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## SOCIO-POLITICAL CHALLENGES FOR RUSSIAN BUSINESS DEVELOPMENT AT THE CURRENT STAGE OF RUSSIA- WESTERN ECONOMIC RELATIONSHIP

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### ABSTRACT

*The tensions in the relations between the Russian Federation and the West has been in the focus of modern global politics, especially in the last few years. Deteriorated diplomatic relations and mutual political and economic sanctions characterize the current situation. This disposition presents various issues of social and political character for Russian business development. The purpose of this article is to examine these issues and the measures the Russian government implements to address them. The authors analyzed official documents such as Economic Security Strategy until 2030, proceedings of Gaidar Forum and other top priority meetings, as well as the relevant sources and statistics. Several conclusions are made as a result of this research. The current political climate between the Russian Federation and the West affects the state of the Russian economy. Even though, the strategic vision for main challenges in Russian economy has been laid out, the perspective to resolve these challenges remain vague.*

**Keywords: sanctions; Russian economy; economic growth; socio-political challenges; business-government relations**

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### INTRODUCTION

In April, 2017 Idriss Jazairy, Special Rapporteur of the UN Human Rights Council, dealing with the negative impact of unilateral coercive measures, stated in his report that over 3 years of economic sanctions Russia has lost approximately 52-52 billion USD, while the countries who imposed sanctions, like the USA, EU states and others, have lost around 100 billion USD. In conditions when challenges of political and military nature have increasing influence on matters of economy and economic measures are used to achieve political goals, the Economic Security Strategy of the Russian

Federation until 2030 was signed by president Putin in May 2017. This document highlights internal and external economic and socio-political challenges for Russian economic security and provides strategic vision of resolving these issues.

According to the Economic Security Strategy until 2030, the main challenges to the economic security of the Russian Federation as follows:

- a) desire of developed countries to use their advantages, including information technology, as a tool for global competition;
- b) restrictions on access to international financial resources and modern technologies;
- c) fluctuations in global commodity and financial markets;
- d) changes in the structure of global demand for energy resources and the development of "green" technologies;
- e) creation of interstate economic associations without Russian participation;
- f) vulnerability of the financial and banking system;
- g) insufficient investment in the real sector of the economy;
- h) gap in the field of advanced technologies between the Russian Federation and developed nations;
- i) increased conflict potential in the zones of economic interests of Russia, as well as near its borders
- j) high level of criminalization and corruption in the economic sphere;
- k) insufficient development of transport and energy infrastructure;
- l) ineffective public governance".

The Gaidar Forum is an annual meeting of government officials, public figures, businessmen and scientists, that acts as "the Russian Davos Forum" and "is an important source of information on major trends in social-and-economic and political development, status of business environment and investment climate of Russia, ... the participation in the Forum makes it possible to determine the prospects for further economic growth and integration of Russia into the global economy". The Ninth Gaidar Forum, held in Moscow from January 16th to 18th, 2018, witnessed a record number of participants, bringing together 15,400 people and had special significance in the context of working out the most effective ways of implementing the Economic Security Strategy.

On January 15, the TASS press center hosted a conference where the program of the event was presented. The Rector of The Russian Presidential Academy of National Economy and Public Administration (host of the Forum), Vladimir Mau, stated that in 2018 the economy will not be the central topic of the forum because "... we want to say that there are things more important than economics, beyond economics." Among the most

important, there were also discussions about the digital society, education challenges and health problems.

However, Gaidar Forum also highlighted certain pessimism, among the experts, regarding the current state of the Russian economy and the prospects for its growth. Such were the results of the audience's vote on the question: "Do you agree with the statement that the world economy recovered from the 2008 crisis and the Russian economy recovered from the crisis of 2015-2016?": 13.9% voted for the "both did", "global economy recovered, Russia - did not" - 50.18%, "global economy did not recover, Russia did" - 7.69%, "both did not recover" - 28.94%.

It is necessary to add that Russia rose in the ranking of Doing Business-2018 to 35th place while in 2017 was five steps lower – 40<sup>th</sup> (and in 2012 – 120<sup>th</sup>). In the "May decrees" of 2012, President Vladimir Putin set the task of achieving the 20<sup>th</sup> position in this rating by 2018. Nevertheless, as noted in the report, in order to provide additional business benefits in Russia, efforts are needed in two areas: "Obtaining building permits" and "International trade".

## **LITERATURE REVIEW**

Together with the Economic Security Strategy of the Russian Federation until 2030 and numerous speeches of the Prime-Minister of the Russian Federation Dmitriy Medvedev (Medvedev 2015), multiple academic papers are written on the topic of the consequences of the Western sanctions on Russia and Russian business and economy development. Among distinguished Russian authors the papers of Gorshkov (2016), Sazhina (2015), Chernenko (2015), Shokhin (2017), Philatova (2017), Kosov (2016), Yarkova (2018) should be named as the most informative source. The proceedings and interviews of the Gaidar Forum 2018 and X Week of Russian Business 2017 also highlight the current status of the Russian economy. The foreign experts Rutland (2014), Connolly (2018), Dreyer and Popescu (2014) also proved to be beneficial for this research and provided a new perspective.

