The Regional Dimensions of Barriers to Business Transactions in Russia

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1 Introduction

Growth is finally underway in Russia.[2] But is this new-found growth – initiated largely by the import-substitution effects from the devaluation of the ruble and increased world oil prices – sustainable? Russia still faces the daunting challenge of restructuring its enterprises and engendering new business investment. While privatization initiatives successfully changed the ownership of many of the country's firms, they have not led to major restructuring of most incumbent enterprises. The mode of privatization most commonly used relied on worker-management buyouts and the resulting insider-controlled firms faced weak incentives to restructure, especially against the backdrop of a policy framework that, up until relatively recently, permitted soft budget constraints. At the same time, the growth of *de novo* private sector businesses in Russia, especially small and medium enterprises (SMEs), is strikingly low, particularly when compared to other transition countries in Central and Eastern Europe. Moreover, the vast majority of new businesses that have taken root are located in the largest, wealthiest cities, such as Moscow and St. Petersburg, exacerbating the already skewed pattern of development of Russia's regional geography.

An incentive framework that engenders efficiency and predictability in business transactions is crucial for sustained enterprise development. In developed market economies, these incentives are conditioned by a set of basic market institutions that work to facilitate and reduce firms' costs of transacting, whether in terms of new investments or restructuring of existing operations. These institutions include vigorously enforced competition policy to keep in check market power exercised by dominant incumbent firms and facilitate the entry of new enterprises; a regulatory regime that ensures that tariffs for and access to infrastructure utility services are market-oriented while protecting the public interest through a decision-making process that is transparent, rules-based and independent; an efficient system for the intermediation of savings into investment capital and the provision of finance to businesses on commercial terms; and an effective legal system to foster the settlement of commercial disputes.

There is little question that Russia has made significant progress in dismantling the central planning system, which, during the Soviet era, had directly governed Russia's industrial structure, conduct and performance. But, to date, the development of these basic market institutions to take the place of central planning remains nascent – especially in regional markets, where day-to-day business transactions are conducted. This is the principal factor making the costs of doing business in Russia excessively high and impeding enterprise formation and restructuring. While there has been much debate as to why at the national level the restructuring of Russian enterprises has been partial and new private sector start-ups are struggling to emerge, little systemic analysis has been carried out to assess the state of basic market institutions in Russia's regions. This study helps to fill this gap.

[2] We use the term "Russia" for the "Russian Federation" throughout the contribution.