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**Russian Federation: Drivers and Challenges of Economic  
Growth and Development**

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# **Russian Federation: Drivers and Challenges of Economic Growth and Development**

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## ***Abstract***

The challenges for the Russian Federation development have been studied in the article by examining the role of the country in the international merchandise trade, trade in services and FDI flows; the evolution of Russian trade patterns by geographical structure and by industries; the composition of Russian outward and inward FDI. The drivers for sustainable economic development of the Russian Federation have been revealed as well as the main hindrances that may impede a stable economic growth.

Key words: trade, foreign direct investment, competitiveness, Russian Federation

JEL codes: F14, F21

## *Introduction*

The role of the Russian Federation in the world economy is growing along with its position on the political stage. Although the way of its development has contradictory features the country has been recognized as an emerging-market economy and is considered among the so called BRICs which will influence the future development of the world economy.

After the global economic crisis, BRICs have been playing an important role in the recovery of the world economy. However after a rapid growth in 2010 the economic growth of China, India and Brazil slowed down a little in 2011<sup>1</sup>. In contrast to other BRICs countries, Russia demonstrated not very high but steady recovery in 2010 and 2011 when its economy grew successively by 4.3%<sup>2</sup> over the two years, with a considerable decline in economic growth from a level of 7.8% in 2009.

In this article we offer the results of the research on the driving forces and challenges of current and further economic growth as well as a sustainable development of the Russian Federation by means of defining its role in the international trade and FDI flows. We also try to identify the sources of Russia's current and future competitiveness.

While examining the dynamics of the trade parameters, like exports and imports, in the long-term period, we have chosen some reference years due to the following reasons:

- In 1996 the market economy in Russia started to influence the major parameters of the economic development after the last step large-scale privatization was completed in 1995,
- The selection of the year 2000 is explained by the fact that it was the beginning of a new phase in the Russian economy, when Yeltsin's epoch was replaced by Putin's governance,
- The period from 2005 to 2011 is interesting because GDP showed an unexpectedly huge growth by 2.4 times, i.e. from \$763.7 billion to \$1850.4 billion.

### *1. The Role of the Russian Federation in the International Trade*

In order to define the role of the Russian Federation in international trade we have examined its place in the world merchandise exports and imports over the long-term period (figure 1). Its share as an exporter has been growing more rapidly in comparison with its share in world imports. In 2011 Russia ranked 8<sup>th</sup> in the world exports, and its share changed from 1.67% in 1996 to 2.87% in 2011. As for Russia's share in world imports it grew from 1.36% to 1.94%

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<sup>1</sup> In 2010 GDP in China grew by 10.3%, in India by 10.4% and in Brazil by 7.5%. In 2011 their GDP growths were by 9.2%, 7.2% and 2.7% respectively (IMF data and statistics).

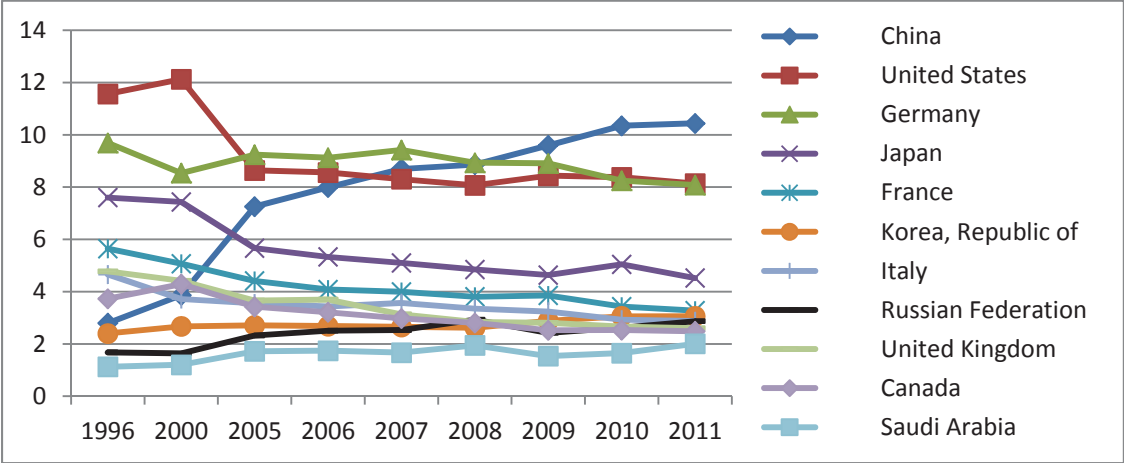
<sup>2</sup> IMF data and statistics /

[http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/weorept.aspx?sy=2009&ey=2011&scsm=1&ssd=1&sort=country&ds=.&br=1&c=911%2C948%2C912%2C922%2C913%2C923%2C915%2C925%2C916%2C926%2C917%2C927%2C921&s=NGDP\\_RPCH&grp=0&a=&pr.x=41&pr.y=16](http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/weorept.aspx?sy=2009&ey=2011&scsm=1&ssd=1&sort=country&ds=.&br=1&c=911%2C948%2C912%2C922%2C913%2C923%2C915%2C925%2C916%2C926%2C917%2C927%2C921&s=NGDP_RPCH&grp=0&a=&pr.x=41&pr.y=16)

over the examined period, so Russia ranked 12<sup>th</sup> on the list of the largest importers in the world.

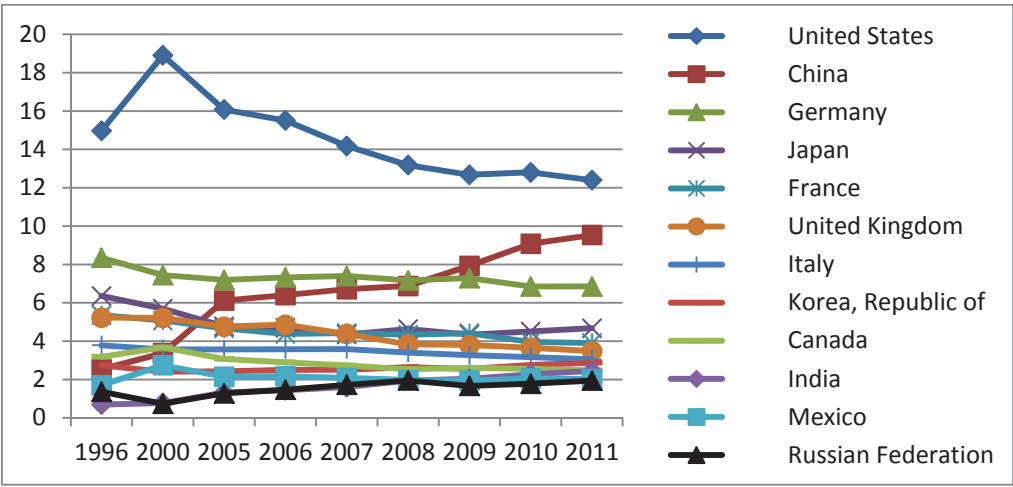
Figure 1. Shares of selected economies, leading in the world merchandise trade, over various years (%)

A. World exports



Source: Author’s calculations, based on UNCTAD database

B. World imports

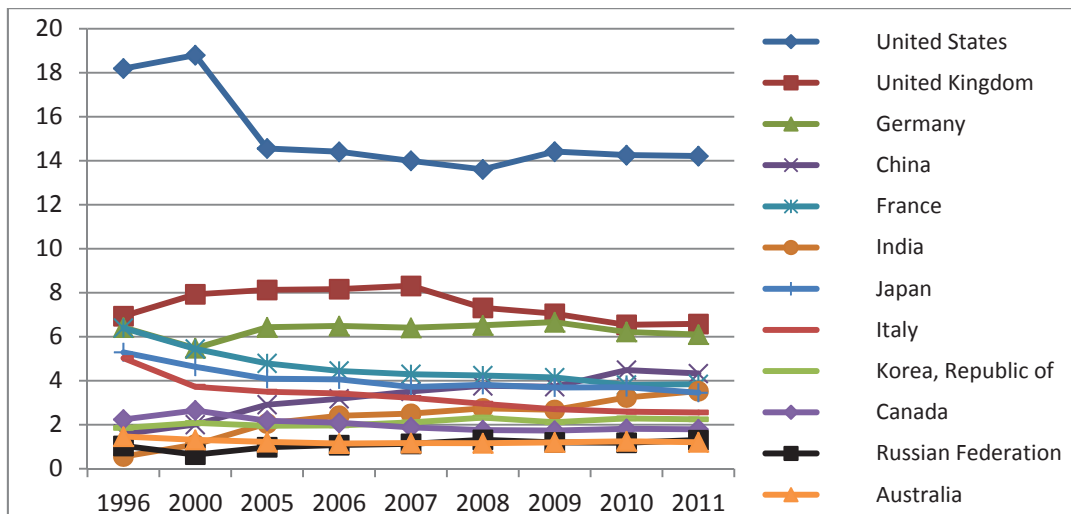


Source: Author’s calculations, based on UNCTAD database

In world trade in services the Russian Federation ranked 11<sup>th</sup> by its share in both exports and imports (figure 2). Yet, Russia is a growing net importer in trade of services while in merchandise trade it is a net exporter. The share of Russia in exports of services grew slightly from 1.03% in 1996 to 1.3% in 2011, but its share in imports of services increased considerably from 1.49% to 2.32% respectively.

