cycle, increases also the competitiveness of the economy.

In order to estimate the relationship between real GDP growth rate on the one hand and GCI and EDB on the other, coefficient of correlation was computed

between them using the sample data from Table 13 and the results are shown in Table 15.

Correlation	*Real GDP Growth*	*GCI*
Real GDP Growth	1	
GCI	-0,3686473	1

Correlation	*Real GDP Growth*	*EDB*
Real GDP Growth	1	
EDB	-0,84897765	1

Table 15: Correlation, Real GDP growth rate vs GCI score – EDB DTF score.

The results show a negative weak association between real GDP growth and GCI scores (coefficient of correlation = – 0,36) and a negative strong relationship between GDP growth and EDB DTF scores (coefficient of correlation = – 0.848). These results are in contrast to what would be expected and imply a possible distortion, since as mentioned above competitiveness should conduce to higher productivity and growth. Similarly, ease in doing local business is supposed to facilitate entrepreneurial activity contributing to an increase of growth as well.

Among the possible explanations that could be given to the above paradoxical results is that the GCI index, though a useful tool of measuring competitiveness, it does not capture completely all aspects of the concept. Similarly, the EDB index focuses only on domestic small and medium sized firms in the largest city and does not measure all aspects of the business environment that matter to firms and investors or all factors that affect competitiveness. For instance, it does not account for an economy's proximity to large markets, the security of property from theft and looting, the strength of its financial system, the strength of underlying institutions or the macroeconomic conditions. The fact, that it also takes into consideration the situation of the two largest cities, Moscow and Saint Petersburg, although better than previously considering only the largest city, does not necessarily represent the absolute picture of the whole country, especially of a vast country as is the case with Russia. Thus, both indexes have limitations in scope and should be complemented with other sources of information in order to have the full spectrum of business environment.

Another explanation for the inconsistent results could be that GDP as a measure does not necessarily capture the magnitude of the whole economic

activity. According to a study concerning the social structure of Russia[40], a remarkable part of economic life of the country's regions is hidden from the Government. About 40% of the Russian able-bodied population is employed in the informal sector of the economy and the number of entrepreneurs is much bigger than in official statistics. Informal businesses have become a special type of life support for a considerable part of the population in some communities and helps people to survive economic crises, currency devaluation, inflation and other macroeconomic shocks. It includes seasonal work, subsistence production, distributed manufacturing and 'garage production'. Seasonal work is the basis of survival for 20 to 50% families in the Russian provinces and is closely connected to local small entrepreneurship. It usually evolves due to inadequately high costs of governmental regulation barriers to people's economic activities which causes outflow of potential entrepreneurs into the grey economy. 'Garage production' is shadowy, unregistered production of goods and services, which are situated mainly in garage complexes. It is estimated that 30% of all PVC window frames in Ulyanovsk for example, as well as a lot of spare parts for imported cars, are produced in garages and all this happens outside the formal economy. These phenomena have historical roots and they were widespread in Tsarist Russia as a means of survival for people in the provinces. They were eliminated later in the Soviet times, by the industrial economy and compulsory employment, but as soon as times changed, society remembered these old ways of living and went back to them. This considerable economic activity of the population remains out of sight not only for state statistics and control, but also is not regulated either by local or by federal government. It seems that this informal structure and economy is convenient for both the people and the Government. Informal employees survive crises and don't protest against cuts in state expenditure on health care and education since they solve their problems by using their own efforts and money, and Government although loses taxes, saves on social security payments.

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40 Simon Kordonsky and Yury Pliusnin, "Life of the Russian Regions Is Hidden from the Government," OPEC.ru Research-based analysis and commentary by experts of Higher School of Economics (HSE, Moscow), *OPEN ECONOMY*, accessed August 25, 2015, http://opec.ru/en/1835186.html.

Another reason for the seeming distortion could be the unequal and inconsistent application of the measures taken by the Government across the regions of the country. As an example could be mentioned, according to a relevant study[41], the unequal enforcement of liberalization reform of business regulation across Russian regions with different governance institutions, which led to unequal effects of liberalization. National liberalization laws (aiming at reducing costs to firms associated with inspections, licensing and registration) were enforced more effectively in sub-national regions with more transparent government, a higher concentration of industry, a more informed population, and stronger fiscal autonomy. The ensued result is that liberalization had a substantial positive effect on the performance of small firms and growth of the official small businesses sector in regions with stronger governance institution whereas in regions with weaker governance institutions no effect of reform or even a negative one was observed. This result can explain the negative correlation coefficient that is computed above, in the present paper, between EDB and GDP growth rate as well as between GCI and GDP growth rate, since EDB affects GCI due to their strong positive correlation.

