



SPIEF
review

NOVEMBER 2015

THE RESULTS

INTERNATIONAL CONFERENCE ON SECURING INVESTMENT GROWTH IN RUSSIA

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of the State Duma
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Straight talk



Speaking at the St. Petersburg International Economic Forum, Russian President Vladimir Putin covered a variety of topics, touching on virtually every major issue of recent months. *SPIEF Review* has published the head of state's key comments, as well as responses from the international audience.

On industry

We have taken decisive steps in a number of areas and the results have been marked. There is huge potential in our engineering sector, in petrochemicals, in the light and processing industries, in pharmaceuticals, and several other sectors.

A demonstrative example is the achievements of our agro-industrial sector.

Of course, our work in this area is far from done, but the fact remains that milk production in January–April 2015, relative to the same period the previous year, grew by 3.6%; butter production by 8.7%; cheese by more than 29%; fish and fish products by 6%; and meat by 12–13%.

Import substitution is not about closing your market and fencing yourself off from the global economy.

We must learn to produce high-quality products that can compete – not just on the domestic market, but globally. Essentially, our task now is to use our internal resources more fully and more effectively to drive development.

I say again: we are responding to external constraints not by closing, but by liberating our economy, and further opening up Russia for business. These are not just empty words; this idea is at the heart of current policy.

This includes ongoing efforts to create the right conditions for business, to look for new partners and open up new markets, and to be involved in bringing about large-scale plans for integration. I would like to point out that in the last year alone, more than 60 businesses with overseas involvement began operating on the Russian market.

Even over the course of this Forum there are several businesses being launched, including in St. Petersburg itself: a pharmaceutical enterprise, a gas turbine factory with foreign partnership – the list goes on.

I would like to thank those of our partners who, despite the well-publicized political problems we are experiencing, continue to work with Russia, to invest their capital and their technology, and to help create new businesses and employment opportunities.

On the business environment

A comfortable business environment is the most important condition for establishing a grassroots layer of non-commodity small and medium enterprises. This is the real way to achieve a diversified economy and job creation.

Our goal is the growth of small and medium businesses to the point where they are able to take on the domestic market and develop their export potential. To this end, we intend to closely link the work of industry support institutions with export stimulus.

I am referring to the recently-established Industry Development Fund, the Far East Development Fund, the Russian Direct Investment Fund, project financing mechanisms, and also the Russian Export Centre, which provides domestic companies with a whole range of services to support their products on overseas markets.

In addition to this, and in response to the wishes of the business community itself, we are setting up a corporation for the development of small and medium enterprise.



I support the statement of President Putin: it is high time to stop these sanctions, and I hope now that everybody in Europe has understood that these sanctions have hurt Europe substantially. If you look at the figures, for instance, within two years – 2014 and 2015 – Germany has lost 50% of its exports to Russia. Italy is losing only 10% of their exports in comparison with last year, so it looks quite good for them. So, the consequences in the different countries in Europe are totally different. We have no common interests in this respect. We have common decisions on the political level, but whatever the reasons and the backgrounds are, these are totally wrong. We also need to understand that Russia, in turning to the East, is doing something quite normal, because the East has a lot of opportunities to offer Russia. Do not forget, we Europeans, and specifically Germans, have strong connections with the Chinese, and extremely good business, and we are very pleased to work together with the Chinese, so why should Russia not do the same?

But the tragedy is in the fact that we have boosted that trend by applying the sanctions. We must move away from that.

Heinz Hermann Thiele,
Owner, Chairman of the Supervisory Board, Knorr-Bremse AG



Mumtalakat is a sovereign wealth fund of Bahrain. What do we want to ask about the Russian economy? I think the Russian economy is very promising, and the Russian economy has very solid fundamentals. I think when we look at the Russian economy from the outside, the Russian economy has a skilled workforce, and a very educated workforce in the country itself. In addition to that, they have the resources that everybody has talked about, coupled with the manpower that they have. On top of that, the Russian economy is a big market, and there is a bigger market around it, and that will make it much easier for us to attract these markets from within the Russian economy. These three components really make us feel very assured that it is a good market to invest in, and we think it will be a long-term investment that we can make.

When we go to a new market, we try to look for a partner that will enable us to work in these economies freely. I think, Mr. President, your initiative to set up the Russian Direct Investment Fund was a very comfortable and big step in that direction, because when we came in to invest in the Russian market, we found an institution that knows the market, that works very professionally, and that works very transparently.

Mahmood Hashim Al Kooheji,
CEO, Bahrain Mumtalakat
Holding Company

This will offer businesses essential financial, legal, and methodological support, including assistance in gaining access to procurement projects announced by the state and publicly-owned companies. In effect, we are consolidating our support mechanisms for small and medium enterprise, and expect it to make an important and tangible difference to the business environment.

On events in Ukraine

We have discussed events in Ukraine several times over, and I realize that there is no getting away from the issue. The thing is, it makes no difference whether we are talking about Ukraine or about another crisis in another country. A few years ago, it was all about Iraq, for example. We are always talking about what happened, but never about why it happened. If you want to talk about Ukraine – and it is evidently important that we do so – then this is exactly where I would like to start. How have we arrived at the crisis in Ukraine? I am deeply convinced that following the breakdown of the so-called bipolar world, when the Soviet Union disappeared from the political map, certain parties in the west (including and above all the United States) experienced a kind of euphoria.

Instead of using the new situation to build a neighbourly relationship based on partnership, they set about establishing new and – as they saw it – free geopolitical spaces. This was the starting point of NATO's expansion east, and the start of many other things. I have spent a lot of time thinking about why this happened, and I have come to the conclusion that, apparently, some of our partners were under the illusion following the Second World War that a certain world order had been established in which the Soviet Union played an integral part.

When the Soviet Union vanished, it left behind a vacuum, and there was a sense that this needed to be quickly filled.

This was not, in my view, the right approach to solving the problem. Iraq happened for largely the same reasons, and even in the United States there are many who think that mistakes were made there. There were indeed mistakes made in Iraq, as many acknowledge, and yet despite this, the same mistakes were repeated in Libya. Now we come to Ukraine. It is not we who are at the root of the crisis taking place in Ukraine. It was a mistake – and I have said this many times before – to support the anti-government, anti-constitutional upheaval and armed coup which, amongst other things, have led to violent conflict on Ukrainian territory amounting in effect to civil war.

On China

China's economy is growing. Anyone who has expressed concern over the falling rate of that growth should have had their fears allayed by what the Chinese Vice-Premier said: 7% is still the highest rate of growth in the world. It is not just Russia: the whole world is looking towards Asia.

Europe is also working to strengthen its relations there. In our case it is, as they say, as God intended: we are neighbours, and this is the natural course to take. Apart from anything else, there are certain values that both our countries have advocated for in the global arena, and to great effect. One of these is equal standing in the global decision-making process.

[...] We are not by any means seeking to join forces with China or any other country in order to set ourselves up in opposition to someone else and, as far

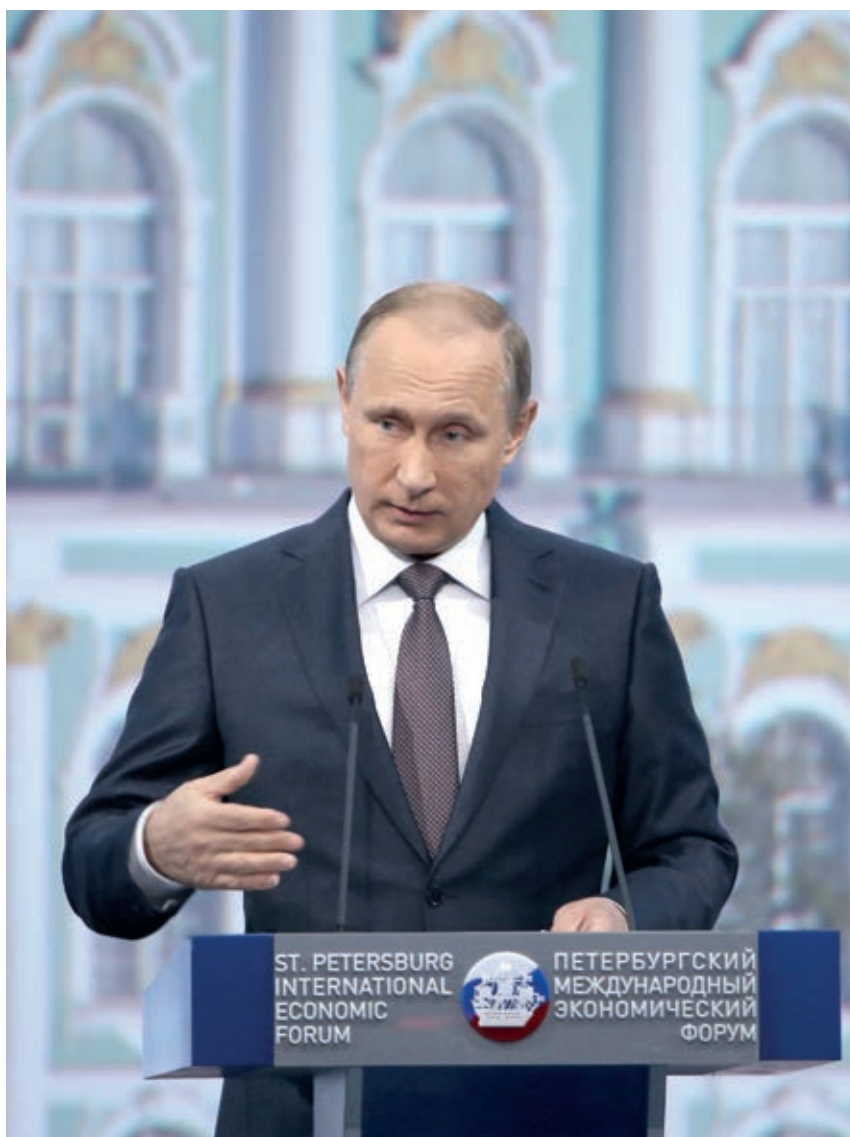
as I understand, Chinese policy follows very much the same lines. We are not coming together “against”, we are building a union “for”: for implementing our national interests.

[...] Russia and China are not building any kind of military block. We are not planning to stand in anybody’s way. We are trying – and, I feel, succeeding – to think on a global scale, not just in allocating responsibility, but in identifying areas of common ground and compromise. We do not exploit our position of strength, but instead seek solutions – and by that I mean solutions through negotiation.

[...] It goes without saying that economic relations between Russia and China must fulfil specific requirements and tasks. It would be better by far if this were to happen not just between major companies, but at the level of small and medium businesses, so that we might see a natural, dynamic web of cooperation across various business sectors. On a country by country basis, China is our number one trade partner. Our turnover is USD 85 billion.

[...] It is true that we should act with caution, avoid rushing, and take care to create the necessary conditions. The same is true of our Chinese partners. I mentioned in my speech that we are not hindering the movement of capital in any way. Not even during the most challenging period of crisis, in 2008–2009, and not even last year did we restrict capital export.

But we expect our partners to adjust their regulations in this direction. The yuan is becoming an ever stronger reserve currency for the region. This much is clear. However, expert observers realize that there is insufficient freedom of capital movement.



Vladimir Putin: “Russia is open to the world — for economic, scientific, and humanitarian cooperation, and for contacts with representatives of civil society and the business community from around the world.”



Alexis Tsipras, Greek Prime Minister: "International relations are becoming increasingly multipolar. The growing role of regional partnership in Asia, the G20 process, and intensifying BRICS partnership show that a new economic reality has arrived. As a young entity geared toward regional integration, the Eurasian Union has the potential to spur new sources of manufacturing, wealth, well-being, and economic growth."



Zhang Gaoli, Vice Premier of the People's Republic of China: "Strengthening partnership between China and Russia, countries with emerging markets, will not only promote the economic development of our two countries, but will have a significant effect on regional and global economic growth. We must forge deeper partnerships in wide-ranging sectors, fully unlock the potential of working together, and expand cooperation in areas such as energy production, agriculture, high-speed rail construction, aviation, space exploration, investment, finance, and the creation of infrastructure and development in the Far East."

If that changes, then we will be taking yet another significant step in the liberalization of our relations.

On weapons of mass destruction

The first point I would like to emphasize, and one which in my view is absolutely fundamental, is that there is a consensus between all the participants in this process, including the United States and other European countries, and, I hope, with Iran, to the effect that we all categorically oppose the proliferation of weapons of mass destruction. This is our fundamental position, and it is this that has allowed us to work quite constructively with the US on this issue.

We are extremely glad that the Iranian position has endured in the face of major changes and has allowed us to achieve the level of agreement that we are seeing today. We will absolutely support these agreements.

The only thing that would be counterproductive in my view would be to purposefully – I want to underline that – purposefully derail the agreements by demanding things from Iran that it would find absolutely impossible to deliver and that are immaterial to solving the key issue at stake – the issue of non-proliferation. But I hope that it will not come to that.

[...] We appeal to all our partners, including the United States and Europe, but above all the United States, to redouble their efforts in the fight against evil, by which we mean fundamentalism and the so-called Islamic State, as well as various other similar groups which are, in effect, branches of well-known global terrorist organizations which have carried out more than one attack on the United States itself.

We call for a path to political settlement – it goes without saying that this includes the transformation of the political regime. We are prepared to discuss this with President Assad. The United Nations has declared its willingness to work with President Assad in the war against ISIS and other terrorist groups.

We are ready to work with the president to smooth the path to political transformation, so that everyone who lives in Syria has a say in the running of the country, and to bring an end to the armed conflict. The main point to be made here is that this cannot be achieved from the sidelines, and using force from afar.

On international business relations

Russia's future relations with any country do not depend on Russia alone. This is a mutual process, and nothing positive can come out of unilateral action. Having said that, we are working to develop our relations with Germany. A colleague was just now telling me about the large number of German businesses operating on our market. To be precise, there are 6,200 businesses, and they are all operating.

It seems they haven't left. About 100 businesses, perhaps 150, have scaled down their operations, but on the whole they are all working – and fairly actively at that. Moreover, I have mentioned that new businesses are being launched as we speak, with German companies keenly involved in the process.

We have traditionally strong links with these companies, and we do not intend to sever or curtail them in any way. We realize that German business wants to see that happen as little as we do.

We have enjoyed a very good, reliable and long-term relationship, and naturally we will do everything we can to maintain and foster these relations in the interests of Russia, Germany, the European continent, and indeed the global economy.

We have already touched upon the situation in which the global economy finds itself. We know that two problems are commonly mentioned. The first of these is the low rate of growth; there is even talk of stagnation, and it is thought that this state of affairs could continue for another year or two at the minimum. The second problem is the overwhelming increase in the debt burden, which in turn hinders development.

What about Europe – what is happening there? Specifically, low growth of 1% in Germany last year, 0.7% in Italy (which was just mentioned by a colleague who said things are good there, and that zero growth has been a feature for several years), and 1.4% in Japan. Faced with these conditions, we are all in need of some extra stimulus for development.



As a businessperson, it seems to me that Russia and China are a couple made in heaven. One has all the natural resources, the richest in the world, and China is very, very short of natural resources while it is quickly developing. But it does have the capital to purchase, and to help. And I just see that from an economic perspective, and I cannot think of two other countries that complement each other so well. Whereas I am sure the President has his strategic thinking vis-à-vis Russia's relationship with China, I am not sure if your businessmen are ready to take advantage of the Chinese market. So, I get the sense in the last day or two, discussing it with many Russian friends here, that Asia is still something that is nice to have, but they are not quite prepared to jump in economically. I just wish, Mr. President, that your business leaders who are sitting here would be more prepared to take advantage of it. Many companies these days from around the world are listed in Hong Kong, because the Hong Kong stock market is now linked up to Shanghai's, and is soon to be linked with Shenzhen's as well. And let me remind you: the Shanghai stock exchange is the fifth largest in the world; Hong Kong's is the sixth largest in the world, and Shenzhen's is the eighth largest in the world. The three of them put together form the second largest stock market in the world. Why not have all the Russian companies list in Hong Kong?

Ronnie Chichung Chan,
Chairman, Hang Lung Properties



Driving investment

Georgy Poltavchenko, Governor of St. Petersburg, talks about the investment generated by major international events and how it should be managed so as to develop the city's infrastructure.

How can we assess the significance of holding events like SPIEF in St. Petersburg?

In my view, this is a purely rhetorical question. SPIEF is a key event in the business life of St. Petersburg. Its success is usually judged by the value of the agreements signed and the total number of participants, but this approach shouldn't detract from quality considerations. These days, reputation is just as important a factor as economic benefit.

The Forum has made St. Petersburg more attractive to investors and tourists alike. There is a concept known as 'publicity capital'. It is valued just as highly as economic and political capital, but it is essentially made up of intangible assets. Every year, SPIEF enables St. Petersburg to grow its economic, political, and publicity capital. We find new investors and sign financial agreements, which in turn form another cornerstone to the city's economic development. In welcoming such esteemed guests, St. Petersburg affirms its status as a regional capital, and also draws attention from around the world – from Argentina and Chile to Vietnam and Japan.

With every successful Forum, we send the world a very clear message: all is well in Russia and in St. Petersburg. We are moving in the right direction and our progress shows no sign of stopping. Incidentally, at the beginning of September our city was recognized by the World Travel Awards as the leading tourist destination in Europe. The current geopolitical situation being what it is, this award is worth a great deal.

How has SPIEF affected the development of the city's infrastructure?

Initially, beginning with the first event in 1997, the Forum was held at the Tauride Palace. This being the headquarters of the Interparliamentary Assembly of Member Nations of the CIS, the Forum largely focused on issues relevant to the commonwealth. Preparing for and holding the St. Petersburg Economic Forum, as it was then known, presented no great challenge for the city.

Once Russian President Vladimir Putin decided to raise the profile of the Forum, and SPEF became SPIEF, with attendees including leading heads of state, it became clear that the city's infrastructure was not sufficiently developed to meet the Forum's needs. St. Petersburg began to focus on developing its reception, hospitality, and events industries.

As an established tourist destination, the city would have made advances in each of these three areas regardless. The Forum, however, helped to significantly speed up this process. For example, there was a sharp increase in hotel construction. Hotels and other similar accommodation providers had almost doubled in capacity by the end of 2011, from 15,000 to 28,000 rooms. And from 2012 to 2014, the number of high-quality rooms rated three stars and higher, which are the most in-demand among Forum participants, increased by 40%.

It wasn't so long ago that Pulkovo Airport was forced to operate under a special regime during the Forum and close itself to ordinary passengers. In 2015, following large-scale reconstruction under a public-private partnership scheme, the airport was able to operate as normal during the Forum for the first time in many years. The newly modernized Pulkovo is now one of the five best airports in Europe in terms of passenger satisfaction with the quality of service.

For a long time there has been talk about the city's huge potential as a location for conferences and exhibitions. Thanks to SPIEF, development in this area has gained momentum. The Lenexpo Exhibition Complex, which the Forum moved to in 2006, was a good location by the standards of the nineties, but too small for the scale of the 'Russian Davos'. In addition, the event has caused a fair amount of inconvenience to local residents. It was important for the city not only to move SPIEF out of the historic centre, but to achieve its potential in the area of convention tourism.

As a result, back in February 2007 the government of St. Petersburg signed an agreement with Gazprom on the construction of a new convention and exhibition centre in the south of the city. The next SPIEF will take place there, on the Forum's anniversary year.

What investment projects have been successfully implemented in St. Petersburg thanks to the Forum?

Projects are often discussed during the Forum, which afterwards take form. Take, for example, the project to develop Pulkovo Airport, which was finalized in 2009 at the Petersburg Dialogue event a month after SPIEF had taken place. Conversely, some get off the ground through the signing of memorandums and agreements as part of the Forum's business programme. At SPIEF 2012, for instance, financial documentation was signed on the construction of the central section of the Western High-Speed Diameter, the largest road construction project in Russia.

Work on the motorway is ongoing, and it is expected to open in 2016. One of the latest investment projects to have been launched centres around an agreement reached in 2014 between the St. Petersburg Government, investor company MERA Stal, and Italian company Danieli. The agreement outlines the establishment of an innovative construction facility in the Kolpinsky District with investment totalling more than RUB 7.5 billion. In May this year we laid the foundation stone, and the facility will be commissioned in 2017. SPIEF propels development in the most varied of spheres: from economics and science, to education. In 2012, we signed an agreement with Microsoft on holding the final of the Imagine Cup, a competition for young computer programmers, in St. Petersburg. In the summer of 2013, our city became a Mecca for programmers. First, 120 teams from almost 40 countries arrived to take part in the ACM International Collegiate Programming Contest, and then students and senior school pupils from 69 countries came for the Imagine Cup. The level of interest was huge, which is very important for St. Petersburg. According to research carried out by Russoft for 2014, St. Petersburg IT companies make up around 21% of the total number of IT companies in the country. The city development strategy to 2030 identifies the accelerated growth of the IT sector as one of the most important aspects of the knowledge economy.

At last year's Forum, the St. Petersburg Government signed agreements worth a total of RUB 40 billion. In what areas will they be implemented?

In science and innovation, municipal services, information technology, and communications. The biggest agreements relate to health care, car manufacturing, and communications. In particular, we have an agreement with the Centre for Nuclear Medicine at the Berezin International Institute for Biological Systems which will enable us to build a proton therapy centre worth around RUB 8 billion. Given the challenges being faced by the car manufacturing cluster, the agreement with Toyota Motor Corporation on the allocation of RUB 6 billion to increase the production capacity of the local plant and to launch another model, the Toyota RAV4, is of particular importance.

Also of great significance as far as the city is concerned is the RUB 9 billion agreement with T2 Mobile to invest in the development of St. Petersburg's telecommunications infrastructure. Agreements have been signed relating to the construction in St. Petersburg of the Federal Test Centre, which will be a world class facility for testing power industry equipment. In addition, an agreement has been concluded with Rostec to help the St. Petersburg defence industry and enterprises in the radioelectronics cluster modernize their production processes, train personnel, and export high-tech products.

In the same category, we have the agreement on the establishment in St. Petersburg of Russia's first Import Substitution Centre. In early September, the centre opened as an information and technical platform for the practical implementation of an import substitution programme. More than 70 of the city's leading industrial enterprises are involved in the centre's work. Also tied to the import substitution programme is the strengthening of St. Petersburg's so-called 'horizontal' links. The Forum provides a good opportunity for regional leaders to network. Whereas before the Forum provided a space for resolving specific, current issues, this is now a very important aspect of the Forum and is conducted separately. Framework agreements are signed at SPIEF, and later followed up with visits by delegations and the signing of specific contracts. This provides St. Petersburg with new suppliers, and this means first and foremost high-quality domestic sources of food, as well as Russian producers of medicine, electronics, medical technology, and other high-tech equipment produced for regional markets.

Over the course of the Forum, 40 cultural events were held for participants. How difficult was this to organize?

For a few years now we have on principal sought to avoid lavish official receptions, not so much for economic reasons as out of respect for the traditions of St. Petersburg and its creative potential. The city has a rich cultural past, but its present is no less interesting. This is the main challenge we face when making preparations for the Forum, and at the same time is a competitive advantage. When putting together the cultural programme, we consciously focus on the creative component, combining the classic and the modern. The SPIEF 2015 cultural programme included two charitable projects that I would like to draw attention to. The first is the play *The Touchables* – the world's first production involving actors with hearing and sight impairment. The second is the musical *Mowgli Generation*, created by Russian actor Konstantin Khabensky. The musical was a real achievement for the children who took to the stage for the first time side by side with stars such as Diana Arbenina and Alexander Kerzhakov.