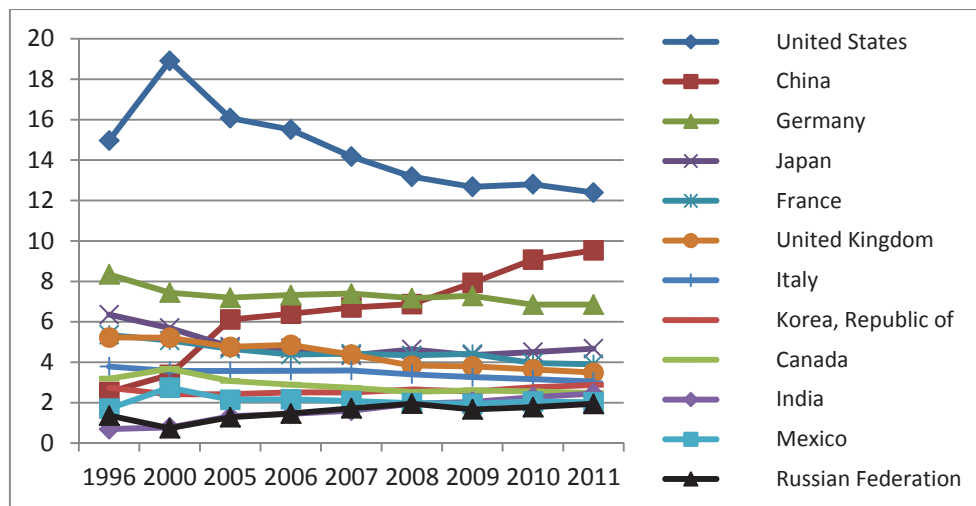
Figure 2. Shares of selected economies, leading in world trade in services, over various years (%)

### A. World exports



Source: Author's calculations, based on UNCTAD database

### B. World imports



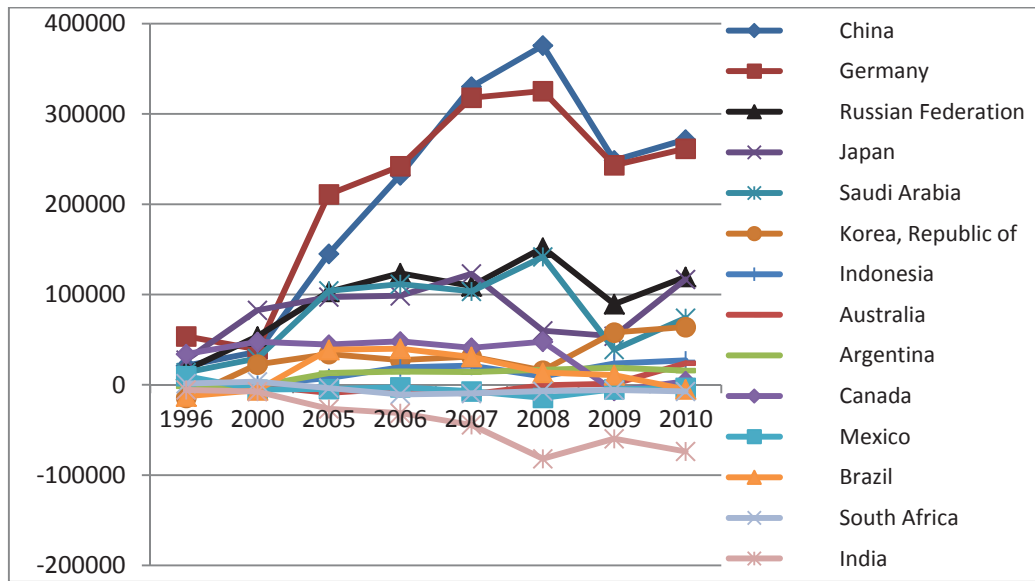
Source: Author's calculations, based on UNCTAD database

Thus, currently the Russian economy has a huge capacity of growing as a consumer of foreign goods and services. It might use this opportunity for structural reforms toward a new export base, including enhancement of its competitive advantages as an exporter of tradable services.

After the market reforms Russia had run trade surplus and since 2008 it is in third position. The trade surplus had been increasing until 2008 and then after considerable reduction recovered in 2010 when it equaled \$119.5 billion (Figure 3). By this absolute indicator the Russian Federation is behind China (\$ 271.6 billion) and Germany (\$261.5 billion).

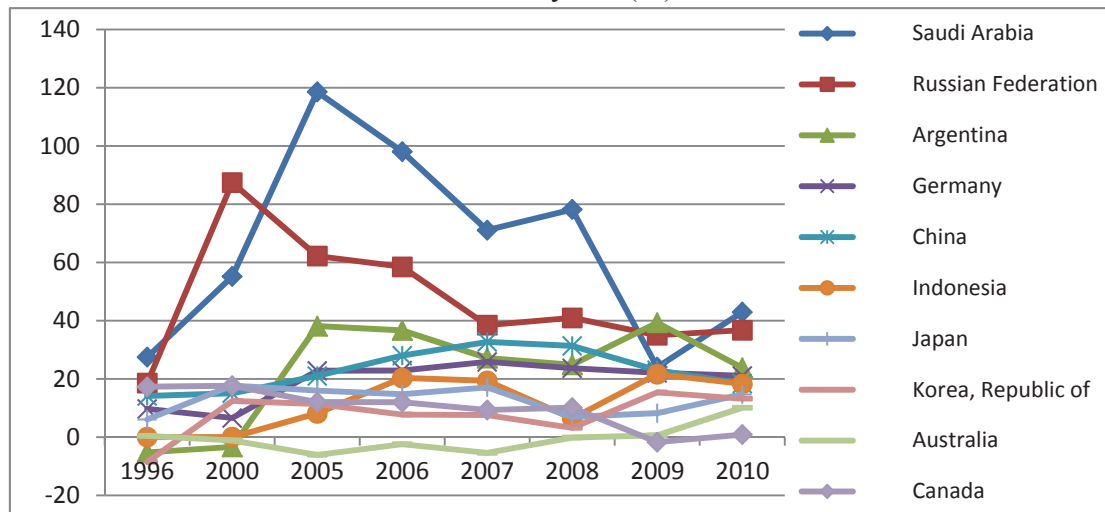
Russia's share of trade surplus in percentage of imports is one of the largest. In 2010 it was 36.7%, which allowed Russia to take the second place in the world, following Saudi Arabia; whose share was 42.9% (Figure 4). For many years this indicator was very high in Russia and reached its peak of 87.4% in 2000, but since then it started annual plummeting.

Figure 3. Trade balance of selected economies over various years (in US Dollars at current prices and current exchange rates in millions)



Source: Author's calculations, based on UNCTAD database

Figure 4. Share of trade surplus in imports of selected economies, leading by this index, over various years (%)



Source: Author's calculations, based on UNCTAD database

The main sources of the positive trade balance of the Russian Federation have been based on booming natural resource prices and increased volume of oil and gas exports. About 63% of the Russian exports consist of oil and gas, the other 12% of top 10 exporting commodity groups comprises the products based on other natural resources (Table 1).

