

18 Years Later – Russia on Track to Finally Enter the WTO

On December 16, 2011, an agreement was reached for Russia to join the WTO. Although membership is likely to provide an important stimulus to improve the business climate and to attract investments, significant challenges remain for Russia to reap the benefits. Although accession to the WTO will directly improve Russia's growth performance, the biggest gain is expected to be the improvement in the business climate which should enhance the country's ability to attract investments. The World Bank's estimates suggest that by joining the WTO, Russia should grow by an extra 0.4 to 0.5 % *per annum* on average over the longer term. The total effect – including the indirect effect on investment – will amount to extra 2.8% GDP in the short run, 3.3% GDP in the medium run and 11% GDP in the long term.

Monthly Overview

Joining the World Trade Organization will enhance Russia's ability to attract and retain investments. Membership means a commitment to reduce and remove certain tariff and non-tariff barriers and granting foreign competitors access to the Russian market in exchange for Russia's access to foreign markets. This will provide Russia's firms with stronger incentives to restructure, further reinforce positions of Russia's exporters, and, most importantly, place significant pressure on the government to improve the business climate to enhance the country's ability to compete in global markets.

Although Russia has made substantial progress during the past two decades of transition towards a market-oriented economy, the business climate remains a key issue for investors. Corruption, administrative barriers, judiciary independence, minority shareholder protection and fair treatment are cited consistently in surveys as important issues affecting the business climate, the attractiveness to invest, and overall private sector economic performance. Rankings, although indicating improvement, also place Russia's business climate low relative to other countries at comparable levels of development. Further, capital flight remains an issue drawing attention not only to the difficulty in attracting FDI, but also retaining the interest of domestic investors in Russia as a place to operate. According to official estimates, Russia's net capital outflow in 2011 amounted to about 84 billion US dollars (about 4% of GDP).

After 18 years, Russia finally reached an agreement with the 153 member organization on December 16, 2011. Negotiations began under President Yeltsin in 1993 and during Putin's first term, accession was made a national priority. Further momentum stalled, however, in recent years. Putin raised questions concerning the benefits of joining the organization during his second term and further hindered negotiations by demanding that Belarus and Kazakhstan be admitted at the same time. Georgia exercised its veto as a WTO member to oppose Russian accession after the two countries fought a brief war in August, 2008. Georgia's opposition was recently removed in 2011 through Swiss mediation and likely pressure from both the EU and USA. The recent agreement likely indicates a strong and persistent commitment by the Russian government to join despite these recent setbacks while recognizing the need to attract investments and integrate further into global markets.

Several key challenges remain, however, for Russia to seize the opportunity that WTO accession potentially represents. The country must ratify the agreement within six months. More importantly, however, Russia must follow through with adopting the rules and procedures outlined by WTO membership and commit resources and effort to identify and support the reforms necessary to improve the business climate.

Monthly Highlights

BCDM's highlights aim to provide a brief summary of announcements related to new investment activity that can reflect changes in the quality of Russia's business climate from one month to the next that could be overlooked in less frequent or more aggregate reports.

Although announcements of new investment related activities in December were dominated by the energy sector, activities were also reported across other sectors.

Energy

- *Exploration:* **Rosneft** announced its intention to sign a joint venture agreement in February, 2012, with **Exxon** to invest \$US 3.2 billion to explore the shelves of Kara and Black Seas with the aim of drilling the first exploration well by 2015. These fields are believed to be important potential sources for Russia to maintain oil production as well as leading to further investments in the billions of dollars.
- Russian power utility **IDGC** plans to invest over RUR 30 billion for R&D over 4 years.
- *New Investment:*
 - Russia's **Liotekh** launched world's largest lithium-ion battery cell plant in Siberia,
 - **Rosneft** plans RUR 798 billion of investments in Vankor oil deposits in Siberia by 2037,
 - **Thyssenkrupp** intends to invest EUR 200 mln to build high polymer plant in Kabardino-Balkaria,
 - **Siemens** to enter a JV to manufacture and service gas turbines in Russia,
 - **TNK-BP** started \$US 6 billion in new Arctic oil fields, and Russia's
 - **TGC-2** and **China's Huadian** signed an agreement to build a RUR 20 billion power plant in Yaroslavl.

Autos

- Despite the financial crisis, Russia is positioned to be Europe's largest car market by 2014. In 2011, only Germany sold more cars than Russia, 3.2 million compared to 2.5, while in France 2.2 million were sold. Domestic producers have been given 7 years to adjust to the implications of Russia's accession to the WTO. Meanwhile, **GM** expects Russia's car sales in 2012 to increase by 60 to 75% and will increase plant production in St Petersburg to 100 000 in 2012 and 250 000 by 2015 as well as introduce new models. Subaru is to decide within 2 to 3 years whether to build a plant in Russia.
- Russia's **Avtovaz**, which accounted for 45% of Russia's 1.21 million vehicle production in 2010, is planning a EUR 4 bln investment program by 2020 while **Renault-Nissan** are considering increasing their stake in the firm from 25 to 50% possibly in 2012.

Transportation

- Russian railways monopoly **RZhD** published its strategy through to 2030, signed a deal to purchase 8 high-speed trains from Germany's Siemens to replace currently used cars in need of repair for an estimated total cost of EUR 600 million, including delivery and maintenance, and increased its investment program for 2012 from 16.8 to 428 bn RUR.

