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Competitiveness of Russia: Problems and Perspectives

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El presente trabajo hace una revisión general de los aspectos contemporáneos de la capacidad competitiva de Rusia a nivel global e indica posibles situaciones para un desarrollo que pueda mejorar la valoración mundial de Rusia. Tras una breve introducción, dedicada a conceptos modernos de competitividad nacional, el autor analiza la situación competitiva actual de Rusia utilizando los resultados de los informes y clasificaciones más influyentes a nivel mundial. Esta sección del artículo facilita los indicadores más rigurosos de la posición de Rusia en relación con países similares así como sus posibilidades de desarrollo.

Las tres partes siguientes del trabajo analizan las tendencias positivas y negativas del desarrollo de Rusia durante los seis últimos años. También se presenta la esencia del debate actual sobre el futuro del país, una vez que se celebre la próxima elección presidencial, prestando especial

This paper reviews general contemporary issues of competitiveness of Russia on a global stage and suggests some possible scenarios of further development which could improve the world ratings of Russia. After a brief introduction devoted to modern concepts of national competitiveness, the author analyse current competitive positioning of Russia using the results of the world's most influential research reports and rankings. This part of the paper reveals the most serious indicators of Russia's lag behind the leading and other similar in size, as well as potential and development stage countries.

The next three parts of the paper analyze both positive and negative trends of recent Russia's development over the last 6 years as it is viewed from Russian expert' point of view. The essence of the current debate on the future of the country, after the next Presidential election,

atención a varias estrategias posibles y su influencia potencial en la competitividad del país en el futuro. Al final del trabajo se aborda el aspecto de la modernización de valores en Rusia, lo que parece ser fundamental no sólo para mejorar la competitividad sino también para asegurar el desarrollo venidero del país.

Las consideraciones que se expresan en el artículo, salvo aquéllas que específicamente se referencian, corresponden al autor y no deben interpretarse como oficiales.

Palabras clave: competitividad nacional/global, niveles de competitividad mundial, desarrollo, relaciones gobierno-empresas, estrategia gubernamental, modernización, valores socio-culturales, activos intangibles.

is also presented with emphasis on several feasible strategies and their potential influence on the future competitiveness of the country. At the end the paper addresses the issue of values modernization in Russia which seems to be crucial not just to improve competitiveness but to ensure the future development of the country.

The views and estimates expressed in the paper except for references to different expert opinions are the author's own responsibility and should not be interpreted as presenting an official position on these issues.

Key words: Key words: national/global competitiveness, world competitive rankings, development, government-business relations, government strategy, modernization, socio-cultural values, intangible assets.

After the stage of overcoming the system's development crisis of the 90s, the issue of increasing the competitiveness of Russia in the world has become one of the most important national priorities for the immediate future. The idea was first officially announced at the top level in 2003 and it was caused by the fact that Russia, already exhausted by the centuries-old efforts of modernization and the extremely intricate and inconsistent period of initial democratic and market transformations with lots of problems to solve, has to choose a new strategy for development and to fight its way to a decent place in this rapidly developing world. Along this way, the country, with huge potential, faces plenty of impediments, real threats and challenges. Some of these barriers are to be considered in this paper.

National competitiveness is a very complicated and integrated problem, which has only recently become seriously researched in Russia. It was caused, among other reasons, by publications, including those in periodicals, which announced the results of various comparative research projects of competitiveness that were conducted by different respected international organizations. According to these studies, Russia is still ranked quite unpretentiously - somewhere in the second half of the list of countries analyzed. It is natural that politicians, as well as experts, strive to understand the grounds for such positioning and to offer ways of solving many problems.

1. THE NOTION OF NATIONAL COMPETITIVENESS

Probably the first detailed comparative analysis of national competitiveness was undertaken at the end of the 1980s by the World Economic Forum (WEF) within the "The World Competitiveness Report" project. Approximately at the same time, a well-known American professor, Michael Porter, at the Institute for Strategy and Competitiveness, Harvard Business School, made several important statements in his fundamental work on competitiveness. These statements were later developed and made the basis for further international studies of this issue¹. They serve as a key to understanding positions and prospects both for particular companies or industries as well as for the countries as a whole. So, here are some fundamentals as I view them.

First, none of the definitions of national competitiveness used in previous economic concepts, such as comparative competitive advantages and availability of resources, achievement of particular macroeconomic effects, the phenomenon of rash economic growth and overcoming the technological gap, special government policy or corporate governance, etc, none of them gives the idea of what a competitive country really is. They all are just part of the whole picture.

Second, the level of the competitiveness of a country rests on the combination of interconnected factors - available resources (input), traditional and developing industrial clusters, business strategy and structure, peculiarities of demand in a particular country, as well as government policy. The competitive capacity of national businesses is the efficiency of companies and groups of companies in a particular country. It seems to be a sort of contradiction, because today competitiveness is becoming more and more globalized by its nature. On the one hand, at the beginning of the XXI century, when about 40% of the global gross product is produced by international companies, it becomes increasingly more difficult to define the 'nationality' of goods and services. On the other hand, particular groups of goods and services have a reputation of being 'purely national' both in public thought and on the market. Thus, when we speak about the Swiss products, we think about watches and chocolate, Germans are believed to be good at machine tool manufacturing, Americans - at computer technologies and informational systems, Frenchmen

¹ M. Porter (1990) *The Competitive Advantage of Nations*. N.Y.

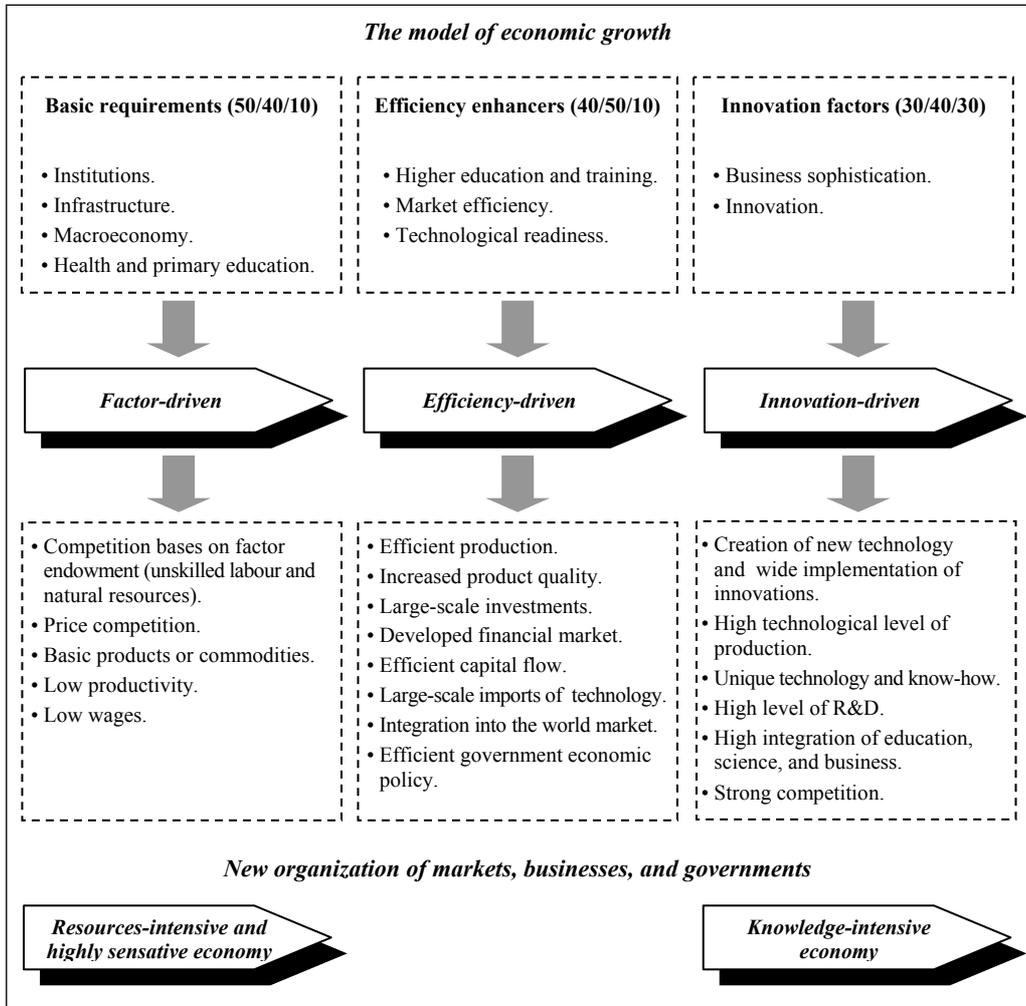
and Italians represent fashion, perfumery and design, while the Japanese and Koreans are associated with home appliances, and Russians are famous for their spacecraft. The research shows that huge branches have been developing for centuries due to competitive advantages based on traditional skills and culture of this or that industry and accumulate these advantages through refining the technology and honing skills of their manpower. Moreover, in the developed countries there are special competitive enclaves (or regional and creative "clusters"), where particular research-and-production communities arise and develop for years, and which include educational, research and social organizations, as well as different companies and media communities. Together, they create a particular regional subculture and special environment, which makes the product or service of such a community highly competitive. Their goal is to bring about knowledge and innovations, to increase productivity and to form new companies and attract personnel and expertise.

