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Influence of business associations on economic policy in Russia

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Part I: Industrial associations in Russia – overall description

*(based on joint paper with
Andrei Govorun)*

Research question: BA impact on economic development?

- Negative presumptions against business associations, following the works by Mancur Olson (1965 & 1982). Many empirical studies supported this critical view (review in Heckelman, 2007)
- However: alternative view – BA as **‘market-supporting’** and **‘market-supplementing’** institutions under conditions of state failure and market failure (Doner & Schneider, 2000 based on a number case studies from developing countries); “New industrial policy” => BA as important coordination instrument (Rodrik, Hausmann)
- Russia for long time as a striking example of imperfect institutions. ***The role of BA in Russian context?***

Russian case: institutional context and previous studies

1) Main trends in BA sector:

- Late 1980s as a starting point
- 1990s – weak and highly politicized sector
- 2000s – two-tier system initiated by the government: with 4 peak associations and 300-400 sector and regional BA

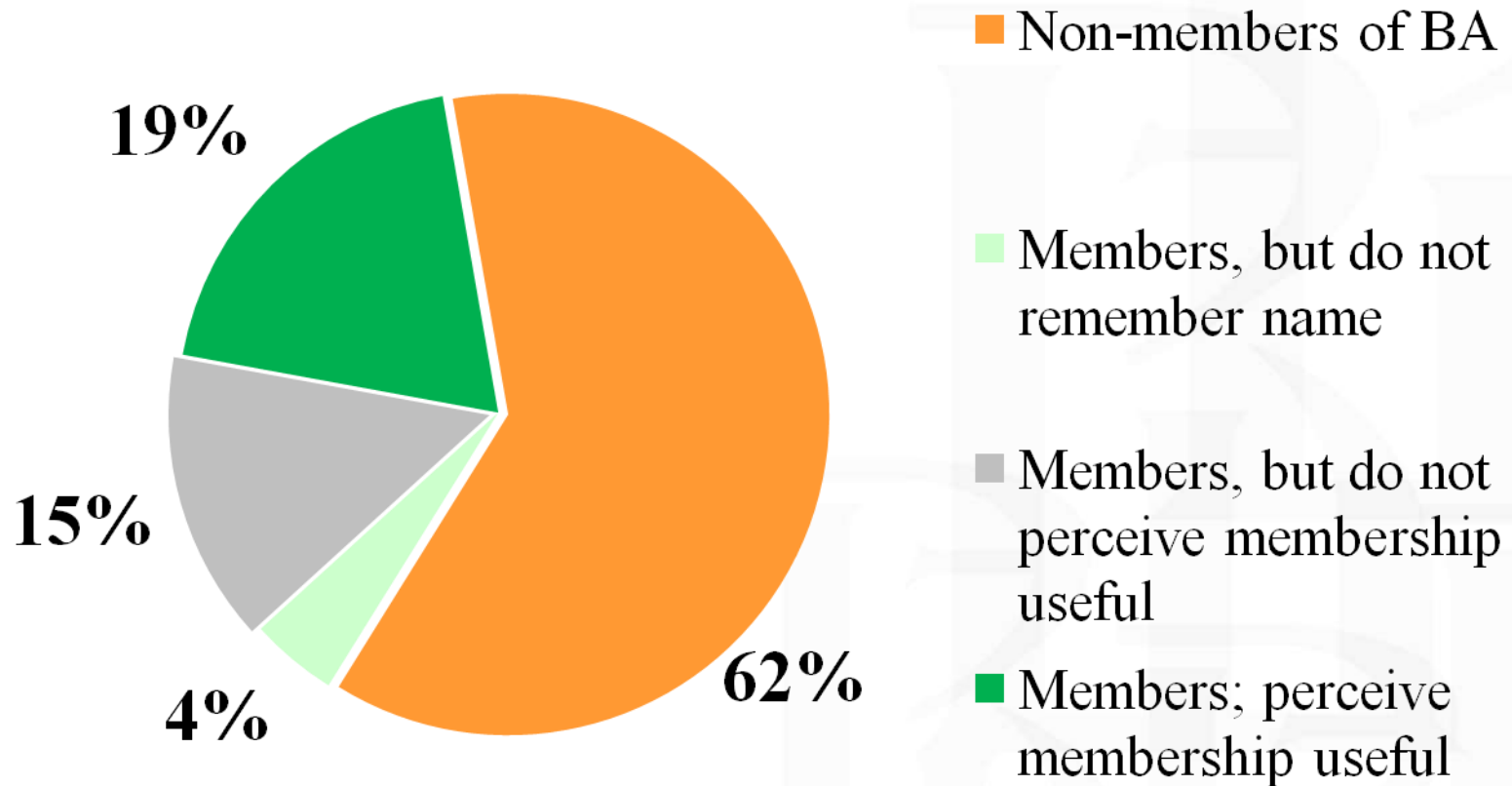
2) Main findings of previous studies (Recanatini & Ryterman, 2001; Frye, 2002; Pyle, 2006; Golikova, 2009):

