

RUSSIA IN GLOBAL RANKING

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Various international organizations has recently published country rankings on various business environment metrics, namely Index of Economic Freedom, Corruption Perception Index, Forbes's "Best Countries for Business". Russia ranks low by all these organizations. The current tragic situation in Russia is determined by the disastrous situation with property rights, freedom from corruption, investment freedom, etc. – the fundamental, cornerstone components of business freedom. This leads to economic stagnation, prevents the advancement of more or less successful areas within the institutional environment. No wonder that certain scores in rankings are moving up while the economy is declining. The main problem in Russia, according to the GEM Project (Global Entrepreneurship Monitor), is that a new business can hardly survive after starting. Most individuals fail when it comes to starting a business in Russia.

The data on the 2014 **Index of Economic Freedom**¹ has been published. The index was created by The Heritage Foundation (an independent organization which is not supported by any government) in conjunction with The Wall Street Journal. The index is compiled based on the data on the previous mid-year. It describes various, including systemic, aspects of business environment. Foreign investors rely on the index, although the reliability of its measures is often controversial. Sometimes the index creators are reproached for being prejudice towards Russia. However, in certain cases, as noted below, their assessments seem to be more optimistic against the real situation.

The authors of the report define economic freedom as “absence of government coercion or constraint of economic activity, distribution, or consumption of goods and services, beyond that which is necessary for the protection and maintenance of liberty itself”. They are sure that there are clear relationship between economic freedom and successful economic development. This is virtually proved, as will be seen, by the data on Russia where the weakness of the most important aspects of business environment and related freedoms slows down economic growth and leads to stagnation in economic development. Seeking advancement to a higher score on the index tends to open up the capabilities of a market-driven economy in ensuring a stable,

positive dynamics and creates predictable conditions for individuals and businesses. A country's overall economic freedom score is a simple average of its scores on the 10 individual freedoms: 1. Business Freedom; 2. Trade Freedom; 3. Fiscal Freedom; 4. Government Size; 5. Monetary Freedom; 6. Investment Freedom; 7. Financial Freedom; 8. Property Rights; 9. Freedom From Corruption; 10. Labor Freedom².

According to the authors, world economic freedom has improved by 0.7 point from last year and the global average economic freedom score has reached 60.3, the highest ever recorded in the 20-year history of the Index. Only six countries have been considered the world's “freest” economies, namely Hong Kong with an economic freedom score of 90.1, Singapore, Australia, New Zealand, Sweden, and Canada (with a score of 80.2). Twenty seven economics have earned the designation of “mostly free” including the United States which has lowered from 10 to 12 place with a score of 75.5, Great Britain (14th with 74.9), Germany (18th with 73.4), Finland (19th with 73.4), Sweden (20th with 73.1) Japan (25th with 72.4). This group includes three former Soviet republics: Estonia (11th with 75.9) which has overtaken the United States, Lithuania (21st with 73.0), and Georgia (22nd with 72.6). The group of “moderately free” countries comprises 55 countries including most of the EU countries, Armenia, Latvia, Israel, Albania, South Africa, Kazakhstan, Kyrgyzstan, “mostly unfree” – 60 countries including the BRIC countries. Twenty six countries have been graded “unfree”. Zimbabwe, Cuba and North Korea bring up the rear.

Russia has had a score of 51.9, gaining 0.8 points from last year, but moved down from 139th to 140th place. Russia is ranked 41st out of 43 countries in the

1 The index is graded on the basis of analysis of the 10 economic freedoms and law which govern business environment, covering 186 countries (experts have managed to provide quantitative ratings on 178 countries though), on a scale of 0 to 100, where 100 corresponds to maximum freedom. Countries are considered “free” economies with economic freedom scores between 80 and 100, “mostly free” economies with scores between 70 and 79.9, “moderately free” economies with scores between 60 and 69.9, “mostly unfree” economies with scores between 50 and 59.9, “repressed” economies with scores below 50. The index has been calculated since 1995.

