



# Business and Investment Climate, Governance System

*Marek Dabrowski*

## Highlights

- Russia's rankings in the most prominent global surveys, dealing with various aspects of business and investment climate and economic and political governance, have systematically deteriorated since the 1990s.
- Failure of democratisation in the 1990s and the autocratic drift since the early 2000s can be considered the leading cause of the poor governance and business and investment climate.
- The deficit of the rule of law and insecure property rights underpinned by the politically dependent judiciary and the dismantling of other systemic checks and balances are the key obstacles to business activity and the leading risk factor in making investment decisions in Russia.
- Excessive centralisation and bureaucratisation, instability of the regulatory environment, infrastructure underdevelopment, and financial sector fragility are other obstacles to business activity. These obstacles increase

---

M. Dabrowski (✉)  
Bruegel, Brussels, Belgium  
e-mail: [marek.dabrowski@bruegel.org](mailto:marek.dabrowski@bruegel.org)

Higher School of Economics, Moscow, Russia

CASE—Center for Social and Economic Research, Warsaw, Poland

transaction costs and investment risk premia and lead to such pathologies as corruption, state capture, and business harassment by administrative and law enforcement agencies.

- A prudent macroeconomic policy, periodic attempts at administrative deregulation, and Russia's comparative advantages such as its large internal market, high-quality human capital, and abundant natural resources cannot fully compensate for these systemic shortcomings.
- The poor business and investment climate hurt growth dynamics, the innovativeness of the economy, structural diversification, and macroeconomic stability (due to capital outflows).

## 6.1 INTRODUCTION

Like many emerging market economies, as demonstrated by various international surveys, Russia faces business and investment climate problems. The insufficient protection of property rights is the biggest challenge. Other negative factors include excessive regulation, the unstable regulatory environment, the outsized role of law enforcement and security agencies, the underdeveloped technical infrastructure and financial sector, and periodic episodes of macroeconomic and financial instability (see Chapter 16).

Problems with business and investment climate seem to have a persistent character despite domestic and external economic liberalisation and mass privatisation in the early 1990s and several attempts at business deregulation and easing administrative procedures in the subsequent decades.

This chapter begins by defining business and investment climate, regulatory environment, and governance and discusses the methodology for measuring them (Sect. 6.2). Section 6.3 contains an overview of Russia's scores in the most prominent global business and investment climate surveys. Section 6.4 presents an overview of Russia's governance and political system. Section 6.5 analyses the impact of governance and the characteristics of the political system on the business and investment climate. Section 6.6 summarises the microeconomic, structural, and macroeconomic consequences of a poor business and investment climate.

## 6.2 DEFINITIONS AND MEASUREMENT METHODOLOGY

The terms *business climate*, *investment climate*, *regulatory environment*, and *governance* are widely used but rarely defined precisely. As a result, there are several explicit and, quite often, implicit definitions of these concepts in the literature and policy debate (see Uzunidis, 2013 regarding *business climate*).

Let us start with business climate. According to Dabson et al. (1996), it '...refers to the perceived hospitality of a state or locality to the needs and desires of businesses located in, or considering a move to, that jurisdiction.' The same authors underline that '...government has a major impact on

business climate, for it is that combination of public services, taxation and regulation that creates the context within which companies operate.’

There are also other meanings of business climate, such as measuring business opinions on short-term macroeconomic conditions and prospects such as sales, profits, employment, and investment, among others (Sauer & Wohlrabe, 2018; Uzunidis, 2013), that is, typical business cycle analyses. This is not an interpretation that will be used in this chapter.

The *investment climate* is defined similarly to business climate, and often these two terms are used as synonyms. We also use them interchangeably in this chapter. We assume that investment decisions are an integral part of business activity.

According to Hayes (2021), ‘...*investment climate refers to the economic, financial, and socio-political conditions in a country or region that impact whether individuals, banks, and institutions are willing to lend and acquire a stake (i.e., invest) in the businesses operating there.*’ It is affected by factors such as ‘...*poverty level, crime rate, infrastructure, workforce participation, national security considerations, political (in)stability, regime uncertainty, taxes, liquidity and stability of financial markets, rule of law, property rights, regulatory environment, government transparency, and government accountability.*’

A similar approach is proposed by the European Bank of Reconstruction and Development (EBRD), according to which the investment climate is defined ‘...*by a wide range of factors that determine whether domestic and foreign investment happens: by the soundness of macroeconomic policies, the strength of economic and political institutions, the functioning of the legal and regulatory framework, the quality of infrastructure and other services, amongst others.*’<sup>1</sup>

The *regulatory environment* is a narrower concept, and it is defined as ‘...*the set of taxes, rules, and laws or regulations that businesses must adhere to.*’<sup>2</sup> The regulatory environment can be seen as a component of the business and investment climate.