- Inter-firm coordination reducing transformation costs
- BA members as more successful lobbyists
- BA members = Firms with higher sales growth

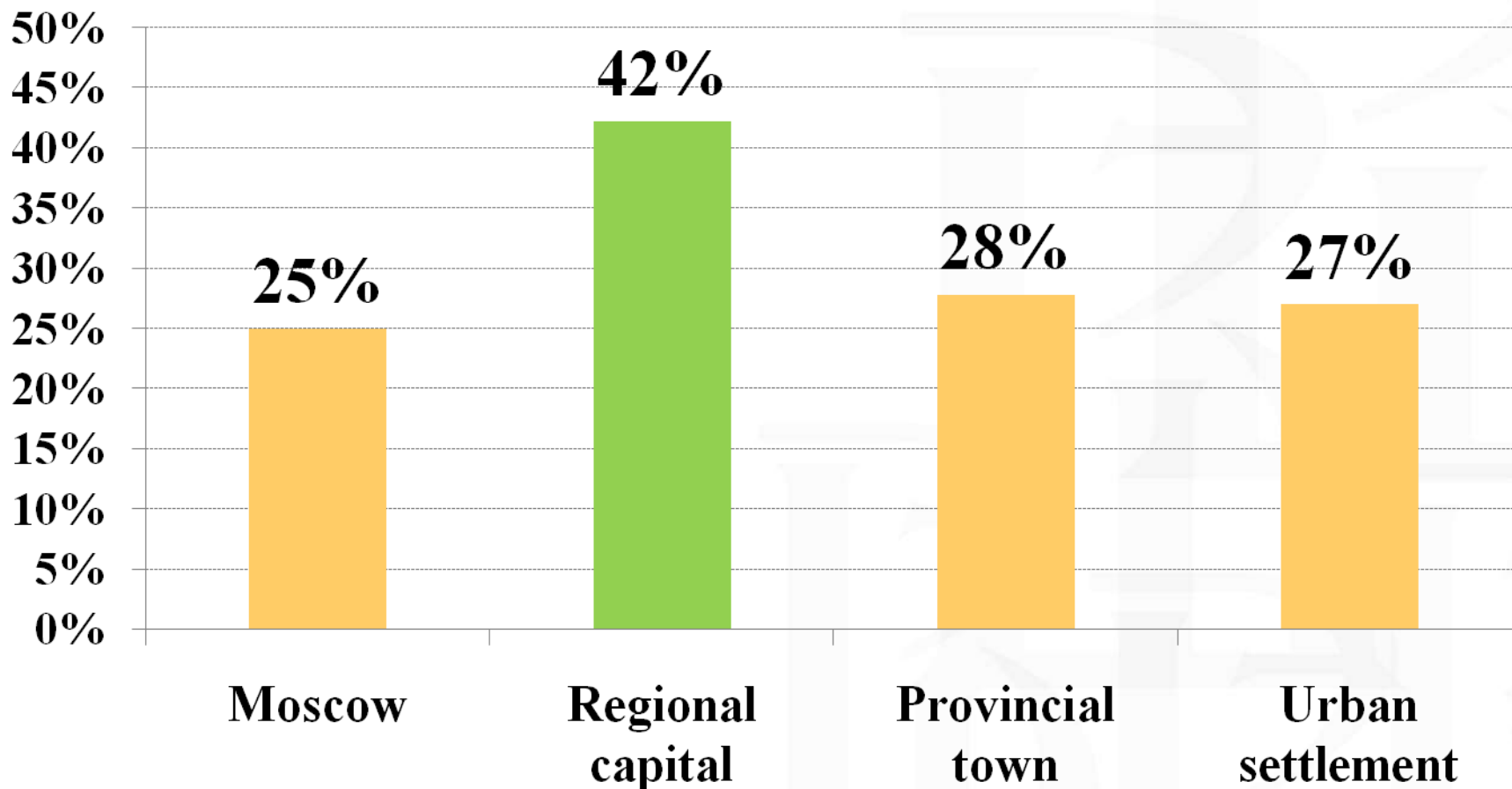
Empirical data

- Survey: 957 manufacturing firms from 8 sectors and 48 regions
- Time period: February – June 2009
- Some parameters of the sample:
 - 1) The enterprises employed about 8% of the average payroll across the whole sample, and in 2007, they produced about 6% of the total output of manufacturing industries
 - 2) the average surveyed enterprise had 587 employees (14% of firms above 1000 workers)
 - 3) 73% of firms had been established before 1991 and 10% after 1998; the government held stakes of 11%, with foreign shareholders participated in 10% of the total firms in the sample, 28% were members of business groups

Descriptive statistics: the membership's rate



Descriptive statistics: BA members in different settlements



Descriptive statistics: activity of firms in investment, export etc

	Members of BA	Non-members of BA
(some) foreign ownership	11%	7%
(some) government ownership	10%	9%
No response to ownership question	10%	20%
Business group member (parent company)	4%	3%
Business group member (subsidiary)	21%	27%
Active in innovations	41%	24%
ISO certification	57%	45%
Management Quality Index	4.25	3.14
Investment Activity Index	1.32	0.98

Descriptive statistics: relations with governments

		Members of BA	Non- members of BA
Provision of assistance to regional and local government authorities	No assistance	17%	26%
	Under 0.1% of sales or no response on the size	56%	57%
	Above 0.1% of sales	27%	17%
Receipt of support from government authorities of various levels	Federal level	16%	12%
	Regional level	34%	21%
	Local level	25%	17%

Main hypotheses

Step 1 - Membership

Firms that are active in exports, innovation and investment
more often participate in BAs

Step 2 - Business-government interactions

- BA members provide more active assistance to regional and local authorities
- BA members receive government support more often