Third, any country develops through certain stages of competitiveness (Figure 1). An analysis of these stages reveals some major obstacles to development (the difficulties in going from one stage to another), as well as the perspectives of social, economic and innovative policies. The competitive capacity of a country is secured by higher technological development, by changing from a resource intensive to a science intensive economy (the economy of knowledge and innovations) and accordingly from static competitive advantages (natural resources, staples) to dynamic competitive advantages (education, knowledge, information, innovations), from using already existing technologies to the development of new ones in different sectors of global technological environment.

For nearly the last two decades of comparative research both the methods of analysis, and the number of countries and factors has vastly changed. In their first report the WEF analyzed more than 20 developed countries and 10 new industrial states, and the ratings were different for these two groups of countries. The latest report of 2007 includes 121 countries rated according to a unified scale and criteria, which makes it possible to observe comparative positive and negative dynamics over the last several years².

² The Global Competitiveness Report 2006-2007. The Global Information Technology Report. World Economic Forum (www.weforum.org).

Figure 1. Stages of economic development



Sources: M. Porter (1990) *The Competitive Advantage of Nations*, N.Y., p. 545. The Global Competitiveness Report 2006-2007. World Economic Forum. Chapter 1.1, pp. 11-12.

Since the year 2000, two definitions of global competitiveness came into use. They differ slightly but at the same time are interrelated. The first developed by Professor Jeffrey D. Sachs of the Center for International Development at Harvard University, focuses on global competitiveness as "the set of institutions and economic policies supportive of high rates of economic growth in the medium term". Thus the new *Growth Competitiveness Index (GCI)* was introduced. Later in the year

2005, this index was modified, and currently it includes the following factors critical to driving productivity and competitiveness:

- *Institutions*: property rights, ethics, undue influence, government efficiency, security.
- *Infrastructure*: general quality, quality and development in specific areas.
- *Macroeconomy*: government deficit/surplus, savings rate, inflation, interest rate spread, government dept, real effective exchange rates.
- *Health and primary education*: medium-term impact on major infection diseases and prevalence of these diseases, infant mortality rates, life expectancy, primary education enrolment.
- *Higher education and training*: quantity and quality of education, on-the-job training.
- *Market efficiency*: efficiency, competition and flexibility on good, labor, and financial markets.
- *Technological readiness*: the ability of an economy to adopt existing technologies in order to enhance the productivity of its industries (technology absorption, laws, transfer, spread, usage).
- *Business sophistication*: the ability to ensure productivity at the top of the global value chain (networks, clusters, business operations and strategy).
- *Innovation*: quality of research institutions, R&D spending, university/industry collaboration, government procurement, number of scientists and engineers, utility patents, intellectual property protection, capacities for innovation.

It is important to note that none of these factors alone can ensure competitiveness. The value of one can be undermined by weakness of one or more of the others.

The second approach to competitiveness, led by Professor Michael E. Porter, was embodied in the Current Competitiveness Index, which uses microeconomic indicators to measure the "set of institutions, market structures, and economic policies supportive of high current levels of prosperity". Thus the key focus in the first definition is *rate of economic growth*, while in the second one it is the *level of prosperity*. A bit later on in the year 2005, this index was renamed the *Business Competitiveness Index* (BCI), and it includes two major groups of factors:

- Quality of the national business environment.
- Company operations and strategy.

The positioning of a country according to these factors determines its rating in the world scale of competitiveness.

2. RUSSIA IN THE GLOBAL RANKINGS

Russia was first included in global competitive ratings after the 1998 crisis when the market economy principles and basic institutions were founded and quite a reliable statistical basis for correct comparative studies appeared. Additionally, an increasing foreign capital and international management presence in the country allowed more expert estimations, which were an essential part of all WEF researches (the so-called "soft data"). Obviously, at that time, the position of Russia in the global competitive scale was closer to the end of the list.

If we look at the place of Russia in the most recent ratings (Tables 1, 2), it is evident that even though its position has improved it is not yet satisfactory. It is even more alarming that compared to most countries with an approximately equal potential (e.g., BRIC) or with similar starting conditions of the post-Soviet period (most of the former USSR republics), the dynamics of recent years in general look quite bad.

Table 1. Russia in the Global Competitiveness Index, 2006-2007

	Russia	China	India
Total ranking 2006-2007	62	54	43
Total ranking 2005-2006	53	48	45
<i>Subindexes</i>			
Basic requirements	66	44	60
1. Institutions	114	80	34
2. Infrastructure	61	60	62
3. Macroeconomic	33	6	88
4. Health and primary education	77	55	93
Efficiency	60	71	41
5. High education and training	43	77	49
6. Market efficiency	60	56	21
7. Technological readiness	74	75	55
Innovation	71	57	26
8. Business sophistication	77	30	25
9. Innovation	59	39	26

Table 2. Russia in the Business Competitiveness Index, 2006-2007

	Russia	China	India
BCI ranking			
2001	58	49	38
2002	60	39	37
2003	61	46	37
2004	58	48	31
2005	70	54	31
2006	79	64	27
Quality of national business environment			
2001	57	49	36
2002	59	40	36
2003	60	45	38
2004	58	48	31
2005	67	54	32
2006	77	65	27
Company operations and strategy			
2001	62	46	41
2002	64	37	38
2003	70	43	37
2004	69	39	29
2005	78	53	28
2006	78	69	25

This position is quite comprehensible if we look at the dynamics of separate rating items presented in tables 3 and 4. Russia has the most troublesome position within the parameters of bank stability, licensed foreign technologies, the independence of law, ownership rights protection, protection of intellectual property, favouritism in administrative decision making, and commercial waste related to crime and corruption.