From the aforementioned the issue of corruption, bribery and inappropriate governance is also raised. According to a research pertaining public contracts in Russia, corruption in allocation of procurement is the main channel of illegally transferred cash (tunneling) that is likely to be directed to politicians in exchange for allocation of procurement. The political cycle in tunneling among firms with government procurement contracts is particularly pronounced in notoriously corrupt regions. The result is that less productive firms are more likely to win public procurement contracts in more corrupt regions and therefore the allocation of public procurement is less efficient under corruption. As a result, the managerial skills needed to run a firm efficiently do not help win procurement contracts in

41 Evgeny Yakovlev and Ekaterina Zhuravskaya, “The Unequal Enforcement of Liberalization: Evidence from Russia’s Reform of Business Regulation,” October 23, 2011, p.1,7–8.

corrupt areas and vice versa - political capital that helps win procurement contracts is not useful in running companies efficiently.[42]

Relevant to corruption is the threat and intimidation against companies, named as “corporate raid”. Although international literature usually defines this term as an ‘unfriendly takeover’ of a firm without legal violation, raiding in Russia is different due to the frequent use of force. Corporate raids are often accompanied by unlawful criminal prosecution of entrepreneurs followed by their imprisonment. As an indicator of the extent of this phenomenon, it is mentioned that over 600 claims from Russian entrepreneurs on corporate raid cases from 2011 to 2013 were submitted to the Business against Corruption Centre for Public Procedures. Claims come mostly from trade, manufacture and construction industries. The victims of the trade sector are usually individual entrepreneurs and small companies that own real estate but don’t have enough resources for protection. Attacks on the industrial sector are another form of continuation of the redistribution process of the most attractive properties which started in the era of the 90’s.43

Corporate raiding in Russia is a distinctive phenomenon and unlike hostile takeovers in the West, is characterized by the use of illegal methods, such as bribery, blackmail, forged documents and the use of armed groups to enforce change of ownership. Corrupt government agencies are involved either as indirect supporters of raider groups or as initiators of raiding attack themselves. It is mentioned that the judiciary, security services, tax agencies, local and regional administrations and even some kind of regulatory agencies were involved in cases of that form in one way or another. In contrast to the often efficiency enhancing effects of takeovers elsewhere in the world, most observers agree that the economic effects of corporate raiding in Russia is negative from an economic point of view. The attacked firms are taken over not for productive purposes, but for

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42 Maxim Mironov and Ekaterina Zhuravskaya, “Corruption in Procurement and the Political Cycle in Tunneling: Evidence from Financial Transactions Data,” June 2015, p.35,36.

43 Anton Kazun and Vlad Grinkevitch, “Raiders Love Tradespeople and Are Afraid of Lawyers,” OPEC.ru Research-based analysis and commentary by experts of Higher School of Economics (HSE, Moscow), *OPEN ECONOMY*, (May 19, 2015), http://www.opec.ru/en/1827434.html.

short-term profits. After a raid has carried out successfully, companies usually are being dismantled and their assets are sold off. This conduces to a negative business climate in general, apart from the direct harmful effects on the attacked companies because if entrepreneurs fear that their firm will be stolen once they are successful, it is less attractive to invest in such a place and start a business. [44]

A relevant analysis indicates that there is an increasing participation of state agencies as well as a shift both in the regional and sectoral distribution of raids over time. Looking for the determinants of that increasing state involvement, it seems that there is a strong positive correlation between the election results for the ruling president and his party, as well as the degree to which elections are manipulated throughout Russia's regions and the number of raids in a given region, whereas regions with governors that have stronger local ties are characterized by a smaller number of attacks. A potential explanation of these findings could be that the federal center may tolerate a certain degree of such activities by regional elites, provided that these elites deliver a high level of electoral support for the center. The effect is weaker in regions where the governors are interested in the long-term development of the regional economy. Governors with a good growth record, however, who keep predatory activities under control are increasingly being replaced by outsiders from the federal center, probably because these outsiders are considered more loyal to the center. As a result, Russia's institutional system is less oriented toward economic efficiency, giving priority to securing political control, while economic objectives play a secondary role. Given the country's high dependency on oil exports, the Russian system might be sustainable as long as oil prices remain high. Sacrificing, however, economic objectives such as secure property rights for innovative entrepreneurs in return for political control of regions, might negatively affect economic situation of the country in the long run.[45]

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44 Michael Rochlitz, "Corporate Raiding and the Role of the State in Russia," in *Post-Soviet Affairs, Nos. 2–3*, vol. 30 (Moscow: International Center for the Study of Institutions and Development, National Research University Higher School of Economics, 2014), p.90.