Next year will mark the 20th anniversary of the Forum. What will be done to make it stand out?

We already have Vladimir Putin's decision to hold next year's Forum at a new venue, the ExpoForum Convention and Exhibition Centre. For the organizers, moving means a complete reorganization of the usual programme. While previously we have stuck to a plan that has been tried and tested over several years, in which we were precisely aware of the area of responsibility of everyone involved, the action plan as far as ExpoForum is concerned was until recently a clean slate. A road map has now been drawn up to turn that clean slate into a series of specific steps with a clear sequence and order of priority. There are a number of issues related to transport access to the Forum site that need to be resolved. The construction of the road to the second entrance of ExpoForum, the expansion of the St. Petersburg highway to four lanes, the construction of an overpass over the railway line from Vitebsky Prospekt, and work to improve the transport accessibility of the Pushkinsky District are all objectives on which we are particularly focusing. In addition, there are plans to build new hotels on the ExpoForum site, providing further convenience for Forum participants.

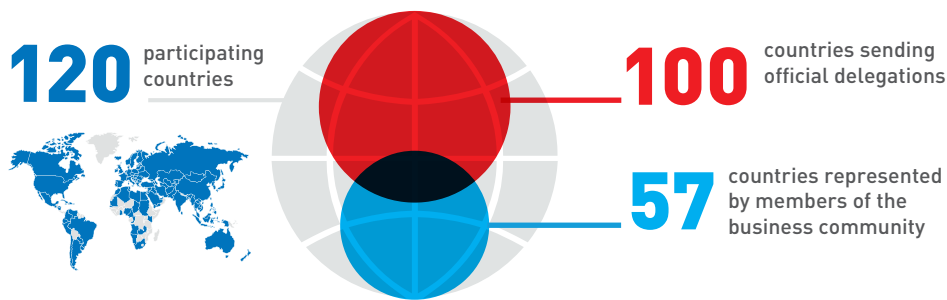


SPIEF
ST. PETERSBURG
INTERNATIONAL
ECONOMIC
FORUM

A MAJOR INTERNATIONAL ECONOMIC AND BUSINESS FORUM

Held annually in Russia since 1997

Participating countries*



Participating companies*



* Maximum number at a single Forum within a five-year period (2011–2015)

Unique opportunities at the Forum



Exchange of experience and expertise



An effective business networking platform



Conversations to make a difference

DOCUMENTS SIGNED IN 2015 **205** agreements worth a total of **293.4** billion RUB**

** Value of agreements (not classed as confidential) calculated based on exchange rate on date of signature

The faces of SPIEF

Participants of the St. Petersburg International Economic Forum 2015 spoke at 84 different events, which were held as part of the main Forum programme. The debates at SPIEF 2015 were received by experts as more substantive, direct and open, with the ideas expressed during the sessions set to prove useful in subsequent work aimed at attaining global economic growth. Key quotes and speakers at SPIEF 2015 are presented in SPIEF Review's photo report 'The Faces of SPIEF'.



"Russian companies must take key positions in those sectors and markets that will shape the economic future and the way of life of people in 20–30 years' time"

Vladimir Putin,
President of the Russian Federation



"In Russia, we're linking the prospects for sustainable economic growth with the transition to an investment-driven growth model"

Elvira Nabiullina,
Governor, Central Bank of the Russian Federation



"Without exaggeration, the Forum is the largest international discussion platform in Russia, drawing ever more interest from both Russian and international businesses with each passing year"

Sergei Prikhodko,
Deputy Prime Minister of the Russian Federation — Chief of Staff of the Government of the Russian Federation, Chairman of the Organizing Committee of the St. Petersburg International Economic Forum



"We don't want a complete turn eastwards. We simply want to trade with the East just as much as the west"

Igor Shuvalov,
First Deputy Prime Minister of the Russian Federation

"Government should be smaller and smarter and more strategic"

Anthony Blair,
Former Prime Minister of the United Kingdom (1997–2007)





"We have seen a 13-fold increase in foreign direct investment over as many years, and already stands at hundreds of billions of dollars"

Sergei Ivanov,
Head of Presidential Administration



"We are focused on supporting entrepreneurs and private business. That's exactly the mission of VEB and the Bank for Development"

Vladimir Dmitriev,
Chairman, Bank for Development and Foreign Economic Affairs (Vnesheconombank)



"It's highly likely that, over time, the EAEU will become just as integrated and significant a structure as the European Union is now"

Anatoly Chubais,
Chairman of the Executive Board, RUSNANO Corporation

"We still do believe in the market and support market fundamentals"

Alexey Ulyukaev,
Minister of Economic Development of the Russian Federation





"Capital markets can be your best friends or your worst enemies — it all depends on what you do with them"

Jacob Frenkel,
Chairman, J.P. Morgan Chase
International



"Over the years, the St. Petersburg International Economic Forum has grown from an event of regional significance to become a major international discussion platform. Today, SPIEF is a firmly established and widely recognized brand in the international political and economic community"

Anton Kobayakov,
Deputy Chairman and Executive Secretary of the St. Petersburg International
Economic Forum's Organising Committee, Presidential Adviser



"My dream is open transport, open circulation, an open flow of people, finance and goods within the EU and the EAEU"

Jean-Pascal Tricoire,
Chief Executive Officer, Schneider
Electric



"Small business, small business financing, small business investment: these represent fundamental pillars of global economic activity"

Lord Mandelson,
Chairman, Global Counsel LLP



"You cannot export democracy by force. It can be exported through democratic instruments"

Romano Prodi,
President, Foundation for Worldwide Cooperation; Prime Minister of the Italian Republic (1996–1998, 2006–2008)



"It is better to look to the future instead of the past. We need to quickly build the kind of economy that the future demands"

Herman Gref,
Chief Executive Officer, Chairman of the Executive Board, Sberbank



"If China can transform part of corporate debt into government debt in the next two years, there is hope that it will go back to a higher rate of growth"

David Daokui Li,
Director, Center for China in the World Economy (CCWE),
School of Economics and Management, Tsinghua University



"Stable price formation should provide for the recoverability of justified expenses, including investing in developing capacities"

Igor Sechin,
President, Chairman of the Management
Board, Deputy Chairman of the Board
of Directors, Rosneft

"We have established a connection through the Iranian port of Bandar Abbas, and we expect a 40% reduction in transportation between India and the Eurasian region at a 30% reduction in cost"

Nirmala Sitharaman,
Minister of State for Commerce
and Industry of the Republic of India





"Experience has taught us that the key is to make sure the risks are allocated properly within the public sector, the private sector and among bearers and stakeholders"

Jin-Yong Cai,
Executive Vice President and Chief Executive Officer, International Finance Corporation (IFC)



"The key role of government in using energy efficiently is to provide incentives and to impose regulations to achieve fair market terms and, ultimately, to lead by example. I think there are a lot of activities and efforts under way in Russia to make that happen"

Hans-Paul Buerkner,
Chairman, The Boston Consulting Group



"We are very much for developing rouble-based payments and believe that Russia has already done a lot for the rouble's convertibility»"

Andrey Kostin,
President, Chairman of Management Board, Member of the Supervisory Council, VTB Bank

"We may grow much faster in the future, we may grow much slower in the future. But what we are feeling now is a bad debt overhang problem"

Kenneth Rogoff,
Professor of Economics and Public Policy, Harvard University





"Soon Russia will be viewed as neither a major oil empire nor a major gas empire, but as a major food empire"

Arkady Dvorkovich,
Deputy Prime Minister of the Russian Federation



"The three priorities of budget spending are: infrastructure, which should stimulate increasing efficiency, along with education and health care"

Anton Siluanov,
Finance Minister of the Russian Federation



"Integration means reliability, accessibility, greater confidence and economic advantage"

Oleg Budargin,
Director General, JSC Rosseti



"Small and medium enterprises do not need more regulation... they need less regulation. Most important they need clear rules of the game"

Shiv Vikram Khemka,
Vice Chairman of the Management Board, Chief Executive Officer, SUN Group



"The future is not based on skill, how much money you have, or even how powerful you are. The future is based on your knowledge, your wisdom, and your innovation"

Jack Yun Ma,
Executive Chairman, Alibaba Group



"The modern economies of developed countries don't rely on coal and steel, or even high-speed internet. These are economies of human capital"

Vladimir Mau,
Rector, Russian Presidential Academy of National Economy and Public Administration



"The togetherness of the BRICS countries and other emerging economies represent a new voice on the political scene"

Ronnie Chichung Chan,
Chairman, Hang Lung Properties



"The Arctic can and probably will play a very significant role in the future supply of oil and gas"

Ben van Beurden,
Chief Executive Officer,
Royal Dutch Shell Plc



"Demand for construction of new nuclear power plants has recovered to pre-Fukushima levels and, in a certain sense, is even beginning to surpass it"

Sergei Kirienko,
Chief Executive Officer, ROSATOM

"Commerce builds bridges between nations and regions of the world"

Robert Dudley,
Group Chief Executive Officer, BP





"The large share of state companies is the main structural disparity in the Russian economy. This is one of the barriers to further investment in the Russian economy"

Alexey Kudrin,
Dean of the Faculty of Liberal Arts and Sciences,
St. Petersburg State University

"Russia is building bridges with new partners, and we are certain that geopolitical tensions are easing"

Kirill Dmitriev,
Chief Executive Officer, Russian Direct
Investment Fund (RDIF)



In the eye of the storm



Nobody knows what the future holds. The topic of uncertainty formed the starting point for discussion at the panel session 'Economics: frank answers to pressing questions' on the first day of SPIEF.

Panellists Herman Gref, Alexey Kudrin, and Igor Shuvalov shared their views on the future of the economy, and what steps the government could take in order to avoid a worsening of the situation. First Deputy Prime Minister Igor Shuvalov opened the discussion by talking about the government's roadmap to setting Russia on a path of sustainable economic growth. He did, however, concede that this roadmap is not without its shortcomings, given that forecasts made in 2014 have proved to be incorrect.

"The situation has turned out much better than we expected in autumn 2014. We were considering the worst possible scenario. We had expected that unemployment was going to be significantly higher, considering the impact felt by businesses in their relations with their creditors. I wouldn't say that the situation is good, but it is not as difficult as we envisioned in the final three months of the previous year," said Shuvalov.

According to Alexey Kudrin, the optimism displayed by the Deputy Prime Minister is unwarranted when factoring in the structural problems facing the Russian economy. Russia is still dealing with sanctions, the anti-offshore law is failing to boost growth, and the country's relationship with the west remains undefined.

"In the eye of the storm" is how Kudrin characterized Russia's position in terms of economic growth. It is not yet clear how Russia will move forward from this point.

"We were all somewhat reassured by the first quarter. The figures were certainly better than had been expected, and it was widely thought that the worst was over. The second quarter has shown that this is not the case. The uncertainties

surrounding quarters three and four are great, particularly as they are not merely cyclical, economic uncertainties, but also political in nature. For example, there are the limits imposed on trade as a result of sanctions, and the possibility of another wave of sanctions. This increases uncertainty and eliminates any hope of finding a traditional way out of the crisis," Kudrin said. The only certainty amid all this uncertainty is Russia's pivot to the east. And while the government as represented by Igor Shuvalov claims that there has been no concerted effort in this regard, it also says that trade with Asia is the only way to decrease dependence on the EU and Europe's reliance on Russian energy resources.

"We are offering China and our other partners in the east not just the option of a free trade zone, but also broader forms of integration. These are based on the understanding that Russia and the Eurasian Union have particular status, because we are in a position to bring together various aspects of integrational cooperation," said the First Deputy Prime Minister. Nevertheless, the agenda for integration with the EU has not been abandoned:

"Even in those countries which are actively driving sanction policies, it is clear that the idea of a 'Greater Europe' stretching from Lisbon to Vladivostok has not gone away. For our part, we support this project. We absolutely want to see the creation of a common economic space. This is a very important goal, and it will always be a goal, whatever happens. On a working level we are continuing to investigate and develop the idea. The next step is to actually get this common economic space established."

The economic space in question will need to be not just established, but also

Will the situation improve?



In July, Minister of Economic Development Alexey Ulyukaev characterized the current situation of the Russian economy as “a process of stabilization”.

“The situation on the Russian economy is starting to improve. It is better than we – the majority of analysts – predicted at the end of last year and the beginning of this one. Month-on-month figures show that the decline has practically halted”, he said.

Mid-year results show that the economy shrunk by 3.4% compared to the same period last year.

The minister claimed that from 2016, the country would find itself on a fairly stable trajectory of economic growth at a rate of 2% per year.

At the end of August, when the rouble once again suffered a prolonged fall, Ulyukaev confirmed this forecast. The Ministry of Economic Development announced that it stood by its prediction that Russia’s economy would grow in 2016, but that the rate of that growth could be somewhat lower.

The minister stated that “the numbers may be adjusted, but we stand by our assertion that we will see positive growth.”

Ulyukaev does not expect a further significant drop in the price of oil. “I think that we have now reached a level we are unlikely to go below”, he said. “We are seeing a mid-year rate of RUB 58 to the dollar against a mid-year oil price of USD 56 per barrel. It follows that if the trend remains close to our price forecast – and I remind you that our price forecast was a conservative USD 50 per barrel – it will correspond to the forecasted rate of around RUB 60–61 to the dollar.”

capitalized upon, since economics is following a new, as yet unnamed, trend. This issue was addressed by Herman Gref in his contribution to the discussion. Citing economic clusters as an example, Gref named Silicon Valley, Israel and Singapore as drivers of innovation technology. Regulation of the business environment and the recruitment and utilization of human capital are changing dramatically as a result of this new trend.

“What do we need to do within our companies in order to keep pace?” asked Gref. Leaving his own question unanswered, he remarked – with some irony – that at least Russia’s economy had not performed quite as badly as originally predicted.

“The anti-crisis roadmap was a good thing. But it was good at the end of last year. And we are now halfway through the next. We are endlessly discussing yesterday’s situation and problems, but nobody is even attempting to talk about what will happen in the future,” said the Sberbank chief.

And contrary to widespread opinion that the crisis presents a source of growth, such an environment is hardly conducive to the creation of an innovation economy. Capital-intensive fields require an atmosphere of growth.

“The only thing the crisis contributes is an incentive for officials to make changes,” concluded Gref. And indeed, officials are trying to do so, including in the aforementioned sphere. A knowledge-based economy is something the government is committed to building as part of the transformation process, said Shuvalov.

But these efforts are hampered by the crisis, and the accumulated problems behind it. The First Deputy Prime Min-

ister had a response to Gref's grievance: "The government cannot turn growth on or off just like that. We are not interested in growth at any cost, which would only lead to more problems. What we need is high-quality, knowledge-based growth."

The debate continued in a typical dispute about who is to blame. The Sberbank CEO expressed his conviction that poor management is the culprit, with it invariably being the underlying cause of a crisis.

"There are external factors to this crisis that we are now discussing. There is, for example, the fall in global oil prices. And yet, are we really surprised by that? Did we not know that there can be fluctuations in commodity markets? We knew. What did we do about it? I still maintain that the current situation is the cumulative result of system-wide imbalances. This is the result of a very long time spent not solving the problems which have accumulated in our economy. In other words, it is about bad management," insisted Gref.

The discussion could not avoid touching upon the issue of freedom in the media. The experts agreed that free discussion and an atmosphere of political competition unquestionably makes for a healthier economy. Alexey Kudrin explained just how important this is:

"There is not always a link between democracy and economic growth. However, we have already progressed down the path of democracy and market competition, so neither the Chinese nor the Singaporean model will work for us. In order to precisely define the problems facing society and how to solve them, it is essential that Russia should encourage freer discussion in the media and freer criticism of the actions of the gov-

ernment and president. Nothing should be excluded from discussion."

Bringing the discussion to a close, the participants deliberated over what the future holds: how bad will the Russian economic situation be by next summer? The Sberbank chief claimed that the drop currently being experienced logically indicates that things will only get worse next year. But that is if the focus is on absolute figures.

"I don't think it is useful to talk about macroeconomics in terms of one year. As far as next year is concerned, we have already done all we can. We are seeing the results of what has already been done. It is much more interesting to look at what the situation will be in five or ten years' time," said Gref. But the news was not all bad. According to Gref, unlike other countries which are also experiencing economic difficulties, Russia has everything it needs to turn itself around. Internal resources and human capital make the country self-sufficient.

Alexey Kudrin suggested that comparative economic figures will be positive, but that the overall situation will be worse than now. This is because the Russian economy will have reached rock bottom and only just begun to bounce back.

Igor Shuvalov was more optimistic than his colleagues. He suggested that with hard work and a concerted effort to identify new drivers and points of growth, success could be achieved.

"As Gaidar noted, 90% of a successful economy is psychology," he concluded.



Crises – which naturally occur in most cases – improve productivity, because demand is reduced and only the most efficient survive. For those who survive, average labour productivity reaches its highest level.

Please do not confuse the crisis with sanctions. "Give them a good reason not to lift the sanctions. While they're in place we'll get so much more done." This is a mistake. When there is a distancing from international institutions, technological exchange and financial markets, we limit our potential several times over, and in certain cases can no longer achieve what we set out to do. Yes, we will be able to produce certain things ourselves, on a local scale. But overall we reduce the potential for all economic sectors and enterprises to obtain funding and capital, or to benefit from technology transfer and the application of scientific advances. We are moving away from the concept that the creation of institutional conditions leads to an influx of capital and improves interaction between economic sectors. We are seeing creeping changes in the perception of how the market should work. And then the perfectly good roadmaps put together by the government are undermined by the actions of other power structures.

Alexey Kudrin,
Dean of the Faculty of Liberal
Arts and Sciences, St. Petersburg
State University.

China:

a stranger at the party



The Chinese economy is at the peak of its process of transformation. And this, in turn, has a direct impact on global demand and the growth of the global market. It was no surprise therefore that China attracted particular attention at the St. Petersburg International Economic Forum. Many experts predict China's rapid development as a major consumer and manufacturer; others expect China to change its economic model by shifting focus from copying to creation. What do Chinese economists think, and why is China called "a mysterious stranger at the world party"? Some of them shared their opinions with *SPIEF Review* following sessions on the topic.

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Yang Xiyu, Executive Vice President of the Boao Forum for Asia, believes that China will soon become a leader in innovation, and that its only obstacle is the US's reluctance to cooperate fully with Asia in this field.

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Some of the experts taking part in discussions at SPIEF agreed that no one knows what future awaits China. Do you think it is really impossible to make a prediction? Will the world economy be subject to Chinification?

In economic terms, China, in its pursuit of comprehensive reforms and a policy of opening to the world, will be seen in a completely new light.

The country will soon become the largest producer in the world, as well as the largest consumer market. This status, however, will be based on a completely new platform. For example, consumption of energy and raw materials will drop amid continued economic growth. While retaining their tendency to keep their savings in banks, the Chinese will become the largest group of buyers, both in the domestic market, and abroad.

As a result, China will become the biggest exporter and importer, as well as a significant recipient and supplier of foreign investment.

In political terms, our country will also be reformed, and society will be structured differently. In the main, the framework will remain unchanged: the Chinese Communist Party will still be the central pillar of society. That said, communication between social strata will be more harmonious, interactive and high-quality. In other words, a new form of democracy will be in place. It will be completely unique, and characterized by a distinctive, Chinese quality.

Just as China developed a market economy at home in its own way, the country's democratic regime will retain features which are inherent to it. This is my vision of China's future.

China is much talked about today as a new leader in innovation. How was this achieved in such a short time?

I am wholly confident that China is destined to become the leader in innovation and home to new technologies. Essentially, I see the country supplanting the role currently occupied by the US. My conviction is based on two reasons. The first reason has to do with Chinese universities. Our engineering workforce is the largest such resource in the world. We have the highest numbers of engineers among our graduates.

On top of this, Chinese intellectuals, largely due to their industriousness, are among the greatest in today's world. More and more Chinese scientists, researchers and engineers are taking leading positions in their respective fields.

We can say that higher education reforms in the country, alongside ongoing research and development, have contributed greatly to the quality of education and research.

The second reason why I am confident about China becoming a technology leader is that the Chinese authorities have adopted an innovation strategy as a priority in the country's development. For this reason, growth in innovation imports – including innovation in R&D – will continue to play a critical role, and will enable China to reach and retain a leading position in technology.

Moreover, both the Chinese authorities and research institutions are paying increasing attention to international cooperation in the high-tech sphere.

But there are some factors that disrupt the overall rosy picture.

Western countries, especially the US, are reluctant to cooperate, and are sometimes directly opposed to collaborating with China in high-tech industries. Russia therefore represents the largest window of opportunity for China. Our two countries possess the best resources, both in terms of our highly skilled engineering personnel, and research capacity. Both Russian President Vladimir Putin and Chinese President Xi Jinping stress that innovation is the key priority today. Both countries have great potential and share the same goals in their policies.

This fact serves as a solid basis for cooperation between the two countries in the field of technical and technological innovation. I am convinced that collaboration in technological innovations and joint R&D can form the basis for a strategic partnership between Russia and China.

This afternoon I had a very productive discussion about the prospects of expanding cooperation between SPIEF and the Boao Forum for Asia. One of the key points in the discussion was that both events agreed to encourage increased partnership in the high-tech sphere, including on the subject of innovative programmes.

China and Russia do not have many platforms for interaction, and the two countries' cooperation in the context of both forums will help create new opportunities for joint projects in the field.

The Boao Forum, together with SPIEF, will provide effective and far-reaching platforms for the development of bilateral relationships.

Staying on the subject of platforms for collaboration, what are the prospects for Russia and China in terms of energy efficiency?

As a matter of fact, China is the largest consumer of energy, and Russia is the largest producer and supplier of energy. Our two countries share interests in needing to be more efficient than they currently are. For Russia, this relates to the production

of energy and energy products; for China, it relates to consumption. Given the size of the two countries and the stability of our relations, we are interested in obtaining clean and efficient electric power and energy sources.

Closer cooperation in increasing energy efficiency will not result in a so-called zero-sum game, when one of the parties gains at the expense of the other. On the contrary, it will be a win-win situation that will benefit both countries – the consumer and the producer.

For example, the implementation of joint energy efficiency programmes would, from a business perspective, imply a reduction in energy exports. But even with diminishing energy exports, turnover in hard currency will stay unchanged, because Russia will get a considerable advantage as a result of employing more efficient resources and energy production methods. And despite a reduction in volumes, profits would increase due to the introduction of performance-improvement programmes. For example, Russia has vast coal reserves, which creates the opportunity for exporting clean coal technologies that offer very high added value.

For China, a reduction in energy and fuel consumption will result in improved air quality and, of course, help protect the environment. As a result, we will have a more considerable output against the background of importing more resources.

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David Daokui Li, Director of the Center for China in the World Economy at Tsinghua University's School of Economics and Management, explains why China is considered a threat to global stability and examines the question of continued economic growth.

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A reduction in the quality of human capital has been noted at SPIEF. This trend has already set alarm bells ringing worldwide. Does this problem exist for China?

The main cause for concern in China is a rapidly ageing population. As you know, China began to implement a one-child policy in the 1980s. Today, the fertility rate in China is 1.8 births per woman, which is quite an alarming fact. Two years ago, China implemented a reform with a view to easing this policy.

As a result, young families are now allowed to have two children, provided that both the husband and the wife are the only children of their parents. But this is still not enough. This policy is still a matter of heated debate in society, and I believe that

it will be completely abolished within two years. In terms of human capital, China is doing sufficiently well on the whole: we are advancing very quickly in education and are seeing significant improvements in this respect, but the ageing of the country's population is certainly our main cause of concern.

