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Vladimir Kossov

National Research University Higher School of Economics, Moscow, Russia
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On Economic Sanctions, Okun’s Misery Index, Male Premature Mortality, and Possible Directions of Small Enterprise Development in Russia

VLADIMIR KOSSOV
National Research University Higher School of Economics, Moscow, Russia

The article studies the possible measures to increase the sustainability of Russia’s economic development on the background of current hostilities with the West. I argue that the development of small enterprises can assist to overcome the worst consequences of sanctions—the fall in male life expectancy as the analysis demonstrated a strong relationship between the share of small and medium businesses (SMEs) in the national economy and the life expectancy of males. Several suggestions on how to increase the share of SMEs in the Russian economy are proposed.

KEYWORDS econometrics, economic development, economic sanctions, Okun’s misery index, Russia, small business development

INTRODUCTION

Russia’s current hostilities with Western nations accompanied by economic sanctions and bumbling “retaliation measures” have demonstrated the vulnerability of large Russian state-owned and “state-connected” corporations and the overall fragility of the Russian economy. Currently, both local analysts and international development agencies are competing with one another in presenting different versions of despondent scenarios for Russian economic development. A relatively modest outlook presented by the European Bank of Reconstruction and Development forecasts an increase in inflation by 2 percentage points and a fall in Russia’s gross domestic product (GDP) by 0.2% (see EBRD 2014). However, an extremely pessimistic
scenario proposed by Sberbank does not rule out the fall of Russia’s GDP by 8% in 2015 if the “tooth-for-tooth” spiral of mutual blows continues (see Anonymous 2014).

This study aims to explore the possibility of implementing “robust strategies” of economic development that can be applied in all the scenarios to strengthen the sustainability of the national economy. To achieve this goal, I first summarize the current landscape of the Russian economy, identifying the significant “inhabitants” and its main features, including the visible lack of “small species” (SMEs). Second, I present an econometric analysis of the relationship between Okun’s misery index, male life expectancy, and the share of employment in SMEs in the total employment among a range of countries, including Russia. This analysis reveals the significance of SMEs not only for developing and maintaining a healthy economy but also for the individual welfare. The final section identifies feasible measures to change the current economic landscape of Russia and make the national economy sustainably stronger.

THE CURRENT LANDSCAPE OF THE RUSSIAN ECONOMY

The current landscape of the Russian economy resembles the drying savanna of East Africa. To extend the analogy, a few remaining tall trees located at rare sources (the rights for oil and gas reserves; gigantic state-backed infrastructure projects) provide food for giraffes (the largest state-owned monopolies in the energy sector, other state-owned natural monopolies, a few groups of government-beloved businessmen called “oligarchs”). These groups represent the only species that can reach the succulent shoots at the very top of the tall trees. Weak-sighted and thus incredulous, rhinos (the state-owned corporations of the military complex) occupy either the banks of seasonal rivers (export contracts) or rare, small, and quickly drying ponds with remnants of greenery (state contracts). Both species have no natural enemies within the ecosystem and multiply until they exhaust all available resources. Nearby, wily and impudent baboons (subsidiaries of foreign multinational corporations [MNCs]) dig for edible roots. Surveying vultures seeking carrion (local banks that are taking over bankrupt companies for further partition) fly above. Bevies of aggressive hyenas (numerous pedantic state inspectors) gnaw pieces of weakening, isolated fallen animals and generally avoid the imposing baboons. The grass is trampled, and shrubs are hard to find. Gazelles and smaller species either hide from the excited hyenas or hibernate for indefinite periods.

The constituent elements of the present economic landscape were described in several recent studies. Indeed,

- The state-owned corporations are inflated and inefficient (Gavrilenkov 2013).
• The share of state-owned corporations evolves along a U-shaped curve—after total state ownership in 1987, it decreased to a minimum in 1999 because of privatization. Since 1999, state ownership has rapidly increased (Pappe and Antonenko 2014).

• State support to small- and middle-income businesses contradicts state fiscal interests and is considered benevolent philanthropy by the government (Borisov 2013).

