

## ***Russia's Business Climate on Right Track, but Reform Process in Low Gear***

**In October, the World Bank released its latest *Doing Business Index 2013* ranking Russia 112<sup>th</sup> out of 185 countries in terms the ease of opening, operating and closing small and medium sized enterprises, up from 120<sup>th</sup> last year.**

### *Monthly Overview*

There have been several key signals during the last several years that Russia's government recognizes the need to improve the country's *Business Climate* as an important strategy for attracting more diverse investments, improving efficiency, as well as supporting future growth and development. After 18 years, Russia has finally entered the World Trade Organization this past year which required both government interest and initiative and should provide an important stimulus for further improvements in the Business Climate. The Kremlin has introduced Investors' Ombudsmen for both foreign and domestic investors to facilitate resolving disputes as well as providing private sector input into the legislative process. The Agency for Strategic Initiatives was also created in 2011 in part to help identify and support where private sector reforms and attention are most needed. Further, President Putin has placed improving Russia's Business Climate front and center in speeches and policy goal announcements during and after his recent election campaign and, more precisely, aiming to take the country to 50<sup>th</sup> place in the World Bank's *Doing Business Index* by 2015 and to 20<sup>th</sup> within six years.

The World Bank's most recent report, *Doing Business 2013*, ranks 185 countries across 10 pillars comprised of indicators measuring the cost and complexity, as well as institutional strength, of opening, operating and closing small and medium sized enterprises, such as the time required to register a business to obtaining construction permits and the number of forms required to import and export goods and services. In this year's report, which examines conditions in Moscow (*it does not reflect conditions at the subnational level*), Russia has climbed 8 ranks since last year's report to 112 from 120. Although a sign of progress, Russia remains well behind almost all other Former Soviet economies (See **Figure 1** in *Indicators*) except Ukraine (137), Tajikistan (141) and Uzbekistan (154) despite the fact that they shared many of the same fundamental challenges in moving towards a market oriented economy since 1991. Further, during the past year very little change took place across the indicators in Russia relative to other economies with the exception of *paying taxes* and *resolving insolvency* (See **Figure 2**).

This climb of 8 positions overall in the Index along with the lack of change across measures indicates a start in the right direction, but a lack of progress, especially when compared to how far other transition economies, such as Georgia (9<sup>th</sup>), have made during the past few years. Second, this small step in the right direction when placed in the perspective of high growth rates during the past 13 years and the impressive growth of net inward FDI flows suggests that Russia has been able to rely on abundant resources, high energy prices, and a growing consumer population as opposed to enhancing the quality of its Business Climate. Third, while many of the government's recent announcements and activities are welcome signs of a commitment to change this, much more aggressive steps need to be taken to retain progress already made relative to other countries and identify and prioritize where regulatory reform and institutional strengthening is most needed.

**Despite a rise of 8 ranks from 120<sup>th</sup> to 112<sup>th</sup> during the past year in the World Bank's *Doing Business Index*, the quality of Russia's Business Climate remains well behind almost all other former Soviet economies that have faced similar challenges in moving towards a market-based economy. Although Russia seems to be on the right path in terms of reducing the cost and complexity of regulations and strengthening institutions, it will have to pick up the pace of reforms in order to climb an additional 62 ranks by 2015 and 92 to achieve 20<sup>th</sup> over the next five years.**

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**1** | The Business Climate Development Monitor is a joint effort with the NES and FIAC and provides a monthly glance at conditions and activities affecting Russia's ability to attract and retain Foreign Direct Investments (FDI)

## 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.

***New Investment Announcement Activity has remained relatively stable since October with a noticeable decline in the number of announcements related to energy while no announcements were made related to tourism, as was the case in September. Retail activity remains low.***

### Energy

- **Exploration and Development:** **TNK-BP** and **Schlumberger** plan to invest in the development of 'tight oil' reserves in Siberia focusing on hard-to-recover hydrocarbon reserves in the Severo-Khokhryakovskoye field of West Siberia, **Lukoil** plans to invest \$2.7 bln in a geological survey of Russia's Arctic shelf focusing on four license areas in the Laptev, East Siberian and Chukchi Seas while **Gazprom** has decided to invest in active exploration of shale oil;
- **Upgrades and Modernisation:** **Rosneft** plans to invest \$25 bln on the modernization of its refineries (\$ 7 bln has been marked already as spent while the remaining \$18 bln will be over the next five years) while **Mezhregionteploenergo**, a unit of Gazprom, intends to invest RUR 5 bln over the next 8 years in the Vologda Region's heat sector in both construction and upgrades of thermal power facilities;
- **GE, INTER RAO UES Group** and **Russian Technologies State Corporation** will invest an estimated RUR 5 bln in the construction of a new plant manufacturing and servicing 77 MW highly efficient, low emission, 6FA industrial gas turbines near Rybinsk in the Taroslav Region with an initial capacity of 14 units per year beginning operations in 2014;
- **Gazprom** increased this year's investment program by RUR 198 bln to RUR 974.65 bln, of which capital investments will total RUR 890 bln and plans to invest an additional RUR 1.2 tln by 2017 to launch a gas field and pipeline to Vladivostok, part of which (RUR 430 bln) involves the Chayanda field and a gas processing plant in Belogorsk in the Amur Region.