- But there are ***differences for different types of BA***. Especially we expect that members of Chamber of Commerce and Industry (TPP) are less involved in interactions with governments

Specifications

	Dependent variable	Key explanatory variable	Controls
Binary probit	Membership in BAs	Activity*	Size, location, ownership, foundation period
Ordered probit	Assistance to the authorities	Membership in BAs	Size, location, ownership, foundation period, activity
Binary probit	Support from the authorities	Membership in BAs	Size, location, ownership, foundation period, assistance to the authorities, activity

* Activity indicators: management quality, innovations, investments, ISO certification, export

Results-1

Membership in BAs (0 = no, 1 = yes)					
Management quality (medium)	0.108***				
	[0.034]				
Management quality (high)	0.158***				
	[0.045]				
Active in innovations	0.110***				
	[0.038]				
Investment Activity Index	0.084***				
	[0.019]				
ISO certification	0.059*				
	[0.033]				
Exporter dummy					0.000
					[0.036]
Controls	Yes	Yes	Yes	Yes	Yes
Sample size	952	952	928	952	952

Results-2

	Assistance to regional and local authorities	Support from authorities		
		Federal	Regional	Local
BA membership	0.243*** [0.076]	0.012 [0.022]	0.098*** [0.030]	0.073*** [0.028]
Controls	Yes	Yes	Yes	Yes
Sample size	952	951	951	950

Results-3

	Assistance to regional and local authorities	Support from authorities		
		Federal	Regional	Local
Sector-specific BA	0.248*** [0.095]	0.042 [0.029]	0.124*** [0.039]	0.088** [0.037]
Regional BA	0.135 [0.106]	-0.03 [0.026]	0.072* [0.042]	0.073* [0.041]
Top BAs (except TPP)	0.233 [0.166]	0.035 [0.049]	0.182*** [0.068]	0.145** [0.069]
TPP	0.104 [0.133]	-0.036 [0.035]	-0.056 [0.050]	-0.049 [0.043]
Controls	Yes	Yes	Yes	Yes
Sample size	952	951	951	950

Main conclusions

Membership at business associations in Russia:

- more often join BA: larger enterprises and firms in regional capitals more often join business associations; *firms active in investment and innovations*.
- Less often: firm belonging to holding groups; firms hiding their ownership structure.