Finally, *governance* can be defined as ‘...*the traditions and institutions by which authority in a country is exercised*’ (Kaufmann et al., 2009). The World Bank uses this broad definition in its annual survey on the World Governance Indicators (WGI)<sup>3</sup> (see Sect. 6.4). A more detailed specification of this concept includes ‘...*the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them.*’

According to the United Nations Development Programme (UNDP, 2007), ‘*governance is the system of values, policies and institutions by which a*

<sup>1</sup> <https://www.ebrd.com/what-we-do/sectors-and-topics/investment-climate-governance.html>.

<sup>2</sup> <https://study.com/academy/answer/define-regulatory-environment.html>.

<sup>3</sup> See <https://datacatalog.worldbank.org/search/dataset/0038026>.

society manages its economic, political and social affairs through interactions within and among the state, civil society and private sector.’

The EBRD distinguishes between ‘...*political governance (the type of political system, constitutional set-up, relations between state and society), economic governance (state institutions that regulate the economy, competition, property and contract rights) and corporate governance (national and company laws and practices that determine corporate conduct, shareholder rights, disclosure and transparency, accounting standards).*’ Corporate governance will not be discussed in this chapter because it is the subject of Chapter 7.

The most frequent way of measuring the various dimensions of business and investment climate, regulatory environment, and governance and comparing them between countries is by using composite numeric indices produced by global development institutions and non-governmental organisations (NGOs). They allow for cross-country comparison and a dynamic analysis of changes in individual countries. In Sects. 6.3 and 6.4, we review the results of selected surveys for Russia.

However, one must be aware of the methodological difficulties in constructing and interpreting such indices. First, they try to quantify phenomena that have a qualitative character. Therefore, they must rely on some selected proxy indicators. Second, most surveys rely on the opinions of either experts or business practitioners. That is, they have, by definition, a subjective character. There is also the question of the representativeness of these opinions. Third, the construction of composite indices can also be disputable in terms of their composition (selection of detailed measures) and the weights attached to the individual components. Fourth, there are frequent correlations between these components (multicollinearity), which may distort the final results.

With all the above-mentioned methodological questions involved (which suggest caution in interpreting survey results), using a global business/investment climate and governance survey seems the best available way of empirical analysis.

### 6.3 INTERNATIONAL PERCEPTION OF THE BUSINESS AND INVESTMENT CLIMATE IN RUSSIA

Global surveys dealing with various business and investment climate aspects provide a contradictory picture of the Russian economy. Below we analyse<sup>4</sup> four of them: the World Bank Doing Business (WBDB) survey, the Heritage Foundation Index of Economic Freedom (HFIEF), the Transparency International Corruption Perception Index (TICPI), and the Global Competitiveness Report of the World Economic Forum (WEFGCR).

<sup>4</sup> Sections 6.3–6.5 draw partly from Dabrowski (2019).

**Table 6.1** Russia: WBDB 2020 rankings and scores (Data for 2019)

<i>Category</i>	<i>Rank</i>	<i>Score</i>
Starting a business	40	93.1
Dealing with construction permits	26	78.9
Getting electricity	7	97.5
Registering property	12	88.6
Getting credit	25	80.0
Protecting minority investors	72	60.0
Paying taxes	58	80.5
Trading across borders	99	71.8
Enforcing contracts	21	72.2
Resolving insolvency	57	59.1
Overall	28	78.2

*Source* <https://www.doingbusiness.org/en/data/exploreeconomies/russia#>

The WBDB survey was published annually between 2003 and 2019 but was discontinued in September 2021 due to data irregularities.<sup>5</sup> In the 2020 survey, the last one published (containing data for 190 countries in 2019), Russia obtained a high 28th place in the country ranking and a score of 78.2 on a scale from 0 to 100. Furthermore, Russia's scores and rankings have systematically improved since 2013. However, the methodology of the WBDB survey changed several times, limiting the comparability of WBDB scores and rankings from different years.

The disaggregated scores (Table 6.1) inform us that in the 2020 survey, Russia performed best in getting electricity (94.00), starting a business (93.04), and registering property (88.74), while scoring worst on protecting minority investors (61.67) and resolving insolvency (58.61).

Three other global surveys—the HFIEF, TICPI, and WEFGCR—offer less optimistic pictures.

In the 2022 HFIEF (data for 2021),<sup>6</sup> Russia was ranked 113th out of 177 countries and 43rd out of 45 European countries. Its score amounted to 56.1 (on a scale from 0 to 100). It found itself in the group of 'mostly unfree' countries. The HFIEF scored Russia best on fiscal health (99.3), tax burden (93.1), trade freedom (69.0), and monetary freedom (68.0), and worst on government integrity (29.7), investment freedom (30.0), financial freedom (30.0), judicial effectiveness (34.7), and property rights (36.8) (Table 6.2).