Table 3. BRIC rankings in The Networked Readiness Index, 2004-2006

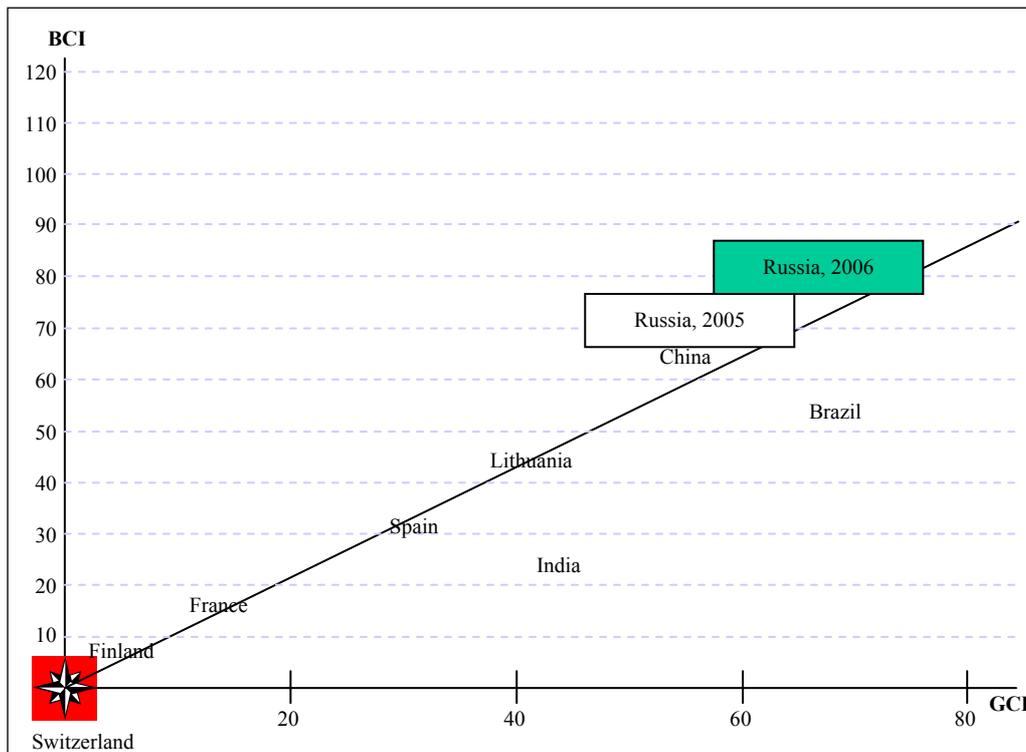
Country	2006	2005	2004
Brazil	53 (of 122)	52 (of 117)	46 (of 104)
Russia	70	72	62
India	44	39	40
China	59	50	41

Table 4. Russia's main competitiveness indicators, 2005-2006

Indicator	Ranking (117)	Ranking (104)	Trend
Macroeconomic and financial situation			
Financial stability	86	72	-
Banks stability	101	91	-
Availability of credits	91	67	-
Venture capital	66	49	-
Stock market	69	74	+
Support of foreign investments	109	97	-
Trade barriers	91	95	+
Technological innovations and their penetration			
Technological readiness	77	69	-
Implementation in business	63	56	- / 0
Licensed foreign technologies	101	87	-
Influence of foreign investments on technology	96	87	-
Quality of fundamental education (mathematics)	21	23	+
Co-operation of science and business	42	40	0
Quality of R&D institutions	31	25	0
IT and communication technology			
Users of mobile phones per 100 citizen	65	74	+
Users of Internet per 10,000 citizen	66	72	+
Government focus on ICT	91	68	-
Number of PC's per 100 citizen	52	47	0
Infrastructure			
Quality	79	64	-
Quality of air transportation	64	66	0
Development of railroad transportation	24	26	+
Wire telephone lines	46	50	+
Government administration - contracts and legal system			
Independence of law	102	84	-
Efficiency of law	95	80	-
Ownership rights protection	106	88	-
Protection of intellectual property	105	84	-
Favouritism in administrative decision-making	106	85	-
Efficiency of legal institutions	80	63	-
Bureaucratic obstacles	90	89	0
Reliability of police service	99	90	-
Commercial waste related to organized crime	101	88	-
Quality of accounting standards and audit	89	81	- / 0
Role of taxes as stimulus for work and investments	81	73	- / 0
Freedom of press	96	84	-
State institutions and corruption			
Foreign economic affairs	83	91	+ / 0
Tax collection	69	69	+ / 0
Contracts	82	75	- / 0
Legal decisions	76	83	+
Government spending	87	69	- / 0
Commercial waste due to corruption	109	100	-
Trust in politicians	94	76	-

If we consider the general positioning of Russia in the global competitive field (Figure 2) it is on the level of moderate countries by the size of the territory and resource potential (like Egypt, Nigeria, Vietnam). However by the income p.c., Russia is in the middle group of countries (efficiency-driven economies with GDP per capita up to \$10,000) - like Argentina, Brazil, Chile, Mexico, South Africa, and Turkey. It is also typical that for the most developed countries (the first half of the list) both indices match, and these countries are placed on the axis in the diagram below.

Figure 2. Global competitive positioning of Russia, 2006



Another vital gap index for Russia is *Networked Readiness Index* (The Global Information Technology Report 2006-2007. The World Economic Forum, 2007). It rests on three main sub indexes, capturing:

- the presence of an ITC-conductive environment in a given country;
- the level of ICT readiness and propensity of the three main national stakeholders: individuals, the business sector, and the government; and
- the actual use of ICT by the above three stakeholders.

The *Transparency International* annually makes up the *Corruption Perception Index* based on expert poll results. 163 countries were included in it in 2006; they were put in the scale from 0 (the highest corruption level) to 10 (the lowest level). Finland got the first place (9.5 points), while Russia got 2.5 points, and it is in the 127th place surrounded by Honduras, Nepal and Rwanda. It is sad that the situation does not change: practically in 2000 Russia had 2.1 points; in 2004 - 2.8 points (90th place among 146 countries); and in 2005 - 2.4 points (126th place among 159 countries)³. The most important index of development and country potential is the state of its human resources capital. Russia is not completely successful in this either.

According to the *Human Development Index* including life expectancy at birth, the level of knowledge and the level of life since the year 2000 Russia's ranking is 60-70 with almost no improvement compared to other BRIC countries⁴. In the health protection level, Russia has 130-140 place, and by education level it went down to the 30th place.

Therefore, those industries where the human capital is reproduced and the intellectual potential of the country is generated apparently do not conform to challenges of time. At the same time, approximately 15% of the territory of Russia (bigger than Great Britain, France, and Scandinavia together), where 75% of the country's population reside, is considered to be environmentally bad.

International comparisons show that administrative power quality indices closely correlate with the indices of the social and economic development of a country.

³ *Vedomosty*, 07.11.2006, p. A3 (www.transparency.org).

⁴ Human Development Report, UN, 2000-2006 (www.undp.org/hdr2006).

Table 5. Comparative Governance Quality Indexes

Country	Human Development Index (2004), rating	Corruption Perception Index (2006)	Governance Efficiency (2005)*	Governance Quality (2005)
Norway	100.	95.6	97.6	91.6
Canada	97.3	92.	95.7	95.7
Lithuania	77.	72.1	76.2	83.3
Russia	63.8	23.4	39.	43.8
Ukraine	56.3	38.3	40.5	46.8

* Governance Research Indicator Country Snapshot.

According to another global index prepared by the *A.T. Kearney Consulting Company* and the *Foreign Affairs* magazine, among 62 countries analyzed, in 2004 Russia ranked 44th, in 2005 - 52nd place, and in 2006 - 47th place. It is typical that other BRIC countries did not go higher than the 51st position. The Index comprises 12 parameters combined into four groups: economic integration, country inhabitants' contacts with outer world, technology penetration, international political activity⁵.