I would like to add here that the one-child policy, which has been implemented over the last 30 years, has led to a decrease in the world's population by a number which is twice as large as that of Russia's population.

It is believed (and has in fact been proven) that this factor, the reduction of China's population, has directly resulted in a reduction in global warming.

Do you believe that global economic growth will stop at some point?

I believe that it will never cease, the main reason being the continuous appearance of new innovations. Since we always learn something new from more developed countries, innovation is a factor of fundamental importance.

What should governments undertake in terms of re-industrialization, and how will it affect global growth?

First of all, authorities should impose high environmental standards across various industries. This will reduce air and water pollution. New energy-saving technologies should also be introduced. Once the new standards are imposed, they must be strictly complied with. Many companies that are major polluters will go bankrupt. Consequently, product supply will decrease.

We will then realize that the prices for many products, including such commodities as steel and cement, are increasing. This, in turn, will encourage the development and introduction of new green technologies, and many companies will have to make investments correspondingly. As a result, these technologies will become profitable.

Is China a threat to world stability, or does the country present new opportunities? Why is the rest of the world so anxious about how China will develop?

This is probably because China is very different from the rest of the world. One could compare to China to an uninvited guest, a stranger of some sort at a huge party. China's economy is indeed very large and plays an important role in overall global development. Today, China's GDP is 12% of global GDP, and at USD 10 trillion, stands at five times that of Russia's.

We can see that China, despite the economic recession, is making the most significant contribution to global economic growth. It's important to note here that China's economy has a unique internal structure, which is very different from the standard structure. Therefore, the usual methodologies are very difficult to apply to the Chinese economy.

I should add that the main problem of the Chinese economy is that it is not as efficient as it should be. A high percentage of cash is kept in savings in China.

But this money is not used as it should be. And the issue here is not that the economy could slow down too much or follow the pattern of Thailand (which has experienced great difficulties); the issue is that our politicians who determine the country's economic development are extremely cautious and put too much effort into preventing a serious crisis which may result in a considerable economic decline. The price we pay for this cautiousness is a lack of real efficiency.

Russia has acute problems with private sector debts. What is the situation in China in this respect? How real is the threat that money may leave developing countries?

First of all, let me explain the situation that has developed in China in respect of the national debt. China's total debt amounts to 200% of China's GDP. This may seem a striking figure, but, on the other hand, one should take account of the fact that there are huge amounts of money kept in savings in China. And the holders of these savings are trying to find good investment opportunities.

This is very important. In total, our savings amount to 50% of GDP, i.e. 50% of the savings maintain 200% of the debt, while in the US, for example, only 15% of the savings maintain the national debt. In this respect, the situation with Chinese debt is fairly good.

Another thing is that China's debt has a rather unfavourable structure because we have too many short-term debts and not enough long-term ones. The latter are debts resulting from investments in infrastructure. The situation would become more favourable if we could restructure our debt to some extent.

Capital outflows are by no means a big problem in China. If we imagine financial systems as bodies of water, it can be said that the US's financial system is an ocean, while China's is a large lake. China's GDP is USD 10 trillion, in the US it's USD 17 trillion, while in Russia it's USD 2 trillion; the savings total USD 3.8 trillion in China, and our domestic financial market is USD 15 trillion.

This means that China has a stable financial system capable of absorbing various economically negative factors. Other developing economies find themselves in a worse situation, and for them outflows of capital during a crisis pose a big problem. I think that these economies should unite in order to chart a joint course of action in order to negotiate such situations.

Three hundred years of growth

Despite the current instability of the financial market and the changeability of the figures used to measure market performance, rates of economic growth remain as they were before – so said the majority of participants in the economists' round table, 'A five-year prognosis – the end of growth?'

Leading economic experts used the panel session to present their analysis of the current situation and prognosis for the future.

Needless to say, the world will not end in 2015, and neither will the growth of the global economy. The majority of session participants were of the opinion that the world economy will continue to grow at the same rates it has previously. More than half of those polled believe that over the next five years, Russia's economy will grow at a rate of 2–4%.

"It is enough to look at history. At each point in time, someone said that all the innovations were behind them, and before you turn around, a new innovation has come in, and in fact at an accelerated pace," said Jakob Frenkel, Chairman of J.P. Morgan Chase International.

The panellists were divided as to how representative the figures for economic growth really are. Looking back, we can see how academics continually reassess past judgements in relation to different historical periods and economies. Similarly, it is hard to read the current situation, for example, in the field of pharmacological innovation or internet communication.

"My guess is that true growth is somewhat faster than measured growth," said Kenneth Rogoff, a professor at Harvard University.

As the rector of the Russian Presidential Academy of National Economy and Public Administration Vladimir Mau pointed out, the existence of economic growth, at just 300 years old, is incredibly young compared to the undocu-

mented history of humankind. “For the longest part of human history, modern economic growth did not exist, and it is quite a unique phenomenon. From the point that it started somewhere in England or Scotland 300 years ago, we do not know if it will last forever or for the time being,” added Mau.

According to Anatole Kaletsky, Co-chairman and Principal Economist for economic consulting and asset management group Gavekal Ltd, over the past few years the global economy has been experiencing the fourth structural crisis of capitalism. Having analysed all the crises which have occurred throughout the existence of capitalism, Kaletsky has come to the conclusion that the underlying factor in each of them was the relationship between economic and political forces. And the current crisis has shown that each can be as inefficient as the other.

Because of the economic crisis the world leaders – namely the US and UK – had to change their economic policies for a time, and these temporary measures became drawn out. Now, returning to normal economic policies is having a negative impact on developing markets. This was touched upon by David Daokui Li, Director of the Center for China in the World Economy. Mr. Li’s analysis concluded that reforms should be enacted so that part of the corporate debt can be passed over to the state, and its due date then extended.

Kenneth Rogoff claimed that “Much of what we are seeing, the acute problems we are feeling, is debt,” and most of those at the table agreed with him. In order to explain the cause of the debt problem, Professor Rogoff turned to the reality of human nature: loss of vigilance under prosperous conditions, the weakening of regulatory mechanisms and, as a consequence, stress caused by fear of risk.

Ksenia Yudaeva, First Deputy Governor of the Bank of Russia, expressed the view that the deficit of risk-free assets is one of the global imbalances which affects monetary policy. In her opinion, it is essential to coordinate monetary policy in the area of financial stability because it is partly linked with the problem of global imbalance. “We definitely need the safety net for financial stability purposes and it is not yet there,” said Yudaeva.

Russia’s Deputy Minister of Finance Maksim Oreshkin issued a positive prognosis on economic growth over the next five years.

“The only country that has a positive view from this structural point is actually Russia. If you look at the years 2012–2013 and 2013–2014, growth in nominal demand, in domestic demand, was already below its potential because we have gradual improvement in the current account. Of course, last year there was significant external shock – but Russia adjusted. Now we are in a position with, for example, a really effective exchange rate that is in line with the fundamentals. We are in a position where there is a transfer of wealth from households to the corporate sector which will stimulate investment activity going forward. So here, in my opinion, growth will be faster than in the previous five years”, concluded the Deputy Minister.

Summing up the conclusions of the panel session, moderator Yaroslav Lissovolik, Head of Company Research at Deutsche Bank Russia, made the point that it is not only a high rate of growth that counts, but also the quality of that growth. He named productivity as a key factor which must be developed if we are to see higher rates of growth in the global economy over the coming years.



The key difference between each of the four phases of the crisis of capitalism was the relationship between the market and the government. Now in the first phase, classical capitalism if you like, the market and the government were completely separate. What happened from 1914 to 1932 is that the system broke down, and you had a second phase, where actually the government became dominant. People no longer trusted markets and thought that governments were always right. Then, what happened from 1969 to 1982 is we discovered that governments were often wrong and learnt to put faith in markets. That was the third phase, if you like, market fundamentalism, when people believed that the government was always the problem and the market was the solution. So what is this fourth phase? This may sound rather pessimistic, but it isn’t. You know, in the 1950s and 1960s we thought that the government was always right and the market was always wrong. Then, in the 1980s and 1990s, we thought that the market was always right and the government was always wrong. What we discovered in the last crisis is that the government and the market can both be catastrophically wrong.

Anatole Kaletsky,
Co-chairman and Principal Economist,
Gavekal Ltd.

The prospect of market fragmentation



The current global trading system is in serious need of modernization. Existing mechanisms, having previously supported dynamic growth on the international markets, are now leading to stagnation and volatile monetary systems. The global economic space is being subjected to political influence. Events over the last few months have shown that not all countries are on an equal footing within the global market framework. Some experts are convinced that fragmentation is inevitable. However, there is no reason why this process should be a source of economic discord. These topics, and more, formed the basis of the panel session 'Global finance as a commons — guarantor or threat to stability?'

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Jean-Pierre Thomas, President of Thomas Vendôme Investment, talks about the injustice and inefficacy of the sanctions, and appeals to the west to avoid making the mistake of setting itself in opposition to Russia, and instead work to restore a relationship of trust.

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Russia is back

Since 2008, global trade has been suffering as a result of stagnation. The global system is beginning to run into problems. The organizations governing this system were established back in the post-war period, and now urgently require modernization. The world is not the same as it once was. Russia is back in the global arena as a world power, both in an economic and diplomatic sense. Inevitably, there are those who would rather this was not the case, but it is a fact nevertheless.

China is now one of the major players on the global and political stage. Europe is also getting its act together, though not without difficulty. And the US is determined to maintain its monopoly on world leadership. If we do not modernize our institutions, we risk running into some extremely serious problems.

We need to update the voting systems in organizations such as the World Bank, IMF and UN. We must bring international financial institutions up to date and accept new members as appropriate. The speed of transactions is constantly increasing, especially in Asian countries, relative to industrially developed nations elsewhere. These transactions should not be politicized, in the financial sphere or otherwise.

A multilateral world

We have recently been witnessing a degree of political strong-arming in this sphere. The ongoing EU sanctions, the freezing of Russian assets in connection with the Yukos affair, Ukraine's intention to join NATO – all these could have a significant economic impact.

Globalization is a process which enables the free movement of capital. And capital gravitates to wherever the workforce is cheapest. If we have a centralized, unilateral system, and a system that employs economic sanctions, it goes without saying that the process of globalization itself will become fragmented.

There is nothing at all surprising about this. It all contributes to the creation of a multilateral world. It makes sense that part of this process should be the emergence of other reserve currencies. However, there still needs to be allowance made for

the integration of models and the harmonization of economic systems, otherwise the entire system will be weak and fragile. Greece is a perfect example of this. It is a good thing that we are moving towards the diversification of reserve currencies, but first it will be essential to create defined economic zones.

Back to the table

Western Europe and Europe as a whole must return to the negotiation table, bringing Russia with them. Ultimately, Europe without Russia is not Europe at all. At the same time, it should be understood that Russia has strong links with Asia. It is time to return to the idea of large-scale free trade zones. The end of 2015 must bring with it an end to the sanctions, which are as unfair as they are ineffective, and which have a negative impact on global economic growth.



Russian Deputy Finance Minister Alexei Moiseev talks about the systems for financial settlement developed in Russia as alternatives for SWIFT among others, and the creation of national rating agencies.

A national scale

We have designed our own alternatives for developing the financial system in Russia in such a way as to avoid any disruption in the execution of settlement and other financial operations, whatever conditions may arise. Over the last 12–14 months, a regulatory framework has been created and we have already established a system for processing financial information and procedures regarding card payments.

By the end of the year, I expect to see domestic cards in use. We are currently working with the Central Bank to create a system for the transfer of financial data within our national borders on an independent basis.

We are creating a regulatory framework to allow rating agencies to function within Russia independently of their international operations, the idea being to prevent rating agencies from arbitrarily withdrawing their assessments on Russian companies, and to disallow emissions on the basis of some decision originating from outside Russia.

A national scale will be introduced, and it will be forbidden for companies which represent it to withdraw ratings. At the same time, the Ministry of Finance and Central Bank will only use ratings based on this national scale to present liquidity via their operations and the operations of those organizations regulated by us.

Of course, it would be more economically viable to establish a single source of global expertise which could somehow be bought and sold internationally. However, the events of the last 14 months have shown that we cannot base our actions purely on economic factors. We must maintain the stable functioning of our financial sector.

Achieving the standard

Currently the most important question relates to how the rouble is used in international settlements. We have discussed this issue with our international partners, but progress is proving somewhat slow as our partners point out the high level of volatility in the rouble over the past year. This negative experience should be disregarded.

We can already say with confidence that the Russian financial market is structurally quite well developed, based on the functioning of the stock market, clearance, and shareholder rights. I believe that we are now operating to the highest global standards. We are seeing major global investors, including sovereign wealth funds, entering the Russian market. This in itself is evidence that we have managed to achieve stability in the sector. Many of our international partners are interested in our experience of creating settlement systems. They want to learn from it because they realize that at some point they could very well find themselves in a similar situation. In my opinion, this fact speaks volumes at a time when the international financial infrastructure is being used as a weapon of political blackmail.

I am glad that companies which represent this infrastructure see this in the same negative light that we do. Nevertheless, the financial services market will inevitably see some fragmentation, as unfortunate as that may be. These are the negative consequences of the ill-conceived and rash actions of a number of states.

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Shamshad Akhtar, Executive Secretary of ESCAP, talks about how the Asian economies have faced up to the global financial crises of the last 20 years, and discusses new threats to the market.

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Withstanding the crisis

Over the last eight years, Asia has dealt quite well with the global financial crisis. This is particularly true with regard to sanctions and the increase in oil prices.

The latter is especially important for Asian countries as they are oil consumers, rather than producers. Why was Asia able to successfully withstand the crisis?

The answer lies partly in the fact that they established their own financial systems in 1997–1998. At that time, the Asian financial markets were to a certain extent in disarray. They were far too accessible and suffered from a lack of control.

But in 1997–1998 the crisis arrived, and that was cleaned up. As a result, by the time the crisis of 2008 struck, their financial systems had been modernized, both in terms of regulation and supervision. And they were less vulnerable as a result.

The Asian market had diversified, and so found itself better able to resist the high-risk products that had such an impact on other markets. The situation now is very different to what has occurred over the last eight years. I would say that the global financial crisis has lasted longer than expected. The world is recovering, but fairly slowly. Global trade is also progressing more slowly than we expected. And for Asia, of course, this is a vital factor.

New vulnerabilities

There are now new vulnerabilities emerging, not just in relation to the global financial system, but which will especially impact the Asian markets. Interest rates are rising. Market confidence is falling. There is concern over how growth in the Asian sphere will be affected.

Asian markets are, after all, somewhat more exposed. We need to see a strengthening of the financial regulatory system and the introduction of new regulatory mechanisms. The problems facing Asian markets will worsen if they cannot achieve the financial flows they require. This will happen if requirements for a level of capital for global banking systems or financial institutions are confirmed. In this case, they will reduce crediting of Asian countries and businesses, which will lead to volatility on the capital markets. There are several possible solutions to this problem. The Asian markets are already introducing major initiatives for their protection, with the process funded by accumulated foreign currency reserves. Also envisaged are several lines of credit that have not yet been tested, so income is very modest. This is a fairly complex system, which must be tested as and when new threats arise.

Monetary affairs

Despite the hypotheses of various experts, the evidence suggests that it is possible to establish capital controls. You can effectively manage capital flows without affecting markets. Much has already been done in this regard.

I have frequently heard representatives of central banks say that if any stricter measures are introduced without prior approval, it will be difficult to withstand emerging markets.

This is why we are currently focusing on international cooperation in monetary matters. In order for developed economies to properly scrutinize the new agenda – which is closer to the global financial system – they must first promote oversight systems which provide protection against serious market violations.

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Professor Richard Werner at the University of Southampton is convinced that the current global financial system is US-centric and does not serve the interests of other countries. He argues that an alternative system is required.

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A comparative advantage

It is fascinating to look at the theory of comparative advantage from a historical perspective. The theory revolves around the idea of opening up markets and removing regulations to enable the economy to develop. The theory was first proposed by David Ricardo, a British economist. It was a great piece of propaganda on his part, because there is no country in the world which could have turned itself into an economic power using this theory.

Britain itself became an economic power by introducing restrictions on trade, implementing industrial policies, and through government intervention in the economy. Companies were particularly predatory in their attitude to India, and simply exploited the country. Indian textiles were at that time of higher quality and cheaper than those produced in the UK. However, we know that Britain was a textile power, so it is logical that it did not permit Indian fabrics to be traded freely throughout the empire. Ricardo's theory did not even remotely resemble reality. It was simply free trade propaganda which helped Britain to open new markets.

Welcome to the alternative

Returning to the post-war period, many thought that we were a global community with a fair international financial system that was open to all. But the events of recent months have once again reminded us that this is not the case. The system as we find it today began with the Bretton Woods Agreement, which means that from the very beginning it has been US-centred. It does not treat everyone on equal terms.

And now we are seeing how it can be exploited for political purposes – and then for the worse. In fact, the current system is merely a continuation of the predatory form of the global unilateral system that preceded it. Because of this, it is high time we created an alternative system.

Of course, the new system will be more diverse and diversified, and it will have various cornerstones, because naturally it needs to be fair for everyone and offer an alternative to various different countries. The creation of a more diversified system is inevitable, and could be a historic moment.

Appropriate bargaining

The challenges facing the regionalization of trade relations were discussed by experts during a panel session held at the St. Petersburg International Economic Forum entitled 'International trade: globalization or regionalization?'

Sanctions and responses; establishment of free trade zones and import restrictions; decline in demand and escalation of the crisis – all of these factors undoubtedly affect global economic growth. Simon Evenett, Professor of International Trade and Economic Development at the University of St. Gallen, set the direction for the discussion by identifying ways to normalize international trade relations.

“Something fundamental is changing with the dynamics of international trade, and I would like us to talk about why that is, and what we can do about it. Why is the level of trade important? It is because we have often thought of it as a driver of prosperity for emerging markets,” Evenett said by way of introduction.

Vladimir Salamatov, Director General of the World Trade Center, cited figures showing how trade globalization advances economies. He also expressed his opinion that barriers to economic integration should be removed without delay.

“Out of the 161 countries that make up the WTO, 160, with the exception of Mongolia, are involved in integration processes. In recent years, these 160 WTO members have produced 407 notifications relating to the establishment of new integration associations or the introduction of additional measures under existing agreements. Analysis of this number of associations shows that 31% of them are service agreements, 4% customs unions, and 57% free trade zones (FTZs).

Two percent of all the integration associations are concerned with bilateral interaction between existing integration associations; 31% are agreements between FTZs and individual countries, such as the EU and Honduras. Sixty-seven percent are bilateral agreements between countries – and this is the form of interaction that is the simplest and the most effective in achieving goals,” he said. Free trade zones give more preference to their residents, and this complicates the formation of chains which generate added value. According to Salamatov, multinational corporations account for approximately 33% of all international trade. “And if we include companies that are associated with such corporations and operate in their interests to a greater or lesser extent, another 47% is added to the figure. Thus, 80% of all international trade is carried out through the establishment and presence of such multinational companies,” he added. Christian Friis Bach, Executive Secretary of the Economic Commission for Europe, described the current trade situation in Europe as “a disaster”.

“Discussions on trade agreements have to be part of the solution. We need a ceasefire on the battleground, but we also need a ceasefire in the marketplace. But how can we make such trade agreements work? Here, we need to have thorough discussions in our European context on how we can ensure that we do not put countries in a position again where they are forced to choose between ‘either/or’, but where instead we give them the opportunity to say ‘both/and’. Joining and trading with multiple regional trade agreements is an opportunity. We have to initiate a process whereby we can identify solutions where countries can say, ‘Yes, we would like further integration with one agreement, and we would also like further integration with another agreement.’

When we look at the global context, there are multiple solutions to be found. It can be done,” he said. He also put forward the view that regionalization can inspire integration: “That is indeed what we saw in the early 1990s. Remember, the Uruguay Round faced deep difficulties; it could not perform. Suddenly, we saw the Common Market in Europe; we saw the Association of Southeast Asian Nations (ASEAN) moving in Asia. Then wise politicians and brave and visionary trade negotiators said, ‘We have to bring it together; we have to bring regionalism further into global agreements.’ Regionalism became a building block for further global integration, and we must ensure that the same happens today,” Friis Bach concluded. Technological development should also be one of the building blocks with which to build a global trade system. Sultan Ahmed bin Sulayem, Chairman of DP World, provided an example of how infrastructure facilitates this process.

“We are cooperating with Kazakhstan to promote the ‘New Silk Road’, which is basically looking at the time it takes to send a container from China to Europe. It takes 42 days. Using containers, again, instead of vessels, taking them by rail from China to Kazakhstan will bring this figure down to 12 days. At the end of the day, what makes trade grow is innovation. In our business, in shipping, we expect our business to increase by 4–4.5%.”

However, with technology failing to develop as rapidly as experts would like it to, trade is growing at a slow rate. The change in the global agenda – the onset of the crisis – has become one of the reasons for this lag.

“Trade will grow at a faster pace once Europe puts its house in order and Japan has found another area wherein to grow its economy. In the meantime, we can



“I share concerns that regional and bilateral trade agreements are mostly for trade diversion. There is a zero-sum mentality going on in the world. Some are talking about 3% or 3.5%. But it was 3% two months ago, and I am afraid that now it is 0%, and it is still going down. OECD economies are expected to grow 2%. Compared to a couple of years ago, that is an improvement, but trade is going down. I think something else is going on. We are concentrating on trade agreements, increasing market access, but the most important dimension is the exchange rate. Most people think that quantitative easing is difficult to understand. But the practical impact thereof is currency devaluation. When the currency goes down 30%, whatever trade agreement we are talking about, cutting tariffs by 2–3%, will not matter. We really need trade to increase productivity. Productivity and trade are correlated. And we need productivity, because most countries now face the issue of an ageing population. If you do not increase your productivity, then you are going to have a financial crisis. If we have a zero-sum mentality, and we get into a trade war, we are heading towards another financial crisis. The problem is in demand creation, I think.”

Andy Xie,
independent economist

see some trends. For instance, in the last 20 years, because of the development of technology, we have seen communications and transportation improve tremendously. We have seen segmentation in the global marketplace. We are seeing a trend of more and more investment moving towards the destination, where it used to be trade centres. That means that investments will be sent to different countries now, like physical goods were sent earlier. Movement of money is by and large replacing movement of goods. I think trade will return to higher growth rates, but probably not as high as 6% or 7%, like in the 1990s," Francis Liang, Chairman of the Taiwan External Trade Development Council, said. The benefits of the international trade system are indisputable. As pointed out by Liang, uniform standards and norms are much more useful for the development of trade than a tangle of different rules and regulations.

Lord Mandelson, Chairman of Global Counsel LLP, also mentioned changes in trade patterns. He expressed his conviction that these changes were the cause of a slowdown in trade turnover growth to 3–4%. An increase in growth rates can only be achieved if international trade systems are liberalized. But liberalization on its own will not sufficiently spur growth.

Alexey Mordashov, Chairman of PAO Severstal, reiterated the fact that international trade was the driver of unprecedented worldwide economic growth in 2008. And China's rise occurred in large part due to growth in trade.

"I, like many others, am convinced that acceleration of trade is one of the cheapest and simplest tools for accelerating the growth of the global economy. I think that the current slowdown in trade is not so much due to the restructuring as to

the economic crisis which has held back economic activity," Mordashov said.

He also added that the surge in regional agreements is likely to be a reaction of countries, economic agents, and business to the absence of a global agenda.