45 Ibid., p.89,110.

Corruption has also penetrated into the ailing banking system. Characteristic is the recently ceased by the authorities, banking operation of Anatoly Motylyov who is accused of running one of Russia's largest financial operations taking deposits by offering double-digit interest rates and using the money to finance his personal business ventures.[46] This scenario, which repeated in the past, raises broader questions about the stability of the Russian banking sector, which has been battered by the decline in the oil price, Western sanctions and a volatile rouble. The collapse of Mr Motylyov's banking empire looks to represent one of the biggest bank failures since the Russian economic crisis began last year, hurting pensioners and depositors whose losses are expected to be covered by the state. Yet some critics say that the regulator should have been more proactive not allowing that one billion-dollar banking group to be build up.

Over the past year and a half, the Russian central bank has made an attempt to clean-up the banking sector, withdrawing the licenses of more than 140 Russian banks. The strategy is part of a long-planned move to clear the sector of

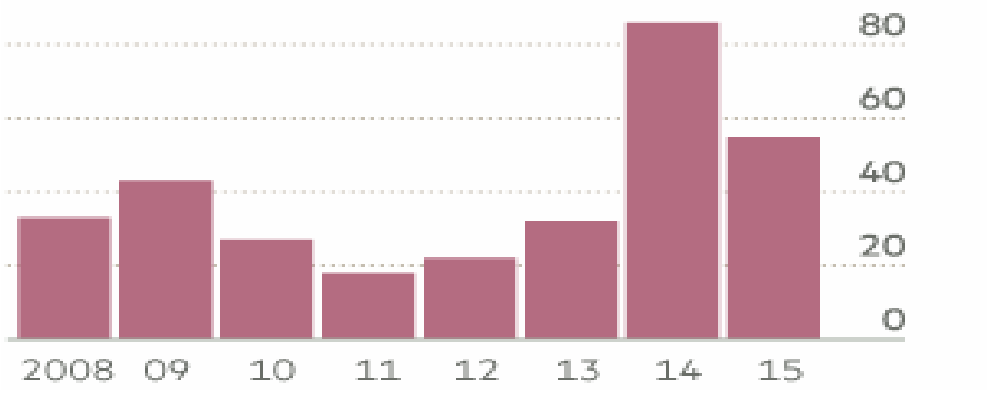

Figure 16 : Number of Russian bank licenses revoked.(After: Courtney Weaver Kynge ."Russia's Anatoly Motylyov: Rise, fall, repeat," Financial Times, September 6, 2015)

weaker players, which hold the assets of families or individual businessmen, and tend to be a source of money laundering. The attempt has largely been lauded by market participants, although critics say that the regulator is still not doing enough,

46 Courtney, "Russia's Anatoly Motylyov: Rise, Fall, Repeat."

pointing to Mr Motylyov's repeated history as a prime example. Since the middle of July, the central bank has revoked the license of about a dozen banks, a move that has affected about 1 per cent of Russia's retail depositors and reduced the total number of Russian banks to about 800 from about 1000 in 2008.[47]

There are signs that the banking sector encounters widespread problems. Trust Bank, for example, Russia's 32nd largest bank by asset size, was revealed to have a 127bn roubles hole in its balance sheet. In addition, the central bank announced recently that Probusinessbank, a bank with western investors including Sweden's East Capital and the hedge fund BlueCrest, had been keeping fictitious bonds on its balance sheet. According to the central bank, Probusinessbank was found to have $1bn more liabilities than its assets at the time its license was withdrawn. The state of the banking system is problematic. Rapid lending in the previous years and retail deposit growth might have covered the underlying problems at some Russian lenders, but the weaknesses are now coming to light as the rate of non-performing loans rises.[48] The current crisis Russia faces, exacerbated these banks' problems and made them more apparent. This state of frequent bank licenses withdrawal creates a general atmosphere of mistrust to financial system which discourages new entrepreneurial activities and hinders access to finance.