<sup>5</sup> <https://www.worldbank.org/en/news/statement/2021/09/16/world-bank-group-to-discontinue-doing-business-report>.

<sup>6</sup> For methodology see [https://www.heritage.org/index/pdf/2022/book/02\\_2022\\_IndexOfEconomicFreedom\\_METHODODOLOGY.pdf](https://www.heritage.org/index/pdf/2022/book/02_2022_IndexOfEconomicFreedom_METHODODOLOGY.pdf).

**Table 6.2** Russia: 2022 HFIEF scores

<i>Categories</i>	<i>12 Economic freedoms</i>	<i>Score</i>
The rule of law	Property rights	36.8
	Judicial effectiveness	34.7
	Government integrity	29.7
Government size	Tax burden	93.1
	Government spending	62.6
	Fiscal health	99.3
Regulatory efficiency	Business freedom	62.5
	Labour freedom	57.3
	Monetary freedom	68.0
Open markets	Trade freedom	69.0
	Investment freedom	30.0
	Financial freedom	30.0
Overall score		56.1
Ranking		113

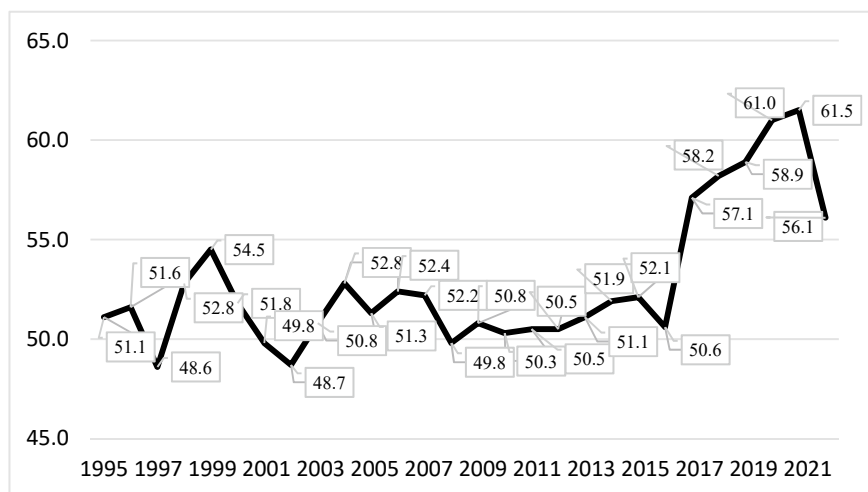
Source <https://www.heritage.org/index/country/russia>

Between 1995 and 2016, Russia was at the bottom of the ‘mostly unfree’ group (scores between 50 and 60) or sometimes fell below 50 (the ‘repressed’ group). Since the 2017 ranking, the scores substantially improved, and in the 2020–2021 rankings, Russia was upgraded into the ‘moderately free’ group (Fig. 6.1). One of the factors that could help in upgrading the ranking was the addition of new indices to the aggregate index, including ‘fiscal health,’ in which Russia scored very well. However, the 2022 ranking brought a visible reversal, and one may expect that the war in Ukraine and associated sanctions and countersanctions (see Chapter 14) will cause further deterioration.

In the TICPI 2021 survey, Russia was ranked 136 out of 180 countries, with a score of 29, the same as Angola, Liberia, and Mali. The ranking scores countries from 0 (most corrupt) to 100 (free from corruption). Since 2012, Russia’s score has changed little, oscillating between 27 (2014) and 30 (2020).<sup>7</sup>

The WEFGCR is another composite index built from 103 detailed indicators, which are grouped into 12 pillars: institutions, infrastructure, adoption of information and communication technologies (ICT), macroeconomic stability, health, skills, product market, labour market, financial system, market size, business dynamism, and innovation capacity. The 2019 WEFGCR ranked Russia 43rd out of 141 countries assessed. It received a score of 66.7 (on a scale of 0–100, with higher scores meaning a more competitive economy), an improvement of 1.1 points compared to the 2018 WEFGCR (Schwab et al., 2019, pp. 482–485).

<sup>7</sup> <https://www.transparency.org/en/cpi/2021/index/rus>. See also <https://images.transparencycdn.org/images/CPI-2021-Methodology.zip> for methodological explanations.



**Fig. 6.1** Russia: HFIEF overall scores, 1995–2022 (Source <https://www.heritage.org/index/visualize?cnts=russia&type=8>)

The disaggregation of the overall score by pillars shows the high notes on macroeconomic stability (score of 90.0 but rank of only 43), market size (score of 84.2 and rank of 6), ICT adoption (score of 77.0 and rank of 22), and infrastructure (score of 73.8 but rank of only 50). Looking at individual indices, Russia ranked well in research institution prominence (score of 94.7, 9th rank), scientific publications (92.2, 22nd rank), costs of starting a business (99.4, 27th rank), flexibility of wage determination (78.2, 17th rank), competition in services (74.5, 17th rank), mobile telephone subscription (100, 9th rank), electricity access (100, 2nd rank), quality of land administration (86.7, 15th rank), e-participation (92.1, 23rd rank), and budget transparency (72.0, 15th rank).