2 For more details on individual freedoms please refer to the materials posted in <http://www.heritage.org/index/book/chapter-5>

Table 1

INDEX OF ECONOMIC FREEDOM IN RUSSIA

Year	Overall Score	Business Freedom	Trade Freedom	Fiscal Freedom	Government Size	Monetary Freedom	Investment Freedom	Financial Freedom	Property Rights	Freedom From Corruption	Labor Freedom
2014	51.9	70.0	74.6	85.6	61.5	69.4	25.0	30.0	25.0	22.1	55.8
2013	51.1	69.2	77.4	86.9	54.4	66.7	25.0	30.0	25.0	24.0	52.6
2012	50.5	65.1	68.2	82.5	48.6	66.3	25.0	40.0	25.0	21.0	63.5
2011	50.5	50.7	68.2	82.7	65.1	63.1	25.0	40.0	25.0	22.0	62.9
2010	50.3	52.2	68.4	82.3	66.5	62.6	25.0	40.0	25.0	21.0	59.6
2009	50.8	54.0	60.8	78.9	70.6	65.5	30.0	40.0	25.0	23.0	60.0
2008	49.8	53.7	44.2	79.2	69.5	64.4	30.0	40.0	30.0	25.0	61.7
2007	52.2	62.0	62.6	79.5	69.5	62.8	30.0	40.0	30.0	24.0	61.5
2006	52.4	59.7	62.6	90.8	63.5	68.0	30.0	30.0	30.0	28.0	61.8
2005	51.3	55.0	63.2	91.5	58.9	65.6	30.0	30.0	30.0	27.0	61.8
2004	52.8	55.0	63.2	91.6	65.1	63.4	50.0	30.0	30.0	27.0	-
2003	50.8	55.0	57.4	90.6	64.5	57.0	50.0	30.0	30.0	23.0	-

Europe region and remains at the bottom of the list of the countries with “mostly unfree” economies, being one place behind Tajikistan.

Table 1 shows Russia’s overall score and its components over the past 12 years. The Table shows that Russia’s current score on the index are lower than it was during the economic growth prior to the crisis (a score of 52.8 in 2004, 52.3 in 2006, 52.4 in 2007), then it dropped during the crisis and stalled between 2009 and 2012, ranging around 50.5, and started to move up slowly since 2013. However, it was very low even in its palmy days, and its dynamics is stagnant.

Russia’s highest score refer to **fiscal freedom** (85.6 in 2014). In 2003–2006 it was even beyond the score (90) that Singapore, the second freest economy, has now in the overall score. Such a high score reflected the indeed successful tax reform which was implemented in Russia in 2002. It has slid down substantially, more than 10 points, since 2007, then increased slightly in the recovery period since 2010. Given such a dynamics and the report’s notes, this index covers not only pure fiscal specifics and tax burden, but also public spending, as well as public debt, which eventually have an impact on changes to taxation. The threat of instability coming from the federal budget’s dependence on global crude oil prices is also considered. At the same time, it is somehow surprising to see a high score on fiscal freedom in 2011–2013, when insurance premiums saw drastic changes and higher tax on self-employed entrepreneurs was introduced. Russia’s 86.9 score in 2013 has been the highest ever in the index in the recent years, but Russia lost 1.3 points in 2014.

Next level is a score of **74.6** on the **trade freedom** category of the 10 economic freedoms. It has moved up considerably since 2013, when Russia was accessed

to the WTO, but lost 2.8 points in 2014. The authors believe that it is associated with maintaining non-tariff barriers, including but not limited to tariff-rate quotas on agricultural products, which boost trade costs and impede imports.

Next is a score of **70.0** on the **business freedom** category of the 10 economic freedoms, which has been beyond the global average economic freedom score. Business freedom is about an individual’s right to establish and run an enterprise without undue interference from the state. Redundant regulations are the most common barriers to the free conduct of entrepreneurial activity. Economic freedom in this area is measured on the basis of data which is to a certain extent similar to that which is used to grade individual components of the **Doing Business** ranking. Its analysis was made in the article called “Предпринимательский климат в России. Процедуры души” [Business environment in Russia. Strangling procedures]¹. In particular, this ranking shows a substantial advancement in such areas related to business freedom as property registration, settlement of disputes related to execution of contracts, starting a business, as well as a relatively high place on bankruptcy proceedings. However, the article shows that any simplification, which should be hailed anyway, to procedures may not lead to a real progress in the respective areas. For instance, it is the bribery that constitutes a key barrier to starting a new business at the local level, which can’t be eliminated by making reasonable changes to the existing registration rules. With allowance for this, the business freedom