"If there was a global agenda, if the world's leading countries had found it possible to bring their positions closer together and take the next step towards liberalization, perhaps we would have seen fewer regional agreements today. We are facing an obvious risk of the fragmentation of global trade as a result of the proliferation of regional agreements," he continued.

The Severstal chief could not avoid touching upon typically Russian problems in trade relations, which he believes can be solved through de-politicization. Indeed, the example of relations between Russia and Europe today shows the consequences of mixing business and politics.

"Seeing the significant trade restrictions – and our president has just talked about the EU's loss of USD 70–100 billion as a consequence of Russia's retaliatory measures – who is to benefit, especially bearing in mind the limited growth in the EU? Russia, too, suffers from the sanctions, and the whole matter is a glaring example of what happens when trade is used as an instrument of political pressure," Mordashov concluded.

Andrey Slepnev, Minister for Trade at the Eurasian Economic Commission, also drew attention to the 2008 crisis. The events of that time were responded to by the creation of the Eurasian Economic Union and Russia's accession to the WTO.

"The agenda we initiated then is ongoing now. We have a new EAEU agreement

coming into force this year, new prospects, a 10-year programme, and great ambitions concerning the services market, the workforce, and infrastructural development. We will stand by this agenda. There is a new initiative we have started to implement, which is the signing of preferential agreements with third countries. The first case of this kind can be seen in our relations with Vietnam,” Slepnev said. Neither did he deny the effectiveness of regional integration: “Of course, the value of the WTO is indisputable. It would be great if the WTO became ambitious enough to satisfy the demand of numerous countries for a trade regime that would meet their current needs. But can the WTO satisfy this demand of member countries? The answer is obvious. And the bright idea of universal trade liberalism has come up against a serious reality. With instability in the world economy, protectionism is growing.”

The conclusion Slepnev made was unequivocal: it would be very difficult for Europe to establish effective cooperation with the United States within the transatlantic partnership without having a cooperation agenda with the Eurasian Economic Union. And it would also be difficult for the EAEU to implement its ambitious programme of cooperation with China without reaching a balance in its cooperation with Europe. In any case, any imbalances in relations will lead to a decrease in growth.

It's generally agreed that today's reality differs – and quite significantly – from the idyllic picture where trade is disconnected from politics, regional agreements do not affect the peaceful relations between states, and technology is able to accelerate a number of trade processes. And as these differences exist, they will fuel the growth and development of recessionary trends.



Christian Friis Bach, Executive Secretary of the United Nations Economic Commission for Europe: “We need a ceasefire on the battleground, but we also need a ceasefire in the marketplace.”

Unpredictable oil



At the SPIEF session entitled 'A new balance in the oil market and its implications', energy company heads from around the world discussed how to predict risks and how to handle low prices for one of the world's most important energy resources.

Oil prices have been cause for worry for many months running now – for producers, consumers, and the public at large, given that prices have a direct bearing on currency exchange rates and, consequently, inflation.

Recently the price of oil has hovered around the USD 50 per barrel mark, and it shows no signs of stabilizing within a range that is comfortable for all interested parties. At the St. Petersburg International Economic Forum in June, energy company chiefs proposed various ways to influence prices, but at the time, the experts' suggestions were rather long-term in nature.

The panel moderator, Nobuo Tanaka, former Executive Director of the International Energy Agency, noted that we are living in interesting times.

It was a subtle reference to the fact that today oil-producing countries are engaged, directly or indirectly, in military action. For that reason, oil prices also depend on the geopolitical situation, which today is marked by instability.

Next to speak was Rosneft President Igor Sechin, who saw the main problem as residing not in geopolitics, but in the fact that nobody had foreseen the onset of an oil crisis and nobody had calculated the risks.

Therefore, he claimed, those risks are now having an impact on the industry that is not just serious, but dramatic. Furthermore, the sharp drop in prices also spurred the process of competition over resources and repartitioned the market.

Now, Sechin said, one thing is clear: if prices do not meet objective requirements, then in the future, both

consumers and producers of energy resources will suffer.

"One obvious component of the price – operational expenses – will only grow with time. The component connected with investment costs also tends to grow. So what has fallen? First of all, price pressure has facilitated a pointed reduction in both marginal and average costs. Secondly, another truly important component of the price for oil has been demand for a price level that meets the needs of national budgets in producer countries. But once the OPEC countries rejected market regulation, they in effect rejected their obligations to shape the revenue portion of their own budgets. This vital limitation is no longer significant. There is a separate question here, as well: how long will producer countries be able to function under large budget deficits? Thirdly, the price of oil today, in contrast to what it was, say, 40 or 50 years ago, is determined not on a 'cost-plus' formula. To a decisive extent it instead depends on both the supply and demand ratio and the market for financial instruments derived from oil prices," the Rosneft chief explained. He also expressed doubt that today's oil prices had nothing to do with dumping and the associated rush to repartition the market.

"An important question to which we will have to pay attention is this: if the large-scale financial flows that have formed from energy resource suppliers to other spheres do not lead to a growth in the real sectors of the economy, then where are those gains being accumulated? I think that demands serious financial and economic analysis," Sechin said.

Until the results of that analysis are in, lessons will need to be gleaned from the



It is hard to believe that on June 19 last year, the price of oil was USD 115 per barrel. Today, it is USD 63 per barrel. So this is a huge dislocation in our industry in a short period of time. I think we all, both in the industry and governments, began to believe that the new normal was USD 100 per barrel.

Cost structures rose, taxation systems rose, and in the end, the rates of return on investment for oil and gas companies at USD 100 per barrel was not much different from USD 10 or 20 per barrel in the past. We are going through a sharp shock in our industry. We have been through this before, so we know how to adjust in terms of cost structures and work with contractors. But USD 1.5 trillion of purchasing power is going to move, in one year, from producing areas of the world to consuming areas of the world. This is really good in China, India, Indonesia and places like Egypt. It is broadly good in Europe and Canada. But it is really painful in the oil-producing heartlands of the world. They have been hit very hard in a short period of time. Russia is adjusting very quickly in terms of its cost structure. It has a cost advantage with roubles, but raw commodity revenue is way down.

Robert Dudley,
Group Chief Executive of BP

Oil reserves



A major report was published recently by a team of American experts, led by Rex Tillerson, about prospects on the continental shelf.

The report states, in particular, that shale oil in the US is an important medium-term, but not long-term, factor. Instead, the Arctic shelf will provide the chief guarantee of long-term stability for worldwide oil supplies. Extensive lag time in implementing such large-scale projects means that now is the time to start work on the Arctic shelf, including work to solve all the challenges associated with it. The authors of the report also note that the technical problems of Arctic shelf exploration can already be solved entirely by existing methods and by work that has already been done.

Furthermore, the report asserts that Russian resources on the Arctic shelf hold the most promise. However, prices, too, must correspond to this long-term trend.

situation at hand. And indeed, it is precisely the kind of crisis situation which can be exploited for good.

“The lesson, it seems to me, has to do with the growing role of technological progress, innovation, and the sector’s responsiveness to favourable factors. In the United States, there is a whole array of such factors at work: the ability to easily attract cheap financial resources, a well-developed financial toolkit, price hedging capabilities, the unprecedented power of the services industry, and highly-developed logistics. They are making active use of the multiplicative effect of objectively expensive shale operations on the economy as a whole. For many components, we can state that the United States possesses the full complement of factors for a fully-developed and competitive oil market. In other regions of the world, only individual elements are present. Incidentally, this allows the United States to transmit signals from its market far beyond its borders, and to effectively impact events on a global scale,” he asserted.

One more problem concerning volatility in the oil sector is the temptation to monopolize services. If only the efficient survive a crisis, then the sector will shed some ballast. Is that the case here? Sechin proposed further work on this idea, holding it to be not strictly true.

“Efficiency depends on many factors. Currently, about 60–65% of the oil that is easiest to extract is situated in the Middle East. The higher prices in the 1970s had a political cause, and the price shock they produced led to the worldwide diversification in oil sources. Then, right up until the present, even while oil prices fell dramatically in the second half of the 1980s and in the 1990s, diversifica-

tion of supply became the single most important pillar of energy security," Sechin continued.

He also pointed out that resources in Africa and the Middle East have never been subjected to an independent audit. States in those regions insist that only service contracts be signed with foreign companies.

That means that those countries are essentially located outside of the global market, while only partnerships would be capable of apportioning risks more evenly.

"Considering these circumstances, there are serious doubts that any individual producer country could win a long-term competition or lead the world to critical dependency on oil suppliers from that country," Sechin observed.

At the same time, the resource potential of the United States is based on an analysis of deposits being developed.

According to Sechin, "For now, the United States Energy Information Administration, in its latest predictions to 2040, is asserting that as a baseline scenario, after about five years of growth, total oil production in the US will stabilize and then start to decline. For that trend to occur, prices for WTI-grade crude oil need to see stable growth, reaching USD 80 per barrel by 2020, and then grow more quickly, to about USD 120, by 2035. Add in target inflation of 2% per year, and you get a predicted price level of USD 170 or above."

His analysis showed that effective oil resources were far from inexhaustible, especially if we take into consideration the multifaceted risks associated with their development. That means that the

battle will continue for these resources, and for access to them.

"One way or another, through shocks and extreme instability or with a more balanced method, we will come out on the price curves and the levels which, according to authoritative agencies such as the IEA and EIA, will be necessary in the future. Of course, it would be preferable to move down this path with fewer losses. I should mention that cooperation between the Russian oil industry and its foreign partners remains strong, and their role in our industry is very important. In terms of capital stock ownership and specific oil projects alone, their role constitutes about a quarter of all activity," Sechin added, and expounded on the large role international projects now play in the energy sector.

"I believe that the division that we used to have between transnational and purely national oil companies is growing obsolete. We are all international companies in terms of the structure of capital and areas of activity. Of course, every company has its own underlying assets and traditionally strong – sometimes preferential – positions in its respective country and the regions where it does business. But there are fewer insurmountable barriers between them, or none at all," he said.

Sechin concluded his talk with a claim that it is necessary to reject unilateral subsidizing at the expense of the oil and gas sector, and to exert closer supervision over the banking sector for the purpose of preventing "bubbles" and price manipulation.

"The critical role companies should play is one in which they continue surveying work in order to diversify reserves, continue technological progress to reduce production costs, and bring in invest-

60–65%
of the easiest-to-recover oil is located in the **Middle East**



Despite the internal and external challenges our industry has faced, we are seeing positive trends, positive numbers in terms of production figures. Last year, we saw a growth in the number of development wells. This year we are seeing an increase in production and exploratory drilling of 8–9% compared to last year. All of this provides a boost to extraction volumes. Last year we grew by 0.6% in terms of extraction volume, and this year that number is 1.2% over five months. This is a result of the government's taxation policy over the past several years. Essentially, our national budget has borne the main brunt of the change in prices and has made it possible for our industry to operate as comfortably as possible. This really is qualitative growth. Our production volume for hard-to-recover reserves is up 6% from last year. Our production volume at new fields is up 9%. Our geographical profile has changed. Our main site, Western Siberia, is seeing slightly lower oil production volumes, while in the Far East and Eastern Siberia those volumes are growing.

Alexei Texler,
First Deputy Minister of Energy
of the Russian Federation

ment to develop new oil and gas provinces. Only this will guarantee long-term stability in prices. At the same time, in the short term, largely because of the price shock the sector has experienced, and as a result of the lower capital investments it caused, I also foresee growing competition for resources, and markets must prepare for continued volatility," Sechin concluded.

Igor Sechin's fellow panellists also proposed ways to avoid large losses due to volatility and unpredictable risks.

Lorenzo Simonelli, President and CEO of GE Oil & Gas SpA, is betting on long-term investment, which is not disturbed to such a great extent by volatility.

Trafigura CEO Jeremy Weir conceded that volatility means profits for traders. However, he does not agree that traders should be seen as speculators.

"Our industry is based on managing risk, and being able to create value out of managing that risk. It takes a long time to develop the strength to do that, and also a lot of investment. We try to provide solutions to our customers, on the producer side and on the consumer side, to effectively navigate through these volatile market conditions and provide services to them in finances and logistics. We manage the risk very closely. The knowledge and experience and the global footprint that a trading company has, and how it can effectively consolidate those exposures, can bring them to a centralized platform to manage that risk appropriately. That brings benefit to both consumers and producers," Weir argued.

"The price decline puts an onus on what types of technologies you are investing in. We think that now is the op-

portunity to really invest in standardization, to achieve operation execution and excellence, and standardization in the products we are utilizing in sub-sea projects and in drilling. We are not going to be able to predict the price of oil. What we have got to be able to do is to retain the investment in technology," Simonelli stated in turn. The president of Petroleos de Venezuela S.A., Eulogio Del Pino, talked about the necessity of having a strategy for collaboration among oil producers.

Such a strategy would enable a reduction in production costs while oil prices are low. Del Pino noted that major investment is needed when oil prices are high. In the current situation, though, attention must be paid to reducing costs.

"For example, Venezuela has the largest oil reserves in the world," said Del Pino. "Most of it is heavy oil. But heavy oil can be blended with light oil. That can be adapted to the existing refinery process. We producers used to be very low-efficiency. Only the low-cost producers would survive."

"Like everyone else, we are looking for cost reduction. I think this is important for countries like Argentina. What really matters is your cost of replacement, because that will also help us to pass through this situation now, where everyone is going to restructure. But countries also need to consider the cost of replacement," commented Miguel Matias Galuccio, President and CEO of YPF S.A.

Roberto Suarez, Deputy Director of Union CubaPetroleo, cited integration as vital for market stabilization.

Glenn Waller, President of ExxonMobil Russia, expressed his concerns that the lack of any prognosis and the complexity

of geopolitical relationships is increasing risk for companies like his own. Consequently, managing those risks is the key to success.

Igor Sechin concluded the session with a clear argument that costs must be reduced and risks must be managed. For that to happen, he believes, only a couple of things are needed: trust and long-term relationships.

What will be done along those lines and when those efforts might lead to market stabilization, clearly, time will soon tell.



Lorenzo Simonelli, President and CEO of GE Oil & Gas, is betting on long-term investment, which is not so vulnerable to volatility.

Role of civil service resurfaces



Malaysia, Singapore, and the UK are all countries which, by reconsidering the mechanisms by which their governance agencies operate, have managed to increase the rate of socioeconomic growth. Representatives from the higher echelons of government in those countries explained ways to reform government.

Taking part in the Sberbank Plenary Session was one of the most esteemed guests of the St. Petersburg International Economic Forum: former Prime Minister of the United Kingdom Anthony Blair. Blair came up with a methodology for reforming government offices, and he created the Prime Minister's Delivery Unit, a special division reporting to the British Prime Minister that planned and monitored reforms.

"The challenge for government is how to get things done. In a world that is constantly changing, that means government itself has to change and reform. This issue of governance is vital, but it requires new ways of working; it requires either new personnel or changes in the mentality of existing personnel," said Blair.

The Anglo-Saxon reform model, which may be applied in any country across the world, requires that several principles be observed. The first of these is concentration.

"You cannot do 50 things. And so, typically, what we have seen is that it is five to seven", commented Dominic Barton, Global Managing Director of McKinsey & Company. "The Malaysian example had seven priorities – very specific priorities on crime, on getting more people to use urban transit, and others. The Colombian government, with President Santos, has had eight. The second principle is that they are measurable. You do not wait five years to see what actually happens. In the case of Malaysia, at the very beginning of the programme, the Prime Minister reviewed the results on those seven every Monday. In this case there was a minister, Idris Jala, who brought it forward."

"The next principle is transparency, included so that no person would be able to avoid responsibility. For example, every six months during the course of reforms,

the Malaysians invited the media to carry out interim assessments. The last element is leadership – the person leading the reforms must be bold and courageous. In Singapore, the efficiency of a government service is assessed in comparison with indicators from the private sector."

"They look at what are the best companies with the best practices in these various areas", said Lim Siong Guan, Group President of GIC. "The whole idea is that everybody knows that you are constantly trying to be the best that you can be, and you try to run a system that is therefore not based on central control... Instead, you base it on what you think the people in the ministries and agencies are able to do and measure that against what they actually do. The idea used in Malaysia is actually a system used in Singapore."

Now let us turn to Russia, and a typical situation as highlighted by federal minister Mikhail Abyzov.

"A major forum takes place in Sochi. There, the business world, represented by ombudsman Boris Titov, presents an excellent report accompanied by a thick folder of papers. He approaches the Prime Minister and says, 'Mr. Medvedev, this material concludes that you need to issue 96 individual orders.' Each of those orders would then be carried out by up to 2,000 government servants. 'Boris, perhaps we should discuss to what extent these assignments correspond to government policies?' 'No. An order is a piece of paper. We can present it and demand results.'

"We are all quite used to this system. Radically reconstructing and changing it would take enormous effort and must be approached with no illusions. Governance according to goals, principles, and values is a very complicated task. I am not expecting results tomorrow," Abyzov said.

Across a number of indicators, **Strategy 2010** was **80%** fulfilled



Governance, in the narrow sense, means executive power, exercised in the main via one of its branches. Governance in the broad sense might also include other state agencies which determine how well the laws are administered and executed – perhaps even the court system. My understanding is that today we are talking about governance in the narrow sense.

Of course, I had in mind a departure from the system of manual control. For that to occur, even if we were to set ourselves precise goals and lay out a roadmap, we would need several steps, the first of which would take about two years. One time I needed a certain regulatory document. When they brought me the government order, I nearly fell off my chair: instead of Putin's name, Stalin's name was on the document.

Some very old rules are still in effect to this day. We therefore need a serious revision of some documents.

Alexey Kudrin,

Dean of the Faculty of Liberal Arts and Sciences, St. Petersburg State University

Strategy 2010, also called the Gref Programme, was a plan for economic development that was adopted for implementation in 2000. When it was finished, it was calculated that in terms of indicators, the plan had been about 50% fulfilled, with several indicators 80% complete and other parts 15–30% complete. According to former Finance Minister Alexey Kudrin, those figures demonstrate the effectiveness of the governance mechanism and loyalty to the declared goals. "You can see the value of our politicians' declarations and promises. What this means is that we need to change the decision-making mechanism, change the system of governance," said Kudrin, now Dean of the Faculty of Liberal Arts and Sciences at St. Petersburg State University.

He also recalled a programme of nationwide projects in which all objectives were concentrated on four main sectors: education, health care, residential construction and agriculture.

"All activity was scheduled, and both the federal centre and the regions participated. With the change in president, the programme was upgraded, but I do not remember whether we discussed its results at the conclusion of Medvedev's presidential term. I cannot even remember whether those national projects were scrapped or if they quietly disappeared of their own accord," Kudrin declared. In this case, who ought to be punished for the fact that the governance system operates inefficiently? Herman Gref's comments on punishment were quite noncommittal.

"This is a typically Russian question: who should be punished? Critically speaking, the correct answer would acknowledge the fact that government offices, what we call the bureaucracy, are made up of real, living people. It is very important for

them to be highly qualified and highly motivated. According to the latest research, employee engagement increases the efficiency of a government servant by about 50%, giving him an advantage over people who face only the threat of punishment. Those people say: 'Go ahead and punish me, I have nothing to lose, my salary is not that high.'"

The comment prompted a pertinent question from the auditorium, which had been hanging in the air. It was asked by Vedomosti Editor-in-Chief Tatiana Lysova: "From what I understood of today's discussion, in order to conduct reforms, a country needs an external supra-governmental body, preferably reporting to the president. My question is for Herman Gref and Alexey Kudrin. Which one of you is prepared to head this body? Who will take on that responsibility?"

The government men, predictably, expressed no commitment to take on the job. Alexey Kudrin declined to comment, while Herman Gref stated that he already has a small organization which faces more than enough problems of that type.

"We are not talking about a supra-governmental structure, actually, but rather about a specialized body that can assist both the government and the president in carrying out transformations – and will do only that, because the other agencies are already overburdened with their current workload," concluded the Sberbank chief. Mikhail Abyzov sees three main defects in the Russian government: redundancy in government functions, a large number of goals and their incompatibility with the resources the state has at hand, and finally, manual control.

"That was an absolutely justified tool for making quick decisions during the 2008

crisis. The negative impact is that it is now starting to be implanted into the system of government administration”, the minister declared.

Herman Gref, CEO of Sberbank and discussion moderator, noted that the question of who would create and look after the functioning of an efficient government would have to be addressed.

“Prime Minister Blair had Michael Barber and his team, and the Malaysian prime minister has Jala. Perhaps the problem is that we have not built the infrastructure. Is that why we are not seeing results?” asked Gref. Alexey Kudrin expressed his view that the required agency ought to be established and made a presidential organization.

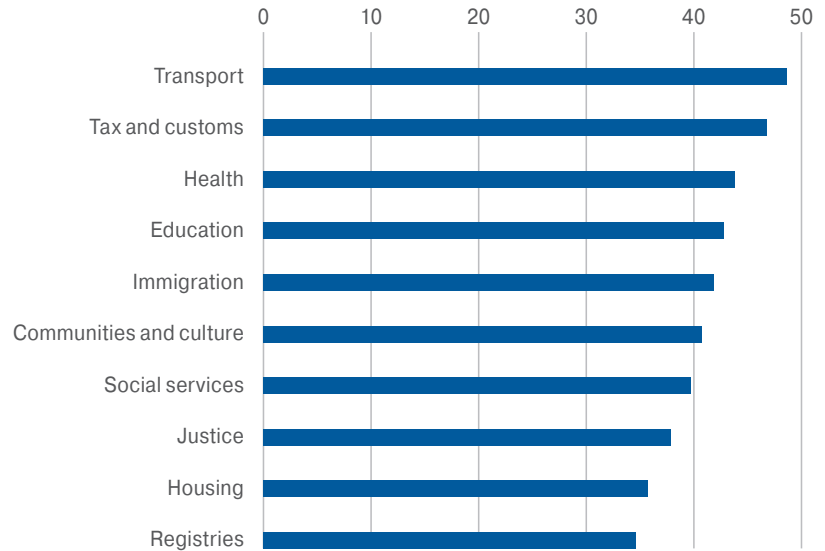
“According to the Russian Constitution, strategic document systems are approved by the president, and he is the one who lays out the main areas of activity and goals for the government each year, by formulating the chief objectives in his message to the Federal Assembly. However, the government absolutely needs its own supervisory body, too, which would monitor the activities of the government itself. It could be like a traffic signal, with red, yellow and green lights. We all need to test ourselves,” asserted the former minister.

Mikhail Abyzov proposed addressing the crisis in government administration by creating a planning centre to coordinate assignments and assess results. The only thing that was not completely clear was the way in which it might be built into the governance system.

“We will hope that the question has reached the Open Government programme,” said Gref, concluding the discussion.