Table 1. Leading export products of the Russian Federation

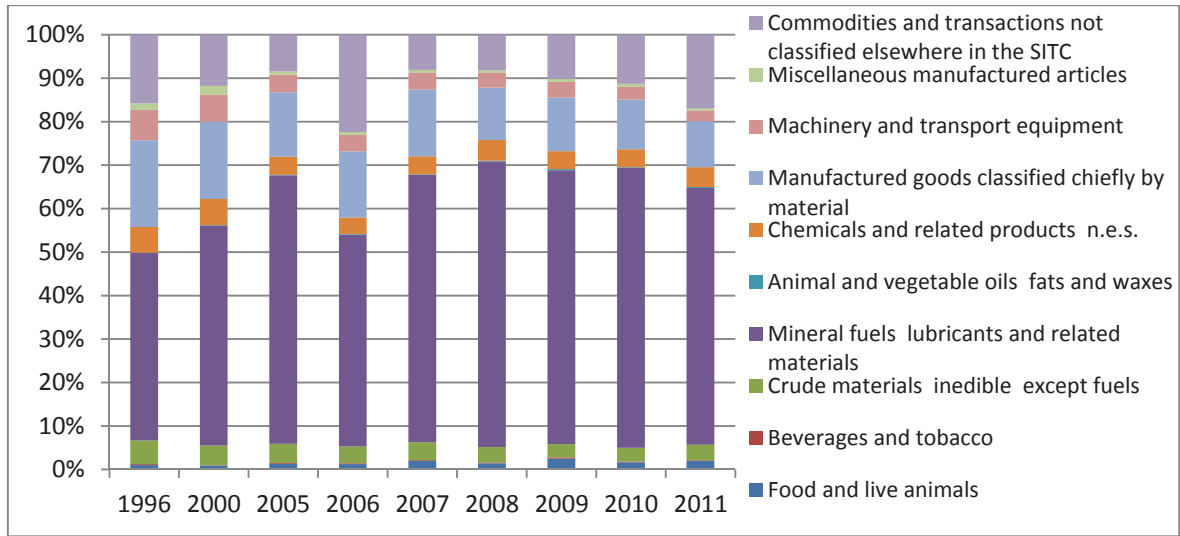
Leading products exported based on average 2009-2010 value SITC Rev 3(3-digit level)	2009-2010			
	Value (f.o.b., millions of dollars)	As percentage		
		Of country total	of transition economies	of world
All commodity groups	337 425	100.0	63.23	2.44
333 Crude petroleum & bituminous oil	111 347	33	67.81	10.4
334 Heavy petroleum & bituminous oil	58 220	17.3	80.49	10.15
343 Natural gas, liquefied or not	43 405	12.9	86.12	20.45
321 Coal excl. non-agglomerated	8 273	2.5	89.54	8.79
562 Manufactured fertilizer excl. crude	6 442	1.9	65.28	13.28
684 Aluminium	6 230	1.8	76.75	6.57
672 Ingots, iron steel primary products	6 044	1.8	52.70	18.98
683 Nickel	4 510	1.3	99.72	26.46
682 Copper	4 203	1.2	56.59	3.84
673 Flat iron non-alloy steel products	4 079	1.2	47.27	5.66
Remainder	84 666	25.1		

Source: UNCTAD Handbook of Statistics, 2011

A further analysis of merchandise trade by sectors and by geographical partners confirms the lack of diversification of Russia's exports. The sectoral pattern of merchandise trade by SITC (1 digit) nomenclature shows that a great share of exports consists of mineral fuels, lubricants and related materials (Figure 5). Moreover, this share grew significantly from 43% in 1996 to 64.4% in 2010. Despite its slight drop in 2011 to 59%, it is still very high, which makes Russian economy dependent on the world prices on mineral fuels.

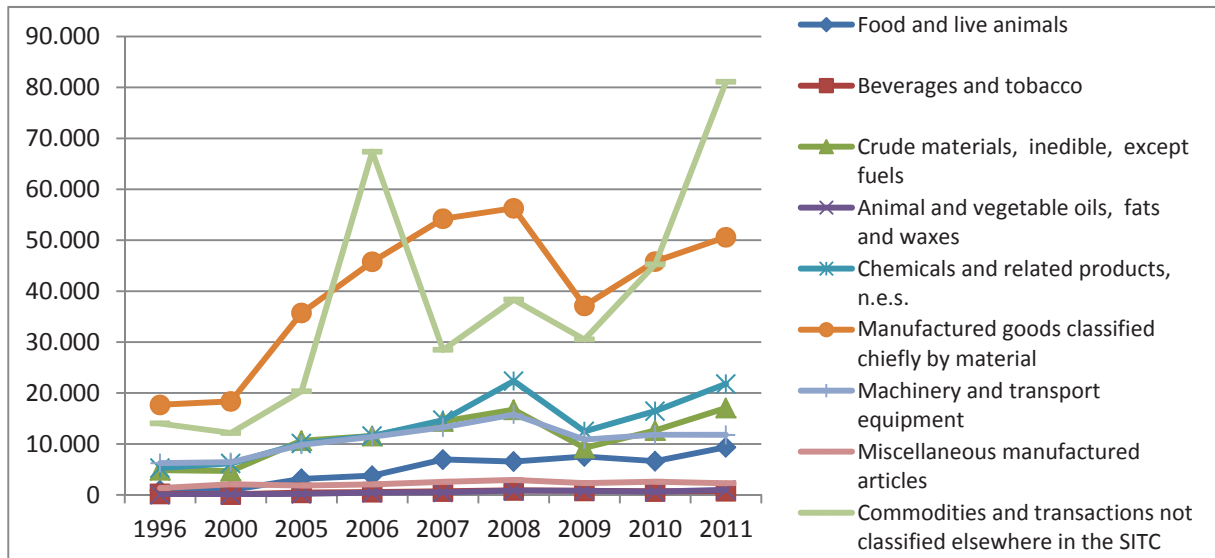
A detailed examination of exports of Russia in absolute values reveals that trade in mineral fuels, lubricants and related materials grew by 7.38 times since 1996. Relatively big amounts of exports could be observed in two other groups (Figure 6), which are manufactured goods. Although the growth rate in these two groups was lower than in the group of mineral fuels, it still increased by 2.7 times since 1996. It is interesting that the exports of the product group of food and live animals was rapidly growing (by 10.4 times since 1996) and almost did not drop during the global crisis of 2008-2009, unlike exports in all other industries.

Figure 5. Shares of Russian total merchandise exports by SITC (rev 3) over selected years



Source: Author's calculations, based on UN Comtrade

Figure 6. Value of Russian exports by SITC (rev 3), excluding group of Mineral fuels, lubricants and related materials over selected years (in US Dollars at current prices and current exchange rates in millions)

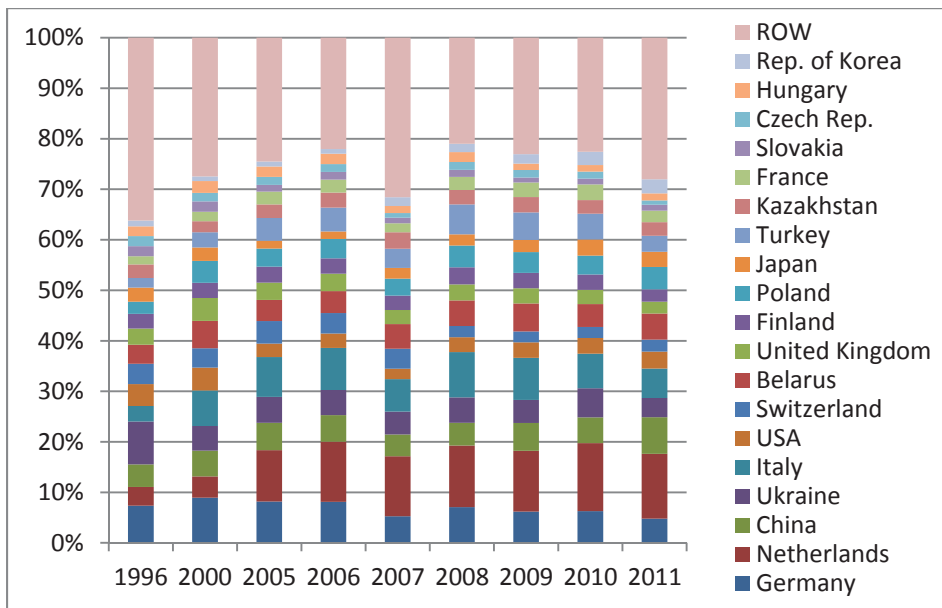


Source: Author's calculations, based on UN Comtrade

The analysis of geographical pattern of Russian exports shows 20 main partners, whose share first increased from 65% in 1996 to 80% in 2008 and then slightly dropped to 73.5% in 2011 (Figures 7, 8).



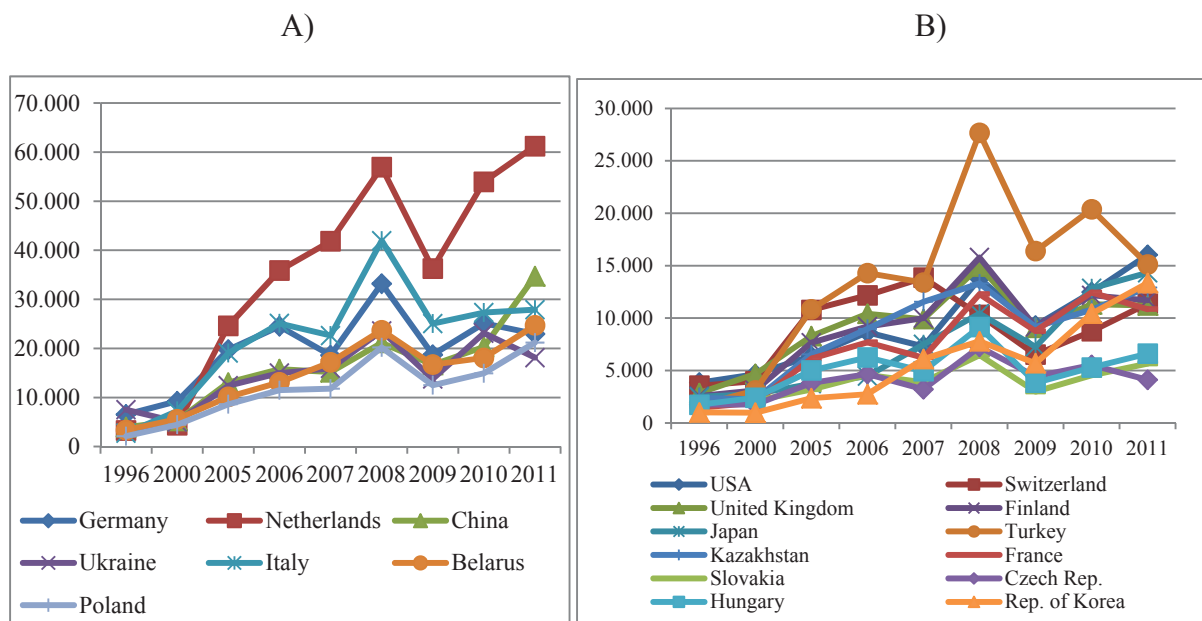
Figure 7. Geographical distribution of Russian exports over selected years



Source: Author's calculations, based on UN Comtrade

Traditionally, the majority of trade partners are from the EU and the CIS region. The top-5 countries among them are the Netherlands, Germany, Italy, Belarus and Ukraine. At the same time importance of several Asian countries is constantly increasing in the Russian exports. Among them are China, Japan and Republic of Korea. Interestingly, export to Turkey grew rapidly until the global crisis, then suddenly dropped and has not recovered yet.