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47 Ibid.

48 Ibid.

V. POLICY AND RECOMMENDATIONS

The immediate concern for Russia must be the ability to manage its slowing economy. With low oil and gas prices and compressed revenues the capabilities of fiscal policy are rather limited. Without fundamental improvements in competitiveness and business environment the rate of improvement in companies will not be high enough to drive growth.

Taking into account the identified strengths and weakness form the benchmarking analysis, the underlying reasons and the broader framework introduced in chapter II concerning the determinants of competitiveness (figure 4) and business environment (figure 5), we will propose an overall policy as well as recommendations on specific areas for the improvement of competitiveness and business environment of the economy of Russia.

POLICY

Russia needs an overall policy towards increasing competitiveness and ameliorating its business environment. A policy that defines priorities among policy areas, followed by a strategy which establishes directions, sets goals via an integrated action plan, monitors and tackles the deviations by corrective action, and eventually conduces to the upgrade of the nation to the global economy.

This policy should take into consideration the strengths and weaknesses of the economy as well as the opportunities and threats of the broader environment as is defined by the political, social, economic, technological, global and regional context. It should define the roles of government at various levels and those dimensions of the business environment where the country needs to excel. Then it should focus on creating an environment with institutions and rules within which businesses can thrive and operate successfully.

Given its strengths Russia has the potential to be much more than a natural resource-rich economy. Its geographic location between Asia and Europe constitutes a potential asset. Its well educated population, the high levels of ICT use and the research base can promote innovation and become the basis for strong science-based clusters. Its large market size offers opportunities to develop

global exports and economies of scale. Considering the above strengths, Russia needs to include in its competitiveness agenda a series of recommended priorities in order to address its weaknesses and utilize its future opportunities.

RECOMENDATIONS

Strengthening of Institutions

Having defined competitiveness as the set of institutions, policies and factors determining the level of productivity, we remark the first thing that holds back Russia's development is its insufficient institutions. The country needs strengthening of the legal, political and social context.

The legal system remains a profound deficiency providing weak protection of property rights against the powerful public and private interest. Even if the quality of laws has improved in some cases, the implementation is often ineffective. The legacy of judicial system that was a tool of the executive branch and not a separate part from government, still hinders legal effectiveness. Thus, an independent and efficient legal system that enforces the law and protects the individual rights is necessary to increase the credibility and impact of government policies. It is important, the government not to interfere with the judiciary, even when decisions might not go in the direction it would prefer. Cooperating with international organizations such as the WTO, could also help to ensure credibility of adherence to policies. As highlighted[49] by the European Court of Human Rights, non-implementation of judgments in series of cases undermines the right to a fair trial. Furthermore a perception of low integrity continues to affect public confidence in the judiciary. The police should also contribute to the enforcement of law and the elimination of organized crime, recovering trust and reliability and conducing to the reduction of business cost due to organized crime and terrorism. Improving the political context is also a crucial issue. Strong government institutions, elimination of corruption and bureaucracy, professionalism and political reforms that will ensure orderly transfer of power, political stability and continuity in policy priorities

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49 EBRD, "Strategy for the Russian Federation" (EBRD, December 18, 2012), p.25.

that are of considerable importance for the business environment. Regarding the social conditions, also although they have improved over time, the country still faces complicated challenges that have to be addressed. Inequality has risen and significant divergence across regions and income groups remains a serious problem that needs sound economic policy. A robust policy also needed concerning the environmental dimension (which also affects the sustainability of competitiveness) including the enforcement of gas emission regulations and better management of country's natural resources (eg water retreatment) to ensure prosperity in the long run.