Room to improve for public sector online services

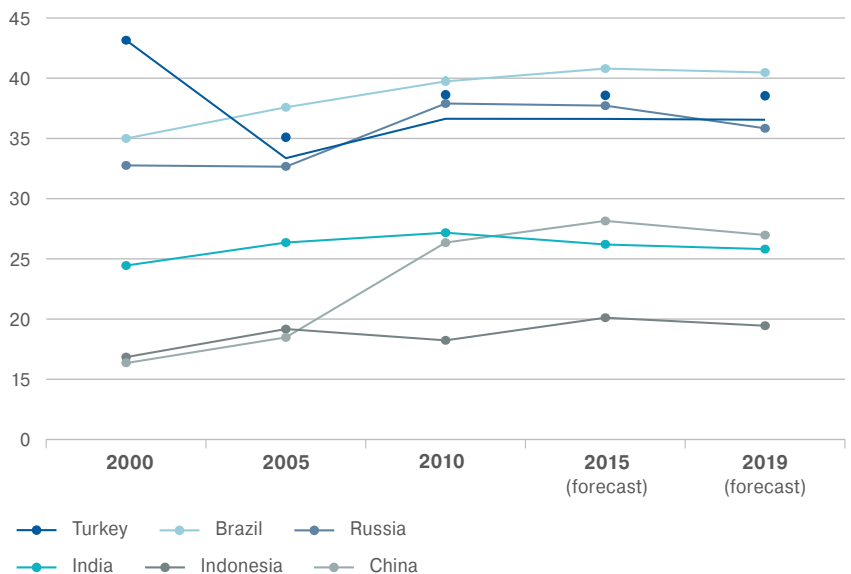
Satisfaction with online government services in Russia, %



Source: Digital Government: Turning the Rhetoric into Reality, The Boston Consulting Group, June 2014

Governments of major emerging markets are expected to maintain their levels of economic involvement

Total government expenditure as a % of GDP



Source: International Monetary Fund, World Economic Outlook, October 2014

Great challenges

The future development of BRICS and the impact of its activities were the focus of two sessions at the St. Petersburg International Economic Forum. The subsequent Ufa summit provided answers to the pressing questions posed over the course of SPIEF.

The impact of what has been done so far was not as great as had been expected – a fact immediately recognized by Alexey Likhachev, First Deputy Minister of Economic Development of the Russian Federation. But, according to Likhachev, this is no reason not to be ambitious and set BRICS “great challenges” with the expectation that they will be swiftly met.

As an example, he pointed out the negative impact on Russia’s foreign trade from a series of different factors. “There are countries which are going against this trend, and Russia’s exports to these countries, as well as imports from these countries, are growing. I am speaking about the BRICS members. These are the exceptions to the rule, which only serves to highlight our good choice of partners in this mutually beneficial and robust union,” he said.

Going against the trend has enabled gradual progress from meeting to meet-

ing, and has seen important decisions being taken. The deputy minister was of the view that for such huge economies this is just a small undertaking, but it is innovative work that will over time yield far greater results.

“As far as fundamental goals and challenges are concerned, we are approaching the Ufa summit with a programme of economic partnership in mind, with a roadmap for projects in key sectors and a roadmap developed with our partners from friendly economic unions. Clearly, this will necessitate regulatory adjustments and the removal of barriers that exist today in the trade of services and investments. And this is also a challenge for our governments – another challenge of the times,” concluded Likhachev.

While this objective remains on the agenda, the results achieved by the union over the last three years show that trade turnover between the BRICS

countries has increased and diversified, and that new points of growth have been found for continuing this work.

Didar Singh, Secretary General of the Federation of Indian Chambers of Commerce and Industry, supported Russia's position on the purpose and success of BRICS.

"BRICS is a very important forum for us, and a very important initiative for us. The real potential is that BRICS represents the potential of the future. And that is what we really need to all work towards", said Singh. "India, of course, is recording very strong growth at the present moment. We now have the largest GDP growth in the large economies, and this is something of great interest, I believe, not just to the world, but specifically to the BRICS economies. We therefore hope that we will see greater collaboration between our countries."

The Chinese and Brazilian representatives at SPIEF pointed out the shortcomings of BRICS which are essential to root out now, during the culmination of efforts to increase cooperation.

"I would like to draw attention to the fact that it is the small and medium-sized enterprises in our countries that are being short-changed. We know entrepreneurs would like to see forums and conferences in the future being planned with a greater focus on the problems that affect SMEs, and the challenges and difficulties that they must overcome. We have participated in many conferences and forums dedicated to regional cooperation, but the general feeling is that we must strengthen efforts in this area. Platforms already in existence for the discussion of issues ought to actually create new business opportunities," said

Yu Ping, Vice Chairman of the China Council for the Promotion of International Trade.

The representative from Brazil, IMF Executive Director Paulo Nogueira Batista, expressed his belief that BRICS countries today have reached "a new plateau of cooperation", and that the new institutions being set up within the organization reflect the fact that the existing international financial architecture does not adequately reflect the size of the countries of which BRICS is composed.

Another problem for BRICS is that not everyone has learned to fully exploit the extensive tools the organization has at its disposal.

"Each country has been independently supporting exports and foreign trade, but we must remove barriers and harmonize the conditions for companies operating in each other's markets," said the head of Delovaya Rossiya (Business Russia) Alexey Repik.

The main tool that will make this possible is the New Development Bank (NDB).

"If the New Development Bank can invest more actively in joint infrastructure, including trade and service infrastructure, and if, through joint investments, we can facilitate trade and the creation of added value based on shared value and technology chains, then BRICS will have become not just a set of bilateral relations between the strongest and most promising economies on different continents, but a truly united economic space, which is precisely what I hope we will soon achieve," said Repik.

The NDB was the subject of a separate discussion at SPIEF 2015, after which

Russia needs
USD 1 trillion
 in infrastructure
 spending;
 funding provided
 by the BRICS New
 Development Bank
 totals
USD 10 billion

SPIEF Review had a chance to talk with the newly appointed president of the organization, Indian representative Kundapur Vaman Kamath.

During the Forum session there were several criticisms levelled at this young and as yet unproven organization.

For example, the head of Beeland Interests, Inc. Jim Rogers, speaking about the intention of the NDB to invest in international infrastructure projects, expressed doubt that the impact in these cases would correspond to the money invested, citing by way of example projects which have already been implemented with the help of similar financial institutions.

In turn, Editor-in-Chief at Business New Europe IntelliNews Ben Aris drew attention to the fact that Russia alone requires USD 1 trillion of investment in infrastructure, whilst the financial provision of the NDB is just USD 10 billion.

As the first to be elected president of the bank, Kundapur Vaman Kamath explained where the work of this new organization would begin, and stressed that he would not repeat the mistakes committed by other similar organizations.

“First of all, we would like to comprehensively examine the development of the banks established by different states and unions currently in existence, including analysing their mistakes. Those mistakes that I have mentioned stem from a sizeable degree of sluggishness seen in developing countries as a whole. Their approach needs to be more flexible. Another point is the scale of innovations – new ways of identifying innovative products and selling them. The third thing to look at is the speed at which we are experienc-

ing change. These three things I consider to be fundamental,” said Kamath.

In the course of the session it was suggested that the NDB could just become yet another bureaucratic institution. But the opinion was also voiced that it may be capable of re-drawing the world map and having a major impact on the advancement of developing economies. We asked the president of the bank whether we should set any store by these expectations.

“I think it’s far too early to draw conclusions or to talk about the creation of some new bureaucratic system. The bank has only just been established and I have only recently been appointed its first president. Before this I worked in the private sector. In fact, we are now beginning with a clean slate, so we must first do what we plan to do, and only then assess the outcome. That said, it is important to bring to this structure that aspect of the private sector to which I have already referred: to eliminate the sluggishness of a bank created by several countries, to accelerate our reaction time when problems arise, and to speed up the decision-making process. This is our goal, and these are the challenges we face,” he answered.

He also pointed out the short time period in which initial conclusions about the work of the bank will be drawn.

“Of course, starting a new venture, opening a new bank, is by no means an easy task. Our goal is to launch our first project in nine months’ time and start seeing some results. Our main task is to provide loans, the first of which will be issued in nine months’ time,” he said.

Kamath also stated that the priorities for funding have not yet been determined. A decision on this will be taken

during meetings of representatives of all five BRICS countries, who will announce what kinds of projects are most important to their respective countries. However, Kamath also stressed the importance of keeping these discussions free of politics.

“The NDB should not be a politically orientated structure. Yes, we have common goals and we are working to achieve them and to meet the major challenges we face. I am confident that we will achieve more if we do not get into politics,” concluded the NDB chief.

The establishment of the NDB was held up as a key achievement at the BRICS summit in Ufa. Following an extended meeting of BRICS leaders, Russian President Vladimir Putin clarified the purpose of the new organization.

The NDB will finance joint projects in the transport and energy sectors, as well as in the field of industrial development. A list of specific projects will be developed before the end of the year. The total capital of the new bank will come to USD 100 billion. Money from national budgets will be contributed over a seven-year period. The amount of money put down initially will come to USD 10 billion.

During the event in Ufa it also was confirmed that the bank will start by financing projects in the countries which have founded the new financial institution. Russia has 37 such projects, including the construction of a high-speed rail line connecting Moscow and Kazan. The development of rail infrastructure is also a priority for other countries in the organization. There are additional proposals to establish port facilities and build helicopters. Projects will be selected by national development banks.



As the first President of the New Development Bank, Kundapur Vaman Kamath explained where the work of this new organization would begin, and stressed that he would not repeat the mistakes committed by other similar organizations.



Reducing tensions

During SPIEF, Peter Lavelle, journalist and host of CrossTalk on RT (the international, multilingual news television network formerly known as Russia Today) discussed relations between Russia and Europe with the President of the Foundation for Worldwide Cooperation and ex-Prime Minister of Italy Romano Prodi. This interview is now presented in SPIEF Review.

I would like to quote something you said recently, which I think sums up the relationship Russia has with Europe, and perhaps the western world in general. You said recently, "You can be tough if it suits you, you can be soft if it suits you, but you cannot be tough when it brings you nothing but harm. Isolating Russia is harmful." Could you elaborate on that?

It seems that, step by step, we have fallen into a very dangerous situation here. We have entered into a continuous confrontation that is growing without any new reason to grow. There are so many common interests in a situation where we should move towards agreement, to at least calm the tension between Europe and Russia.

We have seen that with Minsk II, where European leaders, the German leader and the French leader, very bravely if I may say so, went to Minsk and did support a peace process. However, it seems that the United States only

pay lip service to Minsk II, that they are not interested in peace in Ukraine. One of the most fundamental questions is, why can Europe not act more independently?

I would pose the more general question of whether 'Europe' actually exists. That is the real problem. We are fragmented. The European situation is very different from 12 years ago, when I was President of a European Commission in which you had an entente cordiale, of sorts, between Germany, France, the UK, Italy, and Spain to a degree. In recent years, we have seen an enormous change. From one point of view, France's influence has decreased a lot.

Secondly, when the UK declares that in four years' time it may no longer be 'a member of the club', all the countries that have been negotiating their position among the different countries will be under the German umbrella. This is the new Europe. I called the European Union 'a union of minorities'. Can you call it a union of minorities now?

You certainly can. Can you explain to us, if the European Union is a union of minorities, why does it want another minority, namely Ukraine?

I always said that Ukraine can neither be a member of the European Union nor part of Russia. Ukraine has different characteristics. It must be a bridge and not a battlefield, but with strong unity and independence. If it does not have this then you will never have a link between Russia and Europe, and you will never have peace. This is a problem that must be solved.

Why did the European Union and the United States tolerate the coup in Kiev?

If you look at the past, trying to compile a list of mistakes, your task will never end. We have to look towards the future of the country. We have a situation in which Russia is worse off, Europe is worse off, and Ukraine is worse off. If there were an agreement between the US, Europe and Russia, then in one day, international terrorism could be defeated. This is the real fact of the matter! This is why I am so angry about the situation.

If you consider Libya and other countries, there could be a solution, in which the US and Russia together, and China too – because all big powers are frightened by terrorists – might say, "Let us agree on this for a while, because it is our interests."

One just has to listen to what he has to say – that there is Russian aggression, when in fact there is a peace process, a political process, that needs to be implemented. Why does Europe not stand up and say that? Why can it not say that the United States is wrong and that the European Union fully backs the Minsk II process? It is because Ms. Merkel always steps back when it is important.

You will have to ask Ms. Merkel. It is a simple matter of common sense. Today I read in an Italian newspaper what former U.S. Secretary of State Mr. Henry Kissinger has said; it is absolutely the same as what you are saying now. He said that Russia is

important for peace, that we need Russia's contribution in dealing with crisis, terrorism, climate change, food security and weapons of mass destruction. But that is Mr. Kissinger, and not a left-wing European.

At the same time, as Mr. Kissinger says that President Putin must on his part recognize Europe's internal political problems, and act wisely rather than exacerbate these problems. That is the opinion of Mr. Kissinger, and I completely share his view. It is, however, difficult to give you an answer as to why Ms. Merkel is behaving in this way.

Why does the west not want to recognize that Russia has its own national security interests? This is impossible to answer. As I told you before, I recognize it. I believe it is a strategic mistake on the part of the United States to think that Europe is more useful without Russia than with Russia.

That is a strategic miscalculation, particularly in regards to Europe's energy supply problems. The US is self-sufficient in energy, but will never be a big exporter of gas to Europe, because of the Asian market, among other reasons. The political problem at this moment is the United States and its efforts to demonize Russia and President Putin.

Is Europe afraid of losing Russia for good?

Europe is miscalculating the problem. I also have some questions which I am unable to answer. I will give you an example. In my mind, I never think of the past; I want a solution for the future.

When Russia decided not to build the South Stream pipeline, I told President Putin, and then I told the Italian High Representative for Foreign Affairs and Security Policy, Ms. Federica Mogherini, as well as the German Minister for Foreign Affairs, "The situation is very simple. You have two pipes connecting Russia to Europe: let us make a joint venture, with one third contribution from Russia, one third from Europe, and one third from Ukraine. Russia is happy, Europe is happy, and Ukraine is happy."

Everybody was telling me what a great idea this was. It is very simple. In January of this year, I went through all the steps, everybody was happy, and then nothing happened. Hence, the problem is not rationality, but rather irrationality. In history, irrationality has often occurred in Europe where you have two pipes, and where Europe needs Russian gas, but less now because demand is decreasing. Russia needs to sell gas. Ukraine gains from the gas passing through. I said, "Let us do this."

Somebody wrote to me with the question of whether the Ukrainian government may be divided, and I replied, "Perhaps, but if Russia and Europe agree, I do not think the Ukraine can do anything else." I found, in this situation, that the tension has gone far beyond common sense and beyond any common interest.

When a challenge is an opportunity

With the rise of greater Eurasian integration and the emerging concept of a new Silk Road, members of the Shanghai Cooperation Organization (SCO) face new challenges. The question of how to build a productive relationship with the Eurasian Economic Union (EAEU) and improve the work done within the association was discussed by a group of experts at the SCO Business Forum held during SPIEF.

Heads of financial institutions and government bodies from the region covered a broad agenda, including: the EAEU as a means of renewing and strengthening investment partnership within the SCO, steps to promote cooperation on multilateral projects, financing the SCO's economic programmes, and harnessing new market opportunities.

As Dmitry Mezentsev, Secretary-General of the SCO stated, the time has come to discuss a new model and format for the emerging trade and economic partnership within the SCO, which should now be in line with the development of the EAEU.

According to the Secretary-General, the challenge for the regions that make up the SCO is to realize the concept of the Silk Road. Alexey Likhachev, First Deputy Minister of Economic Development of the Russian Federation, confirmed that through integration, agreements to link up the Eurasian union and the economic interests of the Silk Road would make it possible to set up an entire logistics chain.

"Cooperation projects within the SCO should, first and foremost, be focused on logistics issues, and this should become a factor in leveraging the creation of a barrier-free environment across Central Asia", Likhachev noted.

Karine Minasyan, Member of the Board (Minister) of the Eurasian Economic Commission (EEC), saw great potential for cooperation within the EAEU and the SCO, especially in the field of digital support systems, a prerequisite for infrastructure projects. Only three EAEU members are currently members of the SCO. Since the EAEU focuses on integration and the SCO embraces a broader range of interaction, the activities of the two organizations overlap. The EEC representative was clear that not all SCO member states should become members of the EAEU, but that opening up a new economic space is a possibility in the long term.

Nematullo Khikmatullozoda, the Minister of Economic Development and Trade of the Republic of Tajikistan, expressed his commitment to integration processes across the Eurasian continent.

"Following the implementation of several specific projects, Tajikistan will, in the near future, become a transit route for gas shipped from Turkmenistan to the countries of South Asia, including China," said the Tajik Minister.

According to most analysts, Russia continues to be a strategic partner for SCO member states. Alexey Likhachev noted that Russia is currently one of China's top 10 trading partners. Exchange rate fluctuations notwithstanding, the physical volume of trade is growing, including trade in high-tech products, and the number of bilateral projects is also increasing.

The First Deputy Minister expressed his conviction that, given the current stage of development in the relationship, improving the quality of these projects is vital. As a priority, he proposed making information about business requirements on specific projects more transparent, including the means and

the methods of integration by which governments could offer assistance on projects. Furthermore, it is important to make working through banking unions achievable, not only at the financing stage, but also during the project preparation stage.

The expectations of Chinese business circles with regard to the future work of the SCO were voiced by Yu Ping, Vice Chairman of the China Council for the Promotion of International Trade.

"It is with a great deal of hope that we are watching the increasing role of the SCO Interbank Association and the promotion of the idea of creating an SCO bank. By advancing partnership in these sectors of our trade and economic relations, we can make cooperation between businesses much easier," he noted.

All the conditions for transitioning to making payments in national currencies are now in place, according to Anatoly Aksakov, Chairman of the State Duma Committee on Economic Policy, Innovative Development, and Entrepreneurship, who commented: "The fact that transactions between our banks go through New York or major European banks is wrong, as it leads to an increase in the transaction costs incurred by credit organizations."

Cooperation between national payment systems, in Aksakov's view, presents another possible opportunity for partnership. Such a system has already been set up in Russia, and at the end of the year the National Card Payment System, created by the Central Bank, will begin to issue its own cards. Through cooperation with the China UnionPay payment system, the Russian system will quickly become international.

Russia is one of China's top 10 trading partners

Energy integration



The integration processes taking place in national energy systems will increase efficiency, but will also require substantial financial investment as well as political and technical backing. Despite this, experts at the St. Petersburg International Economic Forum agreed that global efforts to combine markets will have a positive effect on the development of a global energy network. They discussed it at a panel session entitled 'Powering opportunity: integrating European, Russian and Asian energy sectors.'

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Oleg Budargin, Director General of Rosseti, discussed the statistics on Russian electricity exports and expressed his belief that grid power lines can be modernized.

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Spare energy

Integration and consolidation are increasing the reliability of the electrical grid infrastructure, and are also very cost-efficient. We currently have a fair amount of spare electricity – in the region of 20 gigawatts – and we have the opportunity to benefit financially from this reserve and develop our systems for electricity generation.

Unfortunately, in recent years we have reduced our electricity exports to neighbouring countries by almost 30% and are currently exporting only 2% of our electric power. By way of comparison, Germany exports 12% of the electricity it produces, France exports 10%, and there are more than 200 integration projects being carried out in Europe as a whole. A good example of reliable cooperation between two national energy grids is the Gas Interconnector Greece–Bulgaria.

We have signed an agreement with the South Korean electrical grid company KEPCO, which is now being implemented. We have already set up a working group to examine connection points, consumption points, and a timetable for the delivery of electricity to South Korea. Initial volumes total just 4 gigawatts, but this is only the start. We are continually discussing and implementing projects with the State Grid Corporation of China (SGCC). We see these kinds of projects as energy bridges.

Russia's energy network is itself an energy bridge. We have managed to preserve the unity of the energy grid, and ensure that it functions in accordance with a unified technical policy. The modernization and increased reliability of the energy network will allow us to create an east-west energy bridge. It is in the interests of our grid company to be able to attract consumers in Europe and Asia.

Of course, the most important thing and the starting point for integration is mutual trust between partners, consumers and businesses.

Battle for tariffs

A key condition is long-term planning and long-term tariff regulation. As you might expect, integration results in lower costs for project implementation. National energy networks tend to reserve 25–50% of the electricity they generate for their own national energy grids. Lowering the volume of our reserves will allow us to direct reserve funds from electricity generation tariffs towards grid modernization and further generation.

As far as modernization and the creation of new grids are concerned, both the consumer and the technology have changed, and we can no longer talk about simply building a new smart power line. It is possible that what we need is not a line, but a completely different approach to the architecture of the grid.



Bulgarian Minister of Energy Temenuzhka Petkova shared her expectations regarding European market liberalization.

Freeing up the market should give Bulgaria maximum transparency and increase the country's competitive edge. We have drawn up a contract for the acquisition of a platform for the exchange and trade of electric power. Our goal is the total liberalization of the market by the start of 2016. This will mean that we can finally enter the European system. In practice, within the framework of the European Union and common market, the infrastructure is used by all countries.

Naturally this comes at a price, as initial investment in this infrastructure is very high. Monetary investment and use of the results of labour is regulated by tools which define cooperation between EU countries. Each country also has its own regulatory body which sets transit tariffs. These tariffs include the expenses borne by the country in creating the necessary infrastructure.



Executive Vice President of the State Grid Corporation of China Chen Yueming talked about joint energy projects between Russia and China.

Partnership

We currently have a successful working relationship with Rosseti, with whom we have two major projects. In 2015, as part of a meeting between Chinese President Xi Jinping and Russian President Vladimir Putin, the State Grid Corporation of China (SGCC) and Rosseti signed an agreement on the creation of an enterprise to carry out grid projects.

This will enable us to work together on updating generation technology and boost development in other areas. The second project involves the Medvedovskaya sub-

station, construction of which began in 2014 under a joint agreement with Rosseti. This is an ongoing project supported by the energy ministries of both countries.

We also have joint projects with Inter RAO. Firstly, there is the delivery of electricity from Amur Region to China via four power lines. Over almost ten years, nearly 15.4 billion kilowatt hours of electricity have been delivered. Secondly, there is the Erkovetsky project, which has been discussed by the Russian and Chinese energy ministries and involves the simultaneous production of coal and electricity, guaranteeing 35.4 million tonnes of coal per year, and at the same time generating electrical power directly at the coalface to the tune of 7,920 megawatts, to be delivered to the north-eastern regions of China and further south. Two Russian ministers have only just said that in Russia a large quantity of energy is sitting idle. In China we have the opposite situation, with large demand for electricity. It is therefore vital to establish common, synchronized energy grids by building various power lines.

Work in this area has been recognized at the highest levels of Russian and Chinese leadership. The SGCC and Inter RAO are working together under the direct leadership of President Xi Jinping and President Vladimir Putin.

Russian Minister of Energy Alexander Novak presented examples of the integration of the energy market and stated Russia's priority interests.



On a broad platform

Integration is one of the key components of our country's energy strategy. The document was adopted for the period up to 2030, but times pass, the political situation changes, companies are starting to implement new projects, and so we are adjusting our strategy and taking it up to 2035. First of all, by integration we envisage joint projects between Russian and foreign energy companies, and the organization of synchronized operations. Uniform rules and principles of regulation represent the highest point of integration.

An example of a system on a broad platform is the unique Russian energy system, where 69 regional energy grids combine into seven territorial, interconnected transmission lines with a voltage of 220–500 kilovolts and more, and where more than 700 power plants with a capacity of more than 5 megawatts are in operation. But today we are talking primarily about the process of integration with foreign partners, one element of which is the export of electricity. Unfortunately, Russian exports are quite small, totalling only 15 billion kilowatt hours over the last year.

Energy friendship

In terms of the process of integration with our neighbours, I see a number of different mechanisms. The first is synchronous operation with the countries of the former Soviet Union, which was restored after 1992. Tajikistan, Turkmenistan and Armenia are still not part of this regime, although these issues are under discussion.

The second mechanism is the Eurasian Economic Union, which includes five countries. Before July 1, 2016, we must adopt a joint programme for the integration of electric power systems, and by 2025 we should have implemented the plan – in other words we should already be operating under common rules on a single energy market. It is not an easy task because everyone has their own rules and their own legislation, but in the end we will achieve energy systems which operate in a single economic space.