### Autos and Aviation

- **Low Cost Airlines:** Pending the meeting of several conditions, **Aeroflot** is considering investing in a low-cost airline with more than 30 regional routes within a year likely to be created under its subsidiary, Donavia, with a fleet of 20 new planes: financial details were not disclosed;
- Poland's **Boryszew** plans to invest an estimated EUR 10 to 20 mln to open a car part factory for manufacturing plastic car components in the Nizhni Novgorod Region to be launched in the spring of 2013;
- **GM-AvtoVAZ** will invest an estimated RUR 6.2 bln to construct an enterprise for producing automobile body shells and extrusions in the Togliatti special economic zone after receiving approval from the zone's supervisory council;
- **Cordiant** plans to invest \$550 mln to raise its output capacity by 40% by 2018 and expects to double passenger car tire production to 10.5 mln per year and triple truck tire production to 1.15 mln per year;
- A unit of BAZEL, **Russian Machines**, and the US's **Terex Corporation**, plan to invest RUR 400 mln to construct a dump truck plant in Chelyabinsk to be launched in 2013 with a capacity of 100 trucks per year;

- Serbia's **Farmakom MB** plans to invest EUR 80 mln to build an automobile plant in the Kaluga Region with a capacity of 5 mln batteries per year.

### Metals, Minerals and Mining

- *Recycling*: **ZincOx Resources**, which recovers zinc from waste in the steelmaking industry, plans to invest in a joint venture with Ural-Recycling, a subsidiary of Magnezit Group, to construct a waste dust recycling facility in Russia to begin operating in late 2014;
- **Boeing** and **Rostekhnologii** will invest a further \$2 bln to develop new titanium alloys between now and 2018 focusing on high-tensile alloys for use in lower-weight aircraft;
- Russia's **AST Group** will invest RUR 165 mln to construct an electric welding parts plant to be launched in the middle of 2014 in the Nizhni Novgorod Region;
- **RusAl** is planning to find Chinese partners to invest in the construction of a smelter in Siberia with a capacity of 800 000 tons per year;
- Russia's **Siberian Anthracite** intends to invest RUR 27 bln to further develop the company with the aim of increasing its share of the global anthracite coal market from 18% to 75% by 2016.

### Transportation and Infrastructure

- *Logistics Park*: **Raven Russia**, currently implementing a project consisting of 85 000 m2 of warehouses with plans to construct 100 000 m2 of class A warehouses per year, intends to invest \$83 mln to construct a logistics park in the Moscow Region;
- *Affordable Housing*: **AIZhK**, Russia's Agency for housing mortgage lending, and the government of the Moscow Region will invest RUR 15 bln to create an affordable housing market within five years in the region aiming to construct a minimum of 150 000 m2 of housing;
- *Fuelling Stations*: **Gazprom** will invest RUR 1.26 bln to build 43 fuelling stations, 10 of which will offer natural gas motor fuel, in the Rostov Region within 5.5 years;
- **Lemminkainen**, a Finnish construction company, plans to invest EUR 170 mln to construct a 50 000 square meter housing complex in St Petersburg to be completed by November, 2015;
- **RZhD**, Russian Railways, plans to invest RUR 1.37 tln into infrastructure development projects between 2012 and 2014 and has announced plans to invest RUR 6 bln for the construction of a repair depot in the Novosibirsk Region to be launched in late 2014;
- **Russian Post** is planning to invest an estimate RUR 9 bln to modernize including the construction of an exchange office and a hybrid printing center;
- **Volga Resources** is planning to invest an estimated \$250 mln in building a coal and iron ore concentrate terminal with an annual capacity of 12 mln tons at the Vanino Port.