Financial market development

Another priority that has to be set is the development of the financial market. The size of the financial sector is limited for the magnitude of Russia's economy. The country needs a vibrant financial market that will provide capital and strengthen competition through a stronger market for corporate control. While large companies have access to loans and other sources of capital, small and medium size companies have difficulty in getting financed.[50] The banking sector remains highly concentrated and dominated by the state which has a virtually monopoly especially outside Moscow and St. Petersburg. Foreign banks also exist but certainly the country needs to develop a strategy for transition from a financial system dominated by government-owned banks to a competitive private sector system. To increase competition, is crucial to augment the share of the private sector through strengthening private banks (including capitalization of creditworthy, well-governed ones and encouraging consolidation of small private banks) and pursuing privatization strategies for state-owned banks. To attract growing interest from foreign and domestic investors is essential to establish strong and transparent regulation to put the market in a better position so that to deal with the inevitable volatility of financial markets in an emerging economy. In addition, local capital markets require further development by upgrading of physical capital market infrastructure, strengthening of local operators and

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50 Porter and Ketels, "Competitiveness at the Crossroads: Choosing the Future Direction of the Russian Economy," p.53.

boosting participation of local institutional investors, including pension funds, in capital and private equity markets.[51] Russia must cooperate also with the EBRD which is supporting the development of the Russian financial sector by: policy dialogue including a technical cooperation, issuing local currency bonds and equity investments. As it has been mentioned in the analysis section of the present, Russian authorities have proceeded over time to sanitation of the banking sector by revoking many licenses of ill functioned banks (figure 16), a measure that has to continue in order to reassure the soundness and stability of the remaining ones.

Goods market strengthening

Strengthening goods market efficiency must be another priority for Russian economy. Sound anti trust laws, reduction of total tax rate and decrease of impact of business rules on FDI are some directions that will help towards increase of investments, foreign ownership, foreign direct investments and domestic competition. Reductions of trade barriers and tariffs, as well as streamlining of customs procedures are also needed in order to boost the open trade. The country is characterized also by a big percentage of imports (22.1% GDP) and thus it has to enhance the ability of its domestic market to produce the products and services in domestic demand.

Business climate enhancement

Tax issues and trading across borders also count for the business environment as seen from the detailed description of GCI and EDB pillars. As we have seen also by the analysis above, EDB and GCI are strongly positively correlated thus improvements in the business environment is likely to cause increase in competitiveness as well. Starting in detail with the measured weakness that identified by the benchmarking analysis, the country needs to improve the process of construction permits and access to electricity by reducing the required steps, time and cost respectively. As for the border trading apart from the tariffs and barriers, it should also simplify the required procedures for importing-

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51 EBRD, “Strategy for the Russian Federation,” p.35,36.

exporting goods and the respective time and fees. Improving the laws regarding movable collaterals and the credit information systems so as to allow free access to credit information are needed in order to tackle country's business environment deficiency in getting credit. Last, the issue of protecting minority investors should be tackled in order to ameliorate the business environment. An EBRD benchmarking of the Russian corporate governance legislation against the relevant international standards (OECD Principles of Corporate Governance) indicated that although Russia achieved a high level of compliance with these standards there are certain shortcomings in the regulation on the responsibilities of the board and the role of stakeholders in corporate governance[52]. Thus legislation for increasing the shareholder's rights, the liability of directors and the transparency of corporate governance needs to be formed in order for the country to have better performance in that section.

The authorities are increasingly concerned with the country's business environment and corruption perception ratings and are making efforts to improve them. The Russian President ordered the government to prepare a 100-step plan to lift Russia's position in the EDB index from 120 in 2010 to 50 by 2015, and 20 by 2018. These measures were to be developed in part by the Agency for Strategic Initiatives (ASI), which was created in 2011 to improve the investment climate and the dialogue between business and government. In 2011, the ASI launched 22 projects for the improvement of the investment climate. ASI prepared four "roadmaps" consisting of specific proposals to simplify construction permit procedures, improve access to energy infrastructure, supporting exporters and streamline customs regulations. However as we saw from the current analysis these are still among the drawbacks of the country's business climate rising thus concerns about the effective implementation. The authorities have also taken steps to improve anti-corruption legislation, such as investigating potential conflict of interest involving public sector employees, improving training of special officials for fighting corruption, and improving the role of civil society in providing public

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52 "Legal Reform in Russia," *EBRD*, accessed October 10, 2015, http://www.ebrd.com/legal-reform/where-we-work/russia.html.

oversight. However, the continuation of corruption raises serious concerns about the effective implementation of those measures as well.[53]

Seeing also the business environment from a broader perspective a set of priorities needs to be addressed concerning modernizing the administrative roles of government, transforming legacy assets into sustainable competitive advantages and improving the quality of factor conditions including through physical infrastructure, education and training system.[54]