The meaning of all these ratings can be differently interpreted. Of course, they are constantly improved, but they are still not ideal. Most of them are quite indicative and conditional, and they do not always take into account the size of the countries, their inner regional specific features and differences. But no doubt the data provided are noteworthy as they are interrelated and at the present time, they constitute the most sophisticated international research on this topic.

Firstly, they analyze a vast list of different factors affecting the state of society and economics, and this reveals the positive and negative tendencies and the key *painful points* of development. Secondly, they show what allows a number of countries to undergo considerable change in their position in the world during very short periods of time. Thirdly, they allow to define the direction of the country' economic policy vector.

⁵ *Vedomosti*, 18.10.2006, p. A3.

3. POSITIVE CHANGES

A 17-year long period of transition to a new type of society and economy in Russia is over. Institutional foundations for a democratic society and a market economy have been created. In April 2007, the 10th Russian Economic Forum in London stressed again that Russia's prospect is to rank high among the world's largest economic centers. According to a representative of a large western investment bank, Russia has already met two and a half of the necessary requirements: its economy is rapidly growing and its financial markets are flourishing. The expert believes that one and a half requirements are left to be met: to diversify investors and to ensure stable governmental policy. However, as further research data indicates that number of critical requirements seems to be growing wider.

Undoubtedly, *in view of macroeconomics*, stable economic growth within post-crisis years is one of the main positive indicators of Russia's development. Russia is among the most rapidly growing countries in the world with about 7% (\$12,100 p.c., in Brazil - \$9,100 p.c.) annual increase of GDP per capita, which means exceeding the GDP p.c. parameters of 1991 for the first time. Within the period 2000-2006 it grew by 58%. Labor productivity grew by 44% (in the average by 5.4% annually); actual population income increased by 110% (average annual increase is 11.2% - one of the best world indicators), and actual wage level increased by 164% (14.9 annually). According to the Russian Ministry of Economic Development and Trade in 2006, wages grew by 13.4%, retail trade turnover - by 13.4%, paid services - by 7.9%⁶. Actual consumption increased by 9.4% annually, which is the country's record.

The year 2006 was the first since 1991 when the rate of inflation corresponded to government forecasts and fell from 18% per year in 2001 to 9.6% in 2006. Russia's gold and currency reserves (\$314 billion) holds 3d - 4th place in the world.

Over the last 6 years foreign debt decreased from 77% to 6% of GDP. The rouble became fully convertible, and the last stage of negotiations for joining the WTO were completed. State debt is only 9% of GDP including about 5% of foreign debt. Gold and currency reserves are six times as much as the state foreign debt. In 2006 the export of goods

⁶ RBC, 02.03.2007.

was \$305 billion (13th place in the world with a growth of 25%), and export of services was \$30 billion.

By February 1, 2007 the Russian Stabilization Fund was over \$100 billion or 9.9% of GDP in 2006. But if the oil prices fall (their growth period has lasted over 15 years) problems will arise in the cumulative part of the Fund (which is called Future Generations Fund), and it may quickly be exhausted as its income potential may significantly decrease.

Among other developing countries Russia's stock market capitalization is the highest. Over the last 6 years the Russian Trade System (*RTS Index*) grew by 13.4 times, and the index of Moscow Interbank Currency Exchange (*MICE Index*) grew 11.7 times. Within 2006 the RTS index grew by 70.83%, and MICE index by 67.5%. In 2006 the share of market capitalization in GDP grew to 92.7% as compared with 61.5% in 2005. At the same time, trade volume on Russian stock exchanges increased over 3 times during the year. Aggregate capitalization of Russian companies per year increased almost 100% and reached \$908 billion, which made Russia one of the largest developing markets.

As a result of macroeconomic stabilization, Russian credit and investment ratings increased. According to *S&P*, the former rose 9 points. The *Fitch* investment rating reached the point BBB+. In 2006, investments in Russia improved by 13.5%. In the whole of Russian modern history, this is the second highest result in growth rate (in 2000 it was 17%). 2006 witnessed unprecedented capital inflow into the country. According to the Russian Central Bank, the net inflow of private foreign capital was \$41.6 billion, as against \$1.1 billion in 2005. An attractive developing market played a part, as well as financial stability of Russian exporting companies. Liberalization of the gas market, liberal currency legislation, and a strengthening rouble contributed to the growth. The volume of direct foreign investment into Russia surpassed Japan, India, Czech Republic, and Poland, but still is much lower than in China.

The Russian M&A market is gaining more features of a developed market. In 2006 its volume reached 6.5% of GDP (8-10% in developed countries). Assets in different industries are demanded - not just in raw materials production. 70% of transactions are made via investment banks. According to *Ernst & Young*, during the last year the number of M&A grew by 41%, and in 2005 - 2006 it reached the record level of \$71 billion. Russian companies place their shares in world stock exchanges for over \$18 billion. According to *KPMG*, the oil and gas sector

accumulated 80-90% of foreign investments and was a leader in volume. However, last year its share decreased to 60-70%, while metallurgy and mineral resource industries became the leaders. Also important is the fact that market share of state-owned companies M&A's fell from 25% to 19%. Cost capacity of transborder transactions grew by 90%; according to KPMG, foreigners bought assets in Russia for \$14.5 billion, while Russians abroad - for \$9.8 billion, which were 2.5 times higher than in 2005. According to the Russian journal "Mergers and Acquisitions", in Q1 2007, Russians bought assets abroad on \$1.97 bln (3 times higher than a year ago) and the total annual declared plans for foreign M&A's are about \$87 bln. Now Russia holds 3d place among countries with a transitional economy⁷. The most important examples: "Evraz"'s taking over Oregon Steel Mills company, the merger of aluminium companies "Rusal", "Sual", and Glencore (with establishment of one of the largest aluminium companies in the world "Rosal"), the M&A's in telecommunications, metallurgy, oil and gas industry with foreign capital participation. All this makes the Russian market one of the most dynamic. Thus, for example the Altimo Company ranked investing attraction of Russian cell-phone communication companies as the fifth in the world only behind Bangladesh, China, India, and Indonesia.

A boom in Russian IPO's has also taken place. By the end of 2006, about 80 Russian companies were at different stages of IPO, and their aggregate volume was expected to be around \$20 billion.

4. NEGATIVE TRENDS AND THE RISK ZONES

Speaking about *the model (the quality) of economic growth* in terms of competitiveness stages, Russia is currently at the stage of transition from resource-driven with all its limitations to the investment (efficiency)-driven (see Figure 1) with a still strong bent for the former stage. Economical and political models of modern Russian life have been moulded for quite a long period by growing oil prices. This meant that income growth from oil exports led to domestic demand expansion, which over recent years has become an important stimulus for economic growth. The change in this trend may lead to the changes of economic

⁷ *Vedomosty*, 13.03.2007, p. A3.

and political behavior of the players if oil exports income will start falling. Consumption growth will slow down, which will negatively affect the prospect of non-oil sources of growth. Budget income and economic agents' income will decrease, and the state will become unable to exercise control over the situation to the extent it does it now. It is obvious that the "cheap" growth of economy is coming to an end. Its temporary factors like rouble devaluation in 1998, high prices for export goods, free and vacant production capacities, low interest rates on the domestic market, and the relatively favorable situation in labor market will fail to work as did before.

The current economic situation does not look reliable enough. Among the reasons for low competitiveness of our country is its excessive dependence on world prices for small set raw materials. Current prices on many of them are currently much higher than their historical average levels, and the situation is most likely to change. The price decrease for main export goods will inevitably affect not only the budget system and exporting companies' results, but domestic demand as well. Also limitations on investments into resource development eventually could lead to a degradation and deterioration of environment.