Figure 8. Geographical distribution of Russian exports to main partners over selected years, (in US Dollars at current prices and current exchange rates in millions)

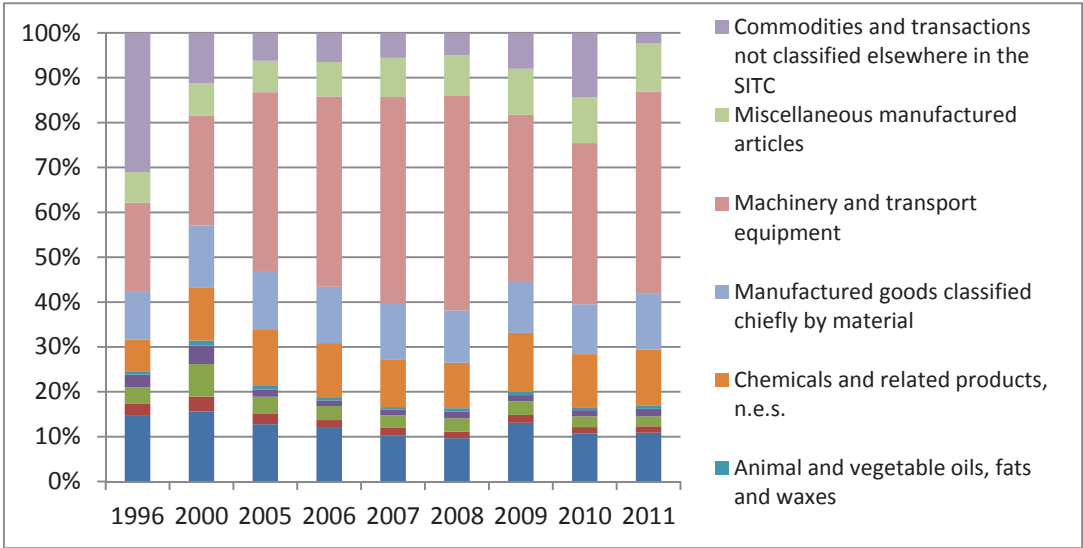


Source: Author's calculations, based on UN Comtrade

During the analyzed period, machinery and transport equipment sectors are the main dominating sectors in the Russian imports (Figure 9). Its share was about 20% in 1996, and then steadily grew up to 47.8% in 2008, then reduced in 2009-2010 and recovered to 45% in 2011. In general, the import of machinery and transport equipment in absolute numbers increased by more than 10 times since 1996.

In addition to the above-mentioned group of goods, Russian imports are almost equally concentrated in the other four broad areas (by 10-12% in each) – chemicals and related products, manufactured goods classified chiefly by material, food and live animals, miscellaneous manufactured articles.

Figure 9. Shares of Russian total imports by SITC rev 3 over selected years



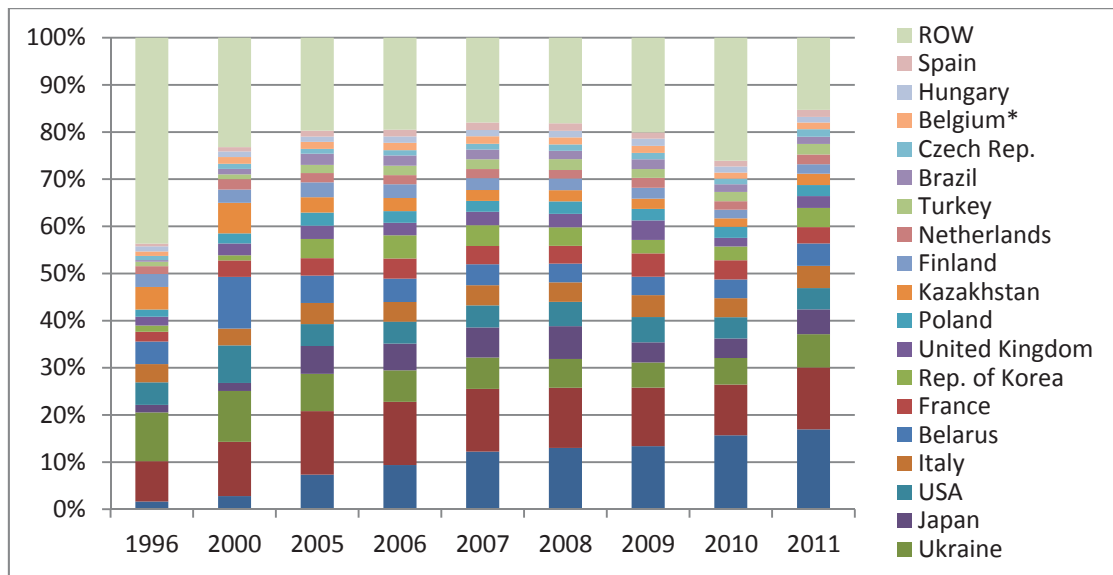
Source: Author’s calculations, based on UN Comtrade

The geographical distribution of Russian imports reveals that the top-20 partners are almost all from the list of top exporters (Figure 10). The share of the 20 main partners in Russian imports is much higher than in exports. Moreover, it grew considerably from 56% in 1996 to 85% in 2011. It is quite obvious that China and Germany occupy a domineering position and the share of the two countries rose by three times from 10% to 30% during the period of 1996-2011.

Thus, the structure of Russian merchandise trade by sectors shows a great dependence on exports of natural resources and imports of machinery and transport. At the same time Russia became more competitive in secondary industries that potentially influence the changing trade structure with the CIS region in the last decade.

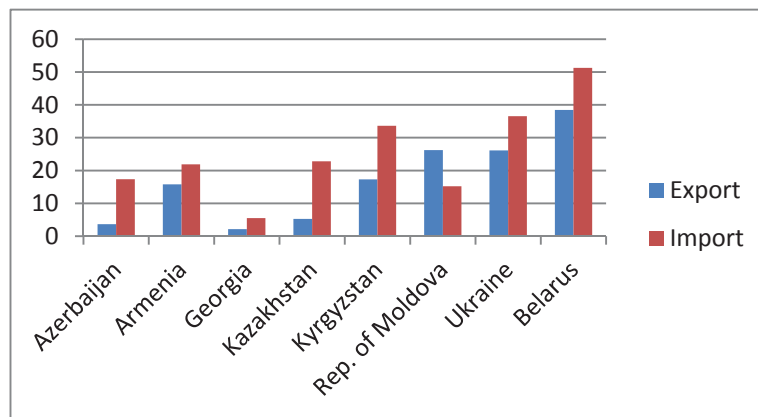
In general, the Russian Federation is considered to be one of the main economic partners for many of the CIS countries (Figure 11).

