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Changing investment climate in Russia : an institutional approach

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Shortened version of the title : Changing investment climate in Russia.

Abstract : this paper proposes an institutional approach of the changing investment climate in Russia. Studying successively official positions about investment policy, legal texts, and then evaluating the effectiveness of the enforcement mechanisms, we show that reality is often at odds with official declarations about the friendliness of business environment. Evidence provided by surveys of both national and international business people also show that during the recent crisis the business climate has not really improved for foreign investors in the country. Still, the situation does not hamper Russia from continuing to be one of the most attractive countries in the world for Foreign Direct Investments.

Changing investment climate in Russia : an institutional approach[1]

The last two years have brought new waves of uncertainty around foreign investors in Russia : new lags in the WTO accession process, adverse implications of the Russia-Georgian war on the relations between the country and its main western economic partners, no real progress in Russia's international ranking regarding corruption, and so on.

Meanwhile, due to the peculiar structure of its external sector, the Russian economy has proven particularly vulnerable to the global financial and economic crisis, underlining its over-dependency on the energy sector and its relatively poor international competitiveness as regards *high-tech* industries and non financial, high value-added services.

While being fully aware of the potentially damaging consequences of such a situation on the national economy, Russian authorities are experiencing difficulties in setting up an institutional environment able to foster durably foreign investments, notably in manufacturing sectors.

The objective of this paper is to answer the two following questions: what have been the main steps taken by Russian authorities towards the building of a stable investment climate during the last two years (2008-2010) ? What are the results achieved so far ? In this aim, we propose an institutional approach of the evolutions that occurred in the very recent past along various dimensions the « investment climate » in Russia. Basing our approach on the existing literature, we define investment climate as *the set of institutions, policies and enforcement mechanisms that are considered as relevant by companies in their investment decisions*.

The first section of the paper is devoted to the definition of the various dimensions of the investment climate, using a methodology that pays due attention to qualitative differences and interrelations between theories and public statements, legislative acts, enforcement processes,

1 *This paper was presented at the conference « Trends in International Business » - Magellan (EA3713), Jean Moulin University Lyon 3, Lyon, France and International Relations Faculty, Prague University of Economics, Czech Republic, 24 June 2010. I am grateful to the participants of this conference for their helpful comments.*

actors' perceptions of their environment and statistical indicators of the current investment climate in Russia. In the second section, we propose a synthetic view of the actual stage of development of the legal framework surrounding investment in the country. In the third section, we study the enforcement of this framework and the opinions of enterprises' leaders about its results. The fourth part offers a statistic survey of the recent dynamics of investment, both domestic and foreign, in Russia. Last section concludes.

1. Investment climate : an institutional approach

The transition process in Russia has been far more arduous than what was expected in 1992. One of the main lessons of these difficulties is that it is extremely difficult for reformers to impose measures from above, without taking into account the existing institutional framework (legal texts, written and tacit norms, habits, expectations, etc.). As far as Russia is concerned, policies would have probably experienced more positive results, had they been adapted to local contexts.

As the World bank defines it, investment climate is "the set of location specific factors shaping the opportunities and incentives for firms to invest productively, create jobs, and expand" (World Bank, 2005, p. 20). The existing literature acknowledges that investment climate is shaped by institutional and political factors (Henisz, 2000, Hallberg, 2005, Majocchi and Strange, 2007, Von Luebke, 2007, Slangen and Beugelsdijk, 2010). In World Bank publications, a "good investment climate" is usually described as being the result of the well functioning of three pillars: macroeconomic stability and openness to trade; good governance and institutions, including control of bureaucratic harassment and crime, as well as effective financial and legal institutions; and adequate infrastructures (Stern, 2003, World Bank, 2005). More precisely, the former chief economist of the World Bank, includes in the investment climate "policy, institutional, and behavioural environment, both present and expected, that influences the returns, and risks, associated with investment" (Stern, 2001). In accordance with this definition, in our analysis of the Russian investment climate we take into account the expectations and appreciations of economic agents regarding their institutional environment. Hence our acceptation of the investment climate as a set of institutions, policies and enforcement mechanisms that are considered as relevant by companies in their investment decisions.

Economic transition in Russia has been characterized as a market oriented institutional change (Economic Commission for Europe, 1992, Kozul-Wright and Rayment, 1997, International Monetary Fund, 2000, World Bank, 2002). Kim *et alii* (2010) see market oriented institutional change as a two stages process : in the first stage, inconsistencies and frictions among formal institutions and between formal and informal institutions produce uncertainty in the economic environment. This uncertainty is detrimental to the investment climate. In the second stage, these frictions are supposed to vanish progressively as market oriented institutions prevail over inherited institutions (Kim *et alii*, 2010, p. 1143). In order to assess the current transformations of the investment climate in Russia, we propose a conceptual framework able to grasp not only the official policy steps taken by the Russian authorities, but also the "institutional frictions" (the "institutional hiatus" as Kozul-Wright and Rayment (1997) put it) prevailing in the business environment. This conceptual framework is based on an institutional approach of economic and institutional changes.

Institutional evolution is a process involving various stages, interconnected with one another. Firstly (at the « theory stage »), policy makers adopt theories about the economic situation their are facing and the policy tools they have to use in order to improve it. Secondly (at the « legal stage »), legal texts (laws, decrees and so on) are adopted on the basis of these theories with the aim to impulse behaviour changes in the right direction. Thirdly (at the « enforcement stage »), at the microeconomic level, this legal framework is enacted by administrative bodies and interpreted by economic agents as a new basis for their anticipations and behaviours. Fourthly (at the «evaluation stage »), the statistical and scientific inquiry apparatus provides various measurements of the results of the whole process. These measurements are images of the reality that allow new theories to be elaborated by analysts and adopted, in turn, by policy makers.

[Figure 1 to be inserted here]

Of course, such a cycle cannot be a simple one : there are multiple possibilities of reverse causation between each dimension of the process. Moreover, each dimension can be directly connected to the three others. For example, the statistical image of the results (the « evaluation stage ») is largely influenced by the theories in use, since the latter contributes to define the

shape and scope of indicators that are used to measure the effectiveness of the policies. In fact, the four stages of the institutional change form a network of mutual influences, even if it is possible to establish a logical hierarchy between them, distinguishing main and secondary interactions, as shown in Figure 1.

Such an approach of the institutional and economic changes is inspired by the institutionalist tradition, initiated by Thorstein Veblen (1964), recently developed by Douglas North (1990) and applied to organizational science by Richard Scott (1995), among others. Its main interest is its usefulness for explaining why, under certain conditions concerning formal and informal institutions, apparently rational policies do not produce the expected results in the economy.

Applying this canvas to the notion of investment climate in Russia, we raise the following questions :

- At the theory stage : given the existing dominant – and rather critical - discourse among western observers regarding investment climate in Russia, what is the discourse of the main policy-makers on the topic ?

- At the legal stage : what have been the main legislative acts taken by Russian authorities in order to change the investment climate during the past two years ?

- At the enforcement stage : is economic actors' perception of the investment climate in accordance with legislative acts aforementioned ?

- At the evaluation stage : what can statistical indicators currently available reveal about the actual behaviours of (foreign) investors in the Russian economy ?

Next sections of this paper propose tentative answers to these questions.