Relations to the government:

- BA members more actively assist regional and local authorities in social development of their regions and they more often receive support from authorities - the channel for 'elite exchange' (Frye, 2002)
- Differences between BA: member firms from industry- and nationwide “peak” associations (with exception of TPP) as the most active participants in this “system of exchanges”

Part II. Violent pressure on business, incentives for collective actions and improvement of investment climate

***(based on joint paper with Anton
Sobolev and Anton Kazun)***

Institutional context in Russia: early and mid 2000s

On one hand:

- Consolidation of state – with much higher state capacity and ‘restoration of order’
- A number of economic reforms (prudent macroeconomic police, radical simplification of tax regulation etc.)
- Economic recovery – with high GDP growth and increase of personal incomes
- Increase of FDI and return of capital investment

But on another hand at the same time:

- **strong increase in violent pressure on business after 2004** – on predatory policing of mid 2000s see Gerber & Mendelson (2008); Firestone (2010); Gans-Morse (2012), etc.

Motorola-Evroset case (2006)

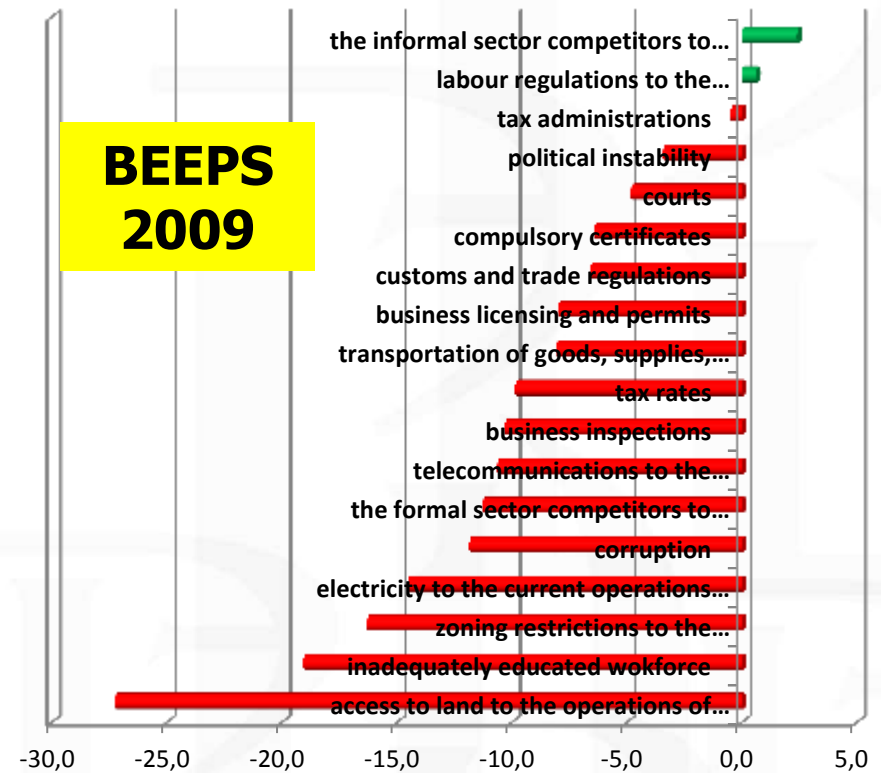
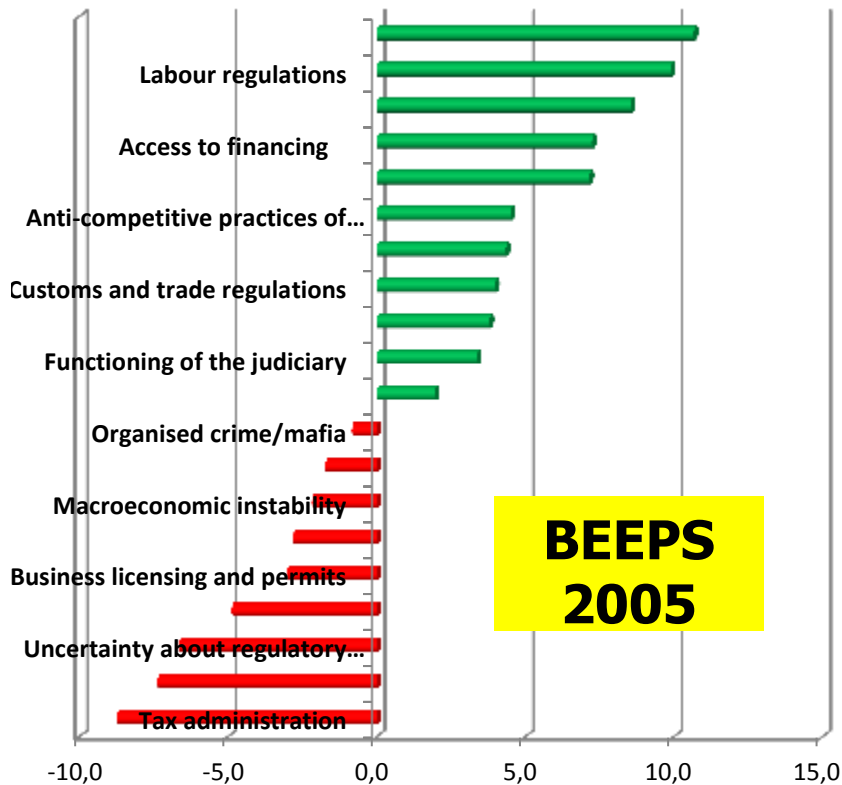
Motorola shipped the phones — seven models in all, worth roughly \$17 million — to Moscow on March 20 and applied for the necessary declaration of compliance for their sale in Russia. It received approval on March 24. And on March 29, after the customs service approved the shipment, the shipment was seized. Six days later, Department K of the Interior Ministry, which investigates economic crimes, announced that it had taken the phones on a seemingly vague basis that they were "not designed for use in the territory of Russia" and, in an apparent contradiction, that Motorola's distributor, Yevroset, "concealed the fact that the phones imported to Russia were counterfeit." Interior Ministry destroyed the C115 phones, worth \$2 million, on April 25, 2006 with journalists watching their destruction — after saying that one model violated safety standards, although there was plenty of suspicions that not all the phones were destroyed. But the same model remained on sale in shops around Moscow.