Figure 10. Geographical distribution of Russian importsover selected years



Source: Author's calculations, based on UN Comtrade

Figure 11. Shares of Russia in the trade of selected CIS countries in 2010, %



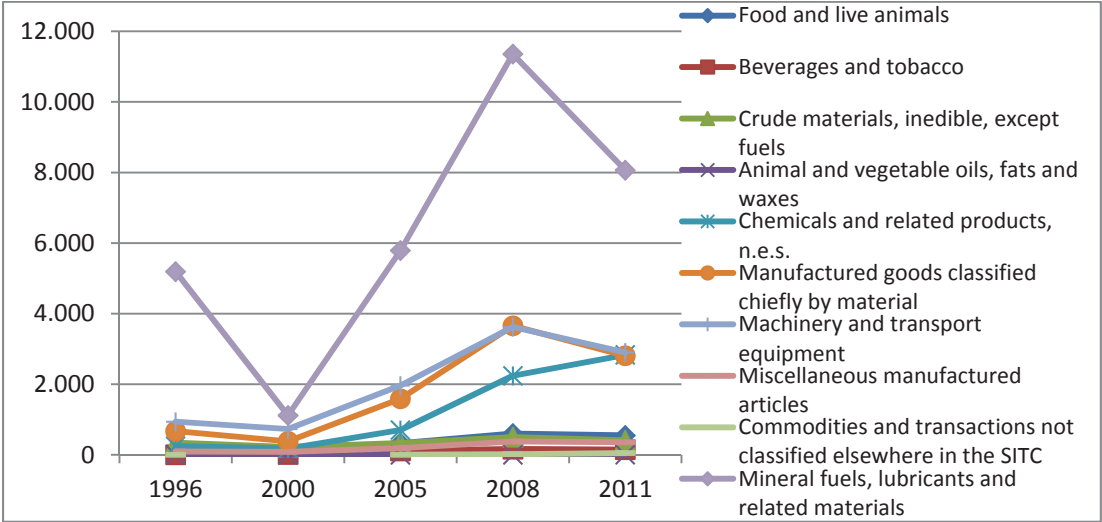
Source: Author's calculations, based on UN Comtrade

Russia's exports to the CIS countries lack diversification as well. About half of these exports are oil and gas. The exports of secondary industry products comprise a considerable share as well. For instance, there is an increasing tendency of exports to Ukraine on the three following groups: machinery and transport, chemicals and related products, manufactured goods classified chiefly by material (Figure 12).

Thus, the trade pattern of the Russian Federation is characterized by the growing concentration of exports on mineral fuels and, therefore, running an enormous trade surplus due to the dependence on high prices on natural resources. A large trade surplus in Russia has become an important part of global imbalances, which are understood "as the confluence of high and increasing current-account surpluses and the huge current-account deficit of the United States, along with some other smaller deficit countries" (Priewe, 2010). Such global

imbalances contributed greatly to the world economic and financial crisis and still jeopardized the sustainable future development of the world economy.

Figure 12. Value of Russian exports to Ukraine by SITC (rev 3) over selected years (in US Dollars at current prices and current exchange rates in millions)



Source: Author’s calculations, based on UN Comtrade

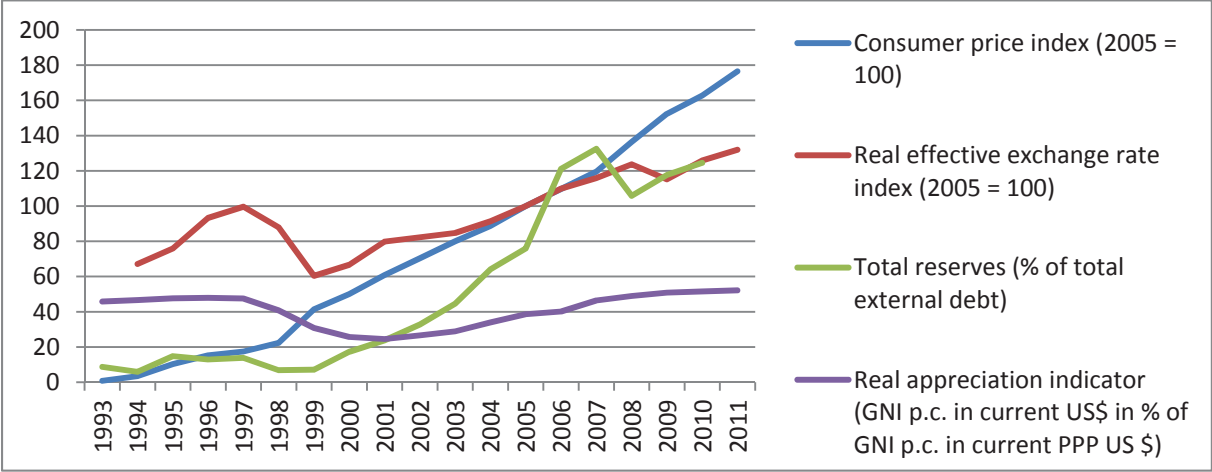
A large trade surplus generally leads to a huge amount of reserves, which might be either a source of structural reforms for sustainable development in a country or reflection of the classical Dutch Disease. Algieri (2004) found strong evidences of the Dutch Disease symptoms in Russia -- a real effective exchange rate appreciation was one of those. Among the main reasons behind this were improvements in terms of trade (rising oil prices) and budget deficits, while upturn in productivity had significant influence as well. The empirical evidence has showed that an increase in international oil prices causes a GDP growth, but it is temporal, because a real appreciation reduces the Russian GDP significantly. It has been shown that output in non-booming sectors in Russia drops when oil prices increase.

Due to the rise in international oil prices after the crisis of 1998, the Russian Federation has experienced the strongest real effective exchange rate appreciation from 60.3% in 1999 up to 131.9% in 2011, which is an increase of almost 119% (Figure 13). By looking at the policy strategy one can find that – the Russian authorities have been using monetary policy as an instrument to prevent the appreciation of nominal exchange rate for years. So the real effective exchange rate growth is explained by a high inflation -- pushed by excessive demand. Due to the oil windfall Russian imports of goods and services had been increasing, thus reducing the trade surplus and influence annual rise in consumer prices which grew by 325% since 1999.

The ratio of the gross national income (GNI) per capita in current dollars to the GNI per capita in purchasing power parity (PPP)-adjusted dollars which is a real appreciation indicator –( Figure 13) reflects the problem of high price level in the Russian domestic market. In fact, GNI per capita in current dollars was very low in 2000-2003, then started growing and came up to 52% of GNI per capita in current PPP US\$ in 2011. Although the index has increased

the purchasing power on the Russian domestic market it is less than half compared to others. This manifest the typical symptom of the Dutch Disease -- which implies that annual growth of imports in goods and services may hamper the domestic production which could make vulnerable the future competitiveness of the Russian Federation in the world market.

Figure 13. Selected macroeconomic indicators of development in Russian Federation, 1993-2011



Source: Author’s calculations, based on World Bank, World Development Indicators.

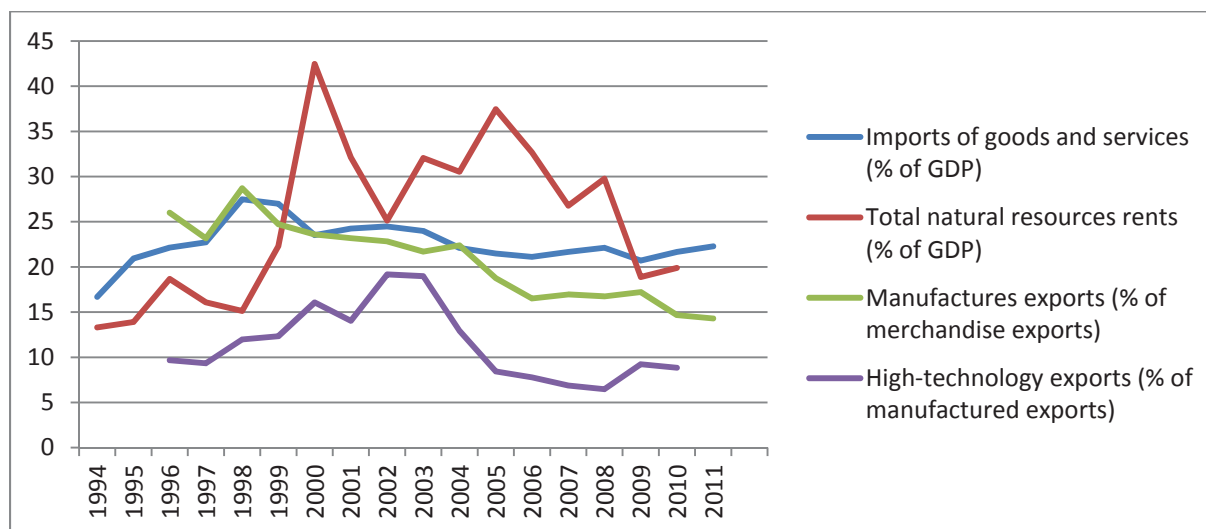
However, according to the statistics the share of domestic production in GDP has been increasing in Russia since 1998. On the contrary to the symptom of the Dutch disease, in Russia the share of imported goods and services has been reducing from 27.4% in 1998 to 22.2% in 2011 (Figure 14). Moreover, the share of total natural resources rents in GDP reduced gradually. This evidence supports the recent arguments of Dobrynskaya and Turkisch (2009) -- that Russia doesn’t suffer the Dutch disease. In spite of the fact that there are some evidences of its symptoms like a real appreciation of the ruble, a rise in real wages, a decrease in employment in manufacturing industries and the development of the services sector; it has been shown that manufacturing production has increased and that contradicts the theory of the Dutch disease.

So, the fact that the manufacturing production in Russia doesn’t suffer from oil-oriented exports pattern allows to support the idea that Russia has chosen a new path of economic development which is called “new developmentalism”. The concept (Bresser-Pereira, 2011) doesn’t reject existence of the Dutch disease in the development path but argues in this case for the strong role of state in the performance of fiscal soundness and managing the exchange rate in terms of trade globalization. The new development theory considers foreign capital inflow undesirable, whereas foreign direct investment is regarded as beneficial -- however not in case of using it for financing current-account deficit, but as a mean for technological upgradation of the economy.