Clusters Development

Clusters development also emerges as another priority. Clusters can drive productivity and innovation and Russia ranks very low (118th). Although has a high presence of local suppliers and supporting industries as a large country that historically was not well integrated into the world economy, these industries have rarely developed into functional regional clusters eg co-located, interconnected and interrelated entities of a specific sector. Russia faces weaknesses in cluster development due to historical location patterns that worked against it, rather than encouraged it. Political choices in the past have favored heavy industry, education and science which led to a relative specialization in capital and resource-intensive clusters as well as in education and knowledge creation. However compared to more advanced economies, the country is relatively weak in business and financial services. The low quality of its management schools (104th ranking in GCI) reflects also that state. The main reason for this economic structure is country's legacy where the planned economy focused on manufacturing, considering service activities contained within large vertical integrated firms as less important. The limited outsourcing of non-core activities by many large companies sustained also this situation. However the country needs to move to a cluster based economy by distributing more effectively the economic activity across regions and transforming co-located and related activities into real clusters. One way that would help to that

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53 EBRD, "Strategy for the Russian Federation," p.24.

54 Porter and Ketels, "Competitiveness at the Crossroads: Choosing the Future Direction of the Russian Economy," p.83.

direction is to adopt a cluster based approach to attract investments. An approach that will focus on attracting FDI inflows around clusters of specific industries will give value to the Russian economy as well as help transfer of technology where the country also lags behind (123rd ranking in GCI). This attempt can be strengthened by mobilizing local companies as partners at targeting and reaching via marketing strategies investors that can address critical weaknesses in the cluster structure. Another way in boosting cluster development will be by creating a program to support the outsourcing of non-core activities of large dominant firms. This would reduce the dominance of legacy companies as regional employers, provide entrepreneurial opportunities for current employees and improve productivity.[55]

Diversification of the economy

Russia's revenues are heavily dependent on mineral resources exports and mainly to oil and gas which render her vulnerable to commodities price decrease. Thus, Russia needs to capitalize on its capabilities in science and research and diversify its economy from natural resource intensive industries. This can be made by reinforcing SME's and cluster creation in non resource sectors as well as to build science and skill intensive clusters which in turn will increase its capacity to attract and retain talents. It needs also to move towards creation of related clusters to the ones that has already strong export positions such as oil and gas products, coal, metal mining and forest products. In addition it can also create added value from its natural resources industry by shifting from simply exporting raw materials to developing clusters. As an example can be mentioned the oil and gas cluster in Norway that has developed world leading expertise in deep sea exploration. This ability has made it an attractive partner for countries with oil deposits in harsh conditions. This position however has been built on a strong cluster-specific business environment that provides much more than just the natural resource deposits. [56] Norway as well as Australia, are two examples of natural resource

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55 Ibid., p.88.

56 Ibid., p.92,97.

exporters were their strong institutions avoid the resource curse that impedes longer term development.[57]

Diversification is also needed since Russia is in transition towards the 3rd stage of development where is supposed to become more dependent on sophistication and innovation factors instead of basic resource factors. This necessitate reinforcing science and research based clusters by interconnecting research and technology institutes, universities, industry and market in order to render the country a thriving knowledge economy, capable of exporting research based products. This will help the country move from inherited prosperity to created prosperity.

Regional Development

Russia is a federal state consisting of 83 regions that are characterized by big differences in development, in progress of structural reform related with transition and on other factors affecting the general businesses environment and economic opportunities in regions such as education, training, availability of jobs, income per capita, ICT and public infrastructure, and corporate standards and practices.

National policies set the overall context and define rules and incentives. Given its huge geographic size Russia must encourage decentralization and responsibility for progress at the regional level for the effective implementation of these policies. Setting priorities and making decisions on how to upgrade competitiveness within the context of national policy needs to happen at the regional level because of their differing conditions. This could be achieved by creating incentives for regional development and performance based support between federal and regional level.[58] The federal governance of USA as well as the European Union governance are useful examples for Russia so that to use

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57 "Institutions Impede Russia's Growth," June 29, 2010, http://www.forbes.com/2010/06/28/russia-policies-growth-business-oxford-analytica.html.

58 Porter and Ketels, "Competitiveness at the Crossroads: Choosing the Future Direction of the Russian Economy," p.88.

similar approaches adopted in its environment. For instance EU provides co-funded programs for its member states development such as COSME which aims at enhancing the competitiveness of SMEs.