2. From theories to laws : the formal context of investment in Russia

In 2008, Russian government launched the «Russian 2020 growth strategy », whose main objective was to shift toward an innovation-driven growth and to reduce the dependence of the economy on the production of raw materials. This announcement followed seven years of unprecedented growth, during which GDP more than doubled while Foreign Direct Investments (FDI) inflows surged, promoting Russia as one of the top five destinations for investments in the world. During this period, however, Russian economic growth was largely driven by extractive and raw materials industries, attracting large inflows of capital and leaving little room for *high-tech* investments and innovative activities (World Bank, 2008, OECD, 2009, Vercueil, 2010).

For this reason, Russian authorities repeatedly emphasized the necessity to set up favourable legal conditions for the diversification of the economy. Attracting foreign capital and technologies being widely seen as a way to improve the level of productivity and innovation of domestic enterprises (Borenzstein, De Gregorio, and Lee, 1998, Lipsey and Sjöholm, 2004), the friendliness of the business environment for foreign investors has become one of the declared priorities of the Government. In next subsections, we explore several domains in which the legal environment of the Russian economy has been changed in the past few years.

2.1. World Trade Organization accession

> *"We need the support of the U.S. plus our own consistency in words and actions in order to join the WTO individually."*
> *Alexei Portansky (Moscow High School of Economics), April 2010.*

Since WTO promotes an internationally harmonized legal framework for national and foreign enterprises, WTO membership is generally associated with a better investment climate. Hence, one could expect that, in order to improve the investment climate in their country, Russian executives try to accelerate its membership. However, the long lasting accession negotiations to the WTO have repeatedly shown the reluctance of Russian authorities to fully comply with the

legal framework of the international organization (Vercueil, 2002, 2007). Having started in 1993, the process is still not completed, 17 years later. Russian is now the largest economy and the only G20 member still outside the WTO.

Meanwhile, the GATT has been transformed in WTO, average tariffs have been lowered all over the world and some rules have become more stringent on the possibility for an economy to protect what it considers to be its economic interests. The organization has also welcomed new countries, among which Georgia and Ukraine, that are now part of the negotiations for accession of Russian and might complicate it. The Working Party[2] on Russia's accession to WTO counts now 60 members and has become the largest negotiation group ever constituted in the organization's history. At the current stage, however, Russian has agreed bilateral market access agreements with all the members of its Working Party (possibly except Georgia). The remaining difficulties lie in three sectors :

1. *Agricultural subsidies.* Russia wants to be allowed to spend $9 billions per year in order to support its production.

2. *Export taxes on timber.* Discussions resumed recently with the EU.

3. *State trading organizations*[3]. These public organizations are seen are market distortions by certain members of the working party.

Russian authorities' attitude about WTO accession has been changing for the last two years. After a period of negotiations within the Working Party, Prime Minister Vladimir Putin declared on June 10, 2009 that Russia, Belarus and Kazakhstan would abandon their separate accession talks in order to enter WTO as a customs union. This statement came as a surprise for at least two reasons : first, it disregarded WTO rules. The organization considers only territories will full sovereignty over their trade policy as potential members[4]. Second, Russia has far more advanced

2 That is, the group of nation members that are involved in the accession negotiations of a given country.

3 World Bank, *Russian Economic Report,* n°19, June 2009

4 The Marrakesh agreement stipulates that unified customs territories applying for membership must have full sovereignty over their trade policies, as do Hong-Kong and Taiwan, and does not mention customs unions of any kind.

its accession talks than its two partners. Such a tactical change could slow down considerably its progress towards accession.

This unexpected announcement was later tempered by other declarations of Russian top officials, saying that Russia would join the WTO in whichever way that would be effective. In April 2010, Russian First Deputy Prime Minister Igor Shuvalov acknowledged that Russia could abandon its plans to join the World Trade Organization in a joint bid with Kazakhstan and Belarus, adding that Russia hopes to complete all procedures by the end of the year[5].

Box 1. Russia's Membership of international and regional structures

Political and security structures :

- United Nations: Security Council, General Assembly, United Nations specialised agencies
- Group of Eight (G8)
- Council of Europe
- Organization for Security and Cooperation in Europe (OSCE)
- NATO-Russia Council (NRC)
- Permanent Court of Arbitration (PCA, « the Hague Tribunal »)

Regional level :

- Council of the Baltic Sea States
- Arctic Council
- Shanghai Cooperation Organisation
- Organisation of the Islamic Conference (observer)
- CIS and CIS structures

Economic structures :

- United Nations Conference on Trade and Development
- World Trade Organisation (observer)
- International Bank for Reconstruction and Development (World Bank Group)
- International Development Association (World Bank Group)
- Multilateral Investment Guarantee Agency
- International Monetary Fund
- International Finance Corporation

5 The Moscow Times, April 16, 2010

• Bank for International Settlements
• Paris Club
• World Intellectual Property Organization
• International Labour Organization
• World Federation of Trade Unions
• World Customs Organization
• International Organization for Standardization
• International Trade Union Confederation

Regional level :

• EU-Russia Partnership and Cooperation Agreement (PCA)
• Organization of the Black Sea Economic Cooperation
• Asia-Pacific Economic Cooperation Forum
• European Bank for Reconstruction and Development

Anticorruption conventions :

•Council of Europe Criminal Law Convention on Corruption (signed January 1999; ratified October 2006)
•UN Convention against Corruption (signed December 2003 ; ratified May 2006)
•UN Convention against Transnational Organized Crime (signed December 2000; ratified May 2004)

Sources : PriceWaterhouseCooper, 2009. Transparency International, 2009a.

Apart from WTO and OECD, Russia is now a member of all relevant international economic organizations and has signed many international agreements (see the list in Box 1), attesting its will to be considered as a full-fledged member of the international economic community.

2.2. Regulations on foreign investments

> *"We will only welcome foreign investments, especially those bringing in new technologies. We don't have any other way"*
> *Alexei Kudrin, Finance Minister of the Russian Federation, February 2010.*

Ensuring a level playing field between domestic and foreign firms is one of the conditions for attracting foreign investors. In this respect, Russia's legal environment is often considered as unsatisfactory by foreign observers (OCDE, 2009). The current state of its legal framework is summarized in Box 2.

Box 2. Russian Legislation Regarding Foreign Direct Investments

- Code of Liberalization of capital movements :
- Federal Law, of 9 July 1999, No 160 – FZ 'On Foreign Investments in the Russian Federation',
- Federal Law, of 10 December 2003, No 173 - FZ 'On Currency Regulation and Currency Control',
- Federal Law, of 2 December 1990, No 395 –I 'On Banks and Banking Activity',
- Federal Law, of 22 April 1996, No 39 - FZ 'On the Securities Market',
- The Law of the RSFSR of 26 June 1991 'On Investment Activity in the RSFSR',
- Federal Law, of 25 February 1999, No 39 - FZ 'On Investment Activity in the Russian Federation Effectuated in the Form of Capital Investments',
- Federal Law, of 29 April 2008, No 57 - FZ 'On the Procedure for the Effectuation of Foreign Investments in Economic Societies Having Strategic Significance for Ensuring the Defense of the Country and the Security of the State',
- Federal Law, of 31 March 1999, № 69-FZ 'On Gas Supply in the Russian Federation',
- Federal Law, of 8 January, No 10 – FZ 'On State Regulation of Development of Aviation',
- Federal Law, of 7 August 2001, No 119 – FZ 'On Auditor Activity',
- etc.