On the negative side, the worst pillar scores and rankings concerned product market (52.9, 87th rank), institutions (52.6, 74th rank), financial system (55.7, 95th rank), and health (69.2, 97th rank). In the detailed indices, the worst notes were attributed to freedom of the press (49.7, 122nd rank), incidence of corruption (28.0, 116th rank), property rights (44.7, 113th rank), social capital (45.3, 104th rank), complexity of trade tariffs (44.4, 109th rank), prevalence of non-tariff barriers (51.9, 103rd rank), internal labour mobility (52.7, 103rd rank), labour tax rate (60.6, 134th rank), financing of small and medium-sized enterprises (SMEs) (38.1, 118th rank), and soundness of banks (48.5, 115th rank).

### 6.4 INTERNATIONAL PERCEPTION OF GOVERNANCE AND POLITICAL SYSTEM IN RUSSIA

The World Bank’s World Governance Indicators (WBWGI) is a composite index that summarises various dimensions of a governance system. In line with the World Bank’s definition of governance presented in Sect. 6.2, it summarises scores in six categories (control of corruption, government effectiveness, political stability and absence of violence/terrorism, regulatory quality, rule of law, voice and accountability) on a scale from +2.5 (good governance) to -2.5 (poor governance) in each category.

Figure 6.2 shows that since the beginning of the WBWGI rating in 1996, Russia recorded negative scores (below zero) in each category, with one exception—‘government effectiveness’ in 2018–2020 (amounting to zero or slightly above zero). The ‘voice and accountability’ variable (the proxy of democratisation) deteriorated systematically over the surveyed period. ‘Rule of law’ and ‘control of corruption’ stayed firmly in ‘negative’ territory (between -0.700 and -1.100). ‘Political stability and absence of violence/terrorism’ fluctuated between -0.700 and -1.500 until 2015, with some improvement in the second half of the 2010s. The two more ‘technocratic’ variables—‘regulatory quality’ and ‘government effectiveness’ looked slightly better, however, with the former deteriorating since the mid-2000s and the latter improving in the 2010s.

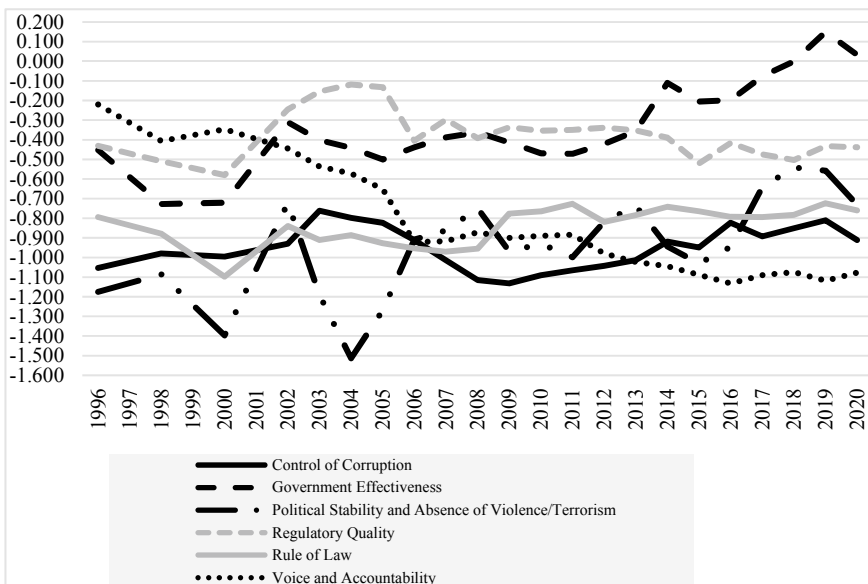


Fig. 6.2 Russia: WBWGI indicators, 1996–2020 (Source <https://databank.worldbank.org/reports.aspx?source=worldwide-governance-indicators#>)