Despite the increase in the share of domestic production in GDP, it is noticeable that the share of manufactures exports has been constantly reducing since 1998 as well as the share of high-technology exports in the manufactured exports in Russia (Figure 14). This evidence confirms

the necessity of upgradation and diversification of Russian manufacturing sector where FDI may play positive role.

Figure 14. Selected indexes of trade and development in Russian Federation, 1993-2011



Source: Author's calculations, based on World Bank, World Development Indicators.

## 2. *The role of the Russian Federation in the world FDI flows*

The Russian Federation has taken key positions as home and host country for FDI not only among former socialist countries but also in the world. It ranked eighth in both the lists of top 20 host economies for FDI inflows and home economies of FDI outflows (UNCTAD, 2011). In 2010 its share in the world FDI inflows was 3.3%, whereas in outflows was 3.9%. It is noticeable that Russia has become the net exporter of FDI since 2009 (Appendix 1).

To capture the importance of FDI inflows in the Russian economy it is also important to assess their share in GDP -- that was 2.8 - 4.5% since 2007 to 2011. This indicator was comparable with that in China where it was equal to 2.3-4.6% in the same period, and higher than in India (1.4 - 3.5%) and Brazil (1.6 - 2.7%)<sup>3</sup>.

We examined the structure of the inward FDI stock by industries in order to evaluate whether FDI have influenced the diversification of Russia's exports. For this purpose we have applied a widely used classification which divides FDI in four groups: resource-seeking, market-seeking, efficiency-seeking and strategic assets-seeking<sup>4</sup>. In 2009 the majority of the FDI stock<sup>5</sup> was resource-seeking (about 47%) and market-seeking (about 36%). The resource-

<sup>3</sup> Source: World Development Indicators, The World Bank

<sup>4</sup> The classification has been developed by D. Dunning (see, for instance, Dunning, J.H. and Lundan, S.M. (2008) *Multinational Enterprises and Global Economy*. Second edition. Cheltenham: Edward Elgar. (Generally one provides such a detailed description of paper in the reference section.)

<sup>5</sup> Source:

[http://www.investmentmap.org/TimeSeries\\_Industry\\_fdi.aspx?selCtry=RUS&selInds=&selOpt=\\_fdi&selYear=0&time\\_series=INSTOCK](http://www.investmentmap.org/TimeSeries_Industry_fdi.aspx?selCtry=RUS&selInds=&selOpt=_fdi&selYear=0&time_series=INSTOCK)

seeking FDI have concentrated in the following industries: petroleum; metal and metal products; coke, petroleum products and nuclear fuel; non-metallic mineral products; wood and wood products; chemicals and chemical products; mining and quarrying. The resource-seeking FDI may slightly change international specialization of the country but they usually influence the increase of exports in traditional industries. The case of Russia is not an exception.

The market-seeking inward FDI are represented in Russia mainly by services such as business services, wholesale and retail trade, finance, transport, storage and communications. FDI in these sectors have improved the quality of services and thus have facilitated the consumption of services on the domestic market, but have not influenced the growth of the share of services in Russia's exports.

It is observed that a relatively small share of inward FDI (about 17%) could be classified as efficiency-seeking. This type of FDI accumulated in the spheres that may in future increase the share of manufacturing products in Russia's export. They are the following: food, beverages and tobacco; machinery and equipment; electrical and electronic equipment. As it was shown in the analysis of Russia's exports by sectors, exports of food products appeared to be the most sustainable during the global crisis. That could be explained, to some extent, by the modernization of the industry with the help of FDI. Especially, exports<sup>6</sup> of such group of food products as production, processing and preservation of meat, fish, fruit, vegetables, oils and fats grew by 30% from 2007 to 2010 and reached \$ 3.3 billion. Quite a considerable increase in exports from 2007 to 2010 was in the following segments where inward FDI stock appeared to be relatively high:

- Manufacture of television and radio receivers, sound or video recording or reproducing apparatus and associated goods (during 2007 to 2010 exports increased by 81.2%)
- Manufacture of electric lamps and lighting equipment (11.1%)
- Manufacture of electronic valves and tubes and other electronic components (4.9%)
- Manufacture of domestic appliances (6.9%), especially: parts of vacuum cleaners, dry cleaners and wet vacuum cleaners; domestic food grinders and mixers; fruit or vegetable juice extractors; electric instantaneous or storage water heaters and immersion heaters; electric smoothing irons, etc.

Thus, it is obvious that Russia did not appropriately use the potential of inward FDI as a source of investment in the structural changes of the economy in order to diversify the composition of its exports and be less vulnerable to the shocks in prices of oil and gas ensuring a sustainable long-term economic development. Nevertheless, last studies show a

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<sup>6</sup> We have compared inward FDI stock and export growth throughout the industries, defined in ISIC rev. 3 nomenclature (6 digit), using the source: [http://www.investmentmap.org/prioritySector\\_trade.aspx](http://www.investmentmap.org/prioritySector_trade.aspx)

significant growth of attractiveness for FDI in industries in Russia such as automotive production, the food industry, the chemicals, logistics and equipment sectors (E&Y, 2011).

According to international surveys, Russia is considered to be one of the most attractive economies for FDI for the period of 2011-2013, taking the fifth place in the world, following China, the United States, India and Brazil (UNCTAD, 2011). At the same time UNCTAD Inward FDI Performance Index<sup>7</sup>, that ranked Russia the 60<sup>th</sup> in the world, lags behind Inward FDI Potential Index<sup>8</sup>, which gave Russia the eighth position in 2010<sup>9</sup>. It is obvious that there are many unfavorable factors hindering FDI and making Russia less attractive which will be considered in the next section.

As was mentioned above, Russia is one of the biggest FDI investors in the world. Moreover, eight Russian companies were in the list of the top 100 non-financial TNCs from developing and transition economies, ranked by foreign assets, in 2008 (Appendix 3).

It is interesting that the intensive expansion of Russia's outward FDI started immediately after the collapse of the socialist system, which happened twenty years ago. To some extent, it is a contradiction to the investment development path paradigm (IDP paradigm) (Dunning and Narula, 1998), which postulates that, before investing abroad, countries (developing as well as transition economies) first host FDI, which influences the enhancing advantages of their companies and, as a result, allows them to invest abroad. So, according to the IDP paradigm outward FDI is the function of GDP per capita.

We have studied the dynamics of net outward investment (NOI) positions and GDP per capita of several former socialist countries which are now leading in outward FDI (Figures 15, 16). It was revealed, that unlike other countries, Russia's NOI position was slightly negative in 1992-2008 and became positive in 2009-2010. It means that Russia's outward FDI growth does not depend on inward FDI stock. It is based first and foremost on a big current account surplus of a country which is rich in oil and gas deposits. In case of Russia, outward FDI mainly plays a role of facilitator and accelerator in exports of oil and gas as well as communication services.

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<sup>7</sup> UNCTAD's Inward FDI Performance Index measures the amount of FDI that countries receive relative to the size of their economy (GDP). The Index is the ratio of a country/region's share in global FDI inflows to its share in global GDP. A full list of countries ranked by the index is available at [www.unctad.org/wir](http://www.unctad.org/wir).

<sup>8</sup> The UNCTAD Inward FDI Potential Index is based on 12 economic and structural variables measured by their respective scores on a range of 0–1 (raw data available on: [www.unctad.org/wir](http://www.unctad.org/wir)). It is the unweighted average of scores on the following variables: GDP per capita, rate of growth of real GDP, share of exports in GDP, telecoms infrastructure (average no. of telephone lines per 100 inhabitants, and mobile phones per 100 inhabitants), commercial energy use per capita, share of R&D expenditures in gross national income, share of tertiary level students in the population, country risk, exports of natural resources as a percentage of the world total, imports of parts and components of electronics and automobiles as a percentage of the world total, exports of services as a percentage of the world total and inward FDI stock as a percentage of the world total (UNCTAD, 2008).

<sup>9</sup> Source: UNCTAD database



In addition, after studying the geographical structure<sup>10</sup> of outward FDI stock it became clear that about 60% of them have flown to classical offshore zones, such as the Netherlands, Cyprus, Bermuda Islands, Virgin Islands, Gibraltar, Belize, Luxembourg, Hong Kong, Seychelles, Mauritius, Marshall Islands<sup>11</sup>. The analysis of sectoral structure of Russia's outward FDI stock reflected that about 80% of them are in the spheres of petroleum, natural gas and metal products.

It is obvious, that while on early stages of transition period companies in the other former socialist countries did not have ownership advantages to invest abroad, Russian companies had a free access to natural resources. So, while the other countries had to develop technology- and knowledge-intensive production and a competitive environment by means of FDI attraction, Russia started investing abroad on the basis of the trade surplus accompanied with inherited post-soviet large-scale enterprises in resource-intensive production. And with maturing of market economy practices, global visions of management pushed further expansion of outward FDI.