Another problem of the old model of economic growth exists - its energy supply. According to all the forecasts, domestic energy consumption in 2008 will for the first time exceed the level of 1990 (the highest ever for Russia). With economic growth at about 7% in 2006, energy consumption increased almost by 5% (they are typically correlated). A question arises: what energy resources should provide further growth? The forecast of decreasing growth rate of oil and gas extraction do not give evident answers. In order to export and supply enough Russian consumers with gas within the next 25 years about \$340-420 billion of investments are needed, and to develop the power energy industry another \$420-540 billion⁸. The situation can be improved to some extent by the liberalization of gas and electric energy markets, and the respective government decisions that were made in 2006. This could level domestic and world prices for energy resources and could stimulate exporters to reorient themselves to the domestic market. So far, the priority of low prices is made void by high energy consumption. By this parameter Russia lags behind Europe as well as competitors from many developing countries.

⁸ *Vedomosty*, 29.03.2007, p. A4.

For instance, according to Russian Development Centre, energy intensity of GDP in China is 45.4%, and in India - 33% of Russian figure⁹.

Speaking about the model for economic growth, we can't but note another negative tendency - Russian citizens use the result of this growth very unequally. According to the Ministry of Economic Development and Trade, income disparity of 10% of the poorest and 10% of the richest has increased in 2006 from 14.9% to 15.3%. Even so, 10% of the poorest got only 2% from the general income growth, while the share of the richest 10% increased from 29.9% to 30.2%. In 2006 in Moscow the average income has grown by 22.8% up to 30,000 roubles (\$1,160) per month (with average in Russia R12,000 per month). However, the gap between the rich and the poor increased from 38 times in 2005 to 41 times in 2006 (in most European countries the normal disparity is 6-8 times)¹⁰.

Thus, if we would like to describe the results of the recent economic growth then I suggest to use the words of one of our well-known Russian economists, Leonid Grigoriev, who said: "The growth is present but with no happiness".

The state of Russian industry and its competitiveness causes serious anxiety. All major industries with the exception of gas have not reached the level of 1989. Less than half of this level has been reached by machine building, construction materials and light industries. The average index of industrial production is 62.5% of the 1989 level. Russian industry has real competitive advantages only in the oil and gas industries, some spheres of pulp-and-paper industry and metallurgy. Some advantages are in power machine building and some spheres of the military space industry. In general, according to the Russian Union of Manufacturers and Entrepreneurs (RUME), only about 20% of enterprises could be considered competitive on foreign markets. But the present tendency of industrial deterioration could capture their number to about 10-12% in the next five years.

The Russian economy is becoming less diversified. According to the Development Centre, last year's share of several dozens of key goods providing over 80% of industrial growth (raw materials, electric energy, products of primary processing) has been constantly growing.

⁹ *Commerzant*, 13.02.2006, p. 8.

¹⁰ *RBC*, 02.03.2007; *Commerzant*, 23.04.2007, pp. 1-2.

Export statistics confirm these figures - by the end of 2006, their share in total export was 68%. However, the competitiveness of Russian industry is getting ever lower due to higher wages and growing production costs¹¹. Russia's share in world export is only 1.7%, i.e. less than the share of Mexico, South Korea, or Spain. With the exception of exported raw materials, weapons and goods to CIS- countries the Russian share is scant - 0.2%. The share of high-tech exports is even smaller - 0.3%. Russia sells such products to a much lesser extent than Philippines, Thailand, Malaysia and China do. The latest develops 20 times as many innovative technologies, and its share is 0.6%.

The lack of resource overflow from raw materials to the processing sector results in Russia's further lagging behind leaders in technology. Increasing costs, decreasing contribution of processing industry to the GDP, lack of stimulus for national capital to investment into these industries, and the lack of modern large corporations capable to provide long-term growth and leadership in these sectors of economy all contribute to this downtrend.

Over the last years labor productivity in the processing industry has been growing, but its growth rate is lagging behind the actual wage growth rate, which leads to a relative decline of competitiveness. Since 1999, actual wages (deflated considering the producer price index) have grown by 72%. Now labor productivity in the processing industry is about 40% of Brazils level and only a third of South Africa level. And though labor productivity in Russia is higher than in India or China, a Chinese workers wages are 30% lower than that of Russian workers.

The volume of trade in electronic devices by Russian companies - a standard indicator of their inclusion into the global production chain is much lower than in China, India or Brazil. According to studies of the Higher School of Economics (HSE) in Moscow, less than 35% of Russian non-resource sector manufacturers export their production beyond the CIS¹². The majority of Russian private enterprises are still characterized by a non-stable production basis, unsteady market, dependence on the world market, and political instability.

¹¹ *Commerzant*, 11.10.2006, p. 8.

¹² *Vedomosty*, 18.12.2006, p. A4.

According to other research by HSE, almost half of Russian enterprises (about 1,000 large and mid-size processing industry companies were studied) can state that their products are almost out of any competition. Hence, they lack motivation to develop or improve quality of their production. 20% of these companies lack strong competition, other 29.7% compete only with other Russian companies, while one third of the latest sell only in their region of basic location and engage only in price competition. Only 12.7% of all companies studied compete with foreign companies¹³. The World Bank study revealed that only 10% of the businessman surveyed regarded Russian companies as competitive in the world market.

Next in the sphere accumulating negative tendencies is **education and science**. Now Russia spends about 5.9% of GDP on education (e.g. in Czech Republic it is 11.3%). In Soviet times, the USSR entered the top ten of most educated countries in the world. Now Russia ranks lower than the 100th place, according to UNESCO. Illiteracy has become threatening. According to the Education Fund of the RF, over 2.2 mln. children never attend school. For each one new school, there are 100 old schools closed. There is a lack of textbooks; their quality is insufficient and do not meet requirements of modern society. Only in recent years has there been large-scale computerization in schools within the national educational project.

Traditionally, Russia holds one of the leading places in the world with a population with higher education (over 50%). Though Ministry of Science and Education of the RF reports that within the period of 1995-2006, the number of students increased from 2.8 mln. to 7.3 mln. and the number of qualified graduates increased from 395,000 to over 1 mln., there still remains a serious problem of their quality corresponding to the new goals and demands of business and state governance.

The system of high-quality higher education has been built in Russia, particularly in engineering and technical fields. In the 90s technical simplification of the Russian economy and pressing social problems caused a huge brain drain from the country, job reorientation of many former researchers and engineers, disqualification of scientific

¹³ *Vedomosty*, 26.07.2006, p. A3.

personnel, and a lack of qualified teaching staff. It means that one of the main competitive advantages of the country was undermined.

In 2006 the World Bank placed Russia in the 11th place out of 25 Eastern Europe and post-Soviet countries according to the level of knowledge, because the country fails to cope with converting scientific research into profitable products¹⁴. With all that, the Russian Ministry of Foreign Affairs indicates that 12% of all scientists in the world live in Russia¹⁵. While the share of scientists in Russia is similar to that in Germany, their labor productivity (according to value added index per one person engaged in industry) is much lower than that in China, India and Brazil¹⁶. Besides, we have a pressing problem of deficient financing for science. Thus, the annual budget of the Russia Academy of Science (RAS) is close to the budget of an average American university, keeping in mind that 100,000 researchers work for RAS.

Business innovation activity. Consequences of this decline are affecting business. According to studies of the Russian processing industry conducted by the World Bank in 2005-2006, over a third of the companies leaders surveyed told about decreasing qualifications of their personnel over the period 1996 to 2005. Only 10% of companies could improve their employees' qualification¹⁷. In 2005, every fourth company suffered a lack of well-qualified staff. According to other expertise, in 2006 this problem concerned as many as 32% of such companies. And they are speaking not just about managerial staff, but primarily about technologists, production engineers, and specialists in machinery¹⁸.