Source : Levashenko, 2010.

One of the limits of the existing legal system is lack of consistency : while the Federal Law 'On foreign Investments in the Russian Federation' states that the legal regime of the activity of foreign investors may not be less favourable than the legal regime of activity, it opens the possibility of introducing limitations to this provision by referring to other, more restrictive normative-legal acts. For example, in the banking sector, foreign credit institutions must submit additional documents in order to register as a Russian legal entity, in violation of the principle of extending the national legal regime to foreign investors.

More recently, the « Law on Strategic Industries » of 29 April 2008[6] prevents foreign states, international organizations and organizations controlled thereby, from the right to take control over 42 types of activities[7] (Levashenko, 2010). Replacing the former case-by-case, opaque system of authorisations, this law has been considered by western analysts as a welcome step toward a clearer legal environment for FDI. However, the sectoral coverage of the law is much broader than in OECD countries, that limit the scope of « strategic industries » to national defence, public order and health (Conway *et alii*, 2009).

Following the legislation passed in 2005, six Special Economic Zones (SEZ) have been established in Russian, with the aim to attract foreign and domestic investments : Zelenograd and Dubna in the Moscow region (micro-electronics and nuclear technology), St. Petersburg (information technology), Tomsk (new materials), Lipetsk (appliances and electronics) and Yelabuga (auto components and petrochemicals). In addition, seven special tourist economic zones were established in 2007 in the Krasnodar, Stavropol, Altai, Kaliningrad,and Irkutsk regions, as well as in the constituent republics of Altai and Buryatia. In June 2008, three port SEZ were established : the airports of Krasnoyarsk in East Siberia and Ulyanovsk in the Volga area, and the Sovetskaya Gavan port in the Khabarovsk Territory. The SEZ in Kaliningrad, previously established in 1996, has been able to attract some moderate investments, but those in the Russian Far East had less success. The special tourist economic zone in Krasnodar, site of the 2014 Sotchi Winter Olympics, was expected to attract significant foreign investment, but the financial crisis and the political uncertainty prevailing in the Caucasus region might postpone many investment projects.

2.3. Protecting intellectual property rights

> *« Legislators will take all decisions to ensure comprehensive support for the spirit of innovation in all spheres of public life, creating a market place for ideas, inventions,*

6 Federal Law, No 57 – FZ 'On the Procedure for the Effectuation of Foreign Investments in Economic Societies Having Strategic Significance for Ensuring the Defence of the Country and the Security of the State'. The law came into force on 7 May 2008.

7 In addition to weapons, aviation and space, the law also names natural monopolies (except electrical power, municipal heating and postal services), the mass media and companies involved in natural resource exploration and extraction (except where the Russian government owns more than 50% of the company) as strategic. According to the law, foreign investors acquiring control over Russian strategic enterprises are required to obtain approval of a special government commission. The Federal Antimonopoly Service and Federal Security Service must establish that the acquisition does not threaten Russia's national security.

discoveries, and new technologies. Public and private companies will receive full support in all endeavours that create a demand for innovative products. Foreign companies and research organisations will be offered the most favourable conditions for establishing research and design centres in Russia. We will hire the best scientists and engineers from around the world. Most importantly, we will explain to our young people that the most important competitive advantage is knowledge that others do not have, intellectual superiority, the ability to create things that people need. »

Dmitry Medvedev, President of the Russian Federation, September 2009.

Doted with fairly good technological capacities (notably in information technologies) and loose legal environment, Russia has been considered by western investors as a kind of heaven for piracy. Meanwhile, as part of its WTO accession talks, the country has signed all major international agreements concerning Intellectual Property Rights (IPR) (See Box 3).

Box 3. Participation of the Russian Federation to international agreements and conventions on intellectual property

- Patent Cooperation Treaty,
- Madrid Agreement Concerning the International Registration of Marks of 14 April 1891,
- Madrid Protocol of 28 June 1989,
- Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks,
- Berne Convention for the Protection of Literary and Artistic Works,
- Brussels Convention Relating to the Distribution of Programme-Carrying Signals Transmitted by Satellite,
- Convention for the Protection of Producers and Phonograms Against Unauthorized Duplication of Their Phonograms,
- Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations,
- Paris Convention for the Protection of Industrial Property,
- Locarno Agreement Establishing an International Classification for Industrial Designs,
- Trademark Law Treaty,
- Nairobi Treaty on the Protection of the Olympic Symbol,
- World Intellectual Property Rights Organization (WIPO) Copyright Treaty and the

WIPO Performance and Phonograms Treaty (joined on 24/07/2008).

Source : PriceWaterhouseCoppers, 2009.

In 2006, Russia signed an agreement with the United States, committing itself to reduce the level of piracy on its territory. From 1 January 2008, Part IV of the Civil Code came into force. It covers patents, trademarks and copyright issues, replacing all previous legislation on these areas, with the aim to be consistent with the requirements of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). On 2 February 2009, the State Duma passed a law that intends to reinforce the protection of such results of intellectual activity as literature, fine arts, scientific research and its applications, trade marks, software and databases, with due reference to the TRIPS agreement[8]. Since then, several meetings between Russian and European Commission officials have been held in order to progress in the EU-financed program of convergence of the legal systems of intellectual property right protection, notably in the pharmaceutical research industry.

2.4. Clarifying the legal and administrative environment of specific sectors

« We want to sell Russian markets to investors in the best manner possible »
Dimitry Pankin, Deputy Minister of Finances, February 2010.

Russian policy makers have often stressed the importance of alleviating the administrative burden on domestic enterprises in all sectors. The corporate tax rate was cut from 24 percent to 20 percent. As regard public procurement, the Government intends to use more broadly internet applications for open contests and auctions and to streamline rules for state and municipal contracts for supplies, works and services[9]. For instance, the new Town Planning Code was adopted in late 2004, with the aim to introduce more transparent regulations on the issuance of constructions permits. A further step was made after 1 January 2007 : a single state examination of construction permits replaced the former, multi-level and opaque system. In 2009, property registration was accelerated by simplifying documentation requirements. As regards bankruptcy

8 *RIA Novosti, 30/01/2009. For instance, the Russian law on topology of integrated microcircuits protects computer programs and semiconductor topologies during 10 years after the date of registration.*

9 *IET «Russian Economy : Trends and perspectives », 09 2009.*

regulation, several changes were introduced to the insolvency law to speed up liquidation and strengthen the rights of secured creditors (World Bank, 2009a).

The electricity power generation network has been restructured and liberalized in 2007 and 2008. Being the world's fourth largest producer of electricity, Russia needs to modernize its electricity system in order to meet the growing demand for electric power. Until 2007, electricity generation was dominated by State-owned Unified Energy Systems (RAO UES), who owned power plants, vertically integrated energy companies, the federal high voltage transmission grid and the energy dispatching system. Almost all its output was sold to the domestic market. In 2008 the unbundling of RAO UES was terminated, resulting in the creation of six wholesale generation companies (WGCs) and 14 territorial generation companies (TGCs). This restructuring and sales of assets have provided several buying opportunities for foreign investors (UNCTAD, 2009a).