1 Виктор Стародубровский. Предпринимательский климат. Процедуры души. // Экономическое развитие России. 2013. № 12. [Victor Starodubrovsky. Business environment. Strangling procedures. // *Economicheskoye Razvitiye Rossii*. 2013. No. 12.]

score on the index of economic freedom seems to be overrated. Furthermore, the authors themselves point out that unreasonable bureaucratic pressure from regulators in Russia leads to their interfering with the entrepreneurial decision-making.

Close to the foregoing category is the *monetary freedom* category of the 10 economic freedoms, showing a score of **69.4**. This is the highest economic freedom score ever in the years under review. Monetary freedom requires a stable currency and market-determined prices. Consequently, businesses and individuals can be predicted in terms of their activity in years to come. Generally, the index tends to increase with certain fluctuations. Indeed, Russia is seeking anti-inflationary monetary policy, which has not been successful yet.

Next is the *government size* category of the 10 economic freedoms with a score of **61.5**. Its high score is determined a small public debt, however the dynamics is less conceivable. For instance, the government ran a responsible financial policy in the period of 2004 thru 2006, and the low score on the index against the backdrop of high budget surplus in 2005 raises questions. The policy worsened in 2007, government spending increased considerably while the index somehow moved up. However, the 2007 index reflects the data on 2006, it remained unchanged in the following year. The trend towards the prevalence of budget deficit in 2011 and in many months within 2012 has had an effect on its dynamics in recent years which is determined by favorable crude oil prices, according (with good reason) to the authors. A budget surplus was expected too at the end of the first half of 2013 covered by the study, but the year eventually saw a budget deficit, and its score was unreasonably high.

The *labor freedom* category has a score of **55.8**, however the report points out that the Labor Code keeps impeding employment growth. The score is below that which was recorded during the crisis and well below the highest score (63.5) in 2012. The labor freedom score is based on employment opportunities for individuals to work as long as they wish and whenever they wish while for businesses to hire and fire employees according to their need. These are almost incompatible. The freedom of employers to hire and fire employees facilitates business effectiveness, however the former task requires serious measures from the government to support the unemployed and promote new jobs. High labor freedom score may reflect how weak trade unions are in protecting employees and the government in performing the said functions.

The rest of the categories of the Index of Economic Freedom have disastrous scores, including those

which play a fundamental role in creating a favorable business environment.

Monetary freedom has received a score of mere **30** and considerably declined in the recent two years from the preceding six years. Conceptually, monetary freedom offers a variety of financial opportunities for building up capital and personal incomes and risk diversification which reduce risk occurrences. It is essential here to score the situation in the banking system and the degree of its regulation, as well as the degree of the stock market development.

Investment freedom has received even a lower score of **25** in the last five years, having been halved since 2003 and 2004. This area is distinguished by the fact that creating an environment facilitating a maximum possible variety of opportunities for both internal and external investment helps provide incentives for their most efficient use for the benefit of promoting economic activity, enhancing productivity, creating new jobs. The persistently deteriorating situation in this area in recent years, including a real decline of capital investment in 2013, proves that such a low score is correct.

Property rights, which refer to the guiding principles of a successful market-driven economy, have been graded the same score of **25**. Its reliability under the Russian circumstances, which injects uncertainty into businessmen about their future, has been underpinning weak investment, extremely weak dynamism, actual economic stagnation in recent years, especially in 2013. Efficient protection of property rights implies a well-functioning and truly independent legal system including judicial system. There is no need to comment on the lack of such independence, prevalence of “telephone justice” in this country. The reliability of incentives enforcing rational conclusion and due execution of contracts is considered too in this area.

Finally, *freedom from corruption* has the lowest score of **22.1**. In 2014, it declined from a score of 24 in the last year, let alone the highest score of 28 recorded in 2006. The scope of corruption in Russia are well known, including its restraining effect on the economic development is obvious. In its turn, maximum openness of public regulatory procedures has become a key tool in coping with the issue for securing freedom and independence of press, independence of courts, and other required conditions.

