

University of Denver

Digital Commons @ DU

Electronic Theses and Dissertations

Graduate Studies

3-1-2009

The Evolution of Small Business Reform in Russia

Megan Hanna

University of Denver

Follow this and additional works at: <https://digitalcommons.du.edu/etd>



Part of the [Economics Commons](#), and the [International Law Commons](#)

Recommended Citation

Hanna, Megan, "The Evolution of Small Business Reform in Russia" (2009). *Electronic Theses and Dissertations*. 265.

<https://digitalcommons.du.edu/etd/265>

This Thesis is brought to you for free and open access by the Graduate Studies at Digital Commons @ DU. It has been accepted for inclusion in Electronic Theses and Dissertations by an authorized administrator of Digital Commons @ DU. For more information, please contact jennifer.cox@du.edu, dig-commons@du.edu.

THE EVOLUTION OF SMALL BUSINESS REFORM IN
RUSSIA

A Thesis

Presented to

The Faculty of the Joseph Korbel School of International Studies

University of Denver

In Partial Fulfillment

of the Requirements for the Degree

Masters of Arts

by

Megan Hanna

March 2009

Advisor: Jonathan Adelman

ACKNOWLEDGEMENTS

I am extremely grateful to Dr. Deborah Anne Palmieri
for her support and gentle guidance.

Table of Contents

Introduction.....	1
Chapter One: Small Business Foundations.....	5
Small Business and Market Economies.....	5
Entrepreneurship in Russia.....	7
Business Relations with the State.....	11
Profile of the Small Business Sector.....	17
Chapter Two: Putting Small Business Development on the Agenda.....	20
Reforms of the 1990s.....	21
Administrative Barriers	24
Taxation.....	29
Access to Credit.....	31
Federal Funding.....	33
Limits of Legislation.....	35
Chapter Three: Implications for Growth of the Small Business Sector.....	41
Access to Premises.....	42
Demographic Challenges.....	43
Infrastructure.....	46
Chapter Four: The Road to Long-term Small Business Development.....	49
Shifting the Burden – Regional Initiatives.....	49
Concept 2020.....	56
Summary.....	58
Bibliography.....	61

Author: Megan Hanna
Title: THE EVOLUTION OF SMALL BUSINESS
REFORM IN RUSSIA
Advisor: Jonathan Adelman
Degree Date: March 2009

ABSTRACT

Small businesses are key drivers in the world's leading economies. Russia on the whole is lagging behind the developed world in terms of small businesses per capita. Entrepreneurship gradually took shape after the collapse of the Soviet Union despite structural challenges. A discourse on small business reform emerged during the presidency of Vladimir Putin. Legislation passed during his tenure illustrates the evolution of reform in specific areas that affect small business. Surveys show that perceived challenges for small businesses have also evolved. As central control recedes, regional and local authorities will ultimately be responsible for the future of small business reform in Russia.

Introduction

This research explores the evolution of small business reform in Russia. Why is it important that the rest of the world keep abreast of small business development in Russia? The Russian government's commitment to small business development is a barometer of where Russia intends to go in the future. The underlying struggle of this story is between pursuing a path of "state corporatism," and truly diversifying and adopting a "market" oriented model with a strong small business sector. Failure to diversify beyond energy and other key industries in Russia will have social and most likely political ramifications in the future. As it continues to become more closely integrated with the global economy, it is even more imperative that Russia take whatever measures possible to protect itself from external shocks.

Small business reform entails improving the environment in which businesses operate and thrive. Improvements have been made to the regulatory environment, but the government has fallen short in formulating a comprehensive strategy that promotes growth of the small business sector.

The theoretical concepts behind small business and its role in market economies are explored in Chapter One. Attention is given to the background of entrepreneurship in Russia. Russia does not have a long history of entrepreneurship and private enterprise. This historical legacy has a profound impact on small business today. The institutions common to developed market economies and which are necessary for small businesses to thrive (legal, financial, etc) were absent when small businesses emerged on the scene in the early 1990s. This has led to an antagonistic relationship between the small business sector and the state. Data on small businesses may not paint an accurate picture of the sector.

In Chapter Two, the small business environment during the 1990s is discussed and a general overview of the legislative actions of that time is given. A new discourse on small business emerged under Putin, and it seemed the government was serious about reforming the small business sector. Despite measurable success of the regulatory legislation passed from 2000-2006, administrative barriers still plague small businesses. Current tax policies favor small businesses but are prohibitive when it comes to growth. Small businesses have limited access to credit, as

the lending culture in Russia does not favor small business. The government has failed to change the lending culture. Federal funding for small businesses has evolved from direct funding (case-by-case basis) to indirect funding (improving the environment). The former was popular in the 1990s but was eventually discredited due to lack of oversight.

The changing perception of challenges facing small business is considered in Chapter Three. Small business leaders today believe that property issues, labor shortages, and weak infrastructure will negatively affect small business growth in the future. Businesses that lease their premises from the government face uncertain leasing arrangements. Falling birth rates and low life expectancies will contribute to the labor shortage problem. Infrastructural improvements will be vital for small businesses to prosper, especially in Russia's more remote regions.

In Chapter Four, possible future trends in small business reforms are identified. Regional and local governments will be expected to play a greater role in small business development in the future as central control recedes. Small business will employ 60-70% of the

workforce according to the Concept 2020, Russia's long-term economic development strategy. However, the Concept does not articulate how this goal will be realized, and devotes only minimal attention to small business development.

For this research, I use surveys conducted by the Center for Economic and Financial Research at the New Economic School in Moscow (CEFIR), OPORTA Russia, and the Ministry for Economic Trade and Development to gauge what the key problems facing small business are. This paper traces the evolution of small business reform in Russia: what has been done, what still needs to be done, and future trends for small business development.

CHAPTER ONE - SMALL BUSINESS FOUNDATIONS

Small Business and Market Economies

Small businesses are the cornerstones of developed economies. For example, small businesses account for close to 50% of GDP in the United States and approximately 51% of the labor force is employed by the private sector. In Russia, small businesses contribute 13-15% to GDP and 18-20% to the labor force.¹ Small businesses are able to thrive in developed economies for several reasons. Developed economies have the institutional capability to not only foster the creation of small business, but to also maintain them. These include legal, financial, and labor institutions. The Global Entrepreneurship Monitor (GEM) international study on entrepreneurship shows a positive relationship between small business growth and overall economic growth. However, small business growth in contemporary Russia is considerably slower than economic growth. A decline in entrepreneurial activity in Russia (2007) was accompanied by a GDP growth rate of 8%.² This suggests that Russia is

¹ “Small Business Makes up 13-15% of GDP.” Kommersant (February 19, 2008) (accessed October 1, 2008)

not, at least in the immediate term, reliant on small business as a main driver for economic growth. Energy exports still account for the vast majority of Russian revenues. Leaders of states that are largely dependent on natural resource exports to generate revenue often have a broad license to enact policies of their choosing. There is less sense of urgency to diversify the economy when the state coffers are full. However, with energy prices sinking, Russia cannot afford to ride the wave of petro dollars indefinitely. A strong economy is a diverse economy. An economy driven by small business is more flexible in dealing with market fluctuations which leads to stability. Furthermore, economic stability leads to social stability, transparency, and makes politics more predictable.³

Small businesses have a positive impact on not only the economy, but also the social sphere. Small businesses create jobs, and consequently social security. Statements by the government confirm that they understand the connection between small business growth and the creation of a strong middle class in Russia. The development of the

² Global Entrepreneurship Monitor: Russia Report 2007; <http://www.gemconsortium.org/document.aspx?id=809> (accessed November 3, 2008)

³ President of Russia, "Vladimir Putin's Address to the Nationwide Conference on Small Business" (March 15, 2000) http://www.kremlin.ru/eng/text/speeches/2000/03/15/0002_type84779_134558.shtml (accessed October 19, 2008)

small business sector in Russia is therefore an exercise in ensuring that the population has the access to an improved livelihood and prosperity.⁴ Having a strong middle class will contribute to economic and political stability, while fostering the creation of a more vibrant and open civil society.

Entrepreneurship in Russia

Entrepreneurship is a relatively young phenomenon in Russia. During Soviet times, entrepreneurship existed only in the shadows, outside official recognition from the state. Other 'socialist' states that fell under the Soviet umbrella allowed for limited entrepreneurial activity (i.e. Poland, Romania and Bulgaria) long before Russia. It is therefore understandable that introducing private enterprise to Russia after the collapse of the planned economy would be a long and complicated process.

Resourcefulness and high levels of education make the Russians strong potential entrepreneurs. Studies have shown that typically 4-6% of the adult population in Russia

⁴ President of Russia, "Vladimir Putin's Opening Remarks at a Meeting of the State Council on Government Support and Development of Small Business in Russia" (December 19, 2001)
http://www.kremlin.ru/eng/text/speeches/2001/12/19/0000_type82912type82913_143102.shtml (accessed October 19, 2008)

express a desire to start their own business.⁵ The Russian entrepreneurs that emerged after the collapse of the Soviet Union were not really that, but rather quasi-entrepreneurs capitalizing on the decay of the Soviet system and the turmoil of the post-Soviet transition.⁶ The entrepreneurial revolution of the early 1990s did not occur on a blank canvass. As Mandel notes, “[Russians were] not dealing simply with the clash of two naturally alien systems, the “market” and the “socialist planned economy,” but with a much more complex encounter, with a number of specific, culturally embedded, and practical organization flows.”⁷

Russia experienced at least four distinct waves of entrepreneurship immediately following the collapse of the Soviet Union. The first wave (1987-1989) sprung from the Soviet co-operative laws and the so-called ‘co-operators.’ These entrepreneurs operated in the ‘shadows,’ and often resorted to criminal tactics and intimidation to maintain their enterprises. They specialized in Western goods which

⁵ I. Astrakhan. and A. Chepurensko. “Small business in Russia: any prospects after a decade?” *Futures* 35 (2003) 356

⁶ T. Gustafson, *Capitalism Russian-style* (New York: Cambridge University Press, 1999) 113

⁷ Ruth Mandel and Caroline Humphries (Ed.), *Markets and Moralities: Ethnographies Transformation of Post-Socialism* (Oxford: Berg Publishers, 2002) Ch.4, 2

were in high demand. According to the Expert Institute of the Russian Union of Industrialists and Entrepreneurs in 1992, about 40% of these entrepreneurs specialized in selling goods from the West, a third of them had friends in the local criminal networks, and 22% were previously tried as criminals. Bribing officials was the norm, and collecting the profits from selling Western goods on the domestic market at inflated prices was common practice.⁸ The second wave (1989-1990) followed the introduction of the notion of private property rights reform under Soviet civil and economic law. Predominately high-level administrators took advantage of the growing deficit of goods, accompanied by the convergence of two economic systems, to create new opportunities for themselves. Most entrepreneurs from this period came from managerial positions, and sought to turn their connections and expertise into capital gains. The third wave (1991-1992) took shape under the “free for all privatization” when information, financial assets and connections were used for grabbing public property. By the fourth wave (1992-1993), small-scale privatization was well under way and massive lay-offs from the public sector led many to engage in

⁸ Astrakhan 347

private enterprise. This led to a boom in the private sector in Russia. Self-employment and family micro-businesses began to spring up in the sphere of petty retail export-import trade and services.

Russian entrepreneurs in the 1990s found themselves stuck in the difficult position of having to deal with corrupt officials and common criminal networks in order to sustain themselves. Officials often exploited business owners through seemingly “legitimate” means such as tax inspections, audits, revocation of registration, etc. Criminal networks, on the other hand, resorted to blackmail and intimidation to collect on a business’s good fortune. Therefore, business owners faced a dilemma – pay bribes to corrupt officials and “smart money” to racketeers, or abandon the business altogether. In an environment where entrepreneurship does not generate respect for the law, firms will respond to state over-regulation by avoiding and evading it.⁹

⁹ Astrakhan 348

Business Relations with the State

In Russia, small business has not yet been institutionalized. The success of entrepreneurship in transition economies is largely dependent on cultural and historical considerations. The Soviet legacy is demonstrated by small business' distrust of institutions (legal, financial). The institutions needed to foster a small business sector in transition economies were often weak or absent, leaving small businesses at an immediate disadvantage during transition periods. As was the case in Russia, policy makers worked to build the necessary legal framework for small businesses while small businesses sprang up concurrently. The 1990s witnessed a somewhat disastrous mix of short-term policy fixes and business growth.

Russian entrepreneurs tend to rely on two strategies for doing business in Russia: keep a distance from the state ("free spirit entrepreneurialism"), or closely integrate with the state in order to maximize profits and obtain special preferences available from government officials. These strategies can be understood as "exit" and "voice." In other words, when an entrepreneur or business decides that it is too costly to give into the rules of the system, he will "exit"

the traditional market game (shadow economy, perhaps). On the other hand, if the entrepreneur identifies the benefits of staying within the system (by expending the energy to change the “rules”), he will facilitate this changing of the rules to suit his own interests. If entrepreneurs understand that collective action advances their bargaining power as well as their individual or business interests, they will likely opt to change the “rules” – the “exit” strategy not only applies to the tendency of businesses to go into the shadow economy, but also paying bribes and dodging taxes which perpetuates disregard for state structures and institutions (rule of law, etc). Factors that influence an entrepreneur’s decision to “exit” or “voice” include the uneven distribution of transformational rent between the regions and other levels of government, and previously accumulated capital and business experience.¹⁰ Business relations with the state are further complicated by mutual antagonism between the government and small business sector – the government believes small business is intent on playing by their own rules, while small businesses believe

¹⁰ See Andrei Yakovlev, “The Evolution of Business-State Interaction in Russia: From State Capture to Business Capture?” *Europe-Asia Studies* 58, no.7 (November 2006) 1035 (accessed October 12, 2008)

the government is generally disinterested in private sector development.

By the end of the 1990s, Russian business was constrained by an “oligarchic” structure and suffered from the “state capture” effects of privatization programs. Namely, well-connected leaders within the business community held considerable political and competitive sway over their competitors, which lead to an uneven and distorted environment for small business. In the early stages of his first administration, Vladimir Putin sent clear signals to the business elite that the position they had held in the 1990s, politically and financially, was to come under closer scrutiny from the Kremlin. Putin had considerable political capital to expend in this pursuit, as the Russian population had become disillusioned with the “Washington Consensus” economic reforms of the 1990s that favored liberalization and stabilization above all else. Putin emphasized administrative reform and state-administered creation of market infrastructure.¹¹ He recognized that Russia is operating a “post-industrial society with a pre-

¹¹ Markus, Stanislav, “Capitalists of All Russia, Unite! Business Mobilization Under Debilitated Dirigsme,” *Polity* 39, No.3 (July 2007) 277-304 (accessed October 14, 2008) 291

industrial machine.”¹² This approach met favor with the public, which is often more comfortable in placing their confidence in state-controlled solutions for economic development rather than in private enterprise - a Soviet cultural carry-over. Consolidation and centralization characterized Putin’s approach to reforming the state apparatus. His quest to bring big business in line culminated with the conviction of Yukos chief Mikhail Kodhorkovsky for tax evasion in 2003. The high profile trial drew a rash of criticism from democracy watchdog groups in the West, but the message was clear - business and politics in Russia would only mix when the Kremlin approved.

As he addressed the Duma in 2008, Putin maintained that it is very important that the legislative and executive bodies work together to implement the necessary legislation to support small businesses. Interestingly, small business interests are not traditionally represented within the Duma. No political party advocates a distinctly pro-small business platform, although they have been known to lobby on behalf of small businesses when it suits their purposes. This is unfortunate seeing as the parliament

¹² Markus 292

plays the main role in shaping the legal environment vital to overall economic and social development in the country.¹³ Although small businesses have limited direct access to policy makers, Duma officials often meet with public organizations including the Russian Union of Industrialists and Entrepreneurs, OPORA Russia (non-governmental organization that works on behalf of small businesses), and the Chamber of Commerce and Industry of the Russian Federation to discuss small business legislation and its implementation. Studies show that small business mobilization can lead to a mutual beneficial relationship with the state.¹⁴ Business associations such as OPORA Russia supply policy makers with information in return for a consultative role in legislation formation.¹⁵ Current Deputy Prime Minister Igor Shukalov expressed a commitment by the Duma to confer with public organizations at various steps in the legislative process to enhance effectiveness of the legislation and to foster transparency between the private and public sectors.

¹³ President of Russia, “Vladimir Putin’s Beginning of Meeting with State Duma Leadership and Faction Leaders” (March 11, 2008) http://www.kremlin.ru/eng/text/speeches/2008/03/11/1250_type82913_162077.shtml (accessed October 20, 2008)

¹⁴ See Hanson (2005), Yakovlev (2006)

¹⁵ Markus 297

The first ministry tasked with addressing small business promotion was the State Committee on Support and Development of Small Business and Entrepreneurship. The committee functioned from 1995-1998. Pursuant to a presidential decree, the committee was dissolved and its functions absorbed by the newly created Ministry of the Russian Federation for Anti-Monopoly Policy and Support of Entrepreneurship (MAP) in 1998. In 2004, the Federal Anti-Monopoly Service (FAS) was established thereby dissolving MAP and with it the functions related to small business development. The dissolution of the state committee and further restructuring of the state entities responsible for small business development programs cast some doubt on whether the administration was serious about small business reform. The Ministry of Economy and Ministry of Trade were merged in 2000. The newly formed Ministry of Economic Trade and Development assumed the role of overseeing small business development of the Russian Federation. German Gref, Putin's key economic strategist, was appointed its first minister. The Ministry continues to address small business development of the Russian Federation today.

Profile of the Small Business Sector

How has the small business sector evolved? The early 1990s saw a boom in the number of new private enterprises. However, by 1996 the growth rate of new enterprises was down 7.6% and continued to stagnate through the financial crisis of 1998. According to OPORA Russia, in 2008 there were 1.136 million small to medium-sized companies in Russia, employing 16 million people, or 25% of the working population.¹⁶ Official statistics from the Ministry of Economic Trade and Development vary slightly, showing an increase of 100,000 small businesses in 2007 bringing the total to 1.1 million small businesses; employment in small business hovers at 10 million (these statistics include medium size businesses). The Ministry for Economic Trade and Development projects that small companies alone will employ up to 8.5 million in 2009, and account for 12% of GDP.

Accurate statistics on the actual number of small enterprises in Russia are difficult to come by, which makes it difficult to determine whether federal reforms have led to an overall increase in the number of small businesses. One of the main reasons for this is that the primary source for

¹⁶ Borisov

this data is registration records for new enterprises. Under Russian law, new enterprises are required to register with the authorities, a task that is complex and time-consuming. Official numbers may also be skewed by the fact that de-registering “dead” enterprises is just as complicated as starting a new firm. Therefore, “dead” enterprises often remain on the books for years with local authorities. One method of checking actual numbers of “registered” enterprises with the actual number of functioning enterprises is to check filed tax returns against the number of registered enterprises. This method turns up some interesting data. For example, in 1996 out of 20,000 registered enterprises in the Magadan region only 4,000 filed tax returns. In Moscow, only two-thirds of registered enterprises filed tax returns in the same year. Furthermore, statistical data does not include license holders (individual entrepreneurs) nor does it take into account the informal sector which is quite large in Russia.¹⁷ It is estimated that as many as one-third of small firms in Russia are privatized state enterprises or subsidiaries of larger corporations.¹⁸ In

¹⁷ Ruta Aidis and Yuko Adachi, “Russia: Firm Entry and Survival Barriers,” *Economic Systems* 31 (2007) 408 (accessed October 14, 2008)

¹⁸ Kontorovich 453

addition, many businesses change their legal status in order to obtain tax advantages. These factors make it difficult to determine the actual number of small businesses in Russia or how many new businesses enter the market each year. That being said, an estimated 20% of Russian small businesses are located in Moscow, and 12% are located in St. Petersburg. Around 30% of Russian small businesses are registered in the Central region (Moscow included), and 18% in the Northwest region. Therefore, almost half of all small businesses are to be found in and around Russia's two largest cities. Moscow and St. Petersburg are the only two cities in Russia that approach the OECD average of small businesses per capita. The small business sector is in need of diversification as well. As of 2000, 75% of small businesses were in retail, construction or industry.

CHAPTER TWO - PUTTING SMALL BUSINESS DEVELOPMENT ON THE AGENDA

The Russian government has implemented numerous small business reforms and enacted a vast amount of regulatory legislation since the collapse of the Soviet Union. The 1990s were turbulent times, economically and politically. Small business reforms of the 1990s were geared towards building a framework for small business to operate within the new economic system. When Putin came to office, small business evolved from a being a “fashionable topic” to occupying a place on the government’s agenda. In the early stages of small business reform, many of the problems small businesses faced were administrative in nature (inspections, registration processes, licenses).¹⁹ While these problems continue to plague small businesses in Russia today, legislation passed during the Putin administration aided in streamlining administrative procedures.

¹⁹ See report by the Russian SME Resource Centre. “Administrative Barriers for SME Development: the Problem and Solutions.” TACIS Project SMERUS 9803 (January 2001) http://docs.rcsme.ru/eng/RC/Analisis_Adm_Barrier-Feb2001/Commission-rep.doc (accessed September 30, 2008)

Reforms of the 1990s

The 1986 USSR Law on ‘Individual Labor Activity’ was the first piece of legislation that encouraged entrepreneurship, although the conventional starting point for private enterprise is the 1988 Law on ‘Cooperation in the USSR.’²⁰ According to official statistics, the year following the adoption of the Law on Cooperatives Law, enterprises increased five-fold, employment eight-fold, and output thirteen-fold.²¹ Cooperatives were the first examples of pseudo private enterprise in Russia. By 1991, all non-state enterprises had legal status, although small businesses were not distinct from mid-size or large businesses in terms of legal status. The period following the collapse of the Soviet Union saw a liberalization of legal norms related to private enterprise, rapid privatization, and small business growth. However, virtually no institutional support was in place to tackle the challenges that would accompany rapid small business growth. In the flurry of economic and political

²⁰ Vadim Radaev, “The Development of Small Entrepreneurship in Russia,” World Institute for Development Economics Research. Discussion Paper No.2001/135 (November 2001) 2 (accessed October 12, 2008)

²¹ Ibid.

restructuring that was happening at that time, voices began to speak out on small business and its place in the new Russia.

As early as 1996, President Boris Yeltsin suggested that “the support of small business to be a prerequisite for the further development of the economy and the appearance of a middle class.”²² Federal Law No.88 “On State Support for Small Entrepreneurship in the Russian Federation,” passed by the legislature in 1995, is widely regarded as the first serious attempt at small business reform. Also known as the SME Support Law, it laid the groundwork for providing funding for the support of small businesses and institution-building. Furthermore, it redefined small firms as private entities employing up to 100 people in industry, construction, and transport firms, 60 in agriculture and R&D, 50 in other “non-productive” sectors, and 30 in retail.²³ This piece of legislation was far from perfect, however. For example, it did not make any mention or classification of medium-size or micro businesses which lead to serious implications for taxation. At the time the

²² “Small Business Now a Big Deal.” The Moscow Times (November 12, 2001) (accessed October 19, 2008)

²³ Vladimir Kontorovich, “Has New Business Creation Come to a Halt in Russia?” Journal of Business Venturing 14 (1999) 452 (accessed October 12, 2008)

SME Support Law was passed, the most important task at hand was to classify small businesses and allow for their existence within the new economic system. From 1991-1998, fifty official documents regulating the small business sector were adopted. The majority of these documents were declarative in nature, expressing what should be done rather than codifying it in law.

In one of his first addresses as president, Putin gave the watching world some indication of how Russia would be run on his watch. He did not shy away from stressing the importance of “key sectors” (energy, heavy industry, transportation, military) and pledging special state protection for these sectors, much to the chagrin of more liberal economic observers within Russia and abroad. Despite the big business shake-ups that characterized Putin’s first term, a strong discourse on the strategy for small business reform began to emerge. Why did this occur? It can be argued that Putin, who enjoyed widespread popular support, had the political capital to push small business reform. Also, the government was looking for ways to balance the budget and expand the tax base as oil prices fell. Small business was considered by the government to be a vehicle for creating a middle class.

Speaking at the 2nd all-Russian congress of small businessmen in 1999, Russia's Minister for Anti-Monopoly Policy and Support for Small Scale Entrepreneurship Ilya Yuzhanov stated that Russia needs a national doctrine on small business.²⁴ The official ideology towards small business was:

... State support of small entrepreneurship [is] one of the most important directions of economic reforms, contributing to development of competition, supply of the consumer market with products and services, creating new jobs, and formation of a wide stratum of owners and entrepreneurs.²⁵

Administrative Barriers

Small business growth and development is largely dependent on the quality of the overall entrepreneurial environment. Excessive bureaucracy, administrative barriers, access to credit, and tax burdens are all issues that have been acknowledged as serious constraints for small business. According to a 2001TACIS study, "administrative barriers" include registration and liquidation procedures of small businesses; licensing of

²⁴ "Russia Needs a National Doctrine for Small Business Development, says Russia's Minister for Anti-Monopoly Policy and Support for Small-Scale Entrepreneurship." Russian Economic News (October 27, 1999) (accessed October 19, 2008)

²⁵ State Decree "On Priority Measures for the Development and State Support for Small Enterprises in the Russian Federation." (May 11, 2003) 2

small business activities; certification and standardization of products, works and services; control and inspection of current entrepreneurial activities; inter-regional commerce or trade; and small business involvement in public procurement.²⁶ Assistance from the state is crucial to the expansion of small business seeing as the state can and should work to establish the institutional requirements that are needed for sustained growth.²⁷ New legislation is only one part of the solution. As current President Dmitri Medvedev notes, new laws will have little lasting impact if they are not “meticulously implemented.”²⁸ Implementation is particularly problematic in Russia due to the inefficient bureaucracy.

The Center for Economic and Financial Research (CEFIR) at the New Economic School in Moscow has monitored the impact of new legislation on administrative reforms since 2000. In 2006, they published a comprehensive analysis of the results of these reforms. Funded in part by USAID, the project included surveys from 2,000 small firms in 20 regions. The administrative

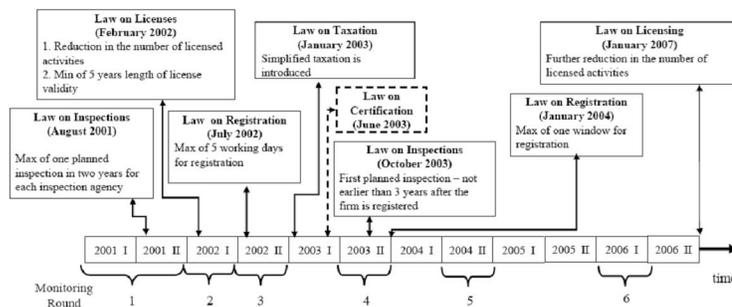
²⁶ Russian SME Resource Centre

²⁷ Valerii Kondrachuk, “State Influence on Small Business Development,” *Russian Politics and Law* 44, no.6 (November-December 2006) 69 (accessed November 3, 2008)

²⁸ Anna Smolchenko, “Medvedev Soldiers on in Corruption Battle,” *The Moscow Times* (October 1, 2008) (accessed October 1, 2008)

barriers monitored included: registration, licensing, inspections, certification, and tax administration. The results of the CEFIR study indicate that administrative barriers have eased somewhat from 2001-2006. Although the legislative reforms from the Putin years yielded positive results overall for small businesses, the tendency to use informal methods (bribes) to ease administrative barriers is on the rise.

Timing of reform and monitoring rounds



Source: Russian SME Resource Centre. “Administrative Barriers for SME Development: the Problem and Solutions.” TACIS Project SMERUS 9803 (January 2001)

The federal Law on Registration passed in 2002 set a benchmark of no more than five days to complete registration for a new small firm. CEFIR found that over the period of 2002-2006, firms spent less efforts and visited fewer agencies during the registration process.

Approximately half of those firms surveyed managed to complete the registration process within the deregulation target of five days. Some firms chose to use intermediaries to aid in the registration process which added time and costs to the firm. Twenty-percent of those firms surveyed relied on personal connections for registration purposes. Medvedev intends to introduce a notification-based registration procedure (draft law to go before the Duma in 2009). This procedure would allow entrepreneurs to open a business without obtaining an agreement from local officials.

The federal Law on Licenses passed in 2002 (amended in 2007 to further reduce the number of licensed activities) aimed to reduce the number of licensed activities for small business operations and set a minimum length of five years for validity of licenses. CEFIR found that although firms spent more efforts obtaining licenses (waiting time, work effort), the share of legitimate licenses (as stipulated by the legislation) exceeded 50% in 2005 and remained stable. License validity is above five years for 84% of legitimate licenses. Local agencies issued less legitimate licenses than federal agencies, but they were easier to obtain. Unfortunately, informal methods

(personal connections, gifts) for obtaining licenses and permits were still used by many firms. Medvedev proposes transitioning to compulsory liability insurance system which would eliminate licenses altogether. Eliminating licenses will decrease financial costs to businesses and decrease the potential for corruption.

The federal Law on Inspections passed in 2001 (amended in 2003) stipulated that a maximum of one planned inspection was allowed over the course of two years for each agency (fire, sanitary, tax authorities, and police). The survey found that tax, fire, sanitary, and police authorities violated the benchmark for 30% of the firms on average. The frequency of inspections is not uniform across the regions. Firms that were inspected multiple times by an agency over the course of the year tended to have more inspections overall. This may be due to a firm's lack of "connections." The frequency of financial losses per firm increased significantly for inspections of licensing agencies; unofficial fines increased from 2002-2006 for tax agency inspections. Informal methods of fighting inspectors were used by firms more often than formal methods (courts). 30% of surveyed firms found inspection procedures to be transparent – an equal number found them

to be non-transparent. Medvedev has proposed limiting inspections to once every three years. Unscheduled inspections would take place by special decision or be approved by the prosecutor's office. Other proposals on inspections include abolishing the Interior Ministry officials' so-called extra-procedural right to carry out inspections of small businesses. The Prosecutor General Office, which is tasked with overseeing legal matters in the Russian Federation, was given a large mandate in 2008 by President Medvedev to tackle the problem of excessive inspections for small businesses. He has stated that the regional Prosecutor General Offices should have the authority to authorize inspections. Yet, he has stated that he would also like to see a separate ministry created for the sole purpose of overseeing inspections – it is unclear what the outcome will be.

Taxation

Taxation has always been a hotly debated topic within the government and the small business community. The government would like the small business sector to substantially contribute to overall federal tax revenue. However, current tax codes make their contribution more or less negligible. Instead of fostering growth, tax policies

have lead to the proliferation of very small businesses (kiosks, one-man enterprises) and have made it difficult for businesses to expand and grow. Reforms made to the Law on Taxation of 2001 (amended in 2003) allowed for special status for very small businesses (less than 10 employees). Ironically, the federal government seemed to give the best breaks to businesses it deemed insignificant to the overall federal budget.²⁹ For example, small businesses benefit from the simplified tax law while medium size businesses face a more significant tax burden (profit taxes of 6% and 24%, respectively). The stark difference between the levels of tax does not encourage small companies to grow. Small businesses that prosper under the simplified tax system are often not strong or profitable enough to move into the regular tax system. This suggests that, ironically, compliance and making advanced tax payments are often more damaging to growth than the actual tax increases.³⁰ Officials believe that businesses will do what they can to cheat the system. This is particularly interesting as the small business sectors of transitioning economies have

²⁹ Jamison R. Firestone, "Small and midsize business in Russia, why institutional investors should care and what to look for," *Russian Investment Review* 4, no.3 (2005) (accessed September 21, 2008)

³⁰ Firestone

generally been viewed as the victims in the overall economic scheme of things. For example, if a mid-size or large business wanted to save a few rubles, they could split themselves into many small companies. This fear is largely irrational and seems to be a stop-gap argument on the part of the government to avoid discussion of simplified tax laws for large companies. Not granting well thought out tax preferences to encourage growth is a rather self-defeating method to prevent tax fraud.³¹

Access to Credit

Lack of access to credit is a major challenge for small businesses. Lending practices in Russia are woefully out of touch with the needs of the population and the small business sector. Distrust and inexperience on part of banks and the small business owners create an unfavorable lending climate. Convincing banks to loan to small businesses will require a fundamental change in the way banks operate in Russia. For one thing, banks do not believe that lending to small businesses is profitable. Russian banks do not have a history of making small business loans, which they consider to be risky. Consequently, approximately 75% of small business start-

³¹ Firestone

up funds originate from private capital. The government acknowledges that this is unsustainable, but has nonetheless failed to foster a new lending culture in the financial sector.

External organizations have provided microfinance loans for small businesses, but their scope is inadequate to meet credit needs for small businesses, estimated by the Ministry of Economic Trade and Development to be 1 trillion rubles (current real lending volume is around 250 billion rubles).³² The European Bank for Reconstruction and Development (EBRD) fund was one of the only credit sources available to small businesses, dispersing 65,000 loans to small businesses since its founding in 1995. USAID has also provided loans to small businesses. However, many experts believe that the state should have a stronger role in the distribution of capital, mainly through mandating small business development programs in state banks or developing other sources of funding. The Development Bank, established in 2007 through the merger of Vnesheconombank, Roseximbank and the Russian Development Bank, is the government's latest effort to

³² E.S. Nabiullina, "Results Achieved by the Ministry of the Russian Federation for Economic Development and Trade in 2007 and Targets for 2008," Meeting of the Board Presentation (March 25, 2007) www.economy.gov.ru (accessed November 22, 2008)

provide funding sources for small businesses and projects that support small business development.

The onus does not fall completely on the banks, however. Weak accounting and cash flow statements on the part of small businesses perpetuate banks' hesitancy to lend to them. Much of this can be attributed to inexperience in the financial sector. Banks are generally more comfortable lending to larger enterprises with which they have close personal relationships. In the financial sector, as with many other areas in Russian society, the importance of personal relationships cannot be understated.

Federal Funding

The federal government contends that its commitment to the small business sector is shown through its funding initiatives. Federal funding for small business development has waxed and waned over the years. There are two types of financial support: direct assistance to small businesses (case-by-case basis) and indirect assistance (creating a favorable environment).³³ During the 1990s, there were four federal state agencies approved to conduct support for small business. They were the Bank for Entrepreneurship Development (founded in 1993), the

³³ Radaev (2001) 15

Fund for the Development of Small Enterprises in the Scientific-Technical Sphere (1994), the State Committee on Support and Development of Small Entrepreneurship (1994) and the Federal Fund for Small Entrepreneurship (1995).³⁴ In 2001, the State Council passed “The Concept of State Policy to Support and Develop Small Entrepreneurship in the Russian Federation.” This law allocated 3,000 rubles to each small business on average, but there was little uniformity in doling out the funds. Despite billions in federal funding for development programs, small businesses still rely heavily on private sources of capital. Direct budget funding has since become unpopular with policy makers due to weak oversight and accountability. The current trend is indirect funding by which federal funds are channeled into regional guarantee funds and special funds designed to support small business. Most recently, the government has advocated using venture funds to promote small business development (through the 2007 law “On the Development of Small and Medium Size Business in the Russian Federation”). Managers of regional venture funds in Moscow, Tomsk and Krasnoyarsk

³⁴ Nonna Barkhatova, “Russian Small Business, Authorities and the State.” *Europe-Asia Studies* 52, no.4 (June 2000) 661 (accessed October 5, 2008)

Krai have already invested 300 million rubles in small businesses.

Limits of Legislation

The legislative changes in administrative procedures over the last decade are generally regarded as positive, although more needs to be done. Business leaders often express frustration at the frequency of legislative changes. Appropriate enforcement of laws by federal, regional and local authorities is difficult at the best of times. When the law is constantly changing, it is understandable that compliance is rare and corruption is rife. Speaking in an interview with *Rossiskaya Gazeta*, the chairman of the Russian Federation Comptroller's Office stated that in order to effectively address corruption in Russia, the laws have to be clarified. If small business owners, for example, are unaware of their rights they will more willingly give bribes. Bribes are often an answer to the stifling bureaucratic steps that are required of small businesses (registration, etc). Paying bribes has become a normal way of expediting or avoiding bureaucratic requirements.

Stamping out corruption in Russia will most definitely be an uphill battle, and not all are convinced that

more legislation will be effective. INDEM Foundation president Georgy Satarov claims that the recent anti-corruption legislation “tackles the consequences rather than their causes.”³⁵ Loopholes in legislation at the federal and regional levels allow for corruption. Sometimes, these loopholes are deliberately included in legislation. Other times the loopholes are simply a result of poor legal skills or legislative work. Furthermore, he states:

“the first thing that needs to be done is to provide the conditions in which it would be possible to counter corruption in Russia in principle. These are first of all external control of bureaucracy and the authorities on the part of society through real rather than manipulated opposition and through independent media, and also the existence of an independent judiciary and parliament, that is, true separation of government branches capable of controlling each other.”³⁶

In Russia, it is very important which signals are sent. Medvedev has sent a strong message to the small business community: “... those in business need to behave responsibly - they have to pay taxes and do business legally, within the normal legal constraints, and not make

³⁵ “Independent Analyst Skeptical About Medvedev’s Anti-Corruption Plan.” Interfax (September 30, 2008) <http://www.cdi.org/russia/johnson/2008-178-8.cfm> (accessed October 1, 2008)

³⁶ Ibid.

use of flagrant, anti-social means of tax dodging.”³⁷ He has admitted that a “vicious circle” has been created in which authorities extract money from businesses, while businesses corrupt the law enforcement agencies. Unless the circle is broken, reforms stand little chance of making a lasting impact. Furthermore, decrees are useless unless a more favorable business climate is created, and a favorable business climate can only be created if all parties work together including the government, law enforcement agencies, and business owners. This stance suggests that small businesses in Russia have outlived their victim status that was prominent in the 1990s.

Corruption at all levels of government hinders the implementation of legislation. Corruption is an ever present challenge to small business in Russia. It is a complex issue that has its roots in Russia’s cultural legacy. Russia ranked #147 in the world on Transparency International’s Corruption Perceptions Index 2008.³⁸ FOM

³⁷ President of Russia, “Dmitri Medvedev’s Opening Address at a Meeting to Discuss the Protection of the Property Rights of Small and Medium Businesses, Smolensk Region (July 31, 2008)
http://www.kremlin.ru/eng/text/speeches/2008/07/31/2130_type82912type82913type8479_204845.shtml (accessed November 22, 2008)

³⁸ Transparency International: 2008 Corruption Perceptions Index
http://www.transparency.org/news_room/in_focus/2008/cpi2008/cpi_2008_table (accessed November 10, 2008)

(Public Opinion Foundation) found that only 1/3 of Russians believe that corruption can be completely stamped out.³⁹

The first serious anti-corruption concept was advanced by the Putin administration in 2005, and was further integrated into a 2006-2010 action plan approved by the Government October 25, 2005. Unveiled in 2008, Medvedev's Anti-Corruption plan expands the concept approved in 2005 and is comprised of three parts. First is the Counter-Corruption Bill which lays out the government's plan to combat corruption, amendments to the Constitutional Act on the government and two bills for amending twenty-five laws including the Code of Criminal procedure and the Act on Operational Search Action.⁴⁰ Although there has been a marked increase in corruption cases to make it to the courts over the last decade, they are mostly high-profile, large-scale cases dealing with procurement or monopoly issues. Unfortunately, the Anti-Corruption plan targets the activity of big business and

³⁹ The Public Opinion Foundation (FOM). "Fighting Corruption." Population Poll (November 30, 2006)
http://bd.english.fom.ru/report/map/dominant/edominant2006/edomt0647_2/ed064713
(accessed October 20, 2008)

⁴⁰ "Professional Ban Elaborated for Bureaucrats." Kommersant (October 1, 2008)
(accessed October 1, 2008)

upper-level elite in a pointed fashion (requiring top officials to reveal their personal financial statements and mandating a two-year minimum period between holding public office and working for large businesses with which they had direct dealings) while provisions for eliminating small-scale corruption facing small businesses are vague and lack mechanisms for implementation. Some businessmen advocate a provocative solution for administrative corruption such as decriminalizing giving bribes in order to encourage citizens to inform on corrupt government officials (who take bribes).⁴¹ Medvedev has emphasized that lowering the level of corruption is necessary to achieve other goals including securing property rights, strengthening legal and judicial systems, and advancing free enterprise. The government clearly understands the corruption problem, but current legislation will not be enough.

Access to legal recourse in the case of grievances on part of a small business is still a challenge in Russia. The judicial system has come a long way from 1991, and on the whole, the situation has improved dramatically for citizens and private enterprises alike. Much work has been

⁴¹ Guriev 10

done to clarify legal procedures, inform citizens of their rights, and make judicial procedures more transparent.⁴²

Although many businessmen and officials believe that Russian citizens suffer from a sense of “legal nihilism,” or general disregard for the law, it is state officials and administrators that are the biggest culprits of turning a blind eye towards the law.⁴³

⁴² For example, a television legal channel *Zakon-TV* is broadcast for 16 hours a day in an effort to improve public awareness of legal rights.

⁴³ Sergey Guriev and Igor Fedyukin, “Challenges 2020: The View from Russian Business,” Ministry of Economic Development. 10 (accessed September 22, 2008)

CHAPTER THREE - IMPLICATIONS FOR GROWTH OF THE SMALL BUSINESS SECTOR

One possible indicator of the evolution of small business reform has been the change in perceived challenges to doing business. In 2007, OPORA Russia surveyed small business owners across 37 regions and found that the greatest challenges to doing business were low access to staff, low access to financing, and low access to premises.⁴⁴ In a report published by the Ministry of Economic Trade and Development in 2007, several problems with small business development were identified: connection to power networks, availability of real estate, availability of financial resources, and administrative barriers.⁴⁵ In another survey published by the Ministry of Economic Trade and Development in cooperation with the New Economic School, the top concerns for business

⁴⁴ Sergey R. Borisov, "OPORA Russia," Presentation by the President (September 17, 2008) http://www.smwa.sachsen.de/set/431/industrietag_russland_referat_borisov.pdf (accessed September 30, 2008)

⁴⁵ Nabiullina, E.S. "Results Achieved by the Ministry of the Russian Federation for Economic Development and Trade in 2007 and Targets for 2008." Meeting of the Board Presentation (March 25, 2007); www.economy.gov.ru (accessed November 22, 2008)

leaders were labor shortages, infrastructural weakness, and quality of public governance.⁴⁶

The focus on administrative barriers, although still a challenge, has given way to more structural problems such as access to premises, labor shortages, and inadequate infrastructure. Whereas these problems affect all levels of economic development, they are especially crucial for small business development. In March 2005, Putin suggested that people who register a small business should be given a medal for bravery. Contrast this with an earlier CEFIR report in which the majority of businessmen surveyed didn't consider opening a business to be a challenge. This begs the question whether the Kremlin really understands what the barriers to long-term small business growth are.

Access to Premises

The Ministry of Economic Trade and Development is looking at ways to ensure that rents do not increase arbitrarily on federal property being leased by small businesses. High rents and uncertain leasing arrangements for federal property pose a challenge to small businesses.

⁴⁶ Guriev 9

CEFIR found that on average 6% of firms felt pressure to be expropriated from their premises by government officials. Older firms are at a greater risk for expropriation seeing as they are more likely to lease public property. Most firms prefer to lease space from private parties because it involves less risk. When leasing public property, small firms must deal with an array of agencies and studies show that the number is on the rise.⁴⁷ The average lease period for public premises is one year, and 19% of leases risk non-prolongation.⁴⁸ More than 70% of small businesses have no legal relationship to their premises, which adds to their vulnerability. Purchasing land is out of the question for most small firms due to prohibitive costs and bureaucratic hassle. The government is planning to introduce legislation that would define the procedure for leasing public and municipal lands to small businesses. This would definitely be helpful.

Demographic Challenges

Russia is in the midst of a demographic crisis.

Falling birth rates and a dismal life expectancy (only 60

⁴⁷ “Monitoring of Administrative Barriers to Small Business Development in Russia.” CEFIR (2006) <http://cefir.ru/index.php?l=eng&id=34> (accessed November 17, 2008)

⁴⁸ Nabiullina

years for males) have serious implications for macroeconomic development and small business growth. The problem affects small business in several ways. Access to *skilled* labor is cited as a growing problem in the business community. The problem is most acute in rural regions where devastating unemployment rates (22-52.7% in some rural regions) and poverty have driven citizens to Moscow, St. Petersburg, and other urban centers.⁴⁹ The issue of internal migration has serious implications for small business development in poorer regions. Small business has not yet been institutionalized to the point that job-seekers would choose employment in this sector over a more stable position in a larger corporation. Those that do draw their main incomes from the private sector often view their jobs as unreliable which can lead to negative perceptions of the small business sector.⁵⁰ Competition for skilled labor in the small business sector is high. The 2007 law “On the Development of Small and Medium Size Businesses in the Russian Federation” allocates funds for building 120 business incubators across the country. To

⁴⁹ Adisa Banjanovic, “Russia’s Unequal Regional Development,” (October 17, 2007) www.euromonitor.com (accessed November 22, 2008)

⁵⁰ Anatoly Zhuplev, Fred Kiesner, and Igor Zavadsky, “Impediments to Small Business Development in Russia,” <http://sbaer.uca.edu/research/usasbe/2004/pdf/47.pdf> (accessed October 22, 2008)

date, thirty-eight have been opened. The goal of the incubators is to foster a culture of entrepreneurship through education, consultancy, and support. Incubators are helpful tools for orienting the labor force to the possibilities of the private sector.

Small business will also be expected to carry the financial burden of Russia's aging population, as the government is planning to increase the Unified Social Tax to 34% (up from 26%) per employee to revive the pension system. The government projects that the working age population will fall from its current 89.9 million to 77.8 by 2020. Also, it is estimated that there will be 837 non-workers for every 1000 workers in 2020, up from 580 non-workers for every 1000 workers.⁵¹

The demographic problem is not easily solved with legislation. Although the government is planning new programs in health and social services, its role is largely diminished. Internal migration will only be solved by lifting the levels of socio-economic development in Russia's poorest regions.

⁵¹ "Russian Population 137 million in 2020." Kommersant (August 6, 2008)

Infrastructure

Russia's weak infrastructure (lack of roads, railway lines, energy capacity, and technology) is a hindrance to small business development as well as broader economic growth. Weak infrastructure impacts small business by affecting distribution channels. The government understands that large-scale infrastructural improvements will attract foreign direct investment (FDI) which in turn will lead to broader possibilities for economic development. Thus far, the government's efforts in this area have been focused on large-scale projects. The government plans to subsidize transportation services in the Far East beginning in 2009. 2.5 billion rubles will be allocated. The government also envisions business taking an active role in infrastructure projects through investment.

Accessing (and affording) power supply is difficult for small businesses as public utilities are monopolized. An estimated 60% of requests for electricity are denied by local authorities. Small businesses face steep rates for electricity, especially in larger cities. In Moscow, connection costs average 102,000 rubles. It is estimated that small businesses pay approximately 43 billion rubles per year in energy costs. Unfortunately, there is no uniform

system of setting rates or supply of electricity which creates yet another area where disparities exist across the country. The government has advocated transparency in setting rates, standard contracts, and subsidies for connectivity costs for small businesses. No concrete measures have been taken on these recommendations.

The Russian government has repeatedly stated that technological advancements are crucial to business growth. There are 34 million internet users in Russia. With a total population of 140 million, clearly the country is ready for a technological revolution. Access to communication technology is not uniform across the regions. Where one would have no problem finding mobile phones or internet cafes in Moscow or St. Petersburg, these technologies are non-existent in more rural areas. The government is currently developing a Strategy for the Development of the Information Society in the Russian Federation. The strategy calls for “electronic” government (ensuring that all federal, regional and municipal offices are accessible online), and although it envisions the level of internet users to increase, no concrete plan for implementation of this goal has been realized. The federal government has established special economic zones in Zelenograd, Dubna,

St. Petersburg, and Tomsk for development of innovative high technologies. Technological access is imperative for small business growth. Without it, they are unable to maximize their operations or connect to the public and potential business partners. The state's leverage over business will diminish as technology increases.

CHAPTER FOUR - THE ROAD TO A LONG-TERM SMALL BUSINESS DEVELOPMENT

Shifting the Burden –Regional Initiatives

For centuries, Russian leaders have contended that the sheer size of the country together with a diverse ethnic make-up necessitated strong, centralized control.

Otherwise, the far reaching regions would be vulnerable to takeover and disintegration of the state. Russia is a vast federation comprised of 21 republics, 8 *krais* (territories), 47 *oblasts* (regions), 2 federal cities, 1 autonomous region, and 6 autonomous districts. In 2000, seven federal *okrugs* (districts) were created. These super districts divided up Russia's regions and republics, thereby adding another layer of authority. Disparities between the regions are huge in terms of living standards, human capital, infrastructure, and communication technologies. The federal government understands that regional and local authorities should play a greater role in small business development, while regional and local authorities believe the federal government is

unclear about its ambitions and should development a national strategy to ensure reforms are uniform.

After the collapse of the Soviet Union, industrial output dramatically decreased and regions that specialized in mineral extraction prospered. Other regions fell behind in socio-economic development. Although centralization policies under Putin led to redistribution of wealth, great disparities still exist between the regions.

Local authorities had limited ability to influence economic development in their areas during Soviet times since they did not have the authority to levy taxes or to set their own land use policies. In 2007 Putin stated that “greater powers for regional and local authorities constitute one of the main criteria for measuring a society’s degree of political culture and development” and “decentralisation of state power in Russia is now at a higher point today than at any other time in [the] country’s history.”⁵² Nevertheless, local governments are affecting regional and urban economic development as central control recedes.

The federal government has taken steps to enhance the performance of local municipalities on small business reform. In 2007, the Law on Local Self-Government came

⁵² Ibid.

into force which effectively transferred administrative powers from the federal government to the local governments. The intent, according to Putin, is to empower local authorities, consolidate the economic foundation for local self-government, ensure the formation of a significant revenue base, and bring the government closer to the people.⁵³

Russia's federal system is a complex quilt of federal, regional, and municipal bodies whose roles often overlap. Coordinated and effective enforcement of the law by all levels of government is possible, as seen in more developed federal systems such as the US. Unfortunately in Russia, cooperation between these bodies is still problematic. Small business owners find themselves in the midst of the bureaucratic web. A TACIS report of 2000 found that administrative barriers were often due to the action or inaction of public officers of executive authorities that adopt legislative acts inconsistent with federal law, allow abuse, or exceed their powers in conducting

⁵³ President of Russia, "Vladimir Putin's Address to the Federal Assembly on Law on Local Self-Government" (April 26, 2007) http://www.kremlin.ru/eng/speeches/2007/04/26/1209_type70029type82912_125670.shtml (accessed October 22, 2008)

inspections of small businesses.⁵⁴ The federal government operates a large number of Soviet-era federal offices in outlying regions although the funds for maintaining these offices have long since dried up. Under-paid and often unsure of their obligations, federal employees often resort to corrupt practices such as accepting bribes for expediting administrative practices. Better results and adherence to legislative reforms were achieved in regions with better fiscal incentives, more concentrated industry, less corruption, and higher government transparency.⁵⁵ Many small business owners would admit that the success of their business is still largely dependent on “who you know,” and whether you have the blessing of the local authorities. Corruption as it relates to small business is most acute at the regional and local levels.

There are several features of the regional/federal relationship that negatively affect small businesses. First, each region negotiates its agreements with the federal government separately resulting in funding disparities among the regions. Also, there is no agreed system for

⁵⁴ Russian SME Resource Centre 3

⁵⁵ “Monitoring of Administrative Barriers to Small Business Development in Russia.” CEFIR (2006)

collecting tax revenues. Small businesses are required to pay federal taxes which are collected by federal officials in regional outposts. Regional authorities have been known to co-opt these officials into selectively collecting taxes from businesses.⁵⁶ Lastly, Russia has a support system for funding poorer regions. Some observers suggest that these policies impede small business development as these regions may actually minimize their economic development in order to qualify for the funds.

There is a growing trend for promoting clusters of growth rather than funding depressed regions directly. For example, in the Irkutsk region there are plans to merge the regional capital, Irkutsk, with the towns of Angarsk and Shelekov.⁵⁷ Developmental funding to the regions has increased six-fold since 2000. Although this shows that opportunities have greatly increased for regions to take control of their economic development, the federal government has not yet developed a system for evaluating the effectiveness of the funding.

⁵⁶ Aidis 404

⁵⁷ Adisa Banjanovic, "Russia's Unequal Regional Development," (October 17, 2007) www.euromonitor.com (accessed November 22, 2008)

Progress of reforms is not geographically uniform in Russia. As early as 2002, Putin acknowledged that certain regions were not doing enough to promote small business growth. As was often the case, regions that had ample resources but took no initiative to build a small business base would request federal aid for these projects, leading to growing skepticism for direct funding to the regions.⁵⁸

Failure to bring outlying regions into the developmental fold will have serious consequences for the federation. Speaking at a conference on socio-economic development in Kamchatka Krai, Medvedev said that “if we do not step up the level of activity of our work [in the Russian Far East], then in the final analysis we can lose everything” with that region becoming a source of raw materials for Asian countries.⁵⁹ Regional authorities in the Far East are also accused of intimidating small businesses and forcing them to relocate to China and the surrounding areas.

⁵⁸ President of Russia, “Vladimir Putin’s Opening Remarks at a Meeting on the Social and Economic Development of the Southern Federal District. (May 16, 2002) http://www.kremlin.ru/eng/text/speeches/2002/05/16/0002_type82912type82913_15059.shtml (accessed September 26, 2008)

⁵⁹ Paul A. Goble, “Will Russia Lose its Far East?” The New York Times (September 30, 2008)

While the federal government tackles small business reform on a macro level, regions and municipalities have implemented their own small business development plans. Moscow's comprehensive plan to promote the development of small business (2007-2009) reflects a growing trend for regions and municipalities to adopt their own reform agendas.⁶⁰ Inter-regional commissions have been effective in reducing administrative barriers at the regional level. Regional cooperation is also ideal for promoting common projects such as creating jobs or improving infrastructure (transportation lines for inter-regional trade). The Krasnodar Regional Coalition oversaw the creation of Centers for SME Development in local chapters of the Chambers of Commerce. In 2007, over 20,000 entrepreneurs applied to the centers for legal advice. Hotlines were also utilized by small business owners when they had questions about legal rights. Since 2007, the centers have settled 800 conflicts between businesses and inspection agencies in the region. The Center for International Private Enterprise (CIPE) has worked with 17

⁶⁰ Small Business in Russia, "Comprehensive Program of Small Business Development and Support in the City of Moscow." http://www.business-in-russia.com/content/document_r_92FF47E4-A657-4EA9BFD5-371023478F57.html (accessed September 26, 2008)

regional coalitions to discuss barriers to small businesses and solutions for development. External organizations like CIPE are helping to create a supportive infrastructure and environment in which businesses can prosper in an ethical way in Russia.

Concept 2020

Economic indicators show that Russia is on an uphill trajectory when it comes to growth. In 2007, Russia grew from 2.7% to 3.2% in share of the global economy. By size, it grew from the 10th to 7th largest economy worldwide. GDP has steadily grown since the financial collapse of 1998, last year growing by 8.1%, the largest increase in GDP since 2000. Overall economic growth in recent years has been fueled predominately by increases in manufacturing along with a marked increase in foreign capital investment. Consumption rates are steadily growing due to increases in real wages. With a population of over 100 million and wages expected to continue to increase, Russia is poised to be one of the world's largest consumer markets in the near future. By the time Medvedev came to office, top officials believed that Russia had attained the

level of political and macroeconomic stability needed to formulate a long-term economic plan. For the first time in the post-Soviet era, Russia had a long-term economic development strategy.

In 2007, the Ministry for Economic Trade and Development published the highly anticipated Concept 2020. This document set various goals and benchmarks for the Russian economy to achieve by 2020. The Concept is a comprehensive strategy that addresses not only economic goals, but also emphasizes the link between economic and social development in the Russian Federation. The Concept is important for several reasons. It sends the message that Russia has a clear vision of where it wants to go economically. Furthermore, if the goals outlined in the Concept are met, Russia will be a key player on the global stage. Inefficient administration and declarative economic policy are cited as two features keeping Russia from being referred to as a developed country.

The Concept was revealed at a moment when uncertainty regarding economic forecasts, even in the short-term, is particularly high. Critics of the Concept contend that its major drawback is that it does not include mechanisms for achieving its goals. For example,

“occupying a leading role in the international arena” does not qualify as a strategic goal.⁶¹ Curiously, the Concept devotes only minimal attention to small business development. Medvedev has stated that small businesses will employ 60-70% of the workforce by 2020, but a strategy for meeting this goal has not been articulated. Heavy emphasis is placed on strengthening manufacturing and defense industries, while little attention is given to development of small and medium size businesses. In short, the government missed an opportunity to incorporate small business development into the national economic strategy

Summary

The institutionalization of Russian small business is more or less the confluence of the state’s developmental ambitions and its institutional capacity.⁶² The current administration has stated that small business will employ 60-70% of the Russian workforce by 2020. The state’s

⁶¹ Galina Kovalishina, “The Future of Russia as Seen by the Ministry for Economic Development,” *Russia Beyond the Headlines* (November 26, 2008) http://rbth.ru/articles/2008/11/26/261108_development.html (accessed December 15, 2008)

⁶² Markus 279

ambitions are clear, but does it have the institutional capability to achieve this goal?

Small business in Russia has come a long way since the tumultuous transition period of the 1990s. There are more small businesses today than ever before in Russia. A discourse on small business reform emerged during the Putin presidency. Small business reform features in the government's economic development strategy. Legislation on small business reform has been successful in alleviating administrative barriers. More work is needed. With the regulatory framework established, small businesses are looking towards the future and challenges that hinder growth. Has the federal government reached the limit on what it can achieve in small business reform? After a period of centralization, the federal government has taken steps to transfer powers back to regional and local authorities. The future of the small business sector will largely depend on regional and local initiatives paired with a clear strategy and oversight from the federal government.

Thus far, supporting small business has been politically neutral for the government. The government has the freedom to act or not-act on small business reform (as evident in the 1990s, small businesses will find a way to

survive). Although the government has indicated that it understands that a strong small business sector has the potential to strengthen the economy and social sphere, the evolution of reforms shows that the small business sector is not yet the top priority of the government. This is unfortunate, given what's at stake.

Bibliography

Aidis, Ruta and Yuko Adachi, "Russia: Firm Entry and Survival Barriers," *Economic Systems* 31 (2007) 391-411 (accessed October 14, 2008)

Astrakhan, I. and A. Chepurenko, "Small business in Russia: any prospects after a decade?" *Futures* 35 (2003) 341-359 (accessed September 21, 2008)

Banjanovic, Adisa, "Russia's Unequal Regional Development," (October 17, 2007)
www.euromonitor.com (accessed November 22, 2008)

Barkhatova, Nonna, "Russian Small Business, Authorities and the State," *Europe-Asia Studies* 52, no.4 (June 2000) 657-676 (accessed October 5, 2008)

Bateman, Milford, "Neo-Liberalism, SME Development and the Role of Business Support Centres in the Transition Economies of Central and Eastern Europe," *Small Business Economics* 14, no.4 (June 2000) 275-298 (accessed October 5, 2008)

Batjargal, Bat, "Social Capital and Entrepreneurial Performance in Russia: A Longitudinal Study," *Organization Studies* 24 (2003) 535-556 (accessed October 12, 2008)

Borisov, Sergey R., "OPORA Russia," Presentation by the President (September 17, 2008)
http://www.smwa.sachsen.de/set/431/industrietag_russland_referat_borisov.pdf (accessed September 30, 2008)

CIPE Eurasian Report
<http://www.cipe.org/regional/eurasia/pdf/RussiaCoalitionsHighlights1207.pdf> (accessed October 15, 2008)

Desai, Padmai, *Conversations on Russia: Reform from Yeltsin to Putin*, New York: Oxford University Press, 2006

Firestone, Jamison R., "Small and midsize business in Russia, why institutional investors should care and what to look for." *Russian Investment Review* 4, no.3 (2005) (accessed September 21, 2008)

Global Entrepreneurship Monitor: Russia Report 2007,
<http://www.gemconsortium.org/document.aspx?id=809> (accessed
November 3, 2008)

Goble, Paul A., "Will Russia Lose its Far East?" *The New York Times*
(September 30, 2008) (accessed October 12, 2008)

Guriev, Sergey and Igor Fedyukin, "Challenge 2020: The View from
Russian Business." Ministry of Economic Development of Russia
(accessed September 22, 2008)

Gustafson, T., *Capitalism Russian-style*, New York: Cambridge
University Press, 1999

Hanson, Philip and Elizabeth Teague, "Big Business and the State in
Russia," *Europe Asia Studies* 57, no.5 (July 2005) 657-680 (accessed
October 16, 2008)

Johnson's Russia List, "Dmitri Medvedev's Opening Address at a Meeting
of the State Council Presidium entitled "On the Implementation of a
Strategy for the Development of the Information Society in the Russian
Federation," (July 17, 2008) [http://www.cdi.org/russia/johnson/2008-134-
5.cfm](http://www.cdi.org/russia/johnson/2008-134-5.cfm) (accessed October 22, 2008)

Kondrachuk, Valerii, "State Influence on Small Business Development,"
Russian Politics and Law 44, no.6 (November-December 2006) 67-76
(accessed November 3, 2008)

Kontorovich, Vladimir, "Has New Business Creation Come to a Halt in
Russia?" *Journal of Business Venturing* 14 (1999) 451-460 (accessed
October 12, 2008)

Kovalishina, Galina, "The Future of Russia as Seen by the Ministry for
Economic Development," *Russia Beyond the Headlines* (November 26,
2008) [http://rbth.ru/articles/2008/11/26/261108_
development.html](http://rbth.ru/articles/2008/11/26/261108_development.html)
(accessed December 15, 2008)

Kuchins, Andrew C., Amy Beavin, Anna Bryndza, "Russia's 2020
Strategic Economic Goals and the Role of International Integration,"
CSIS/IFRI (July 2008) (accessed September 22, 2008)

Kuznetsov, Andrei and Olga Kuznetsova, "Institutions, Business and the
State in Russia," *Europe-Asia Studies* 55, no.6 (2003) 907-922 (accessed
October 5, 2008)

Levin, Mark and Georgy Satarov, "Corruption and Institutions in Russia," *European Journal of Political Economy* 16 (2000) 113-132 (accessed September 1, 2008)

Markus, Stanislav, "Capitalists of All Russia, Unite! Business Mobilization Under Debilitated Dirigisme," *Polity* 39, no.3 (July 2007) 277-304 (accessed October 14, 2008)

Mandel, Ruth and Caroline Humphries (Ed.) *Markets and Moralities: Ethnographies Transformation of Post-Socialism*, Oxford: Berg Publishers, 2002

Mitchneck, Beth, "An Assessment of the Growing Local Economic Development Function of Local Authorities in Russia," *Economic Geography* 72, no.2 (April 1995) 150-170 (accessed October 15, 2008)

Nabiullina, E.S., "Results Achieved by the Ministry of the Russian Federation for Economic Development and Trade in 2007 and Targets for 2008," Meeting of the Board Presentation (March 25, 2007) www.economy.gov.ru (accessed November 22, 2008)

National Anti-Corruption Plan of the Russian Federation, www.kremlin.ru/eng/text/docs/2008/07/206715.shtml (Accessed 10/1/2008)

Neace, M.B., "Entrepreneurs in Emerging Economies: Creating Trust, Social Capital, and Civil Society," *Annals of the American Academy of Political and Social Science* 565 *Civil Society and Democratization* (September 1999) 148-161 (accessed October 5, 2008)

President of Russia, "Vladimir Putin's Address to the Nationwide Conference on Small Business" (March 15, 2000) http://www.kremlin.ru/eng/text/speeches/2000/03/15/0002_type84779_134558.shtml (accessed October 19, 2008)

President of Russia, "Vladimir Putin's Opening Remarks at a Meeting of the State Council on Government Support and Development of Small Business in Russia" (December 19, 2001) http://www.kremlin.ru/eng/text/speeches/2001/12/19/0000_type82912type82913_143102.shtml (accessed October 19, 2008)

President of Russia, “Vladimir Putin’s Opening Remarks at a Meeting on the Social and Economic Development of the Southern Federal District” (May 16, 2002)
http://www.kremlin.ru/eng/text/speeches/2002/05/16/0002_type82912type82913_15059.shtml (accessed September 26, 2008)

President of Russia, “Vladimir Putin’s Address to the Federal Assembly on Law on Local Self-Government” (April 26, 2007)
http://www.kremlin.ru/eng/speeches/2007/04/26/1209_type70029type82912_125670.shtml (accessed October 22, 2008)

President of Russia, “Vladimir Putin’s Beginning of Meeting with State Duma Leadership and Faction Leaders,” (March 11, 2008)
http://www.kremlin.ru/eng/text/speeches/2008/03/11/1250_type82913_162077.shtml (accessed October 20, 2008)

President of Russia, “Dmitri Medvedev speaking at the Beginning of a Meeting on Business Development,” (May 14, 2008) www.kremlin.ru (accessed October 20, 2008)

President of Russia, “Beginning of a Meeting with First Deputy Prime Minister Igor Shukalov,” (July 11, 2008) www.kremlin.ru (accessed October 20, 2008)

President of Russia, “Dmitri Medvedev’s Opening Address at a Meeting to Discuss the Protection of the Property Rights of Small and Medium Businesses, Smolensk Region (July 31, 2008)
http://www.kremlin.ru/eng/text/speeches/2008/07/31/2130_type82912type82913type84779_204845.shtml (accessed November 22, 2008)

President of Russia, “Dmitri Medvedev’s Opening Address at the Meeting of the Anti Corruption Council,” (September 30, 2008)
http://www.kremlin.ru/eng/text/speeches/2008/09/30/1827_type82912type82913_20706.shtml (accessed October 1, 2008)

President of Russia, “Dmitri Medvedev - Meeting on Economic Issues,” (October 9, 2008) www.kremlin.ru (accessed October 20, 2008)

The Public Opinion Foundation (FOM). “Fighting Corruption.” Population Poll (November 30, 2006)
http://bd.english.fom.ru/report/map/dominant/edominant2006/edomt0647_2/ed064713 (accessed October 20, 2008)

Pyle, William, "Collective Action and Post-Communist Enterprise: The Economic Logic of Russia's Business Associations," William Davidson Institute Working Paper Series, Working Paper No.794 (September 2005) (accessed October 14, 2008)

Radaev, Vadim, "How Trust is Established in Economic Relationships When Institutions and Individuals are Not Trustworthy," CEPR/WDI Annual International Conference on Transition Economies – Working Paper (July 2003) (accessed October 10, 2008)

Radaev, Vadim, "The Development of Small Entrepreneurship in Russia," World Institute for Development Economics Research. Discussion Paper No.2001/135 (November 2001) (accessed October 12, 2008)

Rassadina, T.A., "Transformation of the Traditional Values of Russians in the Post-Perestroika Period," Sociological Research 46, no.6 (2007) 59-74 (accessed August 8, 2008)

Russian SME Resource Centre, "Administrative Barriers for SME Development: the Problem and Solutions," TACIS Project SMERUS 9803 (January 2001) http://docs.rcsme.ru/eng/RC/Analis_Adm_Barrier-Feb2001/Commission-rep.doc (accessed September 30, 2008)

Small Business in Russia, "Comprehensive Program of Small Business Development and Support in the City of Moscow." http://www.business-in-russia.com/content/document_r_92FF47E4-A657-4EA9BFD5-371023478F57.html (accessed September 26, 2008)

Smith, Hedrick, *The Russians*, New York: Quadrangle/New York Times Book Co., 1979

Smolchenko, Anna, "Medvedev Soldiers on in Corruption Battle," *The Moscow Times* (October 1, 2008) (accessed October 1, 2008)

Transparency International: 2008 Corruption Perceptions Index http://www.transparency.org/news_room/in_focus/2008/cpi2008/cpi_2008_table (accessed November 10, 2008)

Woolcock, Michael and Deepa Narayan, "Social Capital: Implications for Development Theory, Research, and Policy," *The World Bank Research Observer* 15, no.2 (August 2000) (accessed October 12, 2008)

Yakovlev, Andrei, "The Evolution of Business-State Interaction in Russia: From State Capture to Business Capture?" *Europe-Asia Studies* 58, no.7 (November 2006) (accessed October 12, 2008)

Yakovlev, Evgeny and Ekaterina Zhuravskaya, "Reforms in Business Regulation: Evidence from Russia," (March 14, 2008)
<http://ssrn.com/abstract=965838> (accessed October 12, 2008)

Yegorov, Igor, "Development of Small and Medium Enterprises in Russia," American-Russia Business Council Report,
<http://www.russiancouncil.org/reports/Hell1.htm> (accessed October 20, 2008)

USAID/Russia, "Accelerated Development and Growth of Private Enterprises." Strategic Close Out Report (1999) (accessed October 5, 2008)

Zhuplev, Anatoly, Fred Kiesner, and Igor Zavadsky, "Impediments to Small Business Development in Russia,"
<http://sbaer.uca.edu/research/usasbe/2004/pdf/47.pdf> (accessed October 22, 2008)

"Independent Analyst Skeptical About Medvedev's Anti-Corruption Plan." Interfax
(September 30, 2008) <http://www.cdi.org/russia/johnson/2008-178-8.cfm>
(accessed October 1, 2008)

"Monitoring of Administrative Barriers to Small Business Development in Russia."
CEFIR (2006) <http://cefir.ru/index.php?l=eng&id=34> (accessed November 17, 2008)

"Professional Ban Elaborated for Bureaucrats." *Kommersant* (October 1, 2008) (accessed October 1, 2008)

"Small Business Makes up 13-15% of GDP." *Kommersant* (February 19, 2008) (accessed October 1, 2008)

"Small Business Now a Big Deal." *The Moscow Times* (November 12, 2001) (accessed October 19, 2008)

"Russia Needs a National Doctrine for Small Business Development, says Russia's Minister for Anti-Monopoly Policy and Support for Small-Scale

Entrepreneurship,” *Russian Economic News* (October 27, 1999) (accessed October 19, 2008)

“Russian Population 137 million in 2020.” *Kommersant* (August 6, 2008)