The third area to look at is the eurozone. In 2013, we signed a roadmap for the period up to 2050 for the integration of energy with European countries. A pan-European energy space should be established. Of course, this is an ambitious plan, and there are many difficulties to be overcome.

The fourth area for development is the east. This area of operations is currently being developed on an ongoing basis. We have many projects linked with Asia. These include the unified energy ring with our partners in South Korea, Japan, Mongolia and China, and our already established relations on crossflows, as well as potential projects for the construction of coal-fired generation facilities and DC lines. In addition to this, we are even considering the possibility of building a 50-gigawatt wind farm, and are currently drawing up a feasibility study for this together with our Chinese partners.



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Rector of the Moscow School of Management SKOLKOVO, Andrey Sharonov, spoke on the quantity of resources needed for the global integration of energy markets and by how much the cost for EU consumers can be reduced with the correct system integration.

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Integration requires huge mutual investments. According to the European Commission, just to create a common energy market in Europe before 2020 will require more than EUR 140 billion of investment in high-voltage networks.

If electricity networks in the EU were properly integrated, consumers could save up to EUR 40 billion annually. According to an analysis done by the International Energy Agency, in OECD countries a total of about USD 100 billion of investment in grids is required per year up to 2040. These investments will primarily help solve the internal problems of each of the participating countries, and investment as a whole will go towards increasing reliability and manageability through the creation of global integrated systems.

Minister for the Development of the Russian Far East Alexander Galushka spoke about the projects in the east of the country and explained how the number of consumers will be increased.



In the Far East there is an excess of power, and the economically rational solution is to export it. We see a very promising opportunity in the delivery of electricity from Sakhalin to Hokkaido, and in the project currently being established to supply electricity from Primorsky Territory to the Korean Peninsula. RusHydro has prepared a feasibility study for the supply of electricity to the Rason Special Economic Zone in North Korea. South Korean companies KEPCO and K-Water are also interested in cooperation.

The export of electricity is about utilizing capacity and provides a basis for reducing the cost of electricity. The price of electricity is one of the factors that critically affect the competitiveness of the investment climate and conditions for doing business in the Far East. The simultaneous effect of increasing the volume of supply and reducing the price of electricity in the Far East is to stimulate the development of the Far Eastern territories.

We are working to increase the number of consumers in the Far East itself by creating accelerated development territories, where there are optimal conditions for the implementation of investment projects in terms of infrastructure, tax, and administration. We support specific investment projects, mainly resource-based, selectively removing restrictions on their implementation on a project-by-project basis.

All of this work is focused primarily on supplying electricity in large volumes to Asia and making it cheaper in the Far East.

The art of neighbourliness

The Eurasian Economic Union (EAEU) is pushing Russian and European business relations to a new level. Participants in the session 'Business perspective on EU–EAEU as a formula for cooperation.'

Severstal Chairman Alexey Mordashov described the European Union as “a neighbour we mustn't separate from.” He continued: “In spite of the complicated political situation and the resulting reduction in economic links, the EU remains our main and traditional partner.”

The essential structural problem outlined by Viktor Khristenko, Chairman of the Board of the Eurasian Economic Commission, is the lack of common goals at the present time and, consequently, a misunderstanding about what the basis for dialogue should be. Khristenko suggested a return to the idea of a 'grand project', put on hold after 2005 but, in his view, as relevant as ever. The common European economic space envisaged an advanced, close, preferential partnership along the lines of an 'enhanced free trade' and 'WTO-plus' model. Accord-

ing to Deputy Minister of Industry and Trade of the Russian Federation Viktor Evtukhov, many companies are looking not only to maintain but to enhance partnerships, even in such difficult conditions. Partnerships with France, Italy, and Germany are growing stronger – these are Russia's main partners in aviation, car manufacturing, transport, engineering, metallurgy, the chemical industry, and pharmaceuticals. Partnerships with Austria, Denmark, Sweden, Norway, the Czech Republic, and other countries are also being expanded. Although the data presented by Frank Schauff, Chief Executive Officer of the Association of European Businesses in the Russian Federation, showed that 80% of foreign business conducted in Russia has been unaffected by the sanctions, the panel participants were unanimous in their agreement that the economic system

should be uncoupled from politics. This was a particular concern in areas which have a supranational dimension, such as health care and pharmaceuticals.

"The field of biotechnology and living systems is a key priority, not just for science but for the economy as well", said Victor Dmitriev, General Manager of the Association of Russian Pharmaceutical Manufacturers. "It could act as a driver, and so we should look at what we can accomplish together."

Business representatives noted that the solution to the political crisis in Ukraine first requires the stabilization of the country's economic situation. "There has been no discussion of projects in Ukraine, nor of the Ukrainian situation in general. Ukraine is an extremely important trading partner for Russia, as Russia is for Ukraine. Access to the Russian market is vital for Ukrainian goods," said Alexey Mordashov.

Alexander Shokhin, President of the Russian Union of Industrialists and Entrepreneurs agreed with Mordashov, adding that there must be a discussion of the Ukrainian question on a trilateral basis involving "the Eurasian Economic Union, the EU, and our Ukrainian colleagues."

"There is a need for decisive action on the part of the authorities, in this case the EU, to seek a compromise, as well as technological and political solutions to the issue at hand", concluded Alexey Likhachev, First Deputy Minister of Economic Development of the Russian Federation. Throughout the EAEU, there are infrastructure projects and new trade routes which would be of interest to business. Several projects were identified over the course of the session: the Eurasian Transport Corridor with a double-decker railway for container transport, and the United Transport and Logistics Company as a single transport

and logistics system, able to compete freely on the global market for international transportation.

Viktor Evtukhov discussed a range of tools that will allow Russia to improve its investment climate. These include special investment contracts which honour certain concessions. Another valuable tool is the Industrial Development Fund, which offers access to low-cost funding on a seven-year contract basis at rates of 5%.

"The more important the role of the Eurasian Economic Union, the stronger its bargaining position in dialogue with the EU will be", noted Dmitry Pumpyan-sky, Chairman of the Board of Directors at TMK.

Philippe Pegorier, the Country President for Russia, Ukraine, and Belarus at Alstom, named two concrete tasks for achieving effective cooperation between the EAEU and the EU: the issue of parallel imports, and harmonization of technical standards and regulations. Pegorier recommended that all of the participants at the round table contact their respective authorities to promote the revitalization of relations between the EU and the EAEU.

Summing up the discussion, Anatoly Chubais, head of the NP "Industry Round Table for Cooperation with the European Union" and Chairman of the Executive Board at RUSNANO, added that the EAEU will, in future, be as integrated as the European Union is today.

"I have heard a direct and unequivocal call for a return to the notion of a common economic area. The leadership of the EAEU and the business communities in Russia, Kazakhstan, and Europe have all come out in favour. It now remains to be seen what EU officials think," said Anatoly Chubais.



What is the best price?

Alexander Novak, Minister of Energy of the Russian Federation, took part in a Bloomberg TV debate at SPIEF where he responded to questions concerning the best oil price for the Russian economy, how long until the Arctic fields go into production, and what to expect from the market for liquefied natural gas.

In June you attended OPEC's sixth International Seminar in Vienna. What do you think of OPEC's decision not to cut back oil production?

What struck me first was how the speakers, particularly those from oil and gas companies, remained relatively calm. This means that the shock of falling prices has subsided, and everyone now knows perfectly well that high prices are probably a thing of the past as there is so much oil on the market.

Today we are coming to the end of another cycle where the number of investments in the sector is shrinking as a result of overproduction. Figures from the largest oil and gas companies attest to this.

As for the OPEC decision, we believe it was foreseeable, as there is no sense in taking decisions to reduce production volumes today, given that the effect would only be short-lived. When there is a possibility of increasing prices by removing the market surplus, this surplus will inevitably reappear when prices are high due to the balance between supply, demand, and price.

The last time OPEC took a decision to reduce the quota was in 2008. Today, these actions will result in a large volume of expensive oil being produced while prices are high. Scientific and technical progress has now made it possible for countries to lower their production costs, improve labour productivity, and increase production volumes. Therefore, the situation can only even out now on the basis of the market. And the price will depend on the balance between supply and demand.

Is Russia satisfied with the current oil price of USD 63 a barrel?

It's clear that our budget is greatly dependent on oil and gas revenues. This is still our Achilles' heel, although we are working on diversification.

Of course, we would like prices to be higher. But as a result of a significant part of our budget comprising oil and gas revenues, and the free-floating rouble exchange rate depending to a great extent on currency receipts, the rouble has become weaker. This has given the Russian economy, and the oil and gas sector in particular, the opportunity to be more competitive. We can see that our oil and gas companies are coping with this price level today. And we are making considerably fewer adjustments to investment programmes than those countries where the link to currency is not so volatile.

Expressed in dollars, oil and gas companies' revenues have fallen on average by 40%. Profit has fallen and investment opportunities have decreased. As concerns the Russian oil and gas sector, if we are talking about revenue in roubles, it has remained at practically the same level as before the change in oil prices. Over the first five months we planned to maintain production volumes. This was our estimate for this year, and in actual fact production increased by 1.6% in Russia.

How have the sanctions affected the development of Arctic fields? We have heard that there are now many restrictions on Arctic projects. Is it possible to develop Arctic projects with oil prices standing at USD 63 a barrel?

A lot depends on the tax system in place in each country. When we ask if it is profitable for a company to invest at these prices, everyone forgets that the cost of production not including tax is completely different. In Russia, it costs USD 5–15 to produce a barrel of oil, depending on the location of the field. The lion's share of the revenue, around 70%, is deducted as tax. Each country has its own system.

In some places tax is deducted not from revenue, but from overall financial results. In Russia the budget suffers significantly when prices fall. Therefore, we need to look at costs without including tax.

We are creating a system to encourage investments in new fields, in the Arctic shelf, and in fields where resources are hard to recover, mainly by regulating the tax system and the imposition of taxes on projects.

Today, the Arctic is estimated to be the only region where there are huge reserves of oil and gas. By our estimates, the Russian Arctic shelf holds around 100 billion

tonnes of oil equivalent. The main goal today is to create databases and carry out geological prospecting to determine what really does lie there.

Therefore, when we talk about sanctions and production costs, we should not look at the situation today and calculate today's production costs; we should look at what the situation will be like 15–20 years hence, when the Arctic fields will actually be in operation.

If we are talking about a twenty-year horizon, what will be LNG's share of the energy market from the Russian government's viewpoint?

We believe that the share of LNG in global gas consumption will rise. This is an objective circumstance. Currently, there are only 19 countries that produce and sell gas, while there are already 30 countries that use it and which have built reception terminals. This number will grow with each passing year. This year alone, 29 new tankers have been built.

The share of trade in LNG will increase at a faster rate. In such remote corners of the world, such as the Asia-Pacific Region, where there are insufficient production volumes, it is practically impossible to supply gas by pipeline. The Russia–China route is the exception.

As for LNG, it now accounts for 33% of total gas trade, if I am not mistaken. That is a trillion cubic metres of gas. The strategy for the development of Russia's gas sector involves creating the necessary conditions for the construction of gas liquefaction plants.

One successful project, which has been implemented between Gazprom and Shell for a long time now, is Sakhalin Energy. It is universally regarded as one of the world's most successful projects. For many years, all its customers have been receiving reliable supplies, with 80% delivered to Japan.

A project to build an LNG plant in the Yamal Peninsula is well under way. This project is already at such a stage that huge investments have been made into it — approximately one third of total investments, amounting to USD 27 billion. The project is commercially viable. It will begin yielding gas in 2017 and all production has already been sold. Our strategy is to provide the opportunity and create the conditions for the promotion of projects.

New directions

Russia's geographical location and size necessitate the successful development of transport corridors, linking the economies of the Asia–Pacific region with Europe in the most effective way for all concerned.

Aside from the energy sector, much attention continues to be given to trade routes: motorways, sea passages, and railways. Initiatives in these sectors were discussed by participants in a panel session entitled 'Transformative infrastructure: realizing mega projects,' held as part of the St. Petersburg International Economic Forum.

According to Nikolai Podguzov, Deputy Minister of Economic Development of the Russian Federation, there are around a dozen large-scale airfield, telecommunications, and energy infrastructure projects currently under development in the country.

"More than RUB 1 trillion will be invested in total," he said.

During the session, several specific transport projects planned for Russia were presented. For example, the Europe–Western China Transcontinental Highway, linking St. Petersburg to the port of Lianyungang in the east of

China, was approved by Shanghai Cooperation Organization (SCO) member states in Dushanbe in 2014.

"The Moscow–St. Petersburg motorway will have a multiplier effect on all associated industries and sectors of the economy, and will contribute to the generation of private investment. The majority of the sections of the corridor will be implemented on the basis of public–private partnerships, in the form of either concessions or life-cycle contracts," said Maksim Sokolov, Minister of Transport of the Russian Federation.

Boris Dubrovsky, Governor of Chelyabinsk Region, named the Yuzhnouralsky Transport and Logistics Centre as the real source of growth in his region.

The Urumqi to Chelyabinsk route can now be covered in three days rather than 36. There are also plans to create a special economic zone around this area.

It is not just these projects which share a similar outlook with the Chinese plan for a new Silk Road, there is also the Trans-Eurasian Belt Development (TEPR), a major, comprehensive project proposed by Vladimir Yakunin, former President of Russian Railways.

Yakunin noted that Russian Railways is also investing in other large-scale projects, such as the modernization of the Baikal–Amur Mainline and the Trans-Siberian Railway, Moscow’s Transport Interchange Hub, and the development of port approaches in the Azov–Black Sea basin.

In the long term, these projects will provide 40,000 jobs and a RUB 500 billion boost to GDP in the period up to 2030.

“The Northern Sea Route shipping lane will receive significant investment to develop new ports, in particular on the Yamal Peninsula, where a gas liquefaction plant is currently under construction. By 2017–2018, this corridor will not only be operating at full capacity, it will increase the volume of cargo transshipments by four to five times,” said Maksim Sokolov.

“The country needs a massive shift in its ability to generate long-term funding at low rates to support investment in the non-financial sector, so that we can provide our clients with more resources at lower prices and for longer,” said Yuri Soloviev, First Deputy President and Chairman of the Management Board at VTB Bank.

Experts also noted the problems that exist along the entire life-cycle of investment projects, from ratings agencies to construction companies, as well as in project restructuring, which has an impact on construction timeframes and the mood of investors.

“There is a 65% failure rate in capital projects around the world”, said Sharon Thorne, Global Managing Partner at Deloitte. “You cannot simply add up the cost estimates and the labour. You have to understand at a really detailed level how the project is going to be delivered and what types of people and skills are required for that development and operation.”

Yves-Thibault de Silguy, Vice-Chairman and Senior Director of the Board of Directors at VINCI outlined the advantages of carrying out infrastructure projects in Russia such as the Moscow–St. Petersburg motorway.

He mentioned the possibility of motorists contributing to the financing of infrastructure. Projects such as this, according to de Silguy, also save time for bodies issuing concessions.

These kinds of projects are simpler to finance; there are incentives to optimize, innovate, and deliver a high quality of service. Finally, this kind of partnership better addresses the expectations of civil society.

“I can say that PPP can be useful and beneficial to Russia, provided that the country continues to develop and change its regulations in order to facilitate this type of approach and provide a framework for it,” de Silguy noted.

To conclude the session, Vladimir Yakunin offered examples of PPP projects which were, in his view, successful, including the infrastructure for the Sochi 2014 Winter Olympics, an infrastructure construction project carried out in Serbia through an inter-governmental agreement, and a joint high-speed rail project with the Finnish railway company VR Group.



“We now need to focus on those projects which lead to breakthroughs in the development of our transport infrastructure. The development of Russia’s airfield infrastructure can be considered a priority in this regard. The state is faced with the task of increasing the number of airports from 300 to 500 by 2030. Not only will this lead to a rise in air traffic, the opening up of the country’s transit potential and the strengthening of the socio-economic ties between all of Russia’s regions, it will also ensure the industry’s transition to new levels of economic growth. It was also noted during the discussion that infrastructure investment is the anchor which will allow the country to reach new levels of growth. Preparations being made in participating cities for the 2018 FIFA World Cup are intrinsically linked to the reconstruction of airports, not only in Moscow but in Russia’s regions too. Infrastructure upgrades mean that regional airports can function more effectively, improving overall figures for passenger flow and transport accessibility, which is especially important given Russia’s geography.”

Mikhail Zherebtsov,
General Director, Administration
of Civil Airports (Airfields)

Formal logic



SPIEF hosted a TV debate entitled 'Paradoxes of the Russian economy', in which perhaps the biggest paradox was that issues affecting the country's economy were discussed by those responsible for its current state. These included representatives of the country's legislative and executive authorities, and the business community.

Investment drying up

It was unanimously agreed at the debate that the main scourge of the Russian financial system is the reduction in investment flows. Ruslan Grinberg, Director of the Institute of Economics of the Russian Academy of Sciences, expressed his belief that the termination of cash injections by the state in late 2013 is the main reason for Russia's economic slowdown, stagnation, and recession.

"There are two schools of thought: some maintain that it is necessary to enhance the investment climate, reduce the tax burden and curb inflation, and then all will be well; others, of which I am one, believe that there is no alternative to state capitalism. State capitalism has its good and bad sides, but dynamic economic growth is achieved through public investment, when the state makes projects appealing for private business."

According to Alexander Zhukov, First Deputy Chairman of the State Duma of the Russian Federation, the paradox is that the government acknowledges its own inefficiency in making cash injections, and its inadequate optimization measures.

"Our budget consists of state programmes, with each one specifying targets to be achieved as a result of its implementation. In other words, if you spend money on health care, mortality should be reduced and fertility increased. It would stand to reason to analyse these programmes, and reduce expenditures on inefficient ones. The government, however, does the opposite: it suggests that 10% be cut across the board. The paradox lies in the fact that investments are reduced, both public and private," Zhukov said.

"At the same time, the Central Bank and the government say that there is no call for money because there is nowhere to put it – there are simply not enough investment projects or demand. The Ministry of Economic Development, however, holds a somewhat different opinion."

The head of the aforementioned ministry, Alexey Ulyukaev, has a clear-cut view on the paradoxes: they simply do not exist, because the domestic economic system is developing in accordance with fundamental circumstances and factors, such as net export increase, consumer demand, and demand for innovation.

"Things are more or less in good shape with net exports: we have a highly positive trade balance, and a similarly positive current account. How could we make use of these resources? Costs have declined, and business has more money now. There is a choice to be made: one could invest in production, stock up on caviar, or put the money in an offshore business. Business wants the government to help it make the right decision: to invest here and now," Ulyukaev concluded.

No tears shed in business

"The only reason why public investments are needed is that the situation would be even worse without them", said Evgeny Bushmin, Deputy Chairperson of the Council of the Federation.

He noted that those who invest on behalf of the state are not risking their own money. Of course, in business, it's the other way round.

Entrepreneurs do not believe in tears, said Boris Titov, Presidential Commissioner

10%
economic growth
from 1999–2000
despite low oil prices

RUB 370
billion
 construction funding
 increase during
the 2009
crisis

for Entrepreneurs' Rights, whom the eccentric TV presenter Vladimir Solovyov called "the weeper for Russian SMEs".

"We can develop. In 1999–2000, with low oil prices, we achieved 10% growth. What is necessary for this? Low costs, as time has shown. At a meeting with the Russian President, a manufacturer asked him to help the US dollar, to strengthen it and make it more expensive, because a low rouble is good for development. Taxes should be used to stimulate growth, and be reduced for those who invest in the future. Energy prices are still high and still growing despite attempts to freeze them. It should be made more profitable to sell oil for refining within the country, since the existing tax plan fosters exports. We should use our mineral resources as a natural advantage. And still we do exactly the opposite, encouraging exports," Boris Titov said.

There are two things business is interested in today: profitable return of capital and risks. Ulyukaev expressed the view that the government should help entrepreneurs in making risks acceptable.

"This means making taxes, quasi-tax payments, fees and duties clear and transparent, and reducing the burden of regulation, which we ourselves use to oppress business mercilessly, provoking it into going underground. By creating or not creating an auspicious investment climate, we put a boundary at which business decides whether to work honestly or to go underground," the minister said.

"Why do we need public investment? For two reasons: to show that we are not joking about the investment climate, that it is not just words, and that we share the risks. By 'we'

I mean the government, the Central Bank, the State Duma, and the regional authorities."

Forward-looking investment is required in manufacturing, transport and energy, as well as in knowledge, education and human capital.

A pipe dream

According to Grinberg, "If we are determined to change the structure of the Russian economy, we should focus on some eight to ten areas and provide support for them. The principle is simple: what can be brought up to international standards must be funded by the state systematically."

Following on from this, the academician suggested focusing on those areas where Russia is yet to compete on a large scale: to invest in mega projects.

"We have the examples of Sochi and Russky Island in Vladivostok, and this is all well and good, but it is not enough – we could do more."

However, as all participants in the debate agreed, neither current nor future projects can be developed without structural reform and efficient allocation of funding.

"In 2009, in response to the previous challenge, we increased spending on construction by RUB 370 billion. Regrettably, this time we approached a similar problem differently, and cut this year's construction spending. I believe there is a way to strike a good balance by consolidating budgets and providing investment funding for budget spending. To achieve this, we need to base our judgement on goals rather than figures," Ulyukaev suggested.

“We need to apply the same measure when assessing the importance of all spending. Why, when we need to make cuts, do we immediately reduce operating expenses by 4%, and investment spending by 17%? Investment lays the groundwork for the future so, like other forms of spending, it must be protected.”

According to Alexander Zhukov, business expects the authorities to pay attention to the steps towards mutual understanding which have already been initiated.

“We need to put a stop to the endless inspections of businesses. The relevant decisions have already been made, and their implementation is an elementary matter. It is also necessary to adopt, as soon as possible, a law stipulating an expedited VAT return procedure for exports. There are a high number of specific measures of this kind,” he said.

In turn, representative of the State Duma Andrey Makarov began with reasonable and specific suggestions, before moving on to the ever-present subject of investment in human capital and the country’s future, which, in his opinion, will enable Russia to integrate more securely into the global economy. In addition to large-scale funding programmes for developing human capital, he returned to the need to separate effective costs from ineffective ones.

Summarizing the situation, Ulyukaev said: “There are two ways to resolve our situation: one is realistic, and the other is a pipe dream. The realistic option is for extra-terrestrials to come to earth and fix everything for us; the pipe dream is for us to get up and do everything ourselves.”



Alexey Ulyukaev: “We need to apply the same measure when assessing the importance of all spending. Why, when we need to make cuts, do we immediately reduce operating expenses by 4%, and investment spending by 17%? Investment lays the groundwork for the future so, like other forms of spending, it must be protected.”

Why growth is needed

Russia's Central Bank has announced its target for gold and foreign exchange reserves — USD 500 billion. Experts discussed how they are planning to achieve this target.

Elvira Nabiullina, the Governor of the Central Bank of the Russian Federation, noted that there was a tendency for central banks to replenish their gold and foreign exchange reserves during periods of volatility in global financial markets so as to withstand external shocks and maintain investor confidence.

“We are operating on the basis that the level of gold and foreign exchange reserves can be increased by 25%, if we take into account the fact that capital issued on a repayable basis as part of currency financing measures will be reimbursed to us,” Nabiullina said. She also noted the importance of market perceptions, especially for Russia, which is transitioning from one regime to another — from one nominal anchor, the currency exchange rate, to another, that of inflation. The Central Bank regulates rouble liquidity levels, so that money market rates are close to the Central Bank's key interest rate, with the decision on the key rate

taken after considering a whole range of factors which allow the Central Bank to achieve its inflation target.