The OECD carried out a synthetic assessment of the legal framework surrounding business activities in Russia, called « Price Market Restriction Index » (PMR). Based on hard data, this index covers a wide range of legal activities that influence the ability of private businesses to conduct their operations. Ultimately, this index provides a measure of the degree of restriction to competition prevailing in a given country. Table 1 shows the results of a comparison conducted between Russia and the OECD average countries on the basis of these criteria.

[Table 1 to be inserted here]

In all the dimensions covered, the index is far higher in Russia than in the average OCDE countries. According to this assessment, the sector in which the state pressure is the tightest are linked to international trade and monopolistic sectors.

2.5. Fighting corruption

> *« Corruption became a systemic problem and we have to confront this problem with systemic actions ».*
> *Dmitry Medvedev, May 2008.*

To say the least, the prevailing assessment of the Russian situation regarding corruption is not

favourable[10]. After a relative improvement following the succession of Boris Yeltsin, the problem seemed to increase anew during the second part of the economic growth period, causing some alarms in western commentaries. In 2008 however, a real change seemed to be possible after the election of Dmitry Medvedev as President of the Russian Federation. Having announced in his electoral campaign that an anti-corruption policy would be one of the priorities of his mandate, he called a governmental meeting on corruption just a few day after his formal inauguration on 7 May. On 19 May 2008, President Dmitry Medvedev signed the Presidential Decree 815 on "Measures against corruption". He also announced the setting up of a National Anti-corruption Plan within one month. The decree created the Presidential Council for Combating Corruption, headed by the President, whose task is to design a national anti-corruption policy, to work out legislative proposals and to coordinate the efforts of the federal, regional and local executive and legislature against corruption. Sergei Naryshkin, chief of the presidential administration, was appointed chairman of the Council executive board.

On 31 July 2008, the National Anti-corruption Plan (NAP) was published, establishing four domains of actions : drafting and adoption of the federal law against corruption ; measures on corruption prevention in public services ; measures on the improvement of public governance and governmental institutions; and measures on the enhancement of legal and anti-corruption education. The plan was signed by the president on 31 July 2008, and converted into draft laws submitted to the State Duma in October 2008 (see Box 4).

Box 4. Main provisions of the National Anti-corruption Plan and the Federal Law «On Counteracting Corruption »

- Withdrawing officials from the boards of directors of state corporations and including new rules on conflicts of interest.
- Creating a system of public legal and anti-corruption education programmes, including a specific programme for lawyers and others within the legal profession.
- Imposing that all public officials, civil servants, the police and judges submit asset declarations, in order to reduce the opportunities for them to take or extort bribes.

10 *In 2002 and in 2005, Russia featured one of the worst corruption indicators of the 33 transition countries surveyed by the « anti-corruption survey » of the World Bank.*

- Establishing that when a bribe is offered, or commercial bribery takes place, the legal entity, not just the individuals involved, will be held liable.
- Establishing new warnings and administrative fines for legal entities. This requirement will be developed through an amendment to the Code of the Russian Federation on administrative offences.

Source : Transparency International, 2009.

Western analysts consider that these changes constitute a real improvement in the anti-corruption legal framework, as they set up a basis for effectively counteracting corruption in Russia (Transparency International, 2009).

2.6. Supporting Small and Medium Entreprises (SME)

« We should pay more attention to the structure of small and medium-sized businesses and extend support to high-tech enterprises ».
« We will ban any unjustifiable interference in entrepreneurship »
Vladimir Putin, Prime Minister of the Russian Federation, January and March 2010.

One peculiarity of the Russian economy is the relative weakness of its SME network. The estimated share of GDP produced by SMEs is around 13-17 %, while their part in total employment is only about a fifth, far below the respective figures in OECD countries. Part of this weakness seems to be due to the difficulties experienced by SMEs in the face of regulatory uncertainty (OECD, 2008, Molz *et alii*, 2010). The Government programme on long-term socio-economic development of the Russian Federation intends to increase the proportion of GDP produced by SMEs to 30 % by 2020.

A new « Law on SME development » had been adopted in 2007, but without being followed by the additional legislative acts that were necessary to put in concrete form its provisions. Shortly after his inauguration in May 2008, President Medvedev signed a decree on urgent measures to eliminate administrative barriers to entrepreneurship. This decision accelerated the adoption of other legislative acts (See Box 5).

Box 5. New measures concerning SMEs in Russia

- Pre-emptive rights to purchase state property leased for at least three years (July 2008)
- Limits to scheduled inspections of SMEs to one every three years : any unscheduled inspection now requires an authorisation of the Prosecutor General (May 2009)
- Introduction of a notification mechanism for 13 types of business activities including retail trade, hotel and restaurants and publishing (May 2009)
- Reduced tariffs for access to electrical grids
- Extension of the obligatory state contract quota of 10-20 % reserved for small businesses to purchases by municipalities.

Anti-crisis measures :

- Increase in budget expenditures to 10.5 billion roubles in 2009 directed at SME support, such as grants to new entrepreneurs, development of microfinancing and interest rate subsidies.
- Injection of 30 billion roubles into the capital of *Vneshekonombank*, targeted on commercial banks and non-bank financial entities working with SMEs.

Source : Conway and alii, 2009.

Additional measures could be adopted in the near future, among which the shortening of the list of products requiring certification, introducing special support for innovative SMEs, ensuring a non-discriminatory access to gas infrastructure, etc.

3. From laws to perceptions : the enforcement problem

« The severity of Russian laws is balanced by the fact that their enforcement is optional »
Mikhail Saltykov-Shchedrin

Despite the aforementioned stock of legal texts whose purpose is to improve the investment climate in Russia, the picture taken from western comments about the country's business environment is mitigated. For instance, the U.S. State Department considers that

> « investors [in Russian] face several significant challenges, including a complex regulatory and legal system that requires professional help to navigate, widespread corruption, a lack of respect for the rule of law, and immature banking and financial markets [...] Concerns about possible liabilities associated with existing operations (especially environmental cleanup) and inadequate bankruptcy procedures are also factors. »[11]

This assessment is confirmed by firms-level studies. Drawing their conclusions from a series of semi-structured interviews with small and medium-sized enterprises managers, Rick Molz, Ian Tabbaa and Natalia Totskaya conclude that "in Russia the institutional environment remains weak, unstable and unpredictable, creating challenges for SMEs to contributes significantly to growth and development of the Russian economy" (Molz *et alii*, 2009). Their conclusion can be confronted to other perceptions of the features that contribute to shape the investment climate in Russian : corruption, competition, and the role of judicial system.

11 *US State Department website (www.state.gov), 2010*

3.1. Corruption assessments, corruption perceptions

«Russian citizen have a primitive economy based on raw materials and endemic corruption »

Dmitry Medvedev, September 2009.

Anderson and Gray (2006) remarked that despite apparent efforts of the Government to strengthen the anti-corruption legislation, enterprises continued to regard Russia as a country were corruption is prevailing. The authors conclude that

> « the results for Russia underscore the fact that policy reforms may be necessary but are not always sufficient to reduce corruption in and of themselves. Fundamental institutional strengthening to ensure policy implementation, build checks and balances, and promote accountability in government is also essential » (Anderson and Gray, 2006).