The Russian specific feature – the tragic situation, to be more accurate, – is Russia falling behind in creating the fundamental conditions required for favorable business environment, which prevents the advancements achieved in restricting barriers related to redundant regulative procedures from contributing to the improvement of the economic situation. The re-

lated improvement in the Doing Business ranking was covered in the previous article. Furthermore, the same is related to the effects of high scores on the various aforementioned economic freedoms. It has to be asserted whenever there is a need to make a real assessment of the situation, without being surprised by seeing certain scores of the rankings move up while the economy is moving the opposite direction. It is the clutches of unfreedom that basically impede the normal economic development. Unfavorable business environment in the country is rooted in the failure of most significant conditions which are required to achieve a successful market-driven economy.

Transparency International, an independent organization, has published its 2013 **Corruption Perception Index**¹. Russia has maintained its **28** score in the index but moved up from **133rd** to **127th**, sharing the same place with Pakistan, Nicaragua, Mali, Madagascar, Lebanon, Gambia, Comoro Islands, and Azerbaijan. This implies that certain countries which had a higher score on the index have begun to lag behind Russia. To compare, Denmark and New Zealand, which have been recognized the least corrupt and shared first place, have a score of 91. Not only Russia has been graded behind Estonia (28th), Latvia (49th), Armenia (94th), but it has found itself behind Moldova (102nd) and Belarus (123rd). Leaving behind Kazakhstan (140th), Ukraine (144th), Kyrgyzstan (150th), Tajikistan (154th), as well as with high corruption remaining a severe issue worldwide (more than two-thirds of the countries have achieved scores below 50 on the index grading scale) is cold comfort for Russia. Russia brings up the rear among the BRICS countries. South Africa and Brazil rank 72nd with a score of 42, China – with 80 (40th), India with 94 (36th). These international comparisons is another clear evidence of how severe the corruption issue is in this country.

Forbes has been ranking the **Best Countries for Business** annually since 2006². It has presented its 2013 rankings (according to the data on 2012) covering 145 countries. Countries are normally graded on 11 different metrics including personal freedom, property rights, investor protection, stable prices, trade freedom (availability of barriers to export and import of goods and services), technology, innovation, monetary freedom, corruption, taxes, and stock market performance. The study is based heavily on generalizing the rankings developed by Heritage Foundation;

1 This index is measured on a scale of 0 to 100, where 0 is highest corruption and 100 is lowest corruption. The index was calculated in 2013 for 177 countries and territories. http://www.transparency.org/news/pressrelease/Corruption_Perceptions_Index_2013_RU

2 <http://www.forbes.com/best-countries-for-business/list/> #page: 2_sort:0_direction:asc_search

World Economic Forum; Transparency International; Freedom House; World Bank; Central Intelligence Agency; Property Rights Alliance.

Russia ranks **91st**, improving by 14 points from the previous year. Ireland ranks first, overtaking the former leader – New Zealand, while Hong Kong took third place, Great Britain was 12th, the United States – 14th, Japan – 28th. Russia has been ranked behind South Africa (41th), Armenia (65th), Azerbaijan (67th), Kazakhstan (70th), Brazil (80th), Moldova (88th), but ahead of China (94th), India (98th), Ukraine (99th). While it is shown that various rankings provide different results for countries, Russia has always been rated very low. Still, such ranking criteria as taxes (45th), technology (58th) look a little bit better. Russia ranks 96th on investor protection, 99th on property rights, 112th on corruption, 117th on personal freedom, 125th on monetary freedom. However, the fundamental areas of the Russian business environment still remain lowest-ranked.