“We have set a floating exchange rate, because we are not targeting a particular exchange rate level through our operations”, Nabiullina added. The current annual inflation figure includes the leap in inflation from December to January, so it is therefore no surprise that the key rate is lower than current inflation levels (at the time of the session, it was 11.5%; from 3 August it was 11%). Decisions about the key rate are made in accordance with forecasts and expectations, while taking into account the current situation. Central Bank forecasts show that, due to the policy pursued and current trends observed in the economy, inflation will be lower than 11% by the end of the year, and it will fall to 7% in twelve months' time. The medium-term objective of the Central Bank is to reduce inflation to 4%.

“Economic entities, the business community, and citizens are taking decisions based not on our forecasts, but on their own inflationary expectations. Because, as a country, we are only just transitioning to an inflation targeting regime, our inflationary expectations are not anchored, and are relatively high. It is because of this that we are maintaining our key rate at a high level, taking into account predicted inflation rates. In our view, this allows us to lower inflation, while at the same time not putting too much downward pressure on the economy,” Elvira Nabiullina said.

Alexander Zhukov, the First Deputy Chairman of the State Duma of the Russian Federation, said that the upsurge in inflation was a direct consequence of the sharp reduction in the value of the rouble and the resulting increase in the price of imports. In his view, we are currently observing a swift downturn in manufacturing, and the expected import substitution following the fall in the exchange rate value has not transpired. One of the main reasons for this, according to Zhukov, was businesses’ lack of access to credit, and the fact that investment was significantly lower compared with the previous year. Kudrin raised the issue of the budget deficit, warning the government against resorting to the dangerous method of monetary financing. The Russian experts were surprised by this statement, noting that everybody remembered well the consequences of the monetary policy followed during the 1995–1998 crisis, and that it served as a good lesson – monetary financing of budget deficits is not an option. “We are not about to make the same mistake twice,” Zhukov said.

When there is a budget deficit, the government’s first response is to use the reserve fund, before looking at privatization options, and then considering market loans which, in the words of Mikhail

Zadornov, Chairman of the Management Board at Bank VTB 24, lead to a significant redistribution of internal credit resources in favour of the state budget, contributing to an increase in rates.

“From my perspective there is only one outcome of this policy – a further reduction in spending relative to GDP,” said Mikhail Zadornov. He added that following this course of action could prove difficult, as the budget includes several ring-fenced areas, including defence spending, social spending, regional budgetary allocations, and the pension fund, which neither the government, society, or parliament has the desire to reduce.

“However, without a specific reduction in these areas of expenditure, we will not be able to balance the budget even at the level of a 1.5–2% budget deficit,” Zadornov commented.

Alexander Zhukov stated that the budget deficit remained, and that it presented a much more serious problem at the regional level, with the regions seeing practically zero investment spending. This in itself is another reason behind the fall in GDP, as both private and government investments are drying up. The foreign expert panellists unanimously recommended that all economic institutions coordinate so as to ensure effective cooperation. Summing up the session, Elvira Nabiullina noted that Russia’s economic slowdown is structural, having begun while oil prices were still high, meaning that the situation can be resolved only by way of structural changes.

“What we need is stable economic growth, and I cannot think of a single case where a country has successfully softened monetary policy in a period of high inflation. We need to reduce inflation – this is a key target,” she said.

If current economic trends continue, **inflation** will be lower **than 11%** by the end of the year, falling to **around 7%** in twelve months, according to experts

Nothing personal

At the end of August, Black Monday forced Alexey Ulyukaev, the Minister of Economic Development of the Russian Federation, to use in a public speech a rhetorical device which was new to him – the oxymoron. The Minister declared that the Russian economy had now reached its lowest point and could not fall any further – the economy was so bad that the outlook could only be good. He expressed similar optimism in the CNBC debate 'Never let a good crisis go to waste: addressing Russia's structural economic dilemmas,' which took place at the St. Petersburg International Economic Forum.

Responding to the first question from CNBC anchor Geoff Cutmore, Alexey Ulyukaev stuck to his position and reiterated the need to maintain a positive attitude even in the most difficult conditions. He made reference to the words of John F. Kennedy, now gaining popularity in the media, about the Chinese character for 'crisis'.

The character contains two elements, representing pain and opportunity, concepts which are understood by practically every Russian school pupil and which present a dilemma for the Russian government. Alexey Ulyukaev has made his mind up, and stressed the need to seek out possibilities for moving forward.

“What does this mean, moving forward? It means shortening the gap between the Russian economy and the economies of developed countries. We currently have an imbalance between potential growth and actual growth, but potential growth is still not particularly high. We believe that by the end of this year we will have reached the end of the recession and that next year we will see actual growth that is closer to potential growth. Potential growth is around 2% of GDP,” said the minister.

He also noted that the potential growth figure is still lower than the global average of 3.3–3.5%. There is now, however, a basis for growth as well as

a desire to grow and that, in the view of the government, is the most important thing.

In line with the general mood, Anton Siluanov, the Finance Minister of the Russian Federation, told debate participants that Russia was no longer suffering from Dutch disease. While in the past, export-related sectors, specifically oil and gas, were the only industries to experience development within the country, now there are opportunities for the expansion of domestic production in areas where demand was previously served by imports.

According to the Finance Minister's projections, inflation could reach around 2% by the end of the year, leading to a reduction in interest rates and thus increasing the availability of credit.

"The devaluation of the rouble has presented us with some advantages: reduced costs, cheaper labour, and an attractive economy. In order to have internal sources of funding, we need cheap credit, our own anchor investor, non-state pension funds, the establishment of a wider pension system, and the creation of new tools for attracting funding," Siluanov said.

In response to Alexey Ulyukaev's claim that the official tax burden in Russia is lower than that in Europe, but higher than those of the other BRICS countries, Southeast Asian states, and former Soviet republics, Cutmore asked the panelists if they still believed in the free market. Frederick William Engdahl, Founder of Engdahl Strategic Risk Consulting, placed high hopes on the BRICS countries in general, and Russia in particular.

"If we look at the entire global picture as economists and political risk analysts, we are seeing a transition across the en-

tire globe right now, where the system has broken down, where markets are not free. Russia and the BRICS countries could have a vanguard role to play in this. They could build a new series of man-made markets in Central Asia, Africa, and Latin America," Engdahl said.

"We still believe in the market, and I believe that we are doing something to support the market fundamentals of the economy, that is to say with regulations", said the Minister of Economic Development. "We have now pushed back tax rises until at least 2018. We have also taken measures regarding the deregulation of the economy. We will be offering inspection holidays for small and medium-sized businesses. We will introduce special immunities for SMEs, with antimonopoly measures also helping in this regard."

That 'something', according to Andrey Makarov, Chairman of the Committee on Budget and Taxes of the State Duma of the Russian Federation, has had a positive role to play.

"There are, of course, questions for business, but if you were talking to business representatives some 10 years ago, you'd be hearing quite a different story. The tax service was named by entrepreneurs as the most corrupt service, one among a trio of key offending state bodies according to surveys of the business community. Today it does not even feature in the top 20," Makarov said. A member of the audience, meanwhile, suggested that an anticorruption leader be appointed. Andrey Makarov did not respond.

"People often paint a gloomy picture of the Russian economy, but this doesn't really reflect the reality," CEO of Sistema Mikhail Shamolin continued on the topic of enterprise. "There are business op-



"The topic of labour productivity in the country as a whole and the structure of employment are very important. The most critical question is the number of employees engaged in producing high value added goods. Of the 80 million-strong workforce in Russia, only 15–17 million are producing high value added goods. A small proportion of workers are providing for everyone else. The situation where there were additional profits coming in from high oil prices, providing a supplementary income, may have lasted for a very long time, but now this model is gradually disappearing. In order to support global competitiveness and produce goods which could be sold on global markets, apart from raw materials, there is a need to increase labour productivity and focus on reducing the number of jobs producing goods without added value."

Mikhail Shamolin,
CEO, Sistema

Inflation
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around
2%
by the end
of the year

opportunities in Russia: private enterprise is developing and regulation is improving. As investors we are intending to remain in the country, because we see opportunities on this market.”

Oleg Deripaska, the President of major Russian company RUSAL and another participant in the discussion, rightly avoided a straight yes or no answer and cautiously warned that the danger lay in “coming back to the old shoes”. In his opinion, what is happening at the moment is more than a crisis. The country must continue to develop, reforming its legal and judicial systems. Aside from the taxation regime, there are other sectors in Russia where progress can be achieved, according to the RUSAL President, such as agriculture and property.

When looking at the Russian economy from an outsider’s perspective today, according to Geoff Cutmore, it is clear that state assets should be privatized and sold on the market.

“There is a large proportion of state-owned companies, which is the main structural imbalance in the Russian economy. State-owned companies are less efficient, less versatile, less transparent, and less likely to introduce new technologies. They also have a tendency to reduce competition, and so additional privatization is also necessary as far as developing competition is concerned,” said Alexey Kudrin, Dean of the Faculty of Liberal Arts and Sciences at St. Petersburg State University.


The former minister does not see a return to a state-led economy, but notes that the reverse process is not happening either. “All the oil and gas companies will be privatized in stages,” Alexey Kudrin stated.

“We are currently experiencing a situation where asset prices are very low, while at the same time companies in the export sector are seeing bumper profits. If we sell off state-owned assets now, then these companies in the export sector with solid financial resources will buy them up. There will then be a concentration of assets leaving state ownership to those private companies which found themselves in a profitable position due to the crisis. I would be very cautious about privatization at the current time, because it will be perceived as unfair, and would rather suggest that privatization measures are held back until such time as the prices of these assets begin to rise,” he added.

The current Minister of Economic Development believes that the question of delayed privatization is an obvious one: “nothing personal, just business.” He agreed with Kudrin that assets are often sold at unfair prices.

There were, however, many proponents of privatization among the panellists. One of them, Andrey Makarov, warned against repeating a situation where profits are privatized and losses are nationalized. Mikhail Shamolin asked to what extent the state really needs to be engaged in managing companies. He argued that privatization can help to deal with the issues of increased labour productivity and a higher number of jobs where people create high value added products.

“I am certain that foreign investors will come to Russia, and I am convinced that once the financial situation has stabilized, economic growth will follow. We need growth of a new kind, based on investment and not on current consumption. Foreign Direct Investment will follow financial investment. The most important thing now is to wait for six months to a year,” Siluanov told the audience.

A close-up photograph of a typewriter's carriage and paper. The carriage is on the left, with a metal rod extending across the page. The paper is white and has the text "Insight and Opinions" printed on it in a typewriter font. The typewriter's body is dark, and a yellow piece is visible on the right side.

Insight and Opinions

The SPIEF Review is an informative edition of the St. Petersburg International Economic Forum. It covers SPIEF topics, commented on by the Forum's partners and key speakers. The edition is distributed among SPIEF participants and at other significant events held by the SPIEF Fund in Russia and abroad.



Crisis or adaptation?

In an interview for SPIEF Review, Oleg Viyugin, Chairman of the Board of Directors, Member of the Audit Committee, and Member of the Nominations and Remunerations Committee at MDM Bank, talks about his view of the Russian economy, looks at the connections between Russian businesses and the public sector, and analyses the possible consequences of the current crisis.

Politicians and economists often point out that a crisis opens up new opportunities and incentives to make changes for the better. Is this something which is happening in Russia?

We're still not seeing that happen here. The response of the authorities, who are largely responsible for reform, is very short-term in outlook, focusing on maintaining stability in the here and now. And it is not the first time we have seen this. In 2008 and 2009, it was exactly the same. At the regulatory level, lessons were not learned about what needed to change for the future.

Things are very different in the business world: some are folding, believing that prospects are limited or non-existent; others are trying to increase efficiency and step up their activity on the market. Overall, we are not seeing a strong push in favour of productivity at the moment: the work ethic is fairly low and there is almost no motivation to sharply increase efficiency.

Much depends on the connections business owners have with the government, and I'm not talking about state-owned companies here. There are entrepreneurs who have succeeded in establishing an informal relationship with the authorities. It is these business leaders who have it the easiest: their transaction costs are much lower. Those who do not have similar opportunities come up against horizontal regulation, which is extremely demotivating.

During the St. Petersburg International Economic Forum session 'Never let a good crisis go to waste: addressing Russia's structural economic dilemmas,' you noted the need to fundamentally reconsider the state's role. It must create the conditions for business and harmonize work to develop it. In this respect, what is the role of the Russian government?

Well, for example, when Lee Kuan Yew came to power in Singapore, he said that the role of any government was to put in place sound, harmonious conditions to enable business to develop.

At the same time he came up with the concept of where Singapore's strength lay, the role it could play in the world economy and how it could integrate into it. If the person at the top is motivated to create a good business, it is possible to improve efficiency.

The ideal solution is to have institutions which facilitate the transition of power and rotation of government figures. Sometimes institutions are democratic, sometimes they are more unusual. In China, the rotation of power now proceeds without complications. There, everyone clearly understands that they have a specific amount of time in which to fulfil their state duties. And this applies to all levels of state organization.

What changes to the economic growth model can we expect to see in our country over the medium term?

The current model is characterized by strong primary sectors, which are not badly managed at all. I mean, for example, the infrastructure industries. The agricultural industry makes up the traditional sector. It is not the industry of the future, but it will always be part of the model.

Meanwhile, fields focused on promoting technology and creating new ideas – the industries of the future – are barely represented in Russia.

No doubt there is something in the defence industry, but this is closed territory and, unfortunately, we see nothing of the results. In any case, this is not productive expenditure. Perhaps it will produce some innovative ideas, but very few will make the transition to consumer goods since this is a very specific sector from the point of view of its structure.

I believe that in the future, Russia's model should not focus attention on the primary sector or offer it advantages. This sector is developing successfully because it is a business which is well understood, it is durable and competitive. We need to turn our focus towards investing in intellectual capital, in public health, in the regulatory

systems which will allow citizens to work within Russia. Sberbank CEO Herman Gref said that we need to better understand the future: it seems to us that digital technologies are the future, but perhaps they represent the present and there is something else which will actually define development over the coming years. In our country, I believe Herman Gref may be the only person thinking about this.

Such things are created not through thinking, but through action. New ideas are emerging in Silicon Valley, but not from government or officials. They are developing on the ground. People like Musk and Brin periodically get together in a hangar and discuss completely crazy intellectual ideas. Government never comes up with these kinds of ideas.

It has a different role. It must set things up so that the people with ideas get together and do business. Our government sees itself as the authority which is responsible for everything, therefore it needs to control everything; it needs to have eyes everywhere. But if there is no freedom, then there can be no development.

The economy today leaves much to be desired. The fall of the rouble and the collapse in oil prices cannot fail to have an impact on rising prices and inflation. Could you give us your prediction as to whether it will be possible to reduce inflation?

We can reduce inflation, that is certain. We are currently seeing a degree of contraction in demand and this process will continue, I am sure, for another 18 months to two years. Where there is reduced demand, inflation can only be artificially created, for example by 'turning on the printers' – in other words, starting to print money.

If this is not done, inflation falls to zero. However, no one wants to print money and as far as I know, Russian President Vladimir Putin is not planning to go down that road. Will we see growth? Probably, yes.

The process of adapting to the external conditions is currently under way. There is no capital, because it has been moved abroad, oil prices have hit a qualitatively new low, around half of what they were. The country is less rich, we need to cut consumption, and this results in falling production and falling incomes for citizens and businesses. I'm not sure that the term 'crisis' is quite the right one to describe what is currently going on in the economy.

The situation is developing in a 'creeping' rather than explosive fashion, because a real process of adaptation is under way. With explosive development you also get a crisis situation.

At the moment, I don't see any factors for real economic growth. The divestment process began back in the second half of 2012.

First of all, there was a sharp fall in investment: from positive rates to nothing, then into negative figures. This was not linked to sanctions and retaliatory measures, or with the war in Ukraine. This was linked to the existing attitudes in our society.



Not by raw materials alone

Russian Minister of Industry and Trade Denis Manturov, speaking at a SPIEF panel session, named the reasons that Russia has not yet transitioned to an innovative industrial policy, and reassured those present that such a transition may be coming soon.

Through external markets to growth

First we need to concern ourselves with the ways in which we will promote our products on the global market. It is very pleasing to see that we have here (at the SPIEF session – ed.) Mr. Sidorsky, a minister from the Eurasian Economic Commission, a union we have with several countries.

Together we try to coordinate our work with the appropriate ministries in the union in such a way that additional potential emerges to enter third-country markets. It is also very pleasing that we have colleagues from many countries here in the auditorium with whom we are actively cooperating today, including the Minister of Industry and Commerce of Bahrain.

You have suggested some philosophical discourse, but we are no longer just philosophizing. We are taking concrete steps toward implementing an industrial policy. What do I mean by that? For many years, we tried to determine whether or not we needed industry. If we need industry, then there ought to be a framework document for that.

Such a document was adopted: the Federal Law 'On industrial policy in the Russian Federation'. I am grateful to all the deputies of the State Duma who actively participated in that process. The law was adopted last December, and will enter into force in two weeks' time. It contains absolutely specific, substantive items that will motivate investors and our traditional industrial enterprises to develop, invest funds, and attract loans in order to create modern examples of industrial production. The tools laid out in that document were operational even before the law went into effect, through the Industrial Development Fund, for example.

You will remember the statement our president made last year at SPIEF, to the effect that we need a special fund that would spur the modernization of Russian industry, and on a competitive basis. That fund was created and allocated a total of RUB 20 billion. Many of our colleagues here already know about it. It has already received 1200 applications from different enterprises. We are bringing the regions on board for them to also take part in selecting and supporting these enterprises and projects through state federal and regional subsidies. That way, we can work together to drive growth in industry.

Stimulus measures

Selling what we are producing today is not a simple task. We need additional tools in the form of leasing. Perhaps you are aware that recently the decision was taken to add RUB 30 billion in additional capital to the State Transport Leasing Company. Why was that done? To promote on the market the things we have already made.

First and foremost, we are planning to promote Sukhoi Superjet 100 aircraft on the domestic market. We will do the same in the shipbuilding industry.

Right now, Alexey Rakhmanov is working together with my colleagues at the Ministry of Industry and Trade and the Ministry of Transport on crafting a similar programme to support shipbuilding, aside from the measures that already exist today in the form of subsidies. The same thing needs to be done with respect to manufacturing production equipment. If you had asked me three years ago how we plan to build up the machine-tool industry, I would not have been able to give you a direct answer.

Today I can say unequivocally that since 2011, we have been implementing a programme to support machine-tool building and we have already made a decent amount of production equipment. Today, this programme, thanks to stimulus measures (again, through operating leases), helps to promote that equipment on the domestic and foreign markets, and to provide it to businesses that are interested in our machine tools. This is how we are providing a catalyst for industry to develop.

Further guarantees

Today, every country has a conceptual need to create added value on its territory. The time of simply supplying a product has passed. We also offer to foreign producers who are interested in our market certain terms for organizing joint ventures and localizing their production within our market. You are aware that we have sector-based plans for import substitution already confirmed.

A lot is being said about that. That does not mean that we have only just begun doing import substitution and were doing nothing before. No. Of course, we were also working before on creating added value here in Russia; we are doing it today, and we will be doing it tomorrow. First and foremost, this means bringing in the critical technologies that we need, by means of offering additional incentives to foreign companies that come to our market.

During meetings with foreign manufacturers, they often ask us: "If we invest our funds into creating our own plants or joint ventures here, what guarantees will we have that our products will be in demand and will be bought by the state, and in particular by state-owned companies?"

Did you know that the state channels an enormous volume of funds to procurement?

We introduced the so-called special investment contracts tool when we passed the law 'On industrial policy in the Russian Federation'.

By agreement with the Ministry of Finance, we have already amended the Tax Code, Federal Law No. 44 'On state procurement', and Federal Law No. 223, which regulates procurement by companies that are fully or partially state-owned. Business structures that have signed a special investment contract with a region or with the federal government will be given additional preferences and guarantees that their products will be purchased first. This is just a short summary of how we see our industrial policy today.

Simple motivation

The ministry has additional tools which we are actively and quickly adjusting as the economic situation changes.

These are subsidies within and across sectors that compensate for the interest rate, bringing it into alignment with conditions on the market. Today, companies rely on the tools that we have. Those include direct loans from the Industrial Development Fund at 5% annual interest.

Please note that this is less than half the rate of inflation. We have kept to those terms, even though they were announced last year, without knowing what interest rates would turn out to be.

The sector-based and cross-sectoral subsidies that our agency has are being realigned to the key interest rate. Previously, we were tied to the refinancing rate, which restricted Russian companies' ability to take out loans. Now we are at 70% to 90% of the key interest rate.

We are proceeding from the idea that this will make it possible to get bank loans on a competitive basis for a total of at least RUB 500 billion. The measures we are taking today are already motivating companies to act. I am also referring to regulatory measures, which provide the regions with a way to reduce profit tax and property tax rates, so that companies can make decisions with more confidence.

Where is capital heading?



In order to evaluate the investment climate in Russia's regions, as well as the work carried out by various governors' administrative teams, the organizers behind a national index surveyed 230,000 entrepreneurs from 76 of the country's regions.

In 2015, the top five regions are: the Republic of Tatarstan, and Kaluga, Belgorod, Tambov, and Ulyanovsk regions.

Alexander Shokhin, President of the Russian Union of Industrialists and Entrepreneurs, covered both the positive and the negative results of the national index compiled by the Agency for Strategic Initiatives at the St. Petersburg International Economic Forum on June 19.

According to the survey, there has been significant progress in how long it takes to obtain a connection to the electricity grid, with the average figure now standing at 163 days. Respondents were satisfied with the time required to obtain a construction permit, with the average figure standing at 149 days. The highest rating among those surveyed – 4.26 – was given to the procedure for registering new legal entities.

“As I recall, the index was first discussed in 2013. Then a presidential instruction was issued, and the index was piloted in 2014,” noted Shokhin. “Last year, 21 separate regions participated and 14,000 individuals were surveyed. The initial results were discussed here at the Forum last year. This tool has received considerable support, and the second iteration has already managed to include all of Russia’s regions. The survey covered 230,000 entrepreneurs based in Russia’s regions, and we can today look at the results from 76 regions.”

Shokhin also added that the index was intended to solve certain practical issues. First of all, it provides an assessment of the quality of the investment climate in the regions. Secondly, it offers an evaluation of contributions made by governors’ administrative teams. “This is highly important, and we feel that governors

have bought into this particular element of the new tool. Another important task is the dissemination of best practices,” Shokhin explained.

Business has rated infrastructure, availability of human resources, and regional support tools poorly: the latter includes financial support, as well as the work done by regional agencies to attract investment. The rating for telecommunications services fell. Property and debt financing remain difficult to access.

“The higher the region places in the index, the more projects with foreign investment it will have, and correspondingly, the more foreign investment it has, the higher it will come in the index,” Shokhin continued. “Each region receives a record of its own ratings. Based on the top results achieved, a handbook will be created outlining the 50 best practices for each indicator. This will allow Russia’s regions to share successful practices and adopt approaches which have worked elsewhere. In this way, the index helps to manage change in the regions and monitor trends.”

Participants in the panel session ‘Presentation of the Russian Regional Investment Climate Index’ discussed which projects and business models attract investment into the Russian economy.