Economic Relations with neighbors

Economic relations between countries are unavoidably connected with external relations and foreign policy. Economic integration however with neighbors can be an important driver of productivity and growth. Historically the Soviet Union was an integrated economic system but after its dissolution cross national linkages between Russia and its neighbors has grown weaker over time. Relations with Baltic countries remain problematic and have hampered the use of trade links between Russia and Western Europe. Political overlay to Russia's trade relations and the increasing use of oil and gas for political reasons has deteriorated its ability to form productive economic relations with neighboring countries.

In its gas crises with Ukraine, Russia shut off supplies to Ukraine and thereby to Europe, resulting to deterioration of its reputation as a reliable gas exporter and making Europe to decide that it needed to find alternative energy sources. As a result the "South stream" pipeline project was canceled. In 2014 the annexation of Crimea caused the reaction of western countries imposing economic sanctions against Russia deteriorating further the relations. In response Russia has refused imports of those countries.

These controversies may be useful politics but are serious drawbacks to productivity enhancing opportunities. After 18 turbulent months some of the world's largest multinational companies are about to scale back operations in Russia unless the business environment improves as low oil prices, currency depreciation, trade embargoes and volatile public policy unsettle international investors. Foreign banks activated in Russia are concerned about the effect of sanctions on external financial and capital flows, as well as about Russian monetary and exchange rate policies. Austria's Raiffeisen Bank has been critical of the central bank's inability to stabilize the rouble, while Deutsche Bank last year terminated its asset management business. In the energy sector, Royal Dutch Shell paused its shale exploration activities in 2014 due to US-EU sanctions, while

BP, which has 19.75% stake in Rosneft, Russia's Kremlin-backed oil company, has warned that further economic sanctions could have an adverse effect.[59]

Russia loses also ground in terms of trading relations with the former soviet states of central Asia. Trade between China and Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan has increased from $1.8bn in 2000 to $50bn in 2013, before reducing slightly amid the decline in commodity prices, surpassing Russia in recent years, as shown in figure 17.

Figure 17: Russia vs China, Trade with central Asian countries. (After: Jack Farchy, "China's Great Game: In Russia's Backyard," *Financial Times*, October 14, 2015.)

This economic dominance means that China is now the region's single largest trade partner and the most important patron of central Asian governments. China dreams to revive a new "Silk Road", ambitioning to stamp its authority and influence from Xi'an to Europe. The Chinese strategy with promises of tens of billions of dollars in investment, if realized, could reshape the former Soviet economies of central Asia, that have been hit by recession in Russia and falling commodity prices.The launch of a regional integration drive by China though, has

59 David Oakley, "Foreign Groups Eye Scaling Back Russian Operations," *Financial Times*, October 19, 2015.

put Russia in skepticism which has been lobbying countries to join its Eurasian Economic Union. [60]

China however is one of Russia's leading trading partners and a fast growing market that could also become a major source of capital investment for Russia. It is also an indispensable partner in assuring security and stability in Russia's broader neighborhood from Central and Northeast Asia to the Middle East. Thus, Russia has to compromise and seek friendly and cooperative relations. A key challenge for Russia's foreign policy will be to live alongside a China that is strong, assertive, dynamic, and increasingly advanced.[61]

In addition to keeping good relations with neighbors, Russia's embrace in multilateral international and regional economic organizations and trade agreements would strengthen its economic relations in a more insulated way from politics to the possible extent.[62] Its membership for example in CIS, BSEC and WTO is a positive step. Cooperation with the EBRD resulted in 792 projects in Russia, amounting to €24.3 billion investment[63], although from July 2014 EBRD stopped undertaking any new business in the country due to sanctions. An endeavor for similar and more far reaching agreements with groups of neighboring countries if combined with amelioration of the internal business climate and opening up competition would offer the potential for expanding trade, improving competitiveness and diversifying the Russian economy.

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60 Jack Farchy, "China's Great Game: In Russia's Backyard," *Financial Times*, October 14, 2015.

61 Trenin, "Russia Reborn. Reimagining Moscow's Foreign Policy," p.77.

62 Porter and Ketels, "Competitiveness at the Crossroads: Choosing the Future Direction of the Russian Economy," p.89.

63 "Russia and the EBRD," n.d., http://www.ebrd.com/russia.html.