The perception of corruption has not really improved since this statement. The Transparency International Corruption Perceptions Index (CPI) of Russia was downgraded in 2008 (2.1, against 2.3 in 2007), placing the country at the 147th rank out of 180 countries (143rd in 2007), on the same level as Bangladesh, Kenya and Syria. Russian *INDEM* foundation[12] estimates that the yearly cost of corruption offences is approximately $300 billion, almost equivalent to Russia's federal budget. The Investigations Committee of the Prosecutor General Office considers that private businesses in Russia pay up to $ 33,5 billion each year in bribes and kickbacks. Still, in recent years there have been few prosecutions and/or dismissals of high-level corrupt officials[13].

As a result, 43 per cent of the Russian citizens surveyed in 2008 did not consider the government's anti-corruption activities in the previous year to have been efficient. According to a survey conducted in September 2008, they consider that the most corrupted parts of the society are civil

12 *INDEM* (« Information science for Democracy ») is a Russian NGO founded in 1990 and devoted to research, assistance of the civil society and consultancy of Government bodies on such topics as anti-corruption.

13 However, the following figures show that the situation is not completely blocked : in January – October 2008, the total number of corruption investigations reached 11492 (up 7.6 % year-on-year), out of which 8890 cases were sent to court for further prosecution. In total, 5285 officials received criminal convictions for corruption offences, up 6,4 % compared to the same period of 2007 (Source : Transparency International, quoting the the Interior Ministry, 2009).

servants (index 4,5), followed by political parties, the Parliament, and Justice (3,9 each), private sector (3,7) and mass media (3,5). There is a general consensus about the endemic corruption among civil servants : 63 % of people surveyed think that they are the most corrupted sector (Transparency International, 2009b). Such a polarization of the public opinion on a specific sector is one of the highest in the world. Respondents to another survey were sceptical about the capacity of the Russian authorities to fight corruption : 56 per cent of business people and 58 per cent of citizens stated that it was 'hardly possible' (Transparency International, 2009a). More generally, in the Newly Independent States (among which Russia), the level of the perceived « State Capture » by private interests (that is, the ability of a private enterprise to obtain, by illegal means, favourable legal conditions from public officials) is the highest in the world : 71 % of respondents think that enterprises use corruption in order to influence politics, laws or governmental rules (Transparency International, 2009b).

3.2. Are Russian markets distorted ? The business point of view

"Modernization begins with oneself"

Igor Shuvalov, February 2010

In 2007, 53% of the total number of violations of antitrust law in 2007 was committed by various levels of the Russian Government, 80% of which being committed by the regional and municipal authorities (Conway *et alii,* 2009). Since then, simplifications in administrative procedures and the Government's efforts to struggle against arbitrary administrative decisions could have diminished the extent of administrative burden on private enterprises. Nonetheless, problems in the tax environment remain : many entrepreneurs complain about the complexity of the tax code and requirements of other regulatory and inspection bodies. According to them, the tax police makes no distinction between genuine, skilled tax-evaders and inexperienced small-business people, who often do not fully understand all the bookkeeping requirements. During tax disputes, companies often have little recourse other than the courts to solve their problems. However, while firms have successfully appealed to the courts, tax authorities are often slow to implement judicial decisions. This behaviour can be harmful in some case since penalties for non-compliance include confiscation of property and freezing a company's bank accounts.

After the 1990's, Government regained control over the oil and gas sector. Now, the state

companies *Rosneft* (oil) and *Gazprom* (gas) play a key role in this sector, that falls upon the 2008 "Law on strategic industries" already mentioned. Recent struggles on Production Sharing Agreements (PSA), that were designed in the 1990's to attract foreign investors, have raised concerns about the safety of the investments realized by foreign companies. Under official pressure, one PSA, « Sakhalin 2 », sold its majority stake to *Gazprom*. As a result, « Kharyaga » and « Sakhalin 1 » are the only remaining major PSAs with majority foreign ownership. In 2007-2008, *BP* experienced a legal dilution of its influence over its investment in oil major *TNK-BP*, after a wave of official actions initiated by Russian state bodies that affected *TNK-BP* operations and expatriate personnel. The event showed extensively the priorities of the Government in such matters and raised questions about the respect of property rights of foreign companies in the country.

The foreign business opinion on the topic can be illustrated in some way by this rather extreme assessment of the head of *Hermitage Capital Management*, one of the largest foreign portfolio investors in Russia by 2005 :

> "Anyone who would make a long-term investment in Russia right now, almost at any valuation, is completely out of their mind. My situation is not unusual. For every me, there are 100 others suffering in silence."[14] (quoted by Bowring, 2010).

3.3. The role of judiciary in the Russian business climate

> *« The investment climate in our country is directly dependent on the judicial system efficiency. Every time I meet with Russian entrepreneurs or foreign investors, they always say the same thing: if Russia is to have a first-class investment climate, the judicial system has to develop, mature and be able to effectively discharge its responsibilities. »*
> *Dmitry Medvedev , February 2010.*

According to *PriceWaterhouseCoopers*, the litigation process of a commercial tax or dispute in

14 *The Hermitage lawyer Sergey Magintsky, who had been fighting corruption of top official in Russia, died in custody in Moscow on 16 November 2009, after 11 months of detention without trial.*

three instances takes from 9 to 12 months (PriceWaterhouseCoopers, 2009). The « Arbitrazh Court » system is competent on commercial disputes between business entities. A survey conducted for the Institute of Contemporary Development concluded that the main problem for the judicial system in Russia is not corruption, but the high level of dependence of judges on government officials. The research showed that cases which do not concern the interests of government bodies are decided objectively. But for sensitive cases, that may result in the condemn of an official, judges tend to protect the interests of the latter. This tendency is explained by the over-dependency of judges' careers and personal situations over the chairman of the court, who is nominated by the President of the Russian Federation. As Bill Bowring puts it, « This does not mean that every judicial decision is dictated by someone or other. It means that any decision in any case may be dictated » (Bowring, 2010). As a result, many western enterprises who have investment or trade disputes in Russia prefer to refer to international arbitration in Stockholm or to courts abroad.

3.4. Aggregating perceptions : a survey of surveys

Many surveys have been conducted to give an aggregate picture of the business climate and its perceptions by economic agents. Most of them offers comparative scores and figures, ranking countries by their respective merits according to the given criterion. Of course, these surveys suffer from limitations. They are dependent on the selection of a rather arbitrary list of criteria ; some of them are constructed on « soft data » : they depend also on the number, characteristics and personal judgements of the persons (almost exclusively businessmen) surveyed. However, thanks to their simplicity, their results are widespread and exert a real influence on business and political decisions. Hence, it is worthwhile to compare the results of these surveys concerning Russia in this section.

The World Bank « Doing Business » publication is one of them. This survey measures the extent of administrative control over such economic activities as starting - and closing - a business, applying for a construction permit, hiring employees, registering enterprises' property, getting credit, protecting minority shareholders against ill-conceived decisions of the management, procedures for paying taxes and exporting, enforcing contracts. As shown in Figure 2, the comparison between Russia and 182 other countries included in the 2009 survey gives an average

performance not far from the mean, while underlining two domains in which the administrative burden seems to be particularly heavy : construction permits (see section 2.4) and international trade.