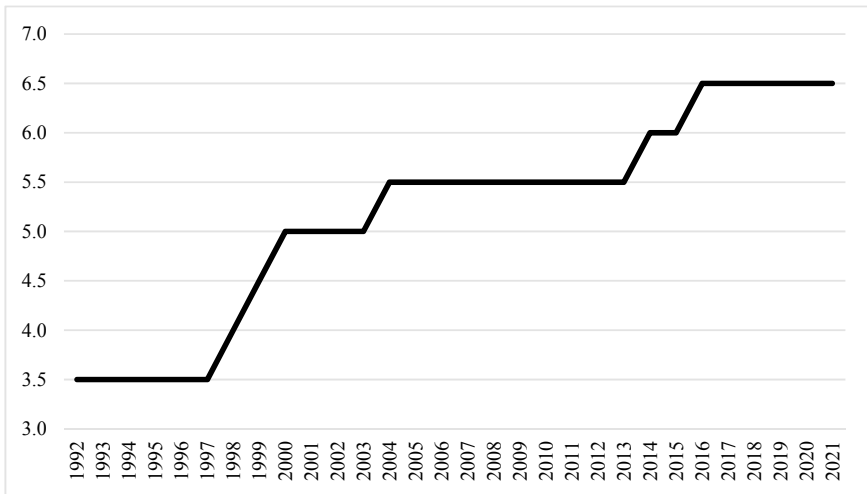
Another worldwide governance survey—the Bertelsmann Stiftung’s Transformation Index (BTI)—assesses various dimensions of political and economic governance in 137 post-communist, emerging market, and developing countries (advanced economies with stable democracies are excluded) (Bertelsmann Stiftung, 2022a). It produces three subindices, which characterise political transformation, economic transformation, and governance. The first one (political transformation) summarises the indices of stateness, political participation, rule of law, stability of democratic institutions, and political and social integration. The second one (economic transformation) considers socio-economic level, market organisation, monetary and fiscal stability, private property, welfare regime, economic performance, and sustainability. Finally, the governance index assesses level of difficulty, steering capacity, resource efficiency, consensus building, and international cooperation. All indices are scaled between 1 (the lowest note) and 10 (the highest).

The BTI 2022 awarded Russia an overall (status) index of 5.27 and a ranking of 66 (Bertelsmann Stiftung, 2022b). The economic transformation index amounted to 6.14 (39th rank), the political transformation index—4.40 (84th rank; moderate autocracy), and the governance index—3.48 (111th rank). In all these indices and most of their components, Russia’s scores have deteriorated since 2006, when the BTI was first published.

Other international surveys concentrate on the political dimension of a governance system. The Freedom House’s Freedom in the World (FHFIW) rating measures seven categories and 25 detailed indicators of political rights and civil liberties in 195 countries and 15 dependent or unrecognised territories since 1972. These are electoral process, political pluralism and participation, the functioning of the government, freedom of expression and belief, associational and organisational rights, the rule of law, and personal autonomy and individual rights (Repucci & Slipowitz, 2022). The scores are awarded on a scale from 1 (the freest) to 7 (the least free).

Figure 6.3 shows a systematic deterioration of Russia’s scores that resulted in its downgrading from the partly free to the non-free category (in 2004). A more detailed picture is provided by another Freedom House survey—Nations in Transit (FHNIT), which monitors changes in political systems in the post-communist countries of Central and Eastern Europe (CEE) and the former Soviet Union (FSU). The overall FHNIT democracy score is the average of seven categories: national democratic governance, electoral process, civil society, independent media, local democratic governance, judicial framework and independence, and corruption.

The 2022 FHNIT report (Smeltzer & Buyon, 2022) assessed the political system in Russia as a ‘consolidated authoritarian regime’ with an overall democracy score of 1.32 on a scale from 1 to 7, with one representing the lowest level of democratic progress and seven—the highest. The democratic percentage amounted to 5.36% on a scale running from 0 (the least democratic regime) to 100 (the most democratic). In all seven categories, Russia’s scores were below 2, with the highest score (1.75) in ‘civil society’. It is also worth



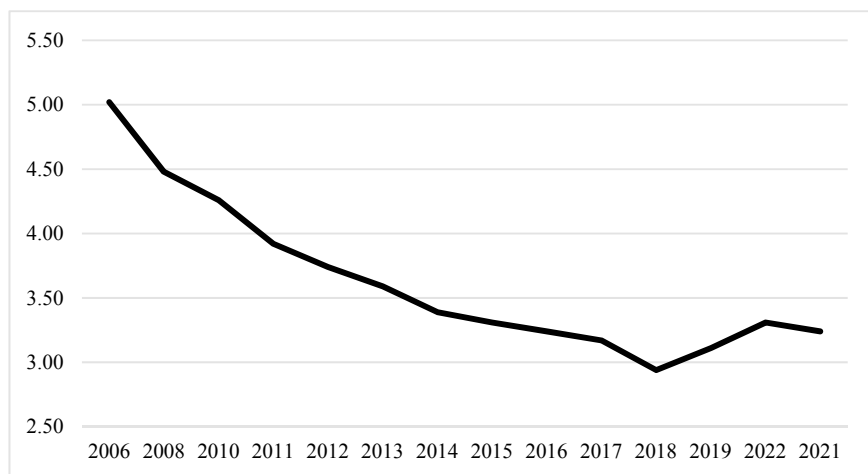
**Fig. 6.3** Russia: FHFIIW scores (a simple average of political rights and civil liberties scores), 1992–2021 (*Source* [https://freedomhouse.org/sites/default/files/2022-03/Country\\_and\\_Territory\\_Ratings\\_and\\_Statuses\\_FIW\\_1973-2022%20.xlsx](https://freedomhouse.org/sites/default/files/2022-03/Country_and_Territory_Ratings_and_Statuses_FIW_1973-2022%20.xlsx))

noticing that Russia’s score in the FHNIT survey systematically deteriorated in the 2000s and 2010s.