So, the majority of Russian TNCs is resource-based and implements market-seeking FDI, which is the evidence of their important role in the growth of Russia's resource-based export.

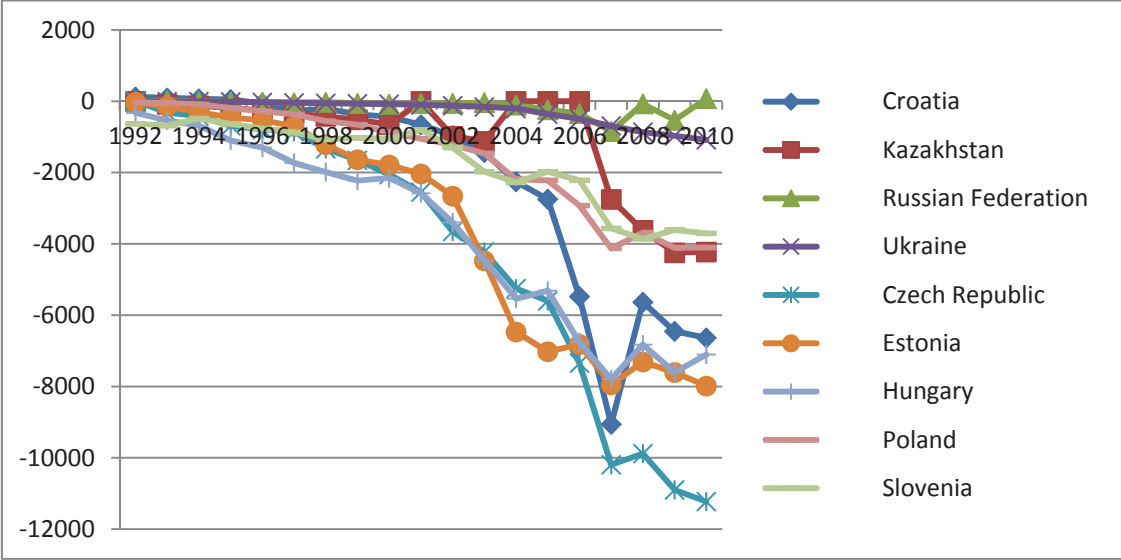
Quite interestingly, there are some other motives of Russian outward FDI in addition to those mentioned above. The studies (Kuznetsov, 2011) state that Russian TNCs expand abroad for reasons such as image-building, avoidance of political risk, strengthening of negotiating power. In some cases, through their FDI abroad, Russian TNCs have received access to cheap

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<sup>10</sup> Geographical and sectoral structure of Russia's outward FDI stock have been analyzed, using the database of Russian Federation State Statistics Service ( <http://www.gks.ru/wps/wcm/connect/rosstat/rosstatsite.eng/>)

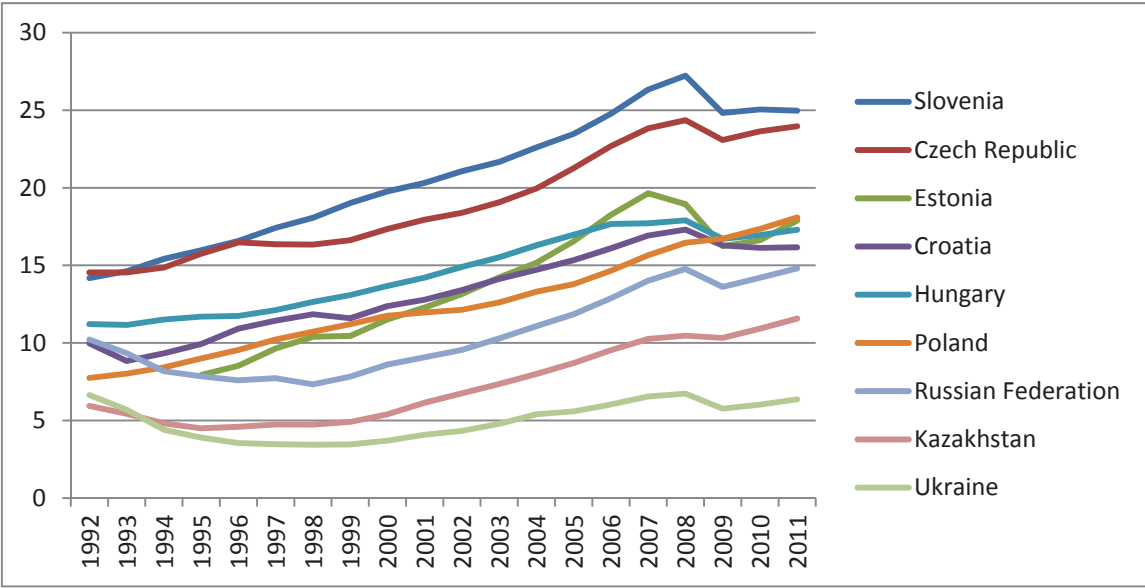
<sup>11</sup> The Netherlands comprise almost half and Cyprus 20% of accumulated FDI outward flows in 2004- 2011

Figure 15. Net outward investment position per capita of several former-socialist countries, 1992-2010, in dollars



Source: UNCTAD database and authors' calculations

Figure 16. GDP per capita PPP (constant 2005 international \$) of several former-socialist countries, 1992-2011, in thousand dollars



Source: World Bank, World Development Indicators

financial resources from international stock exchanges for the development of their businesses in Russia.

In terms of foreign investment strategies more than 30% of FDI by value were in the transnational M&A from 2005 to 2011, May (Appendix 2). Unlike TNCs from European former socialist countries leading in attracting FDI, Russian TNCs give more preference to geographical diversification of their assets through M&A rather than through Greenfield investments. This is clear from the ratio of the value of Greenfield projects to the value of

cross-border M&As. The ratio shows that transnational M&A of the Russian TNCs are more large-scaled than those of TNCs from the other countries. Only Kazakhstan follows the Russian pattern. Czech Republic, Hungary, Poland and Ukraine invest 4-5 times more resources in opening new companies abroad than in M&A transactions.

### ***3. Assessment of the competitiveness of the Russian Federation***

Although the notion of “competitiveness” referring to the country is widely used, its meaning is still vague and contradictive. From the macroeconomic point of view it implies comparisons in prices, costs and exchange rates across the countries. However, in a broad sense national “competitiveness is considered as the set of institutions, policies, and factors that determine the level of productivity of a country” (WEF, 2011).

The analysis of Russia’s competitiveness started in the previous two parts of the article where it has been stated that the development path of the country shows a reduction in the sectoral diversification in trade along with high trade surplus, high inflation and overvalued real effective exchange rate that are, in fact, the symptoms of the Dutch disease. The latter tends to weaken manufacturing industries and influence negatively the productivity of the economy in future. FDI pattern mostly enhances the existing international specialization of Russia and reflects the problem of the Dutch disease.

In order to find long-term determinants of productivity of the country we study well-known ratings held by the World Economic Forum and the Institute of Management Development, rating of Doing Business, rating of Economic Freedom, etc. As it has been shown below the Russian Federation currently is not among the leaders in terms of the long-term economic parameters, which could be advantageous for future development.

Being compared with several other emerging markets (Appendix 4), Russian competitive advantages are the following:

- An access to foreign markets,
- A stable macroeconomic environment: a very low general government debt (9.9% of GDP (WEF, 2011)), considerable gross national savings. Although the budget has a very low deficit (3.6% of GDP (WEF, 2011)), public spending is growing with little transparency,
- The infrastructure is developed in terms of airline seats availability, railroad infrastructure, mobile phones subscriptions and fixed telephone lines,
- Technological readiness in terms of internet development and access to the internet,
- Capacity for innovation, that reflects availability of scientists and engineers, is relatively high in Russia, whose rank is 38 by the Global Competitiveness Report (WEF, 2011).

At the same time a lot of impediments challenge a long-term economic growth and sustainable development. Most of them are concentrated in the following spheres:

- a low pace of institutional development:
  - rule of law and freedom from corruption have not been effective, which is confirmed by WEF Global Competitiveness Index, Index of Economic Freedom and Corruption Perceptions Index,
  - inefficiency of government regulation (favoritism, wastefulness of government spending, red tape),
  - property rights protection (intellectual property protection, protection of minority shareholders' interests),
- market inefficiency (ineffectiveness of anti-monopoly policy and lack of local competition, which pushes inflation; complex non-tariff barriers, rules in dealing with construction permits and getting electricity),
- undeveloped financial market in terms of availability and affordability of financial services, soundness of banks,
- labor market inefficiency (outmoded labor code, low cooperation in labor-employer relations, brain drain, etc.),
- lack of business sophistication in terms of local supplier quantity and quality, nature of competitive advantages, value chains breadth, production process sophistication, etc.,
- underdeveloped technology and innovation (unsophisticated firm-level technology absorption and technology transfer through FDI, poor availability of latest technologies).