[Fig. 2 To be inserted here]

As shown in Table 2, a comparison with other BRIMC countries places Russia in a median position. The Russian situation has not evolved much in the last two years : its relative position improved according to 5 criteria, although 4 criteria show a degradation. The downgrading of its ranking according to the credit criteria may be due to the financial crisis that hit severly the Russian banking system. In addition, a similar analysis conducted in ten Russian cities[15] showed that Moscow, which is taken as the reference city for comparing Russia with other countries, is one of the most difficult cities for doing business in the country (World Bank, 2009b).

[Table 2 to be inserted here]

Completing the « Doing Business » survey, based on hard data obtained by a direct testing of the administrative operations, the EBRD-World Bank Business Environment and Enterprise Survey (BEEPS) propose a yearly coverage of the businessmen opinion on a range of issues about the business environment in Russia and other countries of Central and Eastern Europe, former Soviet Union, as well as Turkey. In Russia the sample is of more than 1000 firms in construction, hotels and restaurant, manufacturing, wholesale and retail, transport and other services. It was carried out from September 2008 to March 2009.

[Table 3 to be inserted here]

The 2008-2009 results of the BEEPS survey indicate a progressive shift of businessmen concerns about their environment in Russia. In comparison with the previous survey done in 2005, business regulations and their enforcement seemed to be more bearable by companies, while business executives increasingly complained about difficult access to skilled and educated workers as well

15 *Namely : Irkutsk, Kazan, Moscow, Perm, Petrozavodsk, Rostov on Don, St Petersburg, Tomsk, Tver, Voronej.*

as inadequate infrastructures (See Table 3). Between 2005 and 2008 the share of firms that reported paying bribes dwindle by half, although these results ranked Russia higher than the regional averages. About a quarter of senior management's time is declared to be spent dealing with public officials or public services in 2008, an increase of 7 percent from the 2005 survey[16].

The last survey used in this comparison is provided by the Global Competitiveness Report (GCR) of the World Economic Forum. Comparing the results of the two BEEPS surveys and the annual GCR is interesting since the two panels of businessmen are different[17] : contrary to the « BEEPS managers », who are largely Russian, the managers surveyed by the GCR work mostly in western multinationals. This structural difference helps to explain the – rare - divergences that can be observed in the two series of assessments of the Russian business climate (Table 3). The BEEPS managers tend to have more difficulties in hiring skilled workers than the GCR ones who are able, in average, to pay them much higher. Conversely, being more internationalized, GCR managers might give greater importance to macro-financial indicators than BEEPs ones. In both surveys however, corruption, tax regulations, infrastructure and criminality are considered by business people as the most problematic characteristics of the business environment in Russia.

[Figure 3 to be inserted here]

The « Global Competitiveness Report » elaborates 12 indicators as a basis for a comparative survey measuring the competitiveness of national economies. These indicators are built through questionnaires posted to top business executives and experts all around the world. The results of the questionnaires are compiled in order to rank economies along the « Global Competitive Index », an aggregated measure of the performance of a given country along this twelve dimensions. Figure 3 offers a comparison between the scores of Russia and France. It indicates that, according to the businessmen surveyed, the main weaknesses of the Russian environment lie in the quality of institutions, the degrees of sophistication in financial markets and business

16 *The World Bank, «Russian Economic Report », n°21, March 2010.*

17 *GCR respondents by firm size (Russian Federation, number of workers) :*

Size	*<101*	*101–500*	*501–1,000*	*1,001–5,000*	*5,001–20,000*	*>20,000*	*No response*
	368	*26*	*27*	*27*	*15*	*1*	*2*

and the goods markets efficiency.

During the last two years, Russian lost twelve places in the GCI ranking (63th from 51st in 2008-2009, among 133 countries), mainly reflecting its economic vulnerability during the crisis. As regard investment climate, the main drawbacks concern the perceived lack of government efficiency (110th), little judicial independence in meting out justice (116th), a lack of property rights (119th), concerns about government's favouritism in its dealings with the private sector, and poor corporate ethics (110th) in the private sector (World Economic Forum, 2009).

4. Reality in figures : from assessing to investing

It can be noted that despite the overall mediocre assessment of the Russian business environment by firms' decision makers, in 2007 Russia was the fourth most attractive destination for FDI after China, India and the United States (UNCTAD, 2007). This ranking was somewhat confirmed in subsequent years, Russia losing only one place, due to its weaker resilience to the crisis[18].

[Figure 4 to be inserted here]

Figure 4 describes the assessment of location factors that induce – or discourage - investors to take a stake in Russia. Clearly, market size and growth, the presence of competitors and, to some extent, access to cheap labour and natural resources are the main declared factors of the investor's presence in Russia : they are more often cited than in OECD or other BRIC countries.

Following their assessments by concrete decisions,multinational firms did not hesitate to invest in Russia in recent years. After a long period of stagnation, FDI inflows accelerated in the middle of the 2000's, doubling each year from 2005 to 2007. In 2007 they reached their record level, after the seventh year of uninterrupted growth in the country. Table 4 offers a synthesis of recent developments regarding economic growth and investments in Russia.

18 *Top six destinations for FDI in 2009–2011 (percent of the responses to WIPS survey) : 1. China, 56 % 2. United States, 47 % 3. India, 34 % 4. Brazil, 25 % 5. Russian Federation, 21 % 6. United Kingdom 18% (UNCTAD, 2009b).*

[Table 4 to be inserted here]

The period of surge of FDI in the world came to an end in 2008. The total amount decreased by 15 %. Interestingly, despite this unfavourable background, BRIC economies did not experience a decline in inwards FDI in 2008[19]. In Russia, FDI inflows were driven mainly by large investments in the power generation industry[20] then being liberalized (see section 2.4), as well as in the automotive[21], beverages[22] and real estate industries. The bulk of FDI in the country has been constantly concentrated in natural resource-related sectors (extraction, as well as oil and gas refining), reflecting one of the structural tendency in investment, both foreign and domestic (see Table 5 and annex for more details about the structure of FDI inflows in Russia).

However, in the second half of 2008, war with Georgia and tensions with certain developed countries, combined with concerns about the business environment and weaker economic performance, reduced investor confidence in the Russian Federation. The subsequent financial crisis definitely scaled back the amount of capital available for investment, resulting in a rapid fall of FDI all around the world. Russia was severely hit, with a drop of inwards FDI estimated to 48 % in January-September 2009 (Illukhina, 2009), in line with the world fall. This drop confirmed that market size and growth are prioritary location factors in Russia, provided the investing firm enjoys continued access to finance during tough times.

[Table 5 to be inserted here]

19 *UNCTAD Investment Brief, 2009, n°1*

20 *Fortum (Finland) acquired a controlling stake in TGC-10, RWE (Germany) bought a majority share in TGC-12, and EDF (France) has entered into a partnership with the Russian bidder TransNeftServis-S to acquire OGC-1, one of RAO UES' most valuable assets. Other foreign investors are ENEL (Italy) and CEZ (Czech Republic). The total amount of foreign investment was of $5.4 billion for the year 2008 (UNCTAD, 2009a).*

21 *Renault (France) increased its equity share from 25% to 50%-plus-one in OAO Avtovaz for $1.2 billion (UNCTAD, 2009a)*

22 *PepsiCo (United States) purchased a 75% stake in Lebedyansky, the country's largest juice producer, for $1.4 billion. This was the biggest deal in juice production in the Russian Federation so far, and the largest foreign acquisition by PepsiCo worldwide (UNCTAD, 2009a).*

5. Concluding Remarks

Investment climate is a multidimensional complex that cannot be correctly grasped without due regard to links and differences between theories adopted by the executive power, political announcements, legislative acts, enforcement processes, and rules incorporation by economic agents.