Finally, the Economist Intelligence Unit Democracy Index (EIUDI) includes five components: electoral process and pluralism, functioning of the government, political participation, political culture, and civil liberties. It applies a scale from 0 (no democracy) to 10 (full democracy). The EIUDI 2021 (EIU, 2022) ranked 165 independent states and two territories. Russia received a score of 3.24 and a ranking of 124 in the group of authoritarian countries. Its best component scores related to political participation (4.44) and civil liberties (4.12), and the worst—electoral process and pluralism (1.75). As in the case of other surveys, Russia’s scores represent a downward trend over time, with the lowest value recorded in 2018 (Fig. 6.4).

## 6.5 FLAWED GOVERNANCE AS THE FACTOR RESPONSIBLE FOR POOR BUSINESS AND INVESTMENT CLIMATE

The overview of international governance surveys in Sect. 6.4 provides a picture of an oversized and overcentralised (given the federal character of Russia) government (the power vertical as frequently phrased by Russian politicians and analysts). Such a government interferes in the business activity and private life of citizens. However, it cannot provide essential public goods such as public security, property rights, and civil rights protections and sufficient technical and social infrastructure.



**Fig. 6.4** Russia: EIUDI scores, 2006–2021 (*Source* EIU [2022], Table 3, p. 33)

Overregulation, the oppressive Criminal Code, and the ambiguous content of many other pieces of legislation allow the public administration and law enforcement agencies to interpret and enforce them arbitrarily. This leads to frequent power abuse for private benefit, administrative harassment, and extorting money and assets from private businesses. The Russian business community often calls it state ‘racketeering’. In practical terms, such practices involve a specific kind of privatisation of public authority and public goods to benefit those who perform political and administrative power. Some authors (e.g., Lansky & Myles-Primakoff, 2018 and Aslund, 2019) call this phenomenon a kleptocratic state.

‘Privatisation’ of the Russian state was possible thanks to an authoritarian drift in the political system that started at the end of the 1990s. Some flaws of the constitutional system (see Chapter 5), for example, the dominance of the executive branch of government over the legislative and judicial ones and the extensive prerogatives of the president, allowed for such a drift. It led to the gradual dismantling of constitutional checks and balances: political dependence of judiciary, reduction in regional autonomy, and political control over media and civil society organisations (CSOs), for example, by using the infamous Foreign Agent Law adopted in 2012 and its subsequent tightening.

Limiting the independence of the legislative and judicial branches of government and media and CSOs reduced their monitoring capacities over the executive branch. It resulted in the lack of transparency and accountability of the latter and created a fertile ground for groups of special interests, rent-seeking, state and business capture by oligarchic groups, and various forms of corruption.

Several comparative cross-country analyses confirm a positive correlation between changes in political and economic systems (Bertelsmann Stiftung,

2022a; Dabrowski, 2021). This should not be surprising if one analyses the impact of democratic mechanisms and institutions on the functioning of a market economy (De Haan & Sturm, 2003). Beyond the already mentioned arguments (the role of political checks and balances in limiting the concentration and abuse of political power and the monitoring role of the media and CSOs), the democratic rotation of political elites and their accountability to the electorate may also reduce the incidence of power abuses, corruption, and state capture. Furthermore, civil liberties support and supplement economic freedom. It is hard to imagine the effective functioning and development of a contemporary post-industrial (service-based) economy without the freedom of movement, expression, speech, and assembly and the right to private property, privacy, and equal treatment under the law, among others, and their adequate judicial protection. Autocratic regimes are also less open to the external world (Gable, 2005), hurting economic and social development.

In the light of the above findings and arguments, no one should be surprised by the negative impact of the autocratic drift and the resulting deterioration in governance quality on the business and investment climate. Regulations, procedures, and institutions that have a more technocratic character and often use digital tools and platforms (for example, business and property registration and issuing construction permits, among others) are more immune to the flaws in the governance system, corruption, and power abuse. However, frequently repeated campaigns of business deregulation (for example, reducing the number and frequency of inspections) serve as indirect evidence that progress in this sphere is not necessarily sustainable and requires periodic reinforcement.