The rapidly developing economy of the Asia–Pacific region is generating project activity in the regions of the Russian Far East. Alexander Galushka, the Minister for the Development of the Russian Far East, described the investment projects which the ministry responsible for the development of the region’s national resource potential has initiated. The projects will receive state support for the completion of specific tasks which the project creators highlighted during the application process.

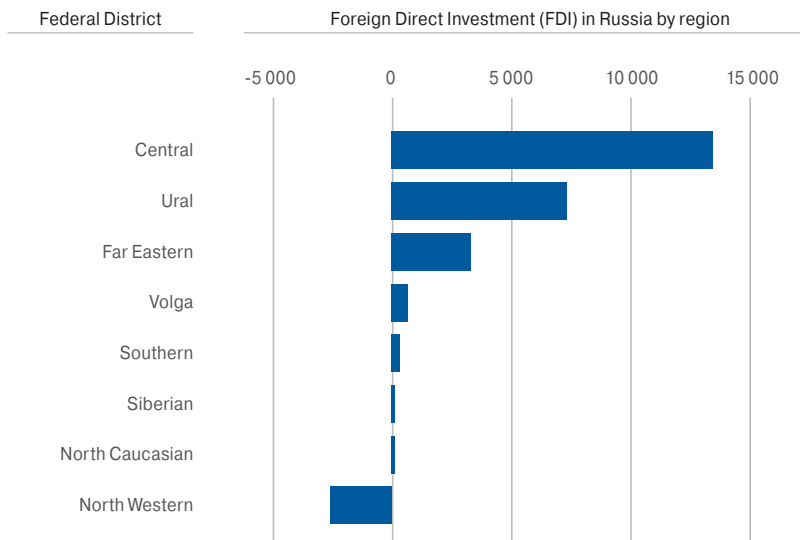


“Russia’s future calls for each region to find its own niche, based on its particular character, climate and location. There are no hopeless regions. There are possibilities even in the furthest-flung territories, under the harshest climatic conditions – presuming, of course, there is a strong team at work. That is the first point. The second relates to infrastructure. Here, a lot depends on the federal centre and Russia’s investment climate. Let’s take, for example, the Kuril Islands. If there had been no road infrastructure and no docking areas for 60 years, and the local airport was good only as a museum piece, then what more would there be to say? These challenges have now been overcome. This is, by the way, a potentially very promising territory for rapid development, but only as a result of federal budget injections. In view of the current budget difficulties, the state is unable to invest in everything. This is especially true of infrastructural investment, which is always highly expensive. It’s important for us to attract foreign investment. This is why we have begun to introduce toll roads. For example, the French company VINCI has already constructed half of the Moscow–St. Petersburg motorway, and in spite of the political squabbles, has not abandoned the project and has no plans to. The company praised Russia as a reliable partner.”

Sergei Ivanov,
Head of Presidential Administration

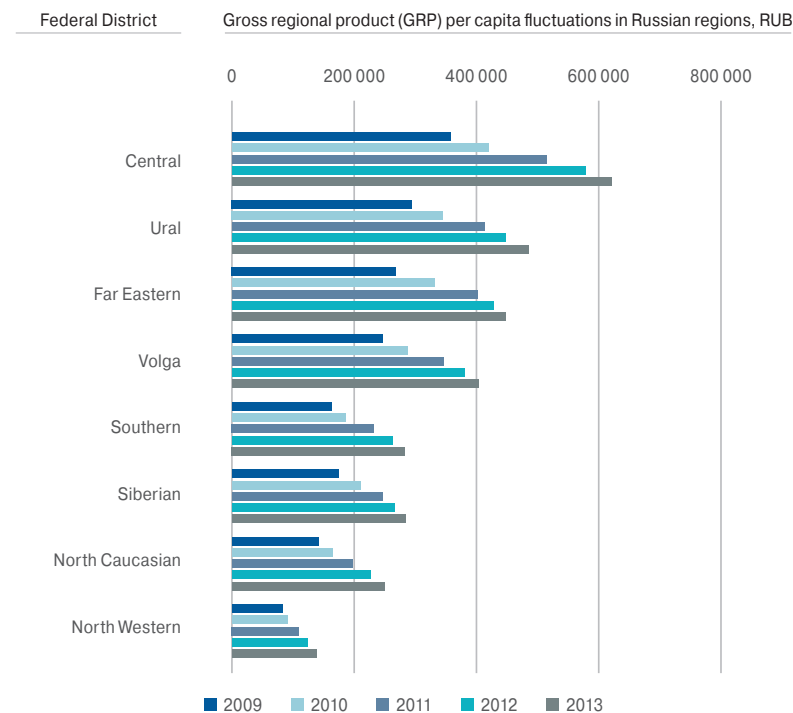
Russian regions' growth formula: freedom to experiment

Foreign Direct Investment (FDI) in Russia by region



Source: Central Bank, 2015

Steady growth for all major regions



Source: Federal State Statistics Service, 2015

According to the Minister, the first six projects will generate RUB 123 billion in private investment, and the next 11 projects – a further RUB 500 billion. The ratio of private to budgetary investment for these projects is greater than ten to one: in other words, one rouble in state investment brings in more than ten roubles in private investment. The next tool for developing the competitiveness of the Russian Far East is the creation of priority development areas.

“In total, these are bringing in more than RUB 300 billion in private investment, mostly based around the export of finished products to the countries of the Asia–Pacific region,” said Alexander Galushka.

In Galushka’s opinion, the key aspects of the law relating to priority development areas are tax incentives, deregulation, cutting bureaucracy, economic freedom, and completed infrastructure built by the Russian Federation and its regions.

Due to the enormous transit potential of the region, the port of Vladivostok was designated as a free port as part of a presidential initiative covering all ports in Primorsky Territory.

The bill for the free port legislation was developed by economists in the neighbouring Chinese provinces of Heilongjiang and Jilin, whose combined GDP currently stands at USD 900 billion, half of Russia’s entire GDP.

“The haul distances to these two provinces are extremely long, and if we create the conditions whereby transit corridors can be established from Heilongjiang to the port of Nakhodka, from Jilin to Zarubino, we will significantly reduce transport costs for these two provinces and earn income from this transit,” the minister said.

Vladimir Dmitriev, Chairman of Vnesheconombank, said that the company supported projects in the Russian Far East, including the Far East Airport, the Dallesproekt downstream timber processing project, coalfields, and aviation industry projects.

The Far East and Baikal Region Development Fund, the North Caucasus Development Corporation, and the Monocities Development Fund have all been set up. The mission of these bodies is not only to highlight projects and business leaders, but to support them by providing capital, attracting resources from both Vnesheconombank and commercial investors, setting up administrative teams, and playing an active role in pre-project work.

The experts were in agreement that attracting foreign investors leads to new experiences for teams and more jobs and suppliers, better workforce training, and an increase in tax revenues. Stefanos Vafidis, General Manager of Coca-Cola HBC Eurasia, saw his company's primary mission as the development of human potential, the training of specialists, and the creation of an effective managerial class. Vafidis noted that the quality of output and work produced by their companies in Russia is better than that done in other regions.

Nestlé has been operating as a foreign direct investor in Russia for 20 years. The CEO of its Russian division, Maurizio Patarnello, discussed the criteria for choosing a region for production, with the main elements being the infrastructure required to support a project, the region's infrastructure in general, the reliability of the workforce and suppliers, and the possibility of dialogue with the regional authorities. "Capital goes where it feels comfortable," Patarnello concluded.



The national rating of the Agency for Strategic Initiatives was presented at the St. Petersburg International Economic Forum on June 19.



Comfort for money

Following a discussion at the St. Petersburg International Economic Forum on entrepreneurial culture, EY's Alexander Ivlev, Country Managing Partner for Russia, shared the results of a study on the investment climate in Russia, and its potential for the future. He expressed his confidence that as long as business is not impeded, it will be in no worse a state than in other countries.

Alexander, has EY's study produced any unexpected results?

Everyone understands what the political situation is; they know what is happening in the world and how business is structured. Part of our research was to determine how investor attitudes had changed over the past year. The results clearly indicate that the previously existing problems have not gone away. And the geopolitical situation has done nothing to change the issues that investors were already talking about.

In all, 77% of respondents said that their work is impeded by constant changes to rules and regulations. Investors need the rules of the game to be clearly laid out, both in terms of the near future and in the long term. They need to know how to manage their business based on the current economic model.

The majority of foreign company representatives confirmed that they recognize the difficulties of the economic situation: 42% said that Russia has become less attractive as a destination for investment.

But more than half of the participants in the survey want to continue or expand their business in our country, and around 60% expect to see an increase in business activity. It does not make sense, therefore, to say that the mood among investors has worsened.

Companies are reconstructing their business and looking for opportunities to market popular, competitive products, which at the same time meet consumer demand.

These companies are not abandoning their niches partly because re-entering the market would be an expensive process, and because they don't wish to lose the market. Furthermore, Russia has become a place where companies produce goods – for neighbouring as well as domestic markets.

It is claimed that Russia is rapidly losing investors. How, in your opinion, can we stop them from leaving?

There is no way to stop investors from leaving. Money goes where it is comfortable for it to go. All we need to do is create the proper conditions. There are also many who see the current situation as an opportunity.

Many business representatives say that the crisis is not so bad, that it's an opportunity for growth. Is that not over-optimistic?

The crisis is certainly an opportunity. When shares become cheaper, it opens up opportunities for companies in the small and medium business category from other countries. Whilst global companies, whose shares are worth billions of dollars, can enter the market easily, companies with a smaller turnover find it more difficult to get into the system and claim their share of the market. But now they have a unique chance to do so.

Of course, I don't think that the crisis is a good thing for either the economy or the general public. However, at times like these, real opportunities do present themselves to some market participants.

If we go back to talking about the specific conditions in which we are now trying to develop business, it would be impossible not to mention import substitution. What do you think – if we hadn't had sanctions, would it still have been necessary to pursue such a policy?

You have just asked the same question that is being asked by many others. If you were listening carefully to the President's speech at SPIEF, then you will know: he said that import substitution does not mean refusing foreign products, goods and services, but is an opportunity to create export-oriented, high-quality Russian products. It seems to me that there are many people who do not fully understand what is meant by the term 'import substitution'.

It is not about rejecting international components, which are used in Russian manufacturing. It is about creating a system which allows participants to increase their competitive edge in terms of price and quality.

There are two models for import substitution: China and Mexico. Mexico has succeeded in creating a system whereby the country supplies itself with everything it needs. At its core, the system is based on domestic demand.

China has followed a similar path, but has called the process 'export-oriented industrialization'. This process fully furnishes the Chinese market with its own high-quality products and also allows it to sell goods on the international market – and China is a key supplier on a global scale. This is where we need to get to.

Which factors do you think are the most important in terms of supporting businesses at the government level?

It's simple: just don't get in the way of business. The development of competition and the business climate – those are the priorities in my opinion.

And to decrease government control?

Entrepreneurs are always saying that all these endless inspections are unnecessary. Yes, from my point of view it is essential to build a comfortable environment in which to conduct business. Much has already been done to this end, including the National Entrepreneurial Initiative directed at lowering administrative barriers – and this initiative is working. Our country has recently started to change its understanding of the term 'business development'.

As an example, the National Investment Climate Rating, published in St. Petersburg, is one of the keys to helping us clear up any problems. There are Russian regions which have made good progress in terms of creating a healthy business environment, and which are now competing with the world's strongest economies. The Republic of Tatarstan, for example, easily stands up to comparison with Belgium or Luxembourg or other European countries. But there are other regions – which shall remain unnamed – which fall short of provinces in China and Vietnam.

The business climate, regional growth, and the development of infrastructure are the three factors on which the growth of the Russian economy depends.

The frequently-heard phrase to the effect that we need to stop 'harassing' business did not come from out of the blue. But surely it would be impossible to just stop all supervisory measures?

In the first place, the word 'harassing' is incorrect. I don't think businesses in Russia are being 'harassed'. It is true that there are too many inspections. There is much more to be done before we arrive at a point where businesspeople can say that the controls don't bother them and everything is as it should be. That said, it isn't helpful to exaggerate. Things may not be as good as we would like them to be, but neither are they as bad as many people think.

Investment:

direct and effective



Russia is ranked third in the world in terms of incoming foreign investment. Since it was established, the Russian Direct Investment Fund (RDIF) has endorsed investment transactions worth a total of RUB 420 billion. Of this amount, RUB 55 billion has been funded directly by the RDIF, with the remainder invested by the Fund's partners and various banks. Data collected by the Fund shows that Russia receives the majority of its investment from countries in Asia and the Middle East, including Qatar, Kuwait, Bahrain, the UAE, China, Korea, Japan, and India. According to expert opinion, the flow of direct investment is a source of optimism as far as the Russian economy is concerned. So what is it about the Russian economy that is attractive to foreign investors? And what are the obstacles to increasing the volume of investment? This was the topic up for debate at a round table event attended by business and government representatives at the St. Petersburg International Economic Forum.

Kirill Dmitriev, CEO of the Russian Direct Investment Fund, believes that efficient project management and popularization of Russian success stories will allow to increase the investment activity.



What are the main challenges facing investors in Russia?

In my opinion, we need to make investments more effective. It is absolutely vital to choose projects with care. Funds are all too often invested in ventures which prove unprofitable. What we need is a reliable system for distinguishing good investment opportunities from bad, as well as high-quality project management, and sound decision making processes. It is also very important to have a successful track record. I must here mention our investment in Alrosa, which saw the shares that we had invested in the company grow instantly by 86%.

These things are far more important to foreign investors than any general talk of growth, and this is what the Russian Direct Investment Fund is all about. We have invested funds in a large number of projects, and we believe that this is attracting genuine interest. Our task now is to increase the number of high-quality investments, and publicize our successes. We are also convinced that the current geopolitical tensions will ease, either this year or next.

What makes the Russian market attractive to investors?

Our Arab partners chose one of the most difficult periods for Russia – December 2014, when banks were charging 27–30% interest – to finance two very important projects. These were a digital inequality project with Rostelecom, and the reduction of electrical grid losses with Rosseti, where we hope to reduce losses by 15%. Their faith in Russian infrastructure during this difficult period was rewarded with a very profitable outcome. The rouble, of course, has strengthened since then, and investments made at what was a difficult time are now producing a healthy income. This has encouraged us to further participate in infrastructure projects, including the construction of toll roads and the development of the Moscow Central Ring Road, along with ports and other infrastructure.

How are projects assessed? How do you avoid disappointing your partners?

We have two types of investment arrangement. In the first, up to 40% of our funds are invested automatically through a series of funds. In other words, our partners trust our decision-making process, in which a detailed analysis of the transaction is key. The second option is for our partners themselves to analyse the potential investment and decide for themselves whether or not they are prepared to enter into it.

In this case we are often talking about significantly larger sums being invested in a specific project. This model has its advantages as it enables us to examine a project through our partners' eyes as well as our own, and with the addition of their expertise we are better able to analyse risks and identify opportunities. We are looking at creating a reliable investment filter in Russia to enable us to successfully identify those projects which will bring a good rate of return.



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Tadashi Maeda, Senior Managing Director of Japan Bank for International Cooperation, alludes to the fact that it is the sanctions that are to blame for Russia's problems with issuing loans.

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What are the main challenges facing investors in Russia? Geopolitical tensions, ineffective management of investment projects and the poor track record that the country has as a result, or other factors? What are your hopes for the Russian investment climate? What changes still need to be made?

The biggest challenges at the moment are geopolitical tension and sanctions. The Japanese government doesn't use sanctions in the financial and energy sectors. Because of the sanctions put in place by the US and European Union, it has become particularly difficult for private banks to issue credit in Russia, especially when dealing with US dollars.

This has led to a situation where our dealings with private banks are conducted entirely in yen. We are also looking into the possibility of carrying out financing in roubles. A stable market – and particularly fund market – is essential in order for this to happen. The most important aspect in infrastructure right now is public-private partnership. However, PPPs exist in different forms in different countries. The assistance of the RDIF will be essential in this regard. Its professionalism and the unique opportunities it provides must be put to good use.

In terms of the engineering sector, Toyota has already invested both funds and manufacturing expertise in Russia. But stable measures and a stable policy are essential conditions for foreign investors in local markets. The situation in the oil and gas sectors is somewhat different. Products from these sectors are exported to countries like Japan, Korea, and China. The most important thing here as far as the Russian authorities are concerned is the presence of infrastructure. For example, transport routes to the coal mines of Krasnoyarsk Territory are vital. Transport infrastructure is also required in Vladivostok, in Nakhodka. All this requires a logical approach. There should be government policy measures in place to coordinate these processes.

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Presidential Aide Andrei Belousov argues that the time has come to give greater freedom to the private sector, and says that the government is already taking steps to achieve this.

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What makes the Russian market attractive to investors?

Russia has the advantage of two vital conditions for rapid economic growth. The first is our significant federal reserve, which in some years has reached almost 30% of GDP (and is currently just below this figure). The second is the fairly rapid expansion of our markets. Today the markets have settled down somewhat, particularly the consumer market. We believe that this is just a temporary situation, and that by next year we will be seeing annual market growth in the region of 3–4%.

We do not exploit this as much as we should. This becomes clear when we look at the figures for capital export, which currently sit at around USD 60–80 billion per year. I should point out that in the first quarter of this year we succeeded for the first time in significantly reducing capital export. In total, the first quarter figures came to USD 37 billion. Of this, USD 24 billion represented a reduction in banks' external borrowings, which leaves us with a figure of USD 10 billion.

This is by far the lowest we have seen over the last five or six years, and is roughly a third of the usual quarterly figures. This is clear evidence of the fact that despite all the rhetoric, despite the sanctions, the business sector feels it is time to direct its attention to Russian and rouble assets. Furthermore, in the first quarter we came to the end of an extended cycle to normalize the consumer market bubble that formed in the second half of the last decade due to a chronic imbalance between wage growth and productivity. This led to over-consumption and a growth in imports that the Russian economy was unable to withstand.

For a time, this was cancelled out by the flow of oil revenues. When oil prices started to drop however, the situation escalated. One way or another, the Russian currency had to lose value. We have completed this cycle and emerged at a new point of equilibrium. Investors know this to be the case, which is why the race is on to see who can claim their spot on the market first. We are aware of this and encourage it.

When will the time come to give more freedom to the private sector?

I think the moment for this arrived a long time ago. The actions of the government and public authorities are aimed at gradually introducing precisely these elements of private enterprise into our economic reality.

But there are two problematic areas associated with this. Firstly, there are issues relating to uneven growth and uneven development in individual regions and industries. These give rise to the kind of imbalances that cannot be solved without the help of the state. In addition, Russia is still dealing with the after-effects of the planned economy. For example, more than 10 million people live in towns and cities dominated by a single industry or company.

As a rule, these areas are incapable of developing without government intervention. Secondly, there are the structural problems that have accumulated over a fairly long period. These are impossible to solve all at once. The obstacles I have mentioned are hindering market expansion in our country. It is important to understand this. Everyone agrees that the market should have more freedom. All the government needs to do is correct the shortcomings of the market in areas where the 'invisible hand' is not guiding things. But this is just a theory. Increasingly, we realize that the exceptions to this rule are also in some ways the rule. Consensus must be sought.

Which brings us to another point. The more open the Russian economy becomes (until recently it was one of the most open in the world), the more we find that in this world the merging of the actions of the state and major companies is the rule rather than the exception. We see this very often when the promotion of the interests of certain large companies becomes the subject of political dialogue – even dialogue at the highest level.

This is the way things are. And it also equates to state intervention at the highest global level in market operations. So let's just work with the realities. We will move towards a more open market, taking the obstacles that arise along the way as they come.



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Bing Hu, Co-CEO of the Russia–China Investment Fund, explains what is preventing Russia's investment climate from reaching its full potential.

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What makes the Russian market attractive to investors?

I have played a role in Russian investments since 2010. Over the last five years I have observed the Russian government actively encouraging reform, and I think the Russian government and Russian businesses work very well in this regard. Recent events have somehow broken the chain of these events. However, I think the decisions taken jointly by the Russian and Chinese governments will help matters progress in the right direction.

As for the Russia–China Investment Fund, we will, of course, adhere to our long-term investment commitments in Russia. Over the next 10 years, we will be investing in various sectors of the economy.

Direct investment and working with the RCIF is very important for us. We also operate in Europe and the US, but we are aware that investors are increasingly coming to Russia. And we are very proud to say that our fund is leading the way in this regard. We are currently launching various projects – in e-commerce, in the consumer and financial sectors, and on the Moscow Stock Exchange. We have invested during the most difficult periods.

I think that the middle class in Russia will grow. In addition, there will be more private and public investment coming from China to Russia. And I especially believe that there will be structural changes in Russia in various sectors: in e-commerce, in modern logistics, infrastructure, agriculture, and private capital markets. These areas have the future potential to generate huge profit. The traditional sectors – oil, gas, and mining – also have a bright future.

Is state regulation of the economy a good or a bad thing? What do you think about the intervention of the Russian government in the economy?

We must allow the market to develop in such a way as to be profitable. The government may intervene when the market is operating inefficiently. Under normal conditions, rapid development can lead to problems which require the government to step in. Intervention is also necessary in order to carry out privatization. This cannot be achieved by individuals. The Chinese government is trying to introduce more private elements into the economy, despite the fact that it is a mixed economy. The Russian government, I think, is doing the same thing. Plans for mass privatization were first tabled four to five years ago. Since then some projects have been temporarily put on hold. But I still think that this is the direction you need to move in.

What are your hopes for the Russian investment climate? What changes still need to be made?

For me the first, most important thing is a private capital market. In Russia, we need to see a steadily growing private capital exchange platform and an established lending market. Currently, the capital market is largely controlled by state-owned banks. In addition, the fund market should be more involved in the economy. There are now many people in China who are taking on entrepreneurial roles and starting their own businesses.

We try to encourage them to participate in listings on the various stock exchanges in China. Many people have become millionaires, even billionaires, and even people as young as 20. I think that in Russia, too, there are different layers, and different levels of capital markets. The government ought to do more to encourage and support the private capital market. In other words, they should be giving people more opportunities to engage in entrepreneurial activity. It is up to the government to encourage cross-border investment and to ensure the best possible conditions for cross-border trade.



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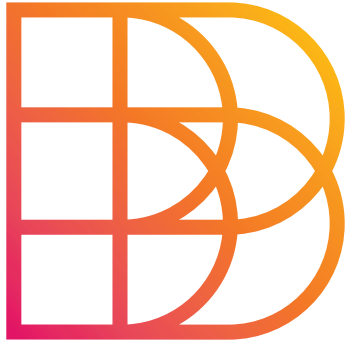
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The Bering-Bellingshausen Institute for the Americas (Spanish: Instituto Bering-Bellingshausen para las Américas, or IBBA) is a new non-governmental organization with a mission to facilitate dialogue between politicians, entrepreneurs, journalists, and scholars based in Russia and the CIS, and the Americas.

IBBA was named in honour of two Russian explorers whose discoveries defined the contours not only of the Western Hemisphere, but of both Americas, from Alaska (Bering) to Antarctica (Bellingshausen).

The focus of IBBA, however, is Latin America.

The Institute was founded in Montevideo, a city that lives up to its moniker of 'the gateway to the continent'. Montevideo is home to the headquarters of the Mercosur Common Market (comprising Argentina, Brazil, Venezuela, Paraguay, and Uruguay), the even broader-based Latin American Integration Association (ALADI), and now our NGO as well. It is also the capital of Uruguay, a country that has consistently been a pace-setter in relations between South America and the Russian Empire, the Soviet Union, the Russian Federation, and the new Eurasian Economic Union.

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