VI. CONCUSIONS

After five consecutive years of growth Russia has been in a new spin of economic crisis which is expected to result in a negative growth rate for the current year and reduced purchasing power for its population. Declining commodities exports, currency depreciation and economic sanctions conduced to this bleak economic situation. With reduced incomes population is unable to drive demand up and the reduced revenues of the country provide limited capabilities for favorable fiscal policy in order to bolster its economy. However, the malaise afflicting the country derives primarily from real economic deficiencies rather than financial market stresses. Russia needs to reshape its economic model in order to increase productivity and regenerate prosperity which necessitates the improvement of its competitiveness and business environment.

The concepts of competitiveness and business environment are wide and comprehensive including a large spectrum of factors. GCI and EDB capture many of these aspects and are considered broadly acceptable benchmarking indicators for measuring competitiveness and business environment, respectively. The indicators provide an overall ranking and score for an economy as well as detailed rankings and scores in each of its constituent pillars. By using these indexes we evaluate the current positioning of Russia's economy and identify its strengths and weaknesses in comparison with other countries (BS-10, CIS, BRIC, USA, EU and China).

Since 2002 in terms of competitiveness Russia ranks overall constantly below EU-28, USA and China, achieving 53rd position (out of 144) in the current year. The identified weaker points regard its institutions, financial market and goods market, while the stronger, its large market size and higher education. In terms of business environment following an upward route since 2011, Russia stands in 62nd position the current year (out of 189), at the top of the BRIC but below EU-28, USA and BS-10 average. The country lags behind in dealing with construction permits, getting credit, protecting minority investors and trading across borders whereas it scores high in registering property and enforcing contracts. Corruption, high tax rates, insufficient access to financing, burdensome

tax regulations and inefficient government bureaucracy count as the most problematic factors for the current situation of Russia's business environment.

A further analysis of the relationship between GCI and EDB in the Russian economy showed that there is a strong positive correlation (+0,93) between them and that the linear equation which approaches the sample data indicates that for every 10 points increase in EDB DTF score an increase of 0,17 points in GCI score is expected. However, a negative correlation was observed between real GDP growth rate and GCI (-0,36) as well as with EDB (-0,84). Among the underlying reasons for this distorted relationship are assumed the limitations of GCI and EDB indexes in measuring all the related aspects of competitiveness and business environment, as well as the limitation of GDP to capture the magnitude of the full economic activity and the related evidence of hidden grey economy in Russia. In addition, the unequal enforcement of the measures across the regions, corporate raiding, corruption, bribery and inappropriate governance of state agencies seems to contribute also to the observed inconsistencies.

There is certainly room for progress and a comprehensive policy is needed to address the identified weaknesses, setting priorities having considered the strengths, opportunities and threats of the Russian economy. Among the priorities, strengthening the institutions of the legal, political and social context is recommended first and foremost. Developing the financial market by improving the regulatory framework, increasing the availability of funds, access to financing, privatization of banks, cooperation with external development banks and sanitation of the domestic banks are also essential. Goods market strengthening by anti-trust laws, tax reduction, and sound business rules reducing impact on FDI, trade barriers, tariffs and streamlined custom procedures will open trade and competition. Streamlining also the processes of construction permits, access to electricity, importing - exporting, getting credit and protecting minority investors will ameliorate the business environment. Modernizing the administrative roles of government and the quality of system inputs including education is also needed for the broader betterment of the business climate. Cluster-based approach to attract FDIs and outsourcing of large dominant firms' non-core activities are recommended for cluster development, which also counts as a basic priority that has to be set. Diversification of the economy by cluster development and

reinforcing of SMEs in non natural resource sectors is also recommended in order for the country to avoid the “resource curse”. Regional development by decentralization, creating incentives and a performance based support between federal and regional level must be another priority. Last but not least, further development of economic relations with neighboring countries and participation in regional and international economic organizations and in trade agreements is recommended for the improvement of Russia’s economy.

Proposals for future research

Relevant to this research the following areas are recommended for potential further research:

- Historically Russia was a centrally planned economy dominated by state owned enterprises. What matters, however, is the effectiveness and productivity of an enterprise and not the ownership regime. A potential research could explore the appropriate governance of a state owned enterprise in order to be productive and effective.

- As shown from the research among Russia’s strengths is higher education. A possible research could explore if this education is appropriate for a market driven economy and what improvements must be introduced in order to help the transition of Russia’s economy into an innovation driven economy.

- Cluster mapping and analysis could be performed for chosen/strategic regions to identify efficient realistic ways to shape the regions economic future.

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