### Agriculture

- **Molvest**, a Russian dairy producer, and Danish-Swedish Arla Foods, will invest RUR 500 mln to launch a new facility at a plant in the Voronezh Region by April, 2013;
- **Belaya Dacha** will invest \$25 mln to construct a lettuce production facility in St Petersburg with a capacity of 8000 tons per year to be commissioned in the last quarter of 2013;
- After signing agreements with the government of the Rostov Region, **Donstar** will cooperate in the construction of a duck farming complex requiring a RUR 5 bln investment while **Donskaya Usadba** will cooperate in the construction of a vegetable production complex requiring an estimated RUR 3.2 bln investment;

- **Evrodon** will invest RUR 17 bln in the construction of a turkey farming and meat processing complex in the Voronezh Region with a capacity of 60 000 tons of meat per year;
- Russian cheese producer **Fromageria**, operating under the Casa Italia brand, will invest RUR 104 mln to build a plant in Volgorechensk in the Kostroma Region to produce Italian-style cheese to be launched in April-June 2013;
- **Magnit**, a food retailer, plans to invest RUR 10 bln in the construction of a greenhouse complex in the Krasnodar Region for year-round vegetable production;
- **Cherkizovo Group** may invest over \$ 200 mln to build a pig farming complex in the Far East with the possibility of exporting production to Asian markets.

#### Other Non-energy Sector Investment Activity

- *Pharmaceuticals:* **Ortat**, a Pharmaceutical packaging producer and subsidiary of R-Pharm, one of Russia's top 5 drug firms, plans to invest RUR 266.9 mln in a pharmaceutical plant in the Kostroma Region with a capacity of 100 mln packaged pills per year;
- *Data Center:* **Yandex** will invest RUR 2.7 bln to build a data center (Yandex DC) in Sasovo in the Ryazan Region in cooperation with the regional government;;
- **Rusnano** plans to invest in launching 9 nanotech centers in Russian regions in 2013 with the first opening in Kazan in 2012;
- **Selgros Cash&Carry** intends to invest an estimated RUR 1.3 bln to construct a wholesale center in the Rostov Region to open in March, 2013;
- **Hevel**, a Renova-Rsnano joint venture, plans to invest in a facility producing solar modules in the Chuvash Republic with a capacity of 1 mln solar modules per year (130 MW);
- **Kronospan Holdings East Ltd**, an Austrian timber processing company, will invest RUR 6 bln to create a plant in Russia's constituent Republic of Bashkortostan by 2017;
- **Aquantia**, a US integrated circuits developer, plans to invest in opening an R&D center in St Petersburg to be launched in 2013;
- *A number of investment plans in consumer retail were announced:*
  - **Media Markt** operates 46 stores in 21 Russian cities and plans to invest in opening five new hypermarkets in Russian cities and two stores in Moscow by the end of 2012;
  - **Burger King Russia** plans to invest in entering the Siberian market by the end of 2012 and plans to add the first two new locations in Surgut;
  - **GMR Planet**, a Russian restaurant holding company, plans to invest in opening at least 40 new Yamkee brand stores in 2013 and to expand the Yamkee restaurant chain to 300 eateries by the end of 2015, each eatery requiring an investment up to RUR 4 mln;
  - **Re:store Retail Group** plans to open 12 more stores by the end of 2012 after opening its 70<sup>th</sup> Apple store in St Petersburg and increase its Samsung stores to 55 by the end of the year and to 75 by the end of next year;
  - **Inditex**, a clothes producer with 274 stores already in Russia, plans to invest in aggressive expansion in Russia by opening 50 to 60 more stores annually;
  - **RBE Group**, a restaurant holding company, plans to invest RUR 1.5 bln over the next two years to launch five restaurant chains in Moscow and Sochi;

- **Shokoladnitsa**, a Russian café chain, is currently comprised of 300 cafes in Russia and the CIS and intends to invest in opening 30 to 40 more cafes annually.

## Outward New Investment Announcements

**Outward new investment announcements in October were noticeably more diverse than usual with announcements made outside of energy in fishing, autos, banking and telecommunications.**

- **Fishing: Russia and Namibia** are considering investing in a state joint fishing venture that could receive quotas for fishing in Namibian waters transferable to Russian users per defined calculations;
- **Oil Exploration:** After investing \$1 bln, **Lukoil** plans to invest up to \$300 mln in 2013 in geological exploration in West Africa while Rosneft is hoping to invest in geological exploration of two sites in Algeria;
- **South Stream Pipeline: Gazprom** and Hungary's electricity company **MVM** plan to invest an estimated \$780 mln in the construction of Hungary's section of the South Stream pipeline which will have an annual capacity of 30 bln cubic meters of gas and scheduled to begin operations in early 2016;
- Russia's **VSMPO-Avisma** and Korea's **Yulchon Co** intend to invest up to \$12 mln in a joint venture producing titanium pipes in South Korea;
- Russia's **Zenit Bank** plans to invest in establishing a representative office in Cyprus: no financial sums were disclosed;
- **AvtoVAZ, Azia Avto**, a Kazakh car manufacturer, and **Yertis**, a state owned investment corporation, plan to invest \$400 mln to create a joint venture to produce cars and car components in Kazakhstan by 2015 eventually reaching a capacity of 120 000 units;
- **Rostelecom** is planning to invest an unspecified amount to launch a 4G network in Tatarstan in the second quarter of 2013.