The business and investment climate in Russia also benefits, in comparison with other emerging market economies, from the country's level of socio-economic development (an upper-middle-income status) and some elements of its social and technical infrastructure such as its relatively good education system, research capacities, human resources, access to cheap energy, communications, and digital networks, among others. Russia's large domestic market and rich natural resources are other incentives for business involvement. Since the beginning of the twenty-first century, its relatively prudent monetary and fiscal policies (although unable to prevent periodic episodes of macroeconomic and financial crises—see Chapter 16) has partly mitigated other shortcomings of the governance system and improved the business climate.

However, the practices of state 'racketeering', corruption, the politically motivated expropriation of business assets,<sup>8</sup> selective enforcement of repressive legislation, and more generally, 'selective' justice (adopting criminal penalties based on doubtful evidence against selected business people), the instability of

<sup>8</sup> The best-known cases of politically motivated expropriation relate to the dismantling of the YUKOS oil company in 2003–2005, taking over a majority stake in the Sakhalin-2 project by Gazprom in 2006, and the nationalisation of Bashneft oil company in 2014—see Chapter 7.

legislation, and ignoring the rulings of international arbitration bodies, among others, undermine the stability of property rights and create business uncertainty. These are the most damaging factors behind Russia's poor business and investment climate, which are not always fully captured by international surveys (see Sect. 6.3), particularly the WBDB.

The renationalisation of the Russian economy after 2003 has given state-owned enterprises (SOEs) a privileged status (see Chapter 7). The same applied to private business groups close to political power. As a result, other market participants have suffered from an uneven playing field. This is another factor discouraging genuine private investment and distorting competition.

## 6.6 ECONOMIC CONSEQUENCES OF A POOR BUSINESS AND INVESTMENT CLIMATE AND FLAWED GOVERNANCE

As discussed earlier in this chapter, the unfavourable business and investment climate has roots in Russia's failure of political and institutional reforms. Democratisation and building a rule-of-law governance system were not completed in the 1990s and were then reversed in the 2000s and 2010s. The invasion of Ukraine in February 2022 and associated Western sanctions along with Russia's retaliatory measures (see Chapter 14) can further worsen the business and investment climate, especially for non-residents and in all activities dependent on foreign trade and investment as well as international finance. It will also additionally consolidate the autocratic character of Russia's governance system.

So far, insecure property rights, the lack of an independent and impartial judiciary, 'selective' justice and law enforcement, an uneven playing field, and the abuse of political and administrative power for private benefits (especially in the case of law enforcement agencies) proved the most critical obstacles to business activity in Russia.

These fundamental shortcomings in the governance system and business and investment climate cannot be compensated for by prudent macroeconomic policies, low and relatively simple taxation (see Chapter 16), and repeated measures aimed at the administrative simplification of business registration, property registration, tax payments, court procedures, and the inspection regime, among others. They also diminish the potential investment attractiveness of the Russian economy stemming from its large territory and population, abundant natural resources (see Chapter 1), human capital (see Chapter 2), vast domestic market, elements of modern infrastructure (for example, in the ICT sphere), and upper-middle-income status.

There are multi-dimensional consequences of these shortcomings. In a microeconomic sphere, they increase the cost of doing business and risk premia of the potential investment projects (see Chapter 8). By limiting market entry and granting privileged market access for SOEs and private owners closely associated with political power (oligarchs), they distort market competition at

the cost of consumers and the economy's innovativeness. They also discriminate against SMEs because their transaction costs and investment risks are too high. As a result, the weight and role of SMEs are smaller in Russia than in many other advanced and emerging market economies. This limits the development of a middle class, the natural political base of a liberal democratic order (Lu, 2005; Moyo, 2018).

Structurally, a poor business and investment climate helps to consolidate the dominant position of resource (upstream) industries, particularly the energy sector, and halts the economy's diversification in favour of high value-added manufacturing and services. Where the service sector develops (the example of business and financial services and the ICT sector), it is inward rather than outward-oriented, i.e., it focuses on serving the domestic market.

Macroeconomically, precarious property rights and business uncertainty are causes of the continuous net private capital outflows, particularly during periods of macroeconomic turbulence and financial crises (see Chapter 16).

### Questions for Students

1. What are the most frequently used definitions of business and investment climate, regulatory environment, and governance, and the differences between these concepts?
2. Which methodological problems are involved in measuring business and investment climate and governance changes?
3. Please present the examples of the most prominent global surveys of various aspects of business and investment climate and governance.
4. How has the international assessment of Russia's business and investment climate and governance evolved since the 1990s?
5. How does political governance influence Russia's economic governance and business and investment climate?
6. Please characterise the main factors determining insecure property rights in Russia.
7. How does a poor business and investment climate contribute to macroeconomic fragility despite prudent monetary and fiscal policies?