According to the survey conducted by The Association of Russian Managers in March 2007, 53.2% of company leaders interrogated believe that an innovation growth in the Russian economy is almost impossible under the present conditions of dependency on raw materials. Just 8.5% of them believe that it is possible only with significant government endorsement¹⁹. Experts note two possible explanations of

¹⁴ *Commersant*, 06.09.2006, p. 8.

¹⁵ "Commersant Business Guide", *Innovation*. 19.04.2006, p. 27.

¹⁶ *SmartMoney*, 07-13.07.2006, p. 8.

¹⁷ *Commersant*, 13.10.2006, p. 8.

¹⁸ *Vedomosty*, 08.02.2007, p. A3.

¹⁹ *Commersant*, 19.03.2007, c. 20.

businessmen's scepticism concerning the innovation-driven model of development. They believe that either the whole matter will shift to the military-industrial sector or that we will not be able to implement this model due to the lack of qualified staff at least in the near future. Hence, their suggestion is to start with massive support of education.

Innovation activity in Russian companies is extremely low. According to the OECD, non-state expenditures on R&D are less than 0.5% of GDP (2.0-2.5% in developed countries). According to the World Bank, Russian enterprises spend 2.6% of their turnover on R&D, while Brazil - 3.1%, India - 3.9%, and China - 5.9%. Russia is essentially backward in the number of international patent applications submitted. Thus in 2005, only 500 inventions were patented (45, 111 in the USA) less than in 2004, while growth of inventions in China was 43.7%. Experts believe that only 10-20% of Russian enterprises can be considered innovationally active.

A serious problem is effective implementation of innovations in business. Company leaders believe that the main reason for such a situation is inefficient state support and regulation, first of all tax regulation. For instance, it was revealed that the increase of the efficiency in the largest Russian companies was not supported by innovations, but rather by market conditions and situation, by selling a non-core assets or just by mere cost reduction²⁰.

As mentioned above, in 2006 Russia experienced the IPO boom. At the same time a major motivation for many of them was the idea of some insurance mechanism (growing number of shareholders and fixed market price in case of business exit), rather than of obtaining additional money for further innovative development. In 2006, in the course of the IPOs the Russian companies raised about \$17 bln. Even so, Rosstat (the Russian statistical agency) reports that only 14.7% of the funds acquired were invested in fixed capital and innovations²¹. We can suppose that the bulk of funds go to pay off debts and purchase assets.

With all the positive development factors of big business in Russia, its reputation still fails to correspond to its relative economic success. According to the index of corporate governance, evaluated by the World Bank, Russia holds rather low positions as compared to other

²⁰ *Commerzant*, 06.09.2006, c. 7.

²¹ *Vedomosty*, 09.04.2007, p. A4.

countries with a similar solvency level. As follows from many trustworthy studies, western business leaders are anxious about the low level of corporate governance, transparency and business ethics in Russia, though some progress is evident. World corporate governance standards (including that of social corporate responsibility) have been introduced rather slowly. According to S&P, 76% of 75 studied Russian well-known companies have an audit committee, only 20% of them have independent Board of Directors, and 77% make their financial statements in accordance with international standards²².

As for business risks PWC organized a survey of 51 Russian top managers represented in the list "Expert-400" and Forbes-200. It showed that despite the fact that 84% of them gave optimistic forecasts for their business and expressed awareness of their growing incomes within the next three years, most of them see as the worst risks for their future the lack of high-qualified staff (76%), excessive control of business (65%), and political instability (57%). Only 10% of them confirmed the acquisition of assets abroad over the last year (27% in the world and 20% average in BRIC), only 12% are planning such M&A's. 90% would like to attract foreign investments, but for 77% of them this would mean rather their enhanced international presence, for 48% - access to technical and organizational innovations, for 34% - managing political risks, and for 17% - exit from their current business²³.

The quality of institutions demonstrates clear negative dynamics. Some experts believe that in 2006 about 65% of all score points, which Russia didn't get in the rankings, were due to risk factors related to institutional practice. This opinion is shared by all most reliable experts groups: Freedom House, WEF, Oxford Analytica, Transparency International, Heritage Foundation²⁴. Repatriation of capital from abroad rather than domestic investment activity is caused by low institutional quality, high risks and poor protection of property rights. This kind of market model is obviously far more speculative than strategic and is not intended to industrial development, innovations and productivity growth.

²² *Vedomosty*, 23.04.2007, p. A4.

²³ *Vedomosty*, 15.03.2007, p. A1.

²⁴ *Vedomosty*, 09.04.2007, p. A4.

The number of administrative staff at all levels is constantly growing: from 2001 to 2005 state administration increased from 377,000 to 593,000 people, mostly in the regions. In 2006 alone the number of officials grew by 7.9%. Engagement in the economy did not change significantly. The comparison of dynamics of the number of officials and dynamics of the GDP in the state sector indicates that labor productivity in this sector fell significantly²⁵.

Corruption is growing concurrently. *Indem Fund* studies indicate that within 2001-2005 business-related corruption multiplied many times. The absolute amount of bribery multiplied 13 times. Some estimates show that in 2001 officials' total annual corruption income was \$33.5 bln., but in 2005, it was \$316 bln. As compared to annual companies' turnover, these figures were 6.3% of the turnover in 2001 and 30.8% - in 2005, i.e. the figure multiplied almost five times²⁶. Increased corruption is a direct consequence of bureaucracy machine growth.

Thus there is an obvious contradiction: the market evaluates Russian economy rather high, while institutional examination gives negative estimates. This mostly follows from the fact that the efficient state has not yet been built, while its ever-growing weakness, non-competence and corruption are dangerous trends for modern Russia. The competitive sector of the Russian economy has been shrinking over the last years. RUME indicates that the state share in stock market capitalization increased by 50% up to about one third of the whole market cap (\$190 bln. in the first six months of 2006). State companies hold over a half of Russian corporate borrowings²⁷. According to the estimates of Alfa-Bank - one of the leading private banks in Russia, the quoted stock of the Russian government corporations at the beginning of 2007 amounted to \$369 bln. or to 35% of 2006 GDP²⁸.

At the same time there is no conception or any efficient system of state regulation in the economy, especially aimed at active modernization. Still a lot is open to question regarding the state. Is it able to govern efficiently, to provide enough security, to stimulate

²⁵ *Vedomosty*, 24.04.2007, p. A3, 17.04.2006, p. A4.

²⁶ *Vedomosty*, 12.07.2006, p. A4.

²⁷ *Commerzant*, 19.04.2006, pp.1, 8.

²⁸ *Vedomosty*, 22.03.2007, p. A4.

competitiveness and innovations, to guaranteed the property of minority shareholders, to decreasing corruption, and many other things.

Serious negative tendencies develop in **demography**. With the present demographic trends the Russian population will inevitably decrease to 125 mln. by 2020 (for September 2006, it was 142.3 mln.) Substantially growing pressure on the social system, first of all on healthcare and provision of pensions that are still far from being effective, will cause population ageing. The year 2007 will be a turning point; in that it witnesses the growth of the specific weight of elderly people and the relative decrease of people capable of working. According to the Institute of Social and Economic Problems of Russian Academy of Sciences, over the last years the number of crippled people increased by 1 mln. annually and has already reached 10 mln. people. The proportion of working people to pensioners is constantly worsening with the forecast as 1.5 to 1.0 by 2008²⁹ Rosstat forecasts that the number of youth aged 17-20 will fall 1.5-1.7 times³⁰.