## **RESEARCH METHOD**

Comparative analysis of the relevant sources and expert interview along with the historical analysis, content and discourse analysis are used to address the research question.

## **FINDINGS AND DISCUSSION**

Economic Security Strategy of the Russian Federation not only determined the main challenges to the economic security of the country but also presented goals and objectives that shall direct the government's effort. We

can highlight the following objectives:

1. Strengthening the economic sovereignty of the Russian Federation;
2. Increasing the resistance of the Russian economy to effects of internal and external threats and challenges;
3. Supporting economic growth;
4. Maintaining the potential for scientific development and increasing the competitiveness of the economy;
5. Maintaining the potential of the military-industrial complex;
6. Improving the quality of life of the population.

The US and the EU announced the sanctions imposed in March 2014 against Russia as measures to force it to fulfill unconditionally the demands of the United States and a number of Western countries regarding Russian position on Ukraine and the Crimea. The content of sanctions indicates that they are aimed at international isolation of Russia, the weakening of its economy. The group of economic, financial, and other types of sanctions refers primarily to the three sectors of the Russian economy: banking, oil and gas, and defense. Nevertheless, there are threats concerning the reducing the volume of imports to Russia in strategic sectors. The main items of Russian imports, accounting for more than 80% of the total volume of Russian imports from non-CIS countries, are machinery and equipment, chemical products, etc. (Gorshkov 2016)

In response to these sanctions, Russia imposed a ban on the import of agricultural products, raw materials and food products originating in the United States of America, the countries of the European Union, Canada, Australia and the Kingdom, Norway.

It is important to note that the most important direction from the Strategy, such as the dependence of the economy on imports and the import substitution program, completely disappeared from the Strategy. Among the challenges in the sphere of economic security there is not a word about the critically high dependence on imported products. Although neither in agriculture nor in manufacturing, the country has reached a level of full independence. Because the imported goods in the structure of consumption in a number of industries constitute above 50%, Russia simply cannot afford a competitive (or at least protectionist-supported) alternative to the import (Philatova 2017).

It should be noted that the Russian Federation is import-dependent in the field of food security, despite a serious attitude towards the agro-industrial complex, which has very unattractive indicators of its development and requires serious investment by the state (Yarkova 2018).

**Table 1. Indicators of Russia's foreign trade in food and agricultural raw materials for its production, million USD (Yarkova 2018).**

Indicators	2015	2016	Relative deviation of 2016 by 2015, %
Goods turnover	42 804,6	41 946,1	98,0
Import	26 584,0	24 902,0	93,7
Export	16 209,0	17 044,0	105,2
Trade balance	-10 386,0	-7 857,7	...

The data in Table 1 in terms of the negative trade balance shows the presence of import dependence. However, we should pay attention to the positive dynamics of the measures implemented at the state level in Russia, namely: the level of food imports fell by 6.3%, and exports increased by 5.2%.

It is possible to deduct how sanctions affect the food security of the Russian Federation. Sanctions lead to an increase in consumer prices. For example, consumer prices rose by 27% for certain types of meat products from 2013 to 2016. (Shakleina, Shvetsova, Shaklein 2018) Sanctions lead to a decrease in consumption. (Yarkova 2018) and to a small increase in domestic production (Yarkova 2018).

If we analyze sanctions against the financial sector, it is especially alarming that banks that fall under sanctions are either completely or partially controlled by the state. That is, sanctions can and should be viewed as a challenge to the state as a whole. In addition to sanctions, international rating agencies in 2014 lowered Russia's credit ratings to "below investment" level, regardless of the real macroeconomic indicators at that time, which corresponded to ratings at 2-3 steps higher. This circumstance seriously hampered access to Russian organizations, which were not subject to sanctions, to world capital markets. This, as well, leads to increase in consumer prices, stagnant wages and increase in unemployment (Kosov 2016).

The consequences of the sanctions imposed on Russia are likely to be most pronounced in the investment sphere. Thus, restrictions on the export of high-tech equipment may lead to postponement of the implementation of some new investment projects. However, the pace of implementation of such investments may fall on its own against the backdrop of weak global demand and low oil prices. Restrictions on new medium and long-term borrowings will lead to a reduction of external financing of new investments. In this regard, the special relevance is gained by the

development, adaptation and implementation of the company's strategy, taking into account the prevailing economic situation, that would not only allow the organization to be preserved as an economic entity, but also contributed to the transition to a new level of development.

Another factor that presents itself as a challenge for Russian economy and business development, and is augmented by the effect of sanctions is the low level of development of the high-tech sector, while knowledge-intensive industries play a strategic role in ensuring the quality and pace of the development of the economy of any country. Today, Russia's lag in applied technological norms from the leading countries - the US, Japan, Taiwan - is about 20-25 years (Sazhina 2012). Industrial output with a high degree of processing accounts for about 7% of Russian exports, while in Germany this figure exceeds 80% (Chernenko, Shvedova 2015).

At the Gaidar Forum, OECD experts noted that Russia's economic growth potential has declined from 7% to 1.5% since the beginning of the 2000s. OECD attributed this to low labor productivity.