### REFERENCES

- Aslund, A. (2019). *Russia's crony capitalism: The path from market economy to kleptocracy*. Yale University Press.
- Bertelsmann Stiftung. (2022a). *Transformation index BTI 2022: Governance in international comparison*. Verlag Bertelsmann Stiftung.
- Bertelsmann Stiftung. (2022b). BTI 2022b Country Report—Russia. Bertelsmann Stiftung, Guetersloh. [https://bti-project.org/fileadmin/api/content/en/downloads/reports/country\\_report\\_2022\\_RUS.pdf](https://bti-project.org/fileadmin/api/content/en/downloads/reports/country_report_2022_RUS.pdf)

- Dabrowski, M. (2019). Factors determining Russia's long-term growth rate. *Russian Journal of Economics*, 5(4), 328–353. <https://rujec.org/article/49417/download/pdf/366392>
- Dabrowski, M. (2021). The antidemocratic drift in the early 21st century: Some thoughts on its roots, dynamics and prospects. *Central European Business Review*, 10(2), 63–83. <https://cebr.vse.cz/pdfs/cbr/2021/02/04.pdf>
- Dabson, B., Rist, C., & Schweke, W. (1996, June 1). Business climate and the role of development incentives. *Federal Reserve Bank of Minneapolis*. <https://www.minneapolisfed.org/article/1996/business-climate-and-the-role-of-development-incentives>
- De Haan, J., & Sturm, J.-E. (2003). Does more democracy lead to greater economic freedom? New evidence for developing countries. *European Journal of Political Economy*, 19(3), 547–563. [https://doi.org/10.1016/S0176-2680\(03\)00013-2](https://doi.org/10.1016/S0176-2680(03)00013-2)
- EIU. (2022). Democracy index 2021. *The China Challenge*. *The Economist Economic Intelligence Unit*. [www.eiu.com](http://www.eiu.com)
- Gable, S. (2005). The effect of democracy on different categories of economic freedom. *European Journal of Political Economy*, 21(4), 967–980. <https://doi.org/10.1016/j.ejpoleco.2004.11.005>
- Hayes, A. (2021, September 1). Investment climate. *Investopedia*. <https://www.investopedia.com/terms/i/investmentclimate.asp>
- Kaufmann, D., Kraay, A., & Mastruzzi, M. (2009, June 29). Governance matters 2009: Learning from over a decade of the worldwide governance indicators. *Brookings*. <https://www.brookings.edu/opinions/governance-matters-2009-learning-from-over-a-decade-of-the-worldwide-governance-indicators/>
- Lansky, M., & Myles-Primakoff, D. (2018). The rise of Kleptocracy: Power and Plunder in Putin's Russia. *Journal of Democracy*, 29(1), 76–85.
- Lu, C. (2005). Middle class and democracy: Structural linkage. *International Review of Modern Sociology*, 31(2), 157–178.
- Moyo, D. (2018, April 20). Why the survival of democracy depends on a strong middle-class. *The Globe and Mail*. <https://www.theglobeandmail.com/opinion/article-why-the-survival-of-democracy-depends-on-a-strong-middle-class/>
- Repucci, S., Slipowitz, A. (2022). Freedom in the World 2022: the global expansion of the authoritarian rule. *Freedom House*. [https://freedomhouse.org/sites/default/files/2022-02/FIW\\_2022\\_PDF\\_Booklet\\_Digital\\_Final\\_Web.pdf](https://freedomhouse.org/sites/default/files/2022-02/FIW_2022_PDF_Booklet_Digital_Final_Web.pdf)
- Sauer, S., & Wohlrabe, K. (2018). The new IFO business climate index for Germany. *CESIFO Forum*, 19(2), 59–64. <http://test1.cesifo.org/en/publikationen/2018/article-journal/new-ifo-business-climate-index-germany>
- Schwab, K. et al. (2019). The global competitiveness report 2019. World economic forum. [http://www3.weforum.org/docs/WEF\\_TheGlobalCompetitivenessReport2019.pdf](http://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf)
- Smeltzer, M., & Buyon, N. (2022). Nations in transit 2022: From democratic decline to authoritarian aggression. Freedom House. [https://freedomhouse.org/sites/default/files/2022-04/NIT\\_2022\\_final\\_digital.pdf](https://freedomhouse.org/sites/default/files/2022-04/NIT_2022_final_digital.pdf)
- UNDP. (2007). *Governance Indicators: A Users' Guide*. Second Edition. United Nations Development Programme, Oslo Governance Centre. [https://www.un.org/ruleoflaw/files/Governance%20Indicators\\_A%20Users%20Guide.pdf](https://www.un.org/ruleoflaw/files/Governance%20Indicators_A%20Users%20Guide.pdf)
- Uzunidis, D. (2013) Business Climate and Entrepreneurialism. In: Carayannis EG (eds) *Encyclopedia of Creativity, Invention, Innovation and Entrepreneurship*. Springer. [https://doi.org/10.1007/978-1-4614-3858-8\\_194](https://doi.org/10.1007/978-1-4614-3858-8_194)