• Bank credits, unless granted to confidents at artificially beneficial terms, are perceived in Russia as testimony of poor financial performance of a company that lacks its own development resources. The basic interest rate of Russia’s Central bank is 8%, the effective rates for credits for legal entities are 12% to 14%. An interest rate of 16% on an individual bank loan is perceived as considerably low (Dmitrieva 2013).

• The young generation is increasingly occupying state-owned and state-connected executive positions. These young executives represent the offspring of high-level governmental officials. The elite view the movement as a positive one. A glass ceiling is evident for young ambitious employees who have no direct relatives among top governmental officials or oligarchs (Sagdiev 2014).

The economic sanctions have already affected the behavior of the aforementioned species. With the restrictions on access to foreign finances for “giraffes,” they became more creative in finding new areas of “greenery.” The largest state-owned company, Rosneft, impacted by the sanctions, recently applied for a $35 billion aid support package from the National Wealth Fund that is financed by earnings from oil exports. The state-owned railways that are not impacted by the sanctions imitated this approach and recently applied for state aid, too. Contracts to build a gigantic $30 billion pipeline to China from the gas fields in Eastern Siberia are offered to corporations whose owners are listed as subject to Western economic sanctions. Packs of aggressive hyenas (state inspectors) started to attack baboons (Russian subsidiaries of MNCs), as they seemed to become easier targets. The overall biomass per square meter is shrinking. The ecosystem is rapidly deteriorating. As a result, for our own surprise, the situation with SMEs in Russia in the first half of 2014 does not differ much from that in the first half of 1991 (the last months of the USSR). The employment in SMEs (individual entrepreneurs, cooperatives, leased enterprises) in the first half of 1991 was 15.5% of the total employment (RSFSR 1991); at the end of 2013, the employment in SMEs in Russia was 14.1% of the total employment (Saydullaev 2014) while the GDP (in constant prices) in the first half of 2014 was around 98% of the level of the first half of 1991.

The long-term effect of sanctions, as evident from Iran’s experience, is a combination of high inflation and high unemployment (Mansury 2014). A high level of unemployment is the consequence of an insufficient growth
rate. Contrastingly, high inflation has been considered a barbaric form of wealth expropriation. The sum of the annual inflation rate and the average annual rate of unemployment is called “Okun’s misery index” (Nessen 2008). In 2013, Russia was ranked 36th in the global misery index, mostly because of the effects of high inflation (Hanke 2014). The forecasts for 2015 see Russia is moving down to at least the fifties in the rankings.

**OKUN’S MISERY INDEX AND MALE LIFE EXPECTANCY**

To analyze the potential fundamental consequences of economic sanctions, we decided to search for publications that connect Okun’s misery index with fundamental social problems such as decreasing male life expectancy. The basis for such a connection is the fact that decreasing male life expectancy in transition countries, including Russia, is a common phenomenon (Picks et al. 2013).

To our surprise, SCOPUS, EBSCO, and Google scholar do not contain publications that embrace “life expectancy” and “Okun’s misery index.” This situation demonstrates the wide divergence of these scientific fields—Okun’s misery index is studied by economists and sociologists, while life expectancy is the domain of demographers.

To find the possible connections between the two parameters, we constructed a test regression model using male expectancy as a dependent variable and Okun’s misery index as an independent variable. The model included six large countries (France, Germany, Italy, the United Kingdom, Iran, and Turkey) with a total male population of 200 million and four observation points: 1995, 2000, 2005, and 2010. The source for data on employment levels and inflation was the Word Bank (2014). The results were not straightforward. On the one hand, one percentage point of Okun’s misery index results in a decrease of male life expectancy by 0.17 years, and the results were statistically valid ($R^2 = 0.70, p = 0.00$). On the other hand, excluding Iran from the model made the regression model statistically invalid ($R^2$ was merely 0.001). Further, at several observation points, male life expectancy in Iran resembled that in Turkey. This allowed us to develop our first hypothesis: The dramatic increase in Okun’s misery index in particular years has long-lasting effects that can be revealed by the deficiency in male life expectancy in the following prosperous years (the male life expectancy in these years will be low, as predicted by Okun’s index). For example, the life expectancy for males in Russia decreased by 3.7 years between 1992 and 1995 (the period of very high—two- and even three-digit—annual inflation rates, and high unemployment). Despite the good economic conditions in 2000–2006, the 1992 life expectancy level was reached only in 2007 (The World Bank 2014).