**Table 2. Labor productivity (Chernenko, Shvedova 2015).**

Countries	Labor productivity, PPP (thousand USD)	Labor productivity, dollar rate (thousand USD)
USA	107,6	107,6
EU	69,3	74,5
Russia	33,9	28,1

If the average labor productivity in Russia, calculated at purchasing power parity, is 3.2 times lower than in the US, then in some sectors this gap is even more significant. Therefore, in comparison with the United States in Russia, labor productivity in the social sphere, education and health care is 6 times smaller, in agriculture - 6.4 times, in construction - 2 times, in the financial sector - 3.5 times (Chernenko, Shvedova 2015)

Yet another challenge the Russian economy is facing at the current stage is maintaining a healthy relationship between the state and the private business, and being responsive to how industrialists and entrepreneurs cope with the consequences of sanctions. The economic sanctions that hit Russia have exacerbated many of the country's economic problems:

- a) Increasing the risks for the state. These are geopolitical risks, economic risks (inflation, crisis), systemic risks (high level of corruption, inefficient management

- system, lack of control over society);
- b) Aggravation of the contradictions between the state power and Russian business as a consequence of the sanctioning pressure of Western countries. The negative impact of direct sanctions, initiated by the United States, posed a number of difficult problems for Russian business: the renewal of licenses of companies working with foreign partners; the severance of relations with Russian companies because of political considerations; measures forcing Russian producers of public catering good to enter the big-scale market unprepared, etc;
  - c) Negative dynamics of registration of individual entrepreneurs. The number of registered IEs as of January 1, 2015 was 3 500 000 against 4 000 000 as of January 1, 2013;
  - d) Imperfection of mechanisms for bringing state support to business. First, the financial resources allocated annually from the federal budget for the development of small and medium-sized businesses; second, readiness for cooperation with small and medium-sized businesses. Programs of such cooperation are developed by federal bodies, and their implementation depends on regional government bodies that do not always ensure the implementation of cooperation programs. (Sazhina 2015)

In November 2017, the Russian Union of Industrialists and Entrepreneurs conducted a survey "Business Environment Index of the Russian Union of Industrialists and Entrepreneurs". Participants were asked additional questions about the consequences of imposing sanctions on Russian business. 55 companies participated in the questionnaire on this topic. 70.4% of respondents indicated "industry" as the main type of economic activity. About 11% of companies belong to the energy sector. The construction sector companies accounted for 9.3%, while the transport and communications sector companies - 7.4%. The majority of respondents (83.3%) are classified as "big business", representatives of medium-sized enterprises accounted for 7.5%, and small businesses - 9.2%.

48.1% of companies that participated in the survey believe that economic sanctions affect the activities of enterprises. 38.9% deny the impact of sanctions on their companies, and 13% found it difficult to answer this question. The following questions revealed which effects from sanction turned out to be more drastic for businessmen: The most critical for Russian business was the rise in prices for raw materials, equipment, components associated with the imposition of sanctions by the EU countries, the United

States, Japan and other countries - this was stated by 64.6% of respondents. The reduction in the availability of loans and credit (48.9%) and the reduction in investment (35.4%) follow as presenting the most tangible negative effects of sanctions. The least tangible effect was discovered regarding these issues: Problems with goods export (6.4%), termination of cooperation in the oil and gas sphere (9.5%) and termination of cooperation in the defense sphere (11.4%).

These polls demonstrate that even though some aspects of sanctions did not affect the surveyed entrepreneurs severely, nevertheless other serious issues still persist and need to be further addressed in domestic and foreign policy.

## CONCLUSION

The current state of the Russia-West relation, specifically the mutual sanctions, certainly has a drastic effect on the Russian economy and business development. Russian economy, struggling with certain challenges like corruption, scientific and technological lag, and ineffective public governance under the pressure of economic sanctions witnessed the aggravation of the economic situation.

The government implemented a number of measures and policies, which succeeded in neutralizing some of the negative effects of the sanctions:

- a) support of import substitution and export of non-commodity goods;
- b) promoting the development of small and medium-sized businesses by reducing financial and administrative costs;
- c) reduction of tensions in the labor market and support for effective employment;
- d) creation of opportunities for attraction of circulating and investment resources in the most significant sectors of the economy;
- e) optimization of budget expenditures by identifying and reducing inefficient costs, concentrating resources on priority development areas and meeting public obligations;
- f) compensation of additional inflationary costs to the most vulnerable categories of citizens (pensioners,



families with several children);

- g) Increasing the stability of the banking system and creating a mechanism for the rehabilitation of ineffective system-forming organizations.

These measures ultimately led to gradually stabilizing the economy and combating the inflation rate. However, our research showed that a number of issues still stay relevant and pose as valid challenges and threats to Russian economic security. As the sanction regime continues, and new sanctions are implemented from both sides we can expect the further exacerbation of the current problems. The Russian government and business need to cooperate closely in strengthening Russian economy and find new ways and specific measures and policies that would secure the welfare of the population of the Russian Federation as well as national economic interests.

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