Long-term observations show the following negative tendency - in the European part of Russia, the population has been decreasing by about 1% per year but with migration from other countries and regions ever growing. If the tendency remains, by 2010 migrants and their relatives may constitute a majority of Russia's population. The years 2010-2015 may witness the work force deficiency. This will first affect the well-developed regions of the country. Growing wages may undermine competitiveness; early employment may undermine educational quality; and migration from other regions may undermines traditional cultural environment.

5. DEVELOPMENT SCENARIOS AND STRATEGIES

A comprehensive analysis of Russia's economy development scenarios is not the subject of this article. However, we suggest to look at just one of the three basic concepts prepared by the group of independent experts headed by Leonid Grigoriev for the future Presidential election in

²⁹ *Nezavisimaya Gazeta*, 25.10.2006.

³⁰ *Vedomosty*, 18.04.2007, p. A4.

2008³¹. Their report suggests four possible strategies for the years 2008-2016 with a different focus, and with social and political coalitions needed to support and implement them.

The first strategy is called *Rentier*. It stipulates an increase of the income level using the natural resources factor for growth but to the detriment of long-term development. Another option is called "*Mobilization*", and it deals with massive government investment in infrastructure and in some targeted strategic industries with more government control over them. The next strategy is called "*Inertia*", and it's actually what Russia is doing now with some consequent and steady changes and with securing stability. Finally "*Modernization*" seems to be the reasonable balance between the consumption of resources for development and long-term stability with strong emphasis on innovation-driven factors, and with a strong interaction among government, civil society and business. This is what most of the liberals in Russia supports and what is at least declared in some of the official documents and speeches.

Now let's briefly look at these strategies in terms of Russia's competitiveness perspectives and try to focus on their essence, both positive and negative.

The Rentier Strategy actually means to keep and increase social obligations and government spending with the help of natural rent. It may increase the number of wealthy people and the middle class as well as the demand on the internal market for both imported and Russian goods. Thus the competition is increasing and it may positively effect the quality of Russian consumer goods and services with some new impulses for the development of these sectors.

The basic negative aspect about this strategy is that it absolutely corresponds to the resource-driven stage of competitiveness with all its static competitive advantages, number of limitations and risks. For example, its financial base is very limited and unreliable which means some high risks for the future social stability in case of the unfulfillment of the declared obligations. This strategy does not put forward the issues of modernization, institutional and structural reforms and innovations. The world experience evidently shows that the country

³¹ "Russia in the Years 2008-2016: the Scenarios of Economic Development", RIO-Centre, Moscow, May 16, 2007 г (www.riocenter.ru).

can't accomplish the breakthrough relying only on the natural resources and Russian economy, as we have seen already, has reached the limits of its previous growth.

The possibility of this strategy according to expert estimations is 20%.

The Mobilization Strategy intends to implement an active government industrial policy ("industrial targeting") and ensure growth of the government sector with relatively smaller social obligations as compared to the first instance. This strategy will focus on those sectors and industries that will secure and develop relatively high technological level (mainly resource- and infrastructure-oriented industries, partly high-tech with still strong military and space emphasis). It will increase investments in these sectors including growth by the government in financing R&D. These industries could serve as drivers for further massive modernization. But in this case the consumption sector in the near future will stay underdeveloped. Of course this strategy could change somehow the global positioning of Russia, but it has several negative sides.

First of all, it has huge administrative costs and thus the high possibility of non-economic methods of governance (administrative targeting) with ineffective management and distribution of resources, continuing corruption, unstable sources of financing since the major export base is still natural resources.

The possibility of this strategy working is also estimated 20%.

The Inertia Strategy is politically neutral, pragmatic and safe. It combines elements from all other strategies with by-sectorial (targeted) approach to modernization and with slow and steady changes (both economic and social) under government control.

The weak part of this strategy is its slow character in a very dynamic world playing a different game on a different field. This will eventually lead to the growing gap between Russia and other advanced countries in terms of productivity, competitiveness, and quality of life. This strategy is sensible both to resource-related factors and to the priorities' choice. It can also conserve the existing administrative practice and preserve the present bureaucracy.

Being rather convenient and easy for everybody this strategy is considered most probable for achievement with possibility at 50%.

Finally, *The Modernization Strategy* means a rather radical shift to innovation-driven economy with new institutions, efficient government regulation of the economy, the increase of competition and entrepreneurship, development of the human capital, and finally, the new quality of life in the country and its new role on the world stage.

The benefits of this strategy, especially in the long-run, are quite obvious. However, modernization, being a national project, first of all needs modernization of the national state itself since without active government involvement this kind of project is not feasible in Russia. On the other hand, it seriously increases the difficulties of its implementation since it needs complicated coalitions of government, business and civil society, the development of social mechanism which will allow to overcome resistance to change, and it needs various compensation schemes for different interests groups. Other difficulties are connected with long-term planning and return-on-investment horizons. This will also require strong political will and consistent efforts by the government in many "new" sectors of its activity, as well as new administrative staff. Finally, there is a need for major socio-cultural modernization (modernization of the values), which is critical for Russia with its historic and cultural tradition, mentality and ethical heritage. That's why the probability of this strategy is evaluated lower than others (just 10%).

In principle all four could be implemented and even now we can identify the forces and political figures behind them. Of course at the moment it is difficult to say which scenario will be chosen. Currently we can see the elements of first three strategies but the basis of growth is still the same - the natural resources - although the investment statistics in the major Russian industries in the years 1999-2004 show some shift of the priorities from the oil and gas sector to communications, transportation and trade³². As it is stated by Director of the Institute for Energy Policy, V. Milov, only the countries with relatively small population (less than 50 m people) are able to convert incomes from their oil and gas sales to a high level of GDP p.c. To achieve this goal, the larger country has to export at least 40-50 tons of oil equivalent per capita, while Russia is currently exporting just about 3 tons p.c.. And given the present level of Russian energy export, the country is able to implement just a limited number of high priority national projects. It has

³² *Commerzant*, 17.05.2007, p. 2.

been calculated that the amount needed to implement such major declared national projects like housing, health care and education is much higher than that accumulated in Russian Stabilization Fund even if provided for its increase with the same growth rate as over the last years. But it's hardly possible to maintain this trend with the oil prices going down, decreasing growth rates of oil extraction from 10% annually in 2002, to 2% in 2006, and decreasing annual oil export growth rate from 13% to 0.3% and gas export growth rate from 6% to 2.5%³³. The large-scale modernization of the country is not possible using this limited amount of sources. In other words the larger countries have to involve other factors besides energy resources sales.

The Russian government is trying to find other ways to answer the challenges of globalization and openness of the country to the world market, especially connected with the entry of Russia into the WTO. To play the global economic game and to be competitive on the world market you have to be large enough. That's why enlargement is taking place everywhere: in industries, in production companies, in banks, in regions, in universities, etc. But several questions remain: is it a right strategy, is it sufficient, and where are the limits of such enlargement?

In business there are a lot of examples. Enlargement under the government roof has started in the energy sector when the oil company Rosneft actually acquired most of the former YUKOS' assets and became the largest oil company in Russia in terms of market capitalization. Then it was gas giant Gazprom (the second in marcap world gas company). At the end of 2006 it was announced about major M&A in the aluminium industry (Rosal), in February 2007, the new United Aircraftbuilding Corporation was established with total assets of about \$4 bln. Other examples are United Shipbuilding Corporation and coming up soon Atomenergoprom (as part of Rosatom) - united nuclear production corporation with both civil and military sectors of production, Rosoboronexport - military export corporation, and Nanotechnology Corporation.