To test our hypothesis, we constructed a model that includes 28 countries: 15 countries of the former Soviet Union (Armenia, Azerbaijan,
Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan), 6 European countries of the former Soviet block (Bulgaria, the Czech Republic, Hungary, Poland, Rumania, Slovakia), and the Islamic Republic of Iran as a country that has suffered and is still experiencing economic sanctions from the West. The reference group of countries for which we assumed a “normal” relationship between male life expectancy and the misery index are France, Germany, Italy, Turkey, and the United Kingdom. The results of modeling are presented in Table 1.

For all the evaluated transitional economies with two exceptions (Czech Republic and Armenia) the observed life expectancy of males was lower that the expected one, using Okun’s misery index as a predictor and the average data for misery index and males life expectancy in reference countries (France, Germany, Italy, Turkey and the United Kingdom).

The greatest difference between expected and observed male life expectancy was found for Turkmenistan (13.79 years), and the second greatest difference was found for Russia (13.45 years). The European countries of

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficient</th>
<th>Standard error of coefficients</th>
<th>p level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>73.77</td>
<td>0.52</td>
<td>—</td>
</tr>
<tr>
<td>MI</td>
<td>−0.02</td>
<td>0.01</td>
<td>0.01</td>
</tr>
<tr>
<td>Year 2010</td>
<td>1.98</td>
<td>0.57</td>
<td>0.00</td>
</tr>
</tbody>
</table>

Fixed Effects = the deficit of male life expectancy

- Armenia
- Azerbaijan
- Belarus
- Bulgaria
- Czech_Rep
- Estonia
- Georgia
- Hungary
- Iran
- Kazakhstan
- Kyrgyz_Rep
- Latvia
- Lithuania
- Moldova
- Poland
- Romania
- Russian
- Slovak_Rep
- Tajikistan
- Turkmenistan
- Ukraine
- Uzbekistan

Note: Number of observations = 96 F(22.76) = 19.4; Durbin-Watson = 1.93.
the former Soviet bloc that recently joined the European Union (Bulgaria, Hungary, Poland, and Slovakia) have the smallest negative difference between expected and observed male life expectancy (3.8 to 6.1 years). A small negative difference between expected and observed male life expectancy was found for Iran and Georgia. This implies that the new members of the European Union, together with Armenia and Georgia, overcame the transition shock, whereas most of the former Soviet Union still suffers from the transition shock. Further, Iran was able to counterbalance the worst effects of the economic sanctions.

**DEVELOPMENT OF SMALL BUSINESS AS A MODERATOR OF THE WORST CONSEQUENCES OF MISERY’S INCREASE**

When we analyzed the peculiarities of the countries that were able to overcome the transition shock, we found that those countries (including Iran) have a relatively high share of employment in the SME sector (up to 70%; IFC 2014). Thus, we formulated the following hypothesis: The higher the share of employment in SMEs in the total employment, the lower in the difference between the observed and expected life expectancy of males. The initial data are presented in Figure 1.

To present the same data more vividly, we substitute the absolute share of employment in SMEs by a reverse indicator—the deficiency of employment in SMEs (taking 80% as the maximum possible level). It is possible to see the strong coincidence in the deficiency of life expectancy.

![Figure 1](image-url)

**FIGURE 1** Data on the deficiency of male life expectancy and the relative deficit of the share of employment in SMEs.
We should stress that the dependent variable is a non-observable parameter—the deficiency of male life expectancy. The dependency of that variable on the share of employment in SMEs is statistical, not functional. Thus, we abandoned the regression technique. To test this hypothesis, we performed an analysis of variance, denoting the difference between the observed and anticipated life expectancy of males as a dependent variable and the share of employment in SMEs in the total employment as an independent variable. The share of employment in SMEs accounted for 42% of the variance in the deficiency of male life expectancy ($p = 0.00$).