- Russia's **Transaero** agreed to purchase 4 Boeing 787 Dreamliners to replace its Boeing 767s. Its rival, **Aeroflot**, has 22 Dreamliners on order. The 787 has a list price of about \$US 200 million per plane.
- Russia's freight carrier **Globaltrans** has signed a frame-contract to purchase 5000 low-sided cars in 2012 with the first 1000 due for delivery in the first quarter. One estimate is that the deal could be worth up to RUR 2.478 billion. Its total fleet is nearly 50 000 cars (58% are gondola and the remaining are rail tank cars).

Agriculture

- **John Deere** is expected to expand investment by \$US 50 million in an agricultural equipment production in the Orenburg region.
- **Danone** has announced its intention to invest EUR 1 billion to expand into the CIS region more generally.

Taxation

- **Henkel** plant in the Ulyanovsk region, an estimated investment of EUR 12 million, will get a tax concession for 5 years, the value of which is not yet known.

Non-energy sector investment activity

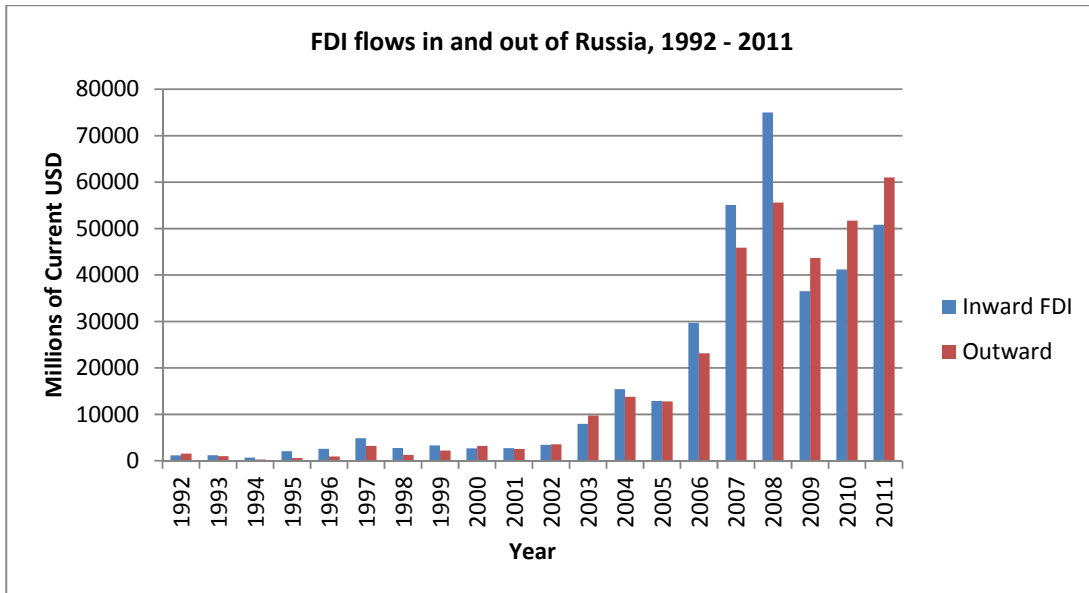
- *Several investment plans in consumer retail were announced:*
 - **Hotel group Accor** will open 32 new hotels in Russia by 2015 under various brand names;
 - **Ikea** announced its intention to double the number of stores in Moscow (from 3 to 6) at EUR 60 mln each and is considering expansion in other regions;
 - **Rosinter** plans to open 20 more restaurants in Russia in 2012;
 - **Azbuka Vkusa** intends to invest \$US 12 to 16 mln to open 3 to 4 premium food retail stores in St Petersburg, **TNK-BP** are planning 50 more Wild Bean coffee shops for 2012;
 - The Bank of Azerbaijan is financing the development of a supermarket chain, **Setka**, which plans to open 50 stores in Moscow, St Petersburg and Ekaterinburg during the next 2 years.
- *Food production:* **Ferrero** plans to invest RUR 987mln to expand its plants in Vladimir while **Nestle** will launch a new production plant in the same region in the Q1, 2012, at an estimated investment of \$ US 52.3 mln.
- **France's ARC** intends to allocate EUR 50 mln in 2012 to **Opytny Stekolny Zavod**, located in the Vladimir region related to creating a glass producing joint venture.

Business Climate Indicators

BCM's indicators aim to provide a monthly snapshot reflecting important trends and changes in Russia's business climate. This first issue provides a brief look at the recent trends in FDI flows.

- **Capital flows and FDI** – Even though the average oil prices in 2011 was above \$100/barrel, the Central Bank of Russia recently estimated that net capital outflows in 2011 reached \$ US 84 billion (about 5% GDP) – explained by poor investment climate, volatility in the developed markets (thus reducing global appetite for risk) and political risks in Russia.

- However, the total Foreign Direct Investments into Russia have grown from again to estimated USD 48 billion in 2011 almost reaching the 2007 level.
- **Figure 1** – Shows that Inward and outward FDI flows for Russia grew rapidly since 2002, and generally, Russia has had net inflows. After 2008, this trend reversed to net outflows of FDI. By reducing tariff and non-tariff barriers and exchanging access to the large Russian domestic market for Russian access to even larger foreign markets, WTO accession should further enhance the country’s ability to sustain FDI flows and support further domestic restructuring and integration into global markets.



Source: UNCTAD, 2011 estimate for FDI inflows from Bank of Russia, outflows annualised from estimates based on first 3 quarters of 2011.

Next Issue

BCDM’s next issue will focus on the flight of Russia’s capital and what it means for business climate development.