(The New York Times, June 3, and June 14, 2006)

Chemists case (2006-2007)

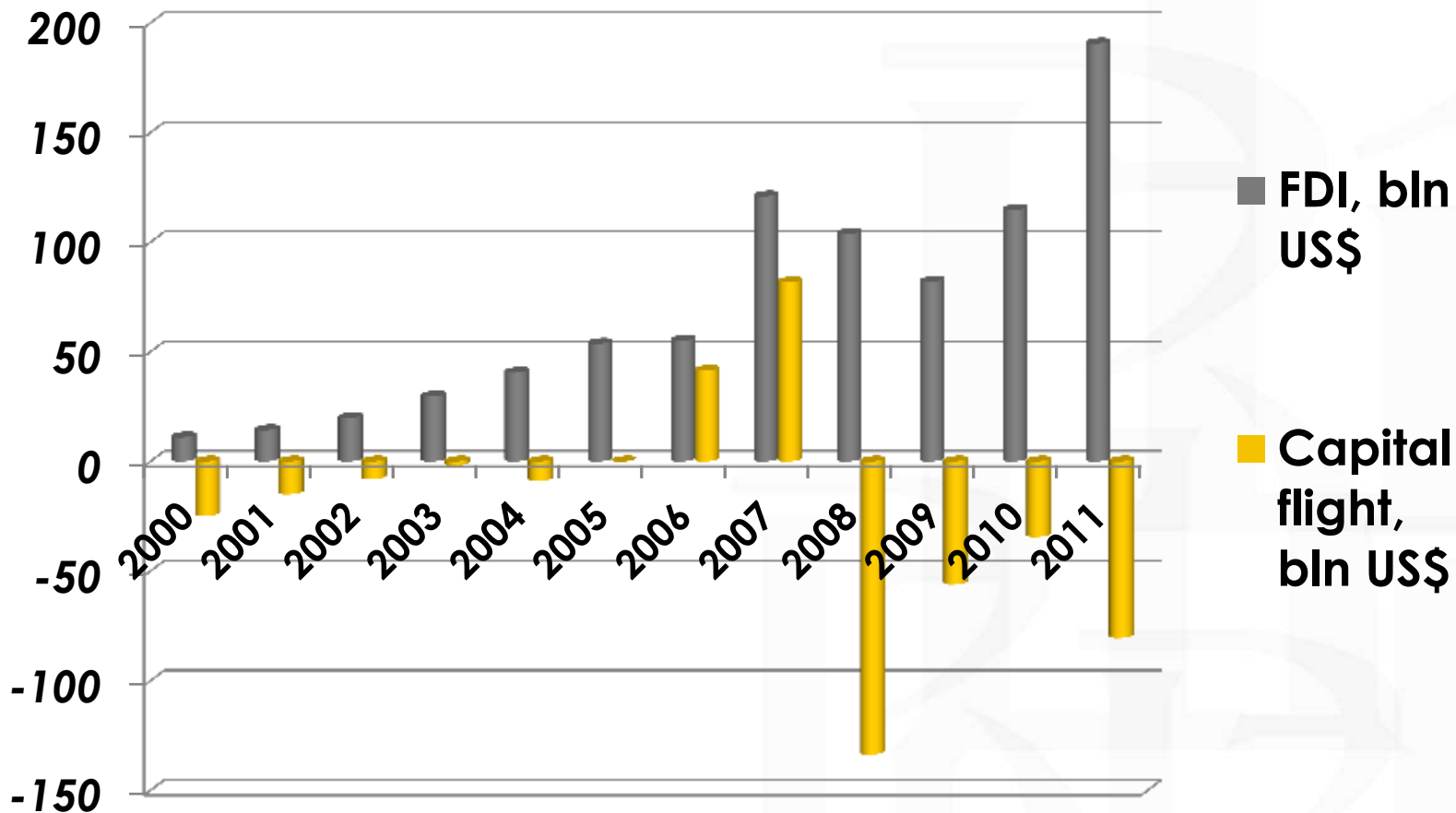
In the middle of 2006, Yana Yakovleva and Alexei Protsky from SOFEX Co. were arrested by Federal Drug Control Service officers – after rejection of an offer to participate in the drug shipments to Tajikistan. On February 16, 2007, the Federal Drug Control Service was compelled to set Yana Yakovleva free after seven months of illegal detention. The decision to set her free was made under pressure of strong social movement in defense of chemical industry in Russia (because such kind of violent pressure from FDCS was typical in the sector). In January 2007 meetings against repressions of the Federal Drug Control Service were held in Moscow and Samara. Nine deputies of the State Duma stood up for liberation of Yakovleva and Protsky. (<http://www.himdelo.ru/>)

Changes in business climate



Conditions for doing business in Russia: “**green = better**” and “**red = worse**” comparing to CEE average indicators in BEEPS 2005-2009

Russia: FDI and capital flight



Firms' behavior before the crisis 2008-2009

- Increasing informal violent pressure on business from enforcement agencies – as unexpected consequence of ‘Yukos affaire’)
- But: high economic growth => lost income opportunities in the case of resistance => dominant strategies of ***personal informal negotiations*** – with paying kickbacks or sharing assets with corrupted officers
- Some exceptions (mostly due to personalities of victims) with resistance to ‘siloviki’ pressure
- In all cases: application to ***public defense strategies*** – individual (like Evroset-Motorola case) or collective (Chemists case) => creation of **NGO ‘Business Solidarity’** as result of this collective public action