The real mechanism of such a positive influence of SMEs on male life expectancy can be presented as follows. First, SMEs, unlike large enterprises, are evenly spread across the country, thus decreasing the chances of existence of permanently depressive regions with high unemployment and no perspectives for males to feed their families. Second, development accelerates job creation in the economy because small businesses typically require less capital; thus, job mobility is easier. Third, employee selection procedures in SMEs are less formal and thus less stressful. All these factors—availability of jobs in every region, increased potential job mobility, and casual selection procedure—contribute to positive life attitudes of males that decrease depression, eliminate bad habits, and increase life expectancy.

The role of SMEs in economic development in both developed and emerging economies was stressed, not just in academic publications but also in numerous reports of international agencies.

**ECONOMIC SANCTIONS AS A WINDOW OF OPPORTUNITIES FOR SMEs**

I have proved the significant impact of the share of employment in SMEs in the total employment on male life expectancy. A natural conclusion of my analysis is that life expectancy of males in transition economies can be positively influenced by an increase in SMEs employment opportunities. A significant increase of the share of total employment for SMEs cannot be achieved through traditional small business support measures. Comparing the situation of SMEs in Russia in 1994 and 2008, Zhuplev and Shtykhno (2009) found low efficiency of traditional small business support measures in Russia.

The economic sanctions imposed on selected Russian companies and individuals in the first 9 months of 2014 have had a profound impact on the Russian economy. First, the sanctions intensified the negative international public image of several prominent Russian business individuals, including the CEOs of the largest corporations. Several important projects (such as the underwater gas pipeline South Stream) were obstructed. Second, the sanctions provoked the increase of capital outflow. Third, the sanctions
triggered inflation. Fourth, the sanctions exacerbated existing high levels of uncertainty. Thus far, the Russian government has attempted to overcome economic sanctions imposed on state owned enterprises (“beloved giraffes”) by offering direct state aid or launching new, gigantesque, state-supported projects such as the building of the pipeline to China, the erection of a bridge connecting mainland Russia and Crimea, and the revitalization of the 3,000-km-long railway in Eastern Siberia. However, government reserves are rapidly emptying: The pension funds are already frozen, new taxes are levied, and free basic medical insurance will soon disappear for a fourth of the Russian population (Ministry of Finance 2014).

There is no alternative for the Russian economy under sanctions than to embark on the development of small and, particularly, medium-size business. I foresee the rapid development of medium-size business within large companies in civil enterprises and the development of small businesses around military enterprises.

Business activity under extreme uncertainty is reminiscent of the traditional Russian practice of planting vegetables in open ground. There are distinct rules, which minimize the damage from uncertainty: the seeds of different varieties should be sown on different days. Adverse weather conditions (drought, hail, floods), pests, and plant diseases cause yield loss. Damage to crops depends on the phase of plant development during which a disaster occurs. Planting different varieties in different weeks reduces loss because, during the disaster, some plants are in the critical phase of their development, whereas others have not yet reached the critical stage.

This practice suggests several strategies for the development of business under extreme uncertainty:

- an increase in the considered options and scenarios;
- diversification—increasing the number of simultaneously implemented projects while decreasing the average size and the total amount of each project;
- adopting a piecemeal approach to project implementation; and
- maintaining individual project independence to the extent possible.

The ghost benefits of any possible economies of scale should be sacrificed to the visible benefits of the economies of scope. Thus, under large, local corporations, I anticipate the development of smaller, semi-independent business units.

Another important factor of SME development is the destiny of the rhinos (the enterprises producing armaments and ammunition). I predict that under economic sanctions, further “miniaturization” will affect Russian enterprises in the military industrial complex. In addition, their survival will depend on the growing presence of small “attendants.” Indeed,
1. The current trend in armament production is the shift from mass production of a limited range of standard weaponry into small batches of highly specialized military systems. Thus, companies in military industries should be (and already are) the conglomerates of semi-autonomous business units specialized in particular segments of military techniques.

2. The presence of precision-guided weapons makes large military enterprises highly vulnerable for any attack. Thus, large military production sites will be further disintegrated. This will further increase already substantial idle production and storage capacities. Since the early 1990s, such capacities were leased by small enterprises. For example, a giant explosives factory offered a significant portion of its shops to leaseholders and thus saved the factory from bankruptcy. Another example is Sapphire JSC, which specialized in electronic microchips for military use. Sapphire JSC created a technopark (Smetanov 2008). This should not be considered a sole example but a general rule of military enterprise conversion into SME hubs.