The logic of this strategy goes hand-in-hand with other major world competitors and is quite obvious in general. Even some well known western businessman explain such a strategy. Thus H-J. Rudloff, Chairman

³³ *Commersant*, 06.09.2006, p. 7.

of Board of Barclays and a member of Board of Rosneft suggests that we have to recall post World war II experience in Europe when one of the major economic drivers of that time were large government corporations, which could adequately compete and attract large-scale investments and know-how. But still the question remains regarding their growth potential and further strategy, management efficiency and innovation capacity in a long-run.

It is interesting to note that the majority of Russian senior managers (72.3%), according to the survey organized by Association of Russian Managers, consider the consolidation of government assets in various industries as a way to strengthen its control over the economy. Just 42% of them believe that the major goal is to improve their global competitiveness, while 24.2% believe that the goal is to reduce costs and improve efficiency of production in a given industry. More than half of the managers surveyed (51.5%) also believe that the state as a primary owner is inefficient. But private M&A's especially in the energy sector, machine building and transportation sectors seems to be quite reasonable³⁴.

In general there are two principal mechanisms of ensuring the global competitiveness of the big national companies: (a) integration of the national firms in the global technological and production chains of existing global business, and (b) building its own global oriented companies and networks, which could play more aggressive and independent game on the world market. With all limitations of state involvement mentioned above, the last option is hardly possible without some state support (regulatory, political, humanitarian etc.) and consistent government policy. But the last one is highly dependent on decision-making practices and policy implementation. Putting it shortly, what we need are another state and another governance.

From my perspective, speaking about priorities, we have to think not of concrete industries as a special targets but about "problem or risk zones" on one hand, or "opportunity zones" on the other with more emphasis in both of them on the new adaptive mechanisms in the society. That's why for certain we have to focus on the human dimension of further growth (on human development factors) as well as on institutional transformations.

³⁴ *Commerzant*, 13.04.2007, p. 20.

Some of the ideas of this kind were already stated by high level government officials and were reflected in the new state budget for the next three years. Thus at the last World Economic Forum in 2007, First Deputy Prime of the Russian Federation Dmitry Medvedev, looking ahead, said, there are three "keys to our future": diversification of the economy and export potential, the creation of modern infrastructure, and the building up human capital³⁵.

All these ideas have been actively debated by politicians and experts during the last year. At the international conference "Modernization of the economy and social development" which took place in Moscow in April 2007, the general message was as follows: exports in the present structure as the major resource of economic growth is exhausted and a new more liberal policy and reforms are urgently needed³⁶.

6. NATIONAL COMPETITIVENESS: INTANGIBLE THINGS MATTERS

Speaking about national competitiveness and visionary changes in the positioning of some countries in the worlds comparative rankings over the last decades a number of experts raise an essential question: why do some countries initiate changes, implement them in a relatively short period of time and decrease their gap with the world leaders or even be already among these leaders in some industries, while others doesn't change over decades. To explain it we probably have to address the notion of "intangible assets", which in our case first of all means the socio-cultural environment in a given country. These factors are not included in the ratings themselves, since they are very difficult to formalize and quantify. But as the American journalist Thomas Friedman in his bestseller "The World is Flat" (2005) said it is ridiculous to avoid their influence. At the first stages of our reforms in the 90-s these factors were almost neglected, and it was certain that easy decisions could be found. Now many Russian high level experts talk about them in a very different way.

³⁵ <http://www.weforum.org>, 12.03.2007.

³⁶ *Commerçant*, 05.04.2007, p. 2.

Three primary qualities of a society are important:

- culture (how *outward* - open to foreign influences and ideas and *inward* it is - focused on development, trust and mutual respect in the society);
- the ability to develop;
- the leadership with the vision of development and the willingness to use power to push for change rather than to enrich themselves and preserve the status quo.

When it became clear that beyond natural resources, economic and technological potential of a country specific national environment (institutional, socio-cultural, political) seriously determine so called *social ability of a nation* to develop successfully, the whole approach to global competitiveness was changed and enriched. Looking back to the end of XIX century, the basic ideas of this approach are to be found in the works of German economist Friedrich List. Comparing technological opportunities of various countries at that time, he stressed the key importance of "mental capital", which accumulates former experience, knowledge, know-how and developing them. He also stated that the forces creating wealth (qualification, knowledge and education) is eventually more important than the wealth itself³⁷. In this respect we can also turn to the very actual words of the well-known Russian philosopher of XIX-XX century Nikolai Berdyaev who said in his famous work "The Fortune of Russia": "The goal of life of a nation is not good, wealth or well-being but creativity of values"³⁸.

Generally speaking social ability is based on national traditions, level of competence, the spirit of innovation, the ways to accumulate and develop human capital and the knowledge base, as well as on society's vision of its future and the ability to convert this vision into the real policy and action, which will allow this society to build new values, reach the higher quality of life, ensure individual opportunities and social harmony. Thus to be a competitive nation, each country has to adapt its values to the present and future challenges and to make these

³⁷ C. Freeman (1987) *Technology Policy and Economic Performance. Lessons from Japan*. London, p. 65.

³⁸ N. Berdyaev (1990) *The Fortune of Russia*. Moscow.

values more productive in an economic sense. The culture here is treated as a wide phenomenon of society's life, reflecting individual aspirations of its members to ensure social heritage, reflect reality and challenges of the time, while preserving its basic national traditions.

The American professor Robert Reich has developed these ideas in the following thesis: the real competitiveness potential of a nation is not in possession of modern technology itself, but in the ability to fix and solve more difficult, large-scale and complex problems of the future. This ability is based on ethics, knowledge and qualification corresponding to the technological stage of the society³⁹. That's why the focus of world competition is shifting from goods and services to systems producing these goods, information, knowledge and know-how. The latest systems in this context are based on the production, managerial, corporate, and technological culture. This important statement suggests that it is impossible to solve the problem of competitiveness addressing isolated and limited number of key (visible) factors and criteria. This is the complex issue of national modernization and transformation. According to M. Porter, it is a marathon and not a sprint in which everything matters including culture as a basic dimension of a society.

Even with culture as a resource of development Russia is more close to a resource-driven stage of competitiveness. We are still more proud of our cultural heritage, but we don't use and develop it in a proper way for our future needs. In terms of a dynamic development, it can't be treated only as static resource almost without development mission. For example, if we take a look at Finland (currently the #2 country in the global competitiveness ratings), then we have to admit that the big part of its historical heritage was connected to the Imperial Russian with Finland being the part of it. But later the use of this heritage, besides many other positive and constructive things, was very different from that of Russia. In a cultural sense Russia is still one of the most influential countries in the world. But in the development of a new cultural values for the modern society it is lagging behind many other far smaller and less wealthy countries. Culture can be strategic resource of Russia only if it is connected to education, knowledge-base enlargement, productivity growth, innovations in a broad sense, and development.

³⁹ R. Reich (1991) *The Work of Nations*. N.Y., p. 174.

Thomas Friedman also put forward several other important theses in this respect. Russia as well as several other countries with transformational economies, has implemented so called *wholesale reforms* - standard macroeconomic and institutional recommendations applicable to every country in transition ensuring stability and initiating growth. Now its time for fine tuning or *retail reforms* - taking into account national specifics, negotiating of various interests, and building coalitions. They are far more difficult to implement, but without all these matters further modernization of society is impossible. It seems that the lack of retail reforms as well as lack of political focus and strong will explains the Russia's lag behind some other post-Soviet countries as well as other developing countries.

At the moment, Russia is at the crossroad. As a famous Russian diplomat of the XIX century Alexander Gorchakov once said "Russia is concentrated". It is developing its national agenda. But despite the chosen scenario and strategy after the 2008 Presidential elections the issue of national competitiveness will be the key issue for future development and the focus of the debate.

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