'Business Solidarity': Timing

1. **July 2006** – officers of Federal Drug Control Service (FSKN) used fully artificial reasons to arrest Yana Yakovleva and Alexei Protsky (owners of 'Sofex' company)
2. Public campaign in defense of Yana Yakovleva (about 100 articles in mass media, petition to president Putin, signed by members of State Duma, writers, scholars)
3. **February 2007** - The court sorted out that FSKN's expertise contradicted basic chemistry laws and released Yakovleva and Protsky from the custody
4. **February 2008** - acquittal of businessmen (followed by other similar cases in the sector)
5. **March 2008** – launching of non-commercial partnership "Business Solidarity" united about 90 SME (mostly from chemical industry) and devoted to help businessmen under pressure
6. **May 2008** – General Cherkesov left the office of FSKN director

‘Business Solidarity’: Limited Success Story

- Why this success was possible?
 - Yana Yakovleva as a businesswoman with personal connections to some policymakers, public persons and journalists => opportunities to organize effective public pressure on enforcement agencies
 - Not one firm, but dozens of similar firms in one sector facing such kind of pressure => reason for collective actions, foundation of NGO Business Solidarity
- Success story but with limited impact on environment: not enough incentives for broader collective actions => Business Solidarity as marginal case. Small organization with limited resources. No assets for “exchange” with ruling coalition.
- Nevertheless:
 - Important signal for other economic actors and for other business associations
 - Accumulation of organizational experience and skills

Crisis 2008-2009 as turning point

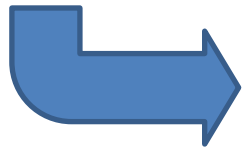
- **Margins vs. costs of doing business:** Before 2008 high demand in global & domestic market provided enough incentives for investment and growth in spite of poor conditions for doing business in Russia. After 2008 – high uncertainty and low confidence in economic policy
- **Policy response:** Short-term – huge increase in social spending in 2009 (resulted in budget deficit now). As a next step → search for new model of economic development: **dialogue with business & elaboration of Strategy-2020**
- Some steps already in 2009-2011 (liberalization of Criminal code, introduction of RIA procedures, creation of ASI). But as the most comprehensive part – **National entrepreneurial initiative** announced by Mr. Putin in February 2012 with idea to improve Russia's position in DB ranking: elaboration of relevant 'road maps', introduction of ombudsman for entrepreneurs, decree on new criteria of governors performance evaluation, WTO accession etc

2009: Structure of incentives shift

- Economic Crisis 2008-2009 brought 4 main changes in the structure of economic agents incentives:
 - Crisis → Capital flight ↑ → Stronger control on firms activity & prosecution of entrepreneurs
 - Decline in incomes → not enough money to pay kickbacks for corrupted officials



Much higher cost of 'doing business as usual'



Incentives for collective actions to
change the environment

'Business Russia' and collective action

- 'Business Russia' as 'peak association' trying to respond to the demand for rule of law from business community.
- Why BR? Because it tried to represent the interests of successful mid-sized business facing the strongest violent pressure
- 2009: Non-public stage – Lobbying the amendments to Criminal code and Code of criminal procedure (in State Duma and Presidential Administration) => prohibition of pre-trial arrests of entrepreneurs, but violation of this prohibition due to opportunistic incentives of corrupted officers in police and securities services
- 2010: Turn to more comprehensive public activity – including analysis and dissemination of best practice (like Kaluga) and development of broader policy advice for the government on improvement of investment climate. **Private investment supporting economic growth** – as asset for 'exchange' with ruling coalition
- October-November 2010 – meetings of BR General Council with Vladimir Putin and Dmitry Medvedev => '**BaC**' as one of ideas
- December 2011 – **National Entrepreneurial Initiative**

Center 'Business against corruption'

- Institutionalization of collective attempts to protect entrepreneurs => NGO 'Center of public procedures Business against corruption' created in Feb 2011 by BR according to the order of first vice prime-minister
- Aim: to defend entrepreneurs facing unfair criminal prosecution
- Model of operation:
 - System of formal public procedures
 - Mass media resonance
 - Grievances to federal officials on regional subordinates



First attempt of public control on law enforcement

'BaC': How does it work?