Our main findings are the following ones :

- at the « theories » and « legal » stages of the institutional evolution process, repeated declarations of top officials have given the image of a country eager to become fully integrated into the world economy. Russian authorities have asserted their will to clarify the legal system regulating natural monopolies, to struggle against corruption ant to support of SME and entrepreneurship. Several laws have been adopted in this aim (section 2).

- The main problems lie at the "enforcement stage" : it appears that legal texts designed to produce a level playing field in Russia are not fully enforced, while some of them are still lacking consistency. Several operations conducted recently by the administration in the energy sector have been at odds with official declarations about the necessity to protect property rights. In addition, it its current state the judicial system is not in capacity to give full effectiveness to the legal framework in Russia (sections 3.1 to 3.3.).

- Consequently, problems arise in the « evaluation » stage : in spite of official declarations, Russian citizens and businessmen surveyed continue to consider that problems affecting the institutional environment are not satisfactorily tackled by the Russian authorities. International assessments of the investment climate rank Russia among the least developed countries in the world, far behind other « BRIC » economies (section 3.4).

- Paradoxically, we cannot conclude from what precedes that Russia is not an attractive

country for foreign investors : recent FDI figures show a sharp decline since 2007, but the Russian evolution is in line with the world dynamics regarding international investment. It can be assumed that this decline is partly due to the reversal of risk appetite and the global tightening of financing conditions that occurred after the financial crisis, and not to country-specific factors (section 4).

The institutional approach used in this paper helps to understand the interactions between all dimensions of the investment climate. It provides an assessment of the Russian business climate evolution during the past two years. Also, it can be used to derive public policy implications from our findings :

- At the theory stage, authorities should adopt straightforward and non self-contradictory policies regarding foreign enterprises. This move could also facilitate WTO accession of Russia.

- At the legal stage, it remains necessary to overcome the lack of independence of the judiciary system vis-à-vis political power: any sound investment climate requires respect of the state of law. Certain contradictions regarding the legal treatment of foreign firms should also be removed.

- The results of the enforcement stage depend on the former. Assuming that main problems at these stages would have been correctly addressed, Russian authorities should ensure that administrative or judiciary bodies are properly prepared for their tasks, namely, interpreting and giving force to legal texts.

The main shortcoming of this study is the lack of a complete analysis regarding sub-national business climates in Russia. As we have shown in section 3.2, local administrations can greatly influence the business environment in their region, given their role in the enforcement process. The same applies with sectoral analysis : in a fast-transforming country, institutional problems can vary from an industry to another, as the negotiations for WTO accession have been showing extensively for 17 years.

Consequently, one would have to go further in analysing the variables evoked above in order to get a more complete picture of the investment climate in Russia. But this would exceed the scope of this paper. The same remarks can be made about the important question of the economic consequences of the barriers to entry maintained by the Russian authorities on some sectors and in some regions. Hence, these topics appear to be an appealing field for future researches on business climate in Russia.

Annex (Source : UNCTAD, 2009a)

Table A1. South-East Europe and CIS: FDI flows of selected countries, 2008–2009, by quarter

(Millions of dollars)

	2008:Q1	2008:Q2	2008:Q3	2008:Q4	2009:Q1	2008:Q1	2008:Q2	2008:Q3	2008:Q4	2009:Q1
Russian Federation		20 537	22 679	16 799	10 305	9 993	15 818	16 342	11 174	9 056 12 892
Total CIS	29 416	33 047	27 089	17 149	15 869	16 970	17 372	13 048	10 383	13 225

Table A2. Number of greenfield FDI projects in Russia, 2004–2009

	2004	2005	2006	2007	2008	2009(Jan–Mar)
Russian Federation	383	513	397	368	561	88
Number of foreign affiliates located in Russian :	1176 (2004)					

Table A3. FDI as a percentage of gross capital formation, 2006–2008

	2006	2007	2008
Russian Federation	16,2	20,2	19,5

Table A4. FDI flows to the Russian Federation, by Countries, 2007–2008

(Millions of dollars)

Economy	2007	2008a
World	47 853	52 173
Austria	324	387
Bahamas	354	-1 003
Bermuda	8 369	7 492
British Virgin Islands	- 392	2 178
Cyprus	12 061	18 336
Finland	980	1 574
France	414	419
Germany	7 695	2 446
Gibraltar	873	641
Italy	780	955
Luxembourg	-2 309	- 123
Netherlands	9 384	8 773
Norway	1 302	244
Seychelles	- 441	59
Sweden	529	500
United Kingdom	3 266	3 657
United States	1 498	2 003
CIS	131	9

a : first three quarters. Note : the data cover only non-banking corporations.

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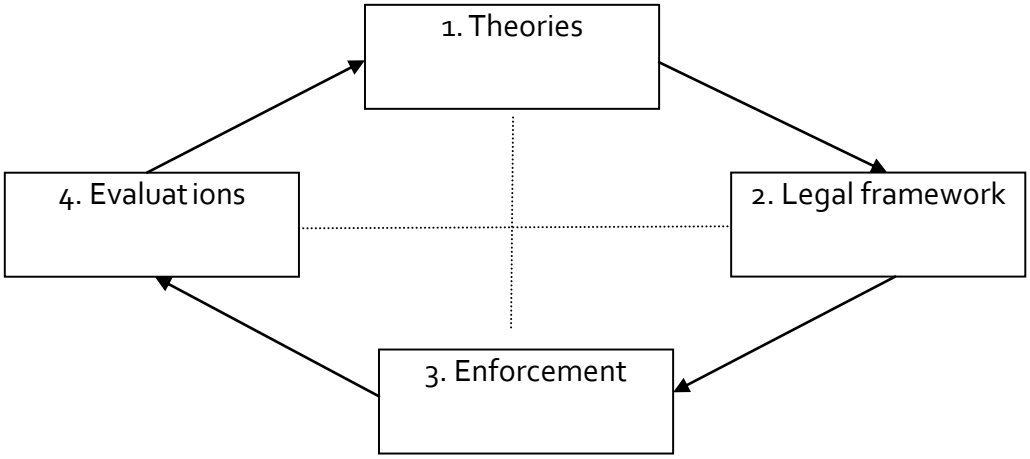
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Figure 1. The conceptual framework : dimensions of the institutional change



