

Why Is Russia So Unproductive?

Analysts say a toxic cocktail of state capitalism, corruption and low investment curbs output.

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Russia is one of the least productive moderately rich countries in the world. **Alexander Avilov / Moskva News Agency**

During his annual phone-in with the public in June this year, President Vladimir Putin described low [productivity](#) as “one of the most acute and important” problems facing Russia.

Economists agree. Russia is one of the least productive moderately rich countries in the world, ranking 39th out of the 42 [monitored](#) by the Organisation for Economic Cooperation and Development (OECD). In cash terms, Russia produces \$24.61 in GDP for every hour worked, half the \$48.15 OECD average.

“Boosting productivity is key to increasing Russia’s GDP growth,” said Jakob Suwalski, lead analyst at Scope Ratings. “However, meeting the challenge is easier said than done.”

Productivity is one of the most-watched indicators of an economy's long-term prospects, measuring how much GDP is produced for every hour worked. As Putin highlighted, higher productivity means higher wages, since the more value workers create, the more they can be paid.

The latest Russian attempt to solve its low productivity problem is its ambitious National Projects public spending program. Alongside a string of new infrastructure construction, the state has promised to throw 52 billion rubles (\$800 million) worth of cheap loans, export promotion and training courses specifically at the productivity issue.

But economists point to a cocktail of “state capitalism,” corruption, low investment, poor equipment and unfavorable demographics to explain Russia's malaise — drawbacks the \$1-per-person-per-year government scheme will struggle to address.

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“When foreign direct investment (FDI) is coming in, productivity generally goes up,” said Standard & Poor's sovereign ratings director Karen Vartapetov, “as firms bring not only cash, but more advanced technology and modern managerial know-how, or ‘technology transfer.’”

But investment, and the import of new equipment and technology into Russia have plummeted since sanctions were introduced in 2014 after the annexation of Crimea.

“When you have sanctions and bans on technology imports, it makes it difficult to improve productivity without this technology already in place and without it being produced domestically,” said Scope Ratings analyst Levon Kameryan. “Therefore, sanctions work as a drag on productivity.”

So severe has the investment drought been that Russia falls into the tiny group of countries where the total stock of foreign investment has gone down, not up, since 2010, the United Nations Conference on Trade and Development (UNCTAD) found.

And the investment problems don't end at Russia's borders. “One of the unusual things about Russia is that [domestic] private investors have been accumulating foreign assets,” said William Jackson, chief emerging markets economist at Capital Economics.

With profits strong and interest rates heading down, it's not for a lack of resources that domestic firms are not investing.

Huge cash deposits

Alfa Bank's chief economist Natalia Orlova says: “Russian companies are not inefficient because borrowing is too expensive. They are sitting on huge [cash] deposits, paying off foreign debt and paying huge dividends. The reason companies are inefficient is because they are not funding enough projects and don't have enough economic activity.”

The poor investment landscape “is symptomatic of a bad business environment,” said

Jackson, pointing to corruption, weak rule of law and insufficient legal protections for investors.

Heavy state involvement in the economy is another reason for Russia's poor productivity performance, economists said.

“The footprint of the state in the economy is massive and it's been expanding,” said Vartapetov. “That comes on top of weak rule of law, a weak judiciary and the use of courts in corporate disputes. So Russia has very weak governance, but also an expanding role of the state in the economy. In that environment you can't expect a significant acceleration in productivity.”

An [IMF paper](#) found that the Russian state accounts for almost half of employment and one-third of GDP, and that specific government policies, such as non-competitive procurement and the refusal to consolidate state-owned companies into leaner organisations, are especially wasteful.

Analysts also point to the state's failure to incentivize competition and innovation as a major barrier.

“There are obviously problems with corruption and the business environment. But that applies to many other countries as well,” said Iikka Korhonen of The Bank of Finland's Economies in Transition (BOFIT) unit. “In Russia, there's been less emphasis and interest on fostering competition, both domestic competition and from abroad. There is more of a tendency to protect incumbents.”

Orlova said the 2008 crisis was a turning point in this regard. “The cabinet's reaction was to spend. They disbursed a lot of money — not only to the population, but also to companies. This sent the wrong message, as companies which were not efficient and should have disappeared were saved. So starting from 2008, we saw a decline in efficiency ... [while] the environment is still the same as before: high corruption and low transparency.”

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On top of these issues, a lack of innovation and demographics are also cited as aggravating factors in Russia's productivity illness.

[Russia ranks 46th on the Global Innovation Index](#), but given its assets — a highly-educated population, strong digital infrastructure and a healthy research & development ecosystem — it should be higher, the study found. However, weak institutions, political risk and a nervous investment climate weigh on Russia's innovative potential. Alfa Bank's Orlova notes that only 8% of Russian companies were involved in innovation, compared to 41% in China, 51% in Turkey and 64% in India. On demographics, “as the share of elderly people — those aged 64 and over — relative to the working age population increases,” said Kameryan, adding that “this has a negative impact on productivity.”

Facing such a daunting list, many are asking how Russia can solve its productivity puzzle.

“That,” says BOFIT’s Korhonen, “is the billion ruble question”.

Few believe Putin’s National Projects, on their own, are the answer.

“To make an economy more efficient, you don’t need to spend more money. You need appropriate legislation and to have appropriate rules of the game,” says Alfa Bank’s Orlova.

Scope Ratings’ Suwalski said: “depending on the effectiveness of their implementation” the projects could begin to nudge productivity in the right direction. But any improvement would be modest, raising Russia’s growth potential from around 1.5% to just 2% a year, he added. A more meaningful increase “requires institutional and structural reforms to improve Russia’s human capital and to change the business and investment climate for the better.”

“The agenda has long been well-known,” says Nikita Meslennikov, lead expert at the Centre for Political Technologies and an adviser under the Yeltsin administration.

“Reduce state power and the administrative burden, [introduce] systemic measures to promote and protect investment, and develop non-resource non-energy exports. Taking this path will be highly complicated.” Along with an overhaul of the economic structure, “it will require moving to a new level of communication between the state, businesses and society.”

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