In terms of rates of business sophistication and innovation the Russian Federation has lost its advantageous position, if compared with India and China<sup>12</sup>,

- inefficiency of policy in environmental public health and ecosystem vitality, which is ranked last by the Environmental Performance Index in the last decade (2000-2010) trend (Appendix 4).

In order to remove these bottlenecks on the way to a continual economic growth, the Russian government initiated the establishment of Customs Union with Belarus and Kazakhstan in 2010 and WTO accession in 2012.

In spite of the fact that the Russian Federation has been an economic leader in the CIS region and has impacted the neighborhood through trade (figure 11, 12), finance (Appendix 1) and remittance channels (Appendix 5), it is still interested in deepening of integration on the post-Soviet territory.

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<sup>12</sup> China's ratings are from 16 to 46 in the group of seven indexes described by the innovative potential of the countries in the WEF Global Competitiveness Report (WEF, 2011) while India ranks from 21 to 78 and Russia – from 38 to 99.

The trade liberalization in the Customs Union (CU) allowed Russian companies to enhance their market power in merchandise trade on the territory of Belarus and Kazakhstan as well as to become more attractive for external FDI and also to increase vertical FDI chains within the CU-countries.

The WTO membership that started in July, 2012 allows, in the long run, creating a more competitive environment for doing business in Russia that might be a precondition for broad modernization of the real sector of the economy.

In the short term, the positive effect will be mostly in resource-based industries while other manufacturing sectors will suffer due to overvalued real effective exchange rate as it has been shown above. This prediction is confirmed by various studies. Thus, according to Ernst & Young assessments, the greatest growth on a country-wide scale is expected in nonferrous metal production (14.45% of the level of the base year), ferrous metal production (3.63%), and in chemical and petrochemical production (2.05%). Production is expected to be reduced to the greatest extent in the following industries: timber processing, pulp and paper manufacture and woodworking (-6.74% in relation to the level of the base year), light industry (-4.35%) and machine-building (-2.77%). (E&Y, 2012).

### *Conclusion*

The Russian Federation plays an important role in the international merchandise trade and trade in services and is among top 15 states by its share in world exports and imports.

For decades Russia has had a positive balance of trade, which has caused many symptoms of the Dutch disease, including overvalued real effective exchange rate, although the share of imports in GDP has been reduced. .

We have studied the evolution of Russian trade pattern by geographical structure and by industries as it transpired over the last decades, from 1996 till 2011. It became clear that there still remains the low level of trade diversification by industries and the fact that resource-driven economic growth keeps threatening the country's sustained development. During the period considered for our analysis, the country became less diversified geographically both in exports and imports, which shows a growing dependence on the narrow circle of partners, where China began to play a very important role.

As for FDI, Russia did not properly use its potential to make the essential structural changes through inward FDI into the economy so that the composition of the country's export should be diversified. The majority of Russian outward FDI is natural resource-based and market-seeking, which testifies for their sustained importance in Russia's increasing raw-material-based exports.

Although Russia has very strong drivers for its development, like a huge trade surplus, capacity for innovation, and well-developed infrastructure, there are many disadvantages in terms of competitiveness which may impede an economic growth. The main hindrances and drawbacks for the country's development are the following: an overvalued real effective exchange rate; high level of inflation; a weak industrial structure, which is vulnerable to oil and gas prices; slowly modernized technologies, badly organized institutions and market inefficiency, an underdeveloped competitive environment, corruption and a weak rule of law. In terms of rates of business sophistication and innovation the Russian Federation has lost its advantageous position, if compared with India and China.

The WTO accession will lead to an unevenly distributed effect of growth among industries of the Russian economy, but at the same time it may strongly enhance the competitiveness through deep integration in the international competitive environment in the long-term period. Yet, what is needed are further institutional reforms towards a fully industrialized market economy.

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Appendix 1. FDI flows, by region and in Russia, 2005-2010 (Millions of dollars)

	2005	2006	2007	2008	2009	2010
World						
FDI inflows	982 593	1 461 863	1 970 940	1 744 101	1 185 030	1 243 671
FDI outflows	882 132	1 405 389	2 174 803	1 910 509	1 170 527	1 323 337
Developed countries						
FDI inflows	619 134	977 888	1 306 818	965 113	602 835	601 906
FDI outflows	745 679	1 154 983	1 829 044	1 541 232	850 975	935 190
Developing countries						
FDI inflows	332 343	429 459	573 032	658 002	510 578	573 568
FDI outflows	122 143	226 683	294 177	308 891	270 750	327 564
CIS						
FDI inflows	26 239	44 642	78 252	108 385	63 794	64 072
FDI outflows	14 037	23 328	50 134	58 490	47 432	60 532
Russia						
FDI inflows	12 886	29 701	55 073	75 002	36 500	41 194
FDI outflows	12 767	23 151	45 916	55 594	43 665	51 697

Source: UNCTAD, 2011

Appendix 2. Outward FDI by main forms, selected economies, 2005-2011 (Jan.-May)

	Cross-border M&As, 2005-2011(Jan.-May)		Greenfield FDI projects 2005-2011 (Jan.-May)		Value of Greenfield projects to value of cross-border M&As
	Number of deals	Value in millions of dollars	Number of deals	Value in millions of dollars	
Czech Republic	54	3310	183	14993	4,5
Estonia	29	203	139	6843	33,7
Hungary	44	2461	128	15108	6,1
Poland	95	2059	209	10664	5,2
Slovenia	25	671	155	7322	10,9
Kazakhstan	21	6067	33	1369	0,2
Russian Federation	399	63805	836	105779	1,7
Ukraine	31	1691	134	9211	5,4

Source: UNCTAD database (<http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx>) and author's calculations



Appendix 3. The top 100 non-financial TNCs from developing and transition economies, ranked by foreign assets, 2008

(Millions of dollars and number of employees)

Ranking by: Foreign assets	TNI*	Corporation	Home economy	Industry	Assets		Sales		Employment		TNI <sup>b</sup> (Per cent)
					Foreign	Total	Foreign	Total	Foreign	Total	
8	61	Lukoil	Russian Federation	Petroleum and natural gas	21 515	71 461	87 637	107 680	23 000	152 500	42,2
23	53	Evraz	Russian Federation	Metal and metal products	11 196	19 448	12 805	20 380	29 480	134 000	47,5
32	77	Severstal	Russian Federation	Metal and metal products	8 066	22 480	9 325	22 393	12 662	96 695	30,2
50	89	JSFC Sistema	Russian Federation	Telecommunications	5 698	29 159	3 983	16 671	11 000	80 000	19,1
64	93	MMC Norlisk Nickel	Russian Federation		4 389	20 823	1 998	13 980	4 000	88 100	13,3
74	83	VimpelCom	Russian Federation	Telecommunications	3 726	15 725	1 520	10 117	10 233	38 403	21,8
81	92	Mechel	Russian Federation	Metal and metal products	2 911	12 010	1 385	9 951	8 244	83 670	16,0
94	81	TMK	Russian Federation	Metal and metal products	2 361	7 071	2 302	5 690	4 101	48 494	27,4

\*TNI, the Transnationality Index, is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment

Source: UNCTAD database (unctad.org/sections/dite\_dir/docs/wir2010\_anxtab27.xls)

Appendix 4. Several ratings of competitiveness and business environment for selected countries

Economy	The Global Competitiveness Index	IMD World Competitiveness	Index of Economic Freedom	Ease of Doing Business	Corruption Perceptions Index	Environmental Performance Index <sup>13</sup>	
						2012	trend rank 2000-2010
Years	2011-2012	2012	2012	2012	2011	2012	
South Africa	50	50	70	35	64	128	124
Chile	31	28	7	39	22	58	117
Kazakhstan	72	32	65	47	120	129	126
Belarus	-	-	153	69	143	65	40
Turkey	59	38	73	71	61	109	17
China	26	23	138	91	75	116	100
Jordan	71	49	32	96	56	117	76
Russian Federation	66	48	144	120	143	106	132
Brazil	53	46	99	126	73	30	23
Indonesia	46		115	129	100	74	66
India	56		123	132	95	125	95
Ukraine	82	56	163	152	152	102	82
Number of countries ranked	142	59	179	183	178		132

Source: WEF, 2011; IMD, 2012; IEF, 2012; WB, 2011; TI, 2012; EPI, 2012

<sup>13</sup> The 2012 Environmental Performance Index (EPI) rankings are comprised of both a snapshot of performance based on the latest available data (the 2012 EPI) and a trend rank based on performance over the last decade (the Trend EPI).

Appendix 5. Remittances from Russian Federation, 2010 (Millions of dollars)

Total	18 795
<b>CIS</b>	<b>13 525</b>
Azerbaijan	867
Armenia	904
Belarus	411
Kazakhstan	221
Kyrgyzstan	1 250
Republic of Moldova	1 346
Tajikistan	2 191
Turkmenistan	24
Uzbekistan	3 834
Ukraine	2 476

Source: Central Bank of the Russian Federation, UNCTAD database

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