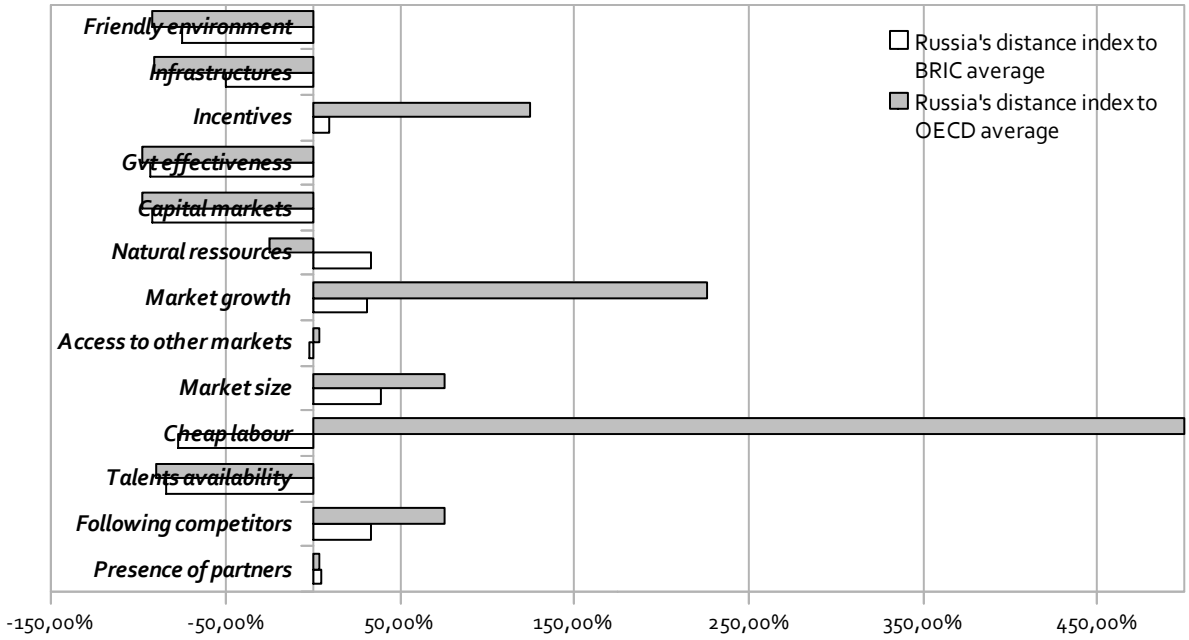
_____ : Main interactions

..... : Secondary interactions

Source : adapted from Vercueil, 2002.

Figure 4 . Investors perception of location factors in Russia

Comparison with BRIC and OECD averages, 2009-2011



Source : author's calculations based on UNCTAD, 2009b.

Table 1 . Main Restrictions to competition in Russia according to the OECD « Price Market Restriction Index » : a comparison with OECD countries

PMR in Russia 2009	*Russian Index, in % of the OECD mean index*
Regulatory barriers to international trade	*1850*
Antitrust exemptions	*920*
Price controls	*625*
Barriers to FDI (foreign acquisition of equity)	*283*
Tariffs	*273*
The use of command and control regulation	*250*
Discriminatory procedures against foreign firms	*200*
Administrative burdens for sole proprietor firms	*188*
Legal barriers to competition	*182*
Scope of the public entreprise sector	*152*
Administrative burdens for corporations	*147*
Government involvement in network sectors	*143*
Direct control over business entreprises	*141*

Source : author's calculations based on Conway et alii, 2009.

Table 2. Comparing Russia with other B(R)IMC according to the « Doing Business » criteria : rankings among 183 countries surveyed

	Mexico	**China**	**Russia**	**Brazil**	**India**	**Evolution of Russia's ranking 2009-2010**
Starting a business	90	151	**106**	126	169	-18
Dealing with construction permits	37	180	**182**	113	175	0
Employing workers	136	140	**109**	138	104	-5
Registering property	99	32	**45**	120	93	4
Getting credit	61	61	**87**	87	30	22
Protecting investors	41	93	**93**	73	41	-5
Paying taxes	106	130	**103**	150	169	5
Trading across borders	74	44	**162**	100	94	-2
Enforcing contracts	81	18	**19**	100	182	0
Closing a business	24	65	**92**	131	138	0
TOTAL	51	89	**120**	129	133	1

Source : World Bank, 2010. Note : a positive sign in the last column indicates a degradation of the ranking.

Table 3. Main problems faced by businessmen in Russia, 2005-2009 : a comparison between two BEEPS surveys and the Global Competitiveness Report

BEEPS 2008-2009	**Rank in 2008-09**	Rank in 2005	**The Global Competitiveness Report 2009-2010**	**% responses**
Skills and education of workers	**1**	4	*Corruption*	**19**
Tax rates	**2**	2	*Access to financing*	**16,9**
Corruption	**3**	3	*Tax regulations*	**11,6**
Electricity	**4**	13	*Crime and theft*	**9**
Access to land	**5**	10	*Inflation*	**8,7**
Crime, theft and disorder	**6**	8	*Inefficient government bureaucracy*	**8,2**
Telecommunications	**7**	14	*Tax rates*	**8,2**
Access to finance	**8**	6	*Inadequate educated workforce*	**4,1**
Transport	**9**	12	*Inadequate supply of infrastructure*	**3,6**
Tax administration	**10**	1	*Other*	**10,7**
Business licensing and permits	**11**	5		

Source : The World Bank, «Russian Economic Report », n°21, March 2010 (note : The most severe problem ranks number 1, the least 14) and World Economic Forum, « Global Competitiveness Report 2009-2010 », 2009.

Table 4. Russia : Economic Growth and Investment, 2007-2010

	2007	2008	2009	*2010**
GDP (growth rate)	8,10%	5,60%	-7,90%	*3,50-5,50 %*
Domestic Investment (growth rate)	22,70%	9,80%	-17,00%	-
Foreign Direct Investment (bns $)	27,8	27	15,9	-
Share of Gross Fixed Capital Formation (% GDP)	19,60%	20,90%	15,60%	*15,10%*

*Sources : Rosstat, Central Bank of Russia, International Monetary Fund, World Bank. * : forecasts*

Executive summary

Repeated declarations of top Russian officials have given the image of a country eager to become fully integrated into the world economy, offering a welcoming investment climate to foreign investors. Several laws have been adopted in this aim. However, problems lie at the "enforcement stage" : legal texts designed to produce a level playing field in Russia are not fully enforced, while some of them are still lacking consistency. Several operations conducted recently by the administration in the energy sector have been at odds with official declarations about the necessity to protect property rights. In addition, it its current state the judicial system is not in capacity to give full effectiveness to the legal framework in Russia. Consequently, Russian citizens and businessmen continue to consider that problems affecting the institutional environment are not satisfactorily tackled by the Russian authorities. International assessments of the investment climate rank Russia among the least developed countries in the world, far behind other « BRIC » economies.

Paradoxically, we cannot conclude that Russia is not an attractive country for foreign investors. After having attracted the fourth biggest amount of FDI in the world in 2007, recent figures show a decline, but this trend is fairly in line with the world dynamics regarding international investment : part of the drop is due to the reversal of risk appetite and the global tightening of financing conditions that occurred after the financial crisis, and not to country-specific factors.

As far as investment climate is concerned, several public policy implications can be derived from the above observations:

- Russian authorities should adopt straightforward and non self-contradictory policies regarding foreign enterprises. This move could also facilitate WTO accession of Russia.
- It remains necessary to overcome the lack of independence of the judiciary system vis-à-vis political power: any sound investment climate requires respect of the state of law. Certain contradictions regarding the legal treatment of foreign firms should also be removed.
- Assuming that the aforementioned problems would have been correctly addressed, Russian authorities should ensure that administrative or judiciary bodies are properly prepared for their tasks, namely, interpreting and giving force to legal texts.