The general framework of the relationship between a military enterprise and an SME is presented in Figure 2.
The main reason for a technopark’s creation is to exploit the available idle capacities—the production shops, offices, and warehouses. Additionally, military enterprises are always located on isolated, well-guarded territory. To leverage and secure existing demand for new products, sufficient financial resources should be allocated as development grants and subsidies for start-ups and other residents of technoparks.

The benevolent behavior of “rhinos” toward the access of smaller species to water sources, that is, system design toward the involvement of SMEs in subcontracting and outsourcing for military production, R&D activities, and auxiliary services, is critical to the sustainability of Russia’s military industrial complex.

CONCLUSIONS AND PRACTICAL IMPLICATIONS FOR FOREIGN INVESTORS

We demonstrated that the SME share of total employment is central to the economy’s growth and the elimination of premature male mortality. The absence of SMEs in a settlement produces a ghost city in an economic desert. At best, the population is forced to rely on state pensions and subsidies, wait for further state benefactions, but avoid any entrepreneurial efforts.

The positive relationship between SMEs employment and male life expectancy is rooted in positive psychology of self-confidence and self-supporting males. Positive emotions are the best defense against stress that, in turn, leads to diseases such as alcoholism.

Early on in the paper, contemporary Russia’s economic landscape was compared to the drying savanna of East Africa that is conducive only to survival of giraffes (large, favored companies that are directly or indirectly controlled by the state). However, baboons (subsidiaries of MNCs) are not unfavorably placed. Local business communities accept their presence and dominance in particular markets; foreign companies have developed an effective technique of individual or collective defense against hyenas (state inspections and local raiders). Unsurprisingly, large businesses in France, Germany, Italy, and the United States serve as constraining forces on national governments with respect to imposing further sanctions on Russia.

Rhinos (state-owned companies in military industries) are nervous. The ban on exports to the West and deprivation of both long-term finance and advanced technologies from the West has revitalized interest toward in-house R&D and innovative organizational solutions including cooperation with SMEs. A significant portion of this cooperation may be conducted in technoparks and technocities using existing land, production, and storage capacities of large military complexes.
Currently, Russian SMEs are shrinking. We have indicated a fraction of possible measures that could reverse the trend. Additional features of the current economic situation create limited reasons for optimism:

- the continuous rhetoric of high-level governmental officials, concerning Russia’s upward movement in the global Doing Business ranking. (IFC and The World Bank, 2014);
- young professionals, particularly for medium-size cities, are striving toward entrepreneurship;
- there are several promising SME directional efforts that include green agriculture or cooperation to Russian diasporas in the West; and
- over the past 20 years, a system of business education (both state and private business schools) and young entrepreneurial networks has been created in Russia. Such schools and networks exist and can be accessed from all regions. The business school curriculum can be easily reoriented toward entrepreneurship.

The speculations presented in this study have implications for the further development of Russian subsidiaries of MNCs. First, under conditions of uncertainty, MNCs must undertake smaller projects by semi-autonomous business units. Thus, the current trends in the concentration of ownership structure of Russian MNC subsidiaries in large regional headquarters should be reversed. Russia’s subsidiaries should represent legal independent entities as was the case during the 1990s and early 2000s. Second, a superior way to overcome uncertainty is to develop SME “clouds” around MNC subsidiaries. One example of such a development is Swedish Oriflame, which created a system of multi-stage marketing to establish approximately 1 million micro-entrepreneurs through micro-credits and marketing advice (Proskurina 2013). However, Russian subsidiaries of MNCs should venture beyond network marketing. For example, car manufacturers should develop ready solutions and financial packages to install small independent specialized repair and service station; beer producers should support the development of brasseries, for example, by offering ready-design solutions or the wholesale lease of attractive premises for opening new brasseries. MNCs in Russia are capable of overcoming the current conditions of high uncertainty and increasing the life expectancy of their actual and potential customers. Sanctions targeting giraffes objectively reinforce other types of species, including SMEs. The Russian government should view the current situation as a rare window of opportunity to change the economic landscape and to increase sustainability of the national economy though increased diversity of active economic agents.

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