The GEM Project (Global Entrepreneurship Monitor) is of interest. Its 2013 report marks the 15th anniversary of the Global Entrepreneurship Monitor³. The Project was designed by members of the Global Entrepreneurship Research Association. Babson College is a founding institution and lead sponsor of the Global Entrepreneurship Monitor (GEM), located in Wellesley, Massachusetts, USA, is recognized internationally as a leader in entrepreneurial management education, Universidad del Desarrollo, one of the top three private prestigious universities in Chile, Universiti Tun Abdul Razak (UNIRAZAK), one of the first private universities in Malaysia. In 2013 more than 197,000 individuals who participate in various phases of entrepreneurial activity were surveyed (2029 in Russia) and approximately 3,800 national experts on entrepreneurship participated in the study across 70 economies, collectively representing all global regions of the world and a broad range of economic development.

Let's compare the data on various phases of entrepreneurial activity over a few years for Russia in 2013 with the United States, Germany, Japan, and China.

It is natural to see a certain, sometimes considerable, boost in entrepreneurial activity in Russia since the 2008 crisis, as well as decline in discontinuation of business which was the highest during the crisis. However, it should be noted that Russia is behind the United States and China but ahead of Germany and Japan on early stages of entrepreneurship, whereas it is behind all the compared countries on the level of entrepreneurial activity of established business. It is a good thing that early-stage entrepreneurial activity, endeavor to start a business has been growing, however our major problem is that it is hard to stay

3 <http://www.gemconsortium.org/docs/download/3106>

Table 2

**THE LEVEL OF ENTREPRENEURIAL ACTIVITY IN THE COUNTRIES PARTICIPATING IN THE GEM PROJECT IN 2013
(AS PERCENTAGE OF THE ADULT POPULATION (18–64 YEARS OLD))**

	U.S.A.	Germany	Japan	China	Russia					
					2013	2012	2011	2010	2009	2008
The level of nascent entrepreneurial activity, % ¹	9.2	3.1	2.2	5.2	3	3	2.4	2.1	1.8	1.7
The level of entrepreneurial activity of owner-managers in new businesses, % ²	3.7	2	1.5	8.9	2.8	2	2.3	1.9	2.3	2
Early-stage entrepreneurial activity index (TEA), % ³	12.7	5	3.7	14	5.8	4	4.6	3.9	3.9	3.5
The level of entrepreneurial activity of established business owners, % ⁴	7.5	5.1	5.7	11	3.4	2	2.8	2.8	2.3	1.1
The level of business discontinuation, % ⁵	3.8	1.5	1.5	2.7	1.6	1	1.5	0.8	2.2	4.4
Necessity-driven entrepreneurs (% of TEA) ⁶	21.2	18.7	25	33.9	35.4	36	27	32	29	
Improvement-driven opportunity entrepreneurs (% of TEA) ⁷	57.4	55.7	59.6	35.9	42	31	42	30.3	37	

¹ The percentage of the population (18–64 years old) who are actively involved in business start-ups as owners and co-owners. The business exists more than three months, but has not yielded wages or other types of labor remuneration.

² The percentage of the population (18–64 years old) acting as owner-managers in a new business. The business has paid wages and other types of labor remuneration to the owner for more than three but less than 42 months.

³ Describes the level of early-stage entrepreneurial activity. The percentage of the population (18–64 years old) acting currently as nascent entrepreneurs and owner-manager in a new business. This is not just a simple sum of the former two indicators. If respondent is involved in both types of entrepreneurial activity, his/her entrepreneurial activity is only considered once.

⁴ The percentage of the population (18–64 years old) acting currently as owner-manager of an established business. The business has paid wages and other types of labor remuneration to the owner for more than 42 months.

⁵ The percentage of the population (18–64 years old) who have sold, discontinued or ceased to be the owner-manager in a business over the recent 12 months.

⁶ The percentage of the population involved in early-stage entrepreneurial activity by necessity, i.e. they have no other options for income.

⁷ The percentage of the population involved in early-stage entrepreneurial activity, who have improvement-driven opportunity motivation to either earn more money or be more independent.

in business, as many failed during the transition from the early-stage entrepreneurial activity to the established business activity. This corresponds to a slightly different view of the data provided by The Russia Longitudinal Monitoring Survey – Higher School of Economics (RLMS-HSE) which shows that about 10%

of the respondents made attempts to start a business under favorable conditions of successful economic growth prior to the crisis, but just less than 4% of them managed to do that. Such a situation reflects the business environment which is prevailing in the country. ●