1. Gathering information on the case:
 - Request to applicant for detailed information
 - Request to the regional office of "Business Russia"
 - Request to counter-part of applicant
2. Obtaining a legal opinion from lawyers cooperating with BaC
3. Decision of Co-Chairs to put the case to Public Council consideration
4. Consideration by the Public Council – as quasi-court procedure
5. Response to the applicant and resorting to top level officials in General Prosecutor Office, Ministry of Interior, Investigative Committee, Supreme Court etc

'BaC': Main focus

Category	Applications		Applications considered by Public Council	
	N	%	N	%
Criminal Prosecution & Raider Attack	83	14%	41	48%
Raider Attack	278	46%	27	32%
Criminal Prosecution	119	20%	15	18%
Corruption	28	5%	1	1%
Administrative Barriers	26	4%	1	1%
Other	76	12%	0	0%
Total	610	100%	85	100%

Source: BaC data for February 2011 – November 2013
In September 2015 – 906 application totally (since Feb 2011)

One of 'Success Stories': Malov's Case

- In **2006** Dmitry Malkov, owner of agricultural enterprise "Agromol" was accused in criminal intent of stealing 1.8 mln rub
 - While the money was a subsidized interest rate under the National Project "Agro Development"
 - Pressure to sell the business by local security officers
- In **2008** he was sentenced to 5.5 years in prison ("Fraud" - art. 159 of Criminal Code)
- In **February 2011** he applied to "Business Against Corruption". In March 2011 BaC launched the public procedure and supported his application
- In **December 2012** the Supreme Court rejected the conviction and completely acquitted Dmitri Malov due to *absence of corpus delicti*

Two sides of one coin

- Very few success stories - only 22 according BaC website. Clear resistance of the system (Malov's case as example) – due to close personal interconnection between courts and law enforcement agencies. → **BaC can't replace independent court**
- But: it plays signaling role for low- and middle-level officers in law enforcement agencies → **number of raider attacks decreased radically**

Overall conclusion on 'BaC'

- Bad equilibrium with corruption is based on incentives from both sides: business and government. It is not enough to have 'political will' for the move from bad equilibrium to good one.
- It is necessary to have:
 - driving forces for this process – also on both sides: honest people in the business + honest people in the bureaucracy.
 - Selection mechanism allowing to identify honest and dishonest behavior → BaC public procedures
 - Non-political instruments of pressure on governmental officials → BaC supervisory council
- That is 'second best solution' – but it allows to start the move from bad equilibrium.

Doing business in Russia–2012

City	Aggregate Rank	Starting a business	Construction permits	Getting electricity	Registering property
Ulyanovsk	1	3	4	5	8
Saransk	2	20	8	1	8
Vladikavkaz	3	27	11	2	2
Rostov-on-Don	4	26	15	3	4
Kazan	5	4	14	17	4
Kaluga	6	17	9	15	1
Stavropol	7	4	2	9	19
Yaroslavl	8	7	17	6	16
Surgut	9	30	1	19	8
Irkutsk	10	8	6	10	18
Petrozavodsk	11	6	16	21	8
Kirov	12	13	5	4	20
Omsk	13	19	20	13	4
Vyborg	14	10	23	12	8
Vladivostok	15	18	22	23	3

City	Aggregate Rank	Starting a business	Construction permits	Getting electricity	Registering property
Volgograd	16	2	27	26	4
Voronezh	17	15	28	16	8
Tver	18	21	25	14	8
Kaliningrad	19	11	3	22	22
Tomsk	20	15	6	10	25
Samara	21	22	24	28	8
St. Petersburg	22	1	9	24	27
Khabarovsk	23	24	29	8	17
Yekaterinburg	24	29	13	19	20
Perm	25	13	12	18	27
Murmansk	26	12	19	27	23
Kemerovo	27	28	21	7	29
Yakutsk	28	8	26	25	30
Novosibirsk	29	23	18	29	24
Moscow	30	25	30	30	26

Doing Business 2015 vs. 2012

DB ranking 2012:

1	Singapore	91	China
4	United States	97	Guatemala
19	Germany	100	Greece
26	France	118	Nicaragua
37	Slovenia	119	Cape Verde
47	Kazakhstan	120	Russian Federation
55	Armenia	121	Costa Rica
59	Bulgaria	122	Bangladesh
62	Poland	137	Madagaskar
81	Moldova	152	Ukraine

DB ranking 2015:

51	Slovenia
56	Italy
59	Luxembourg
60	Tunisia
61	Greece
62	Russian Federation
63	Moldova
64	Cyprus
90	China
120	Brazil

But what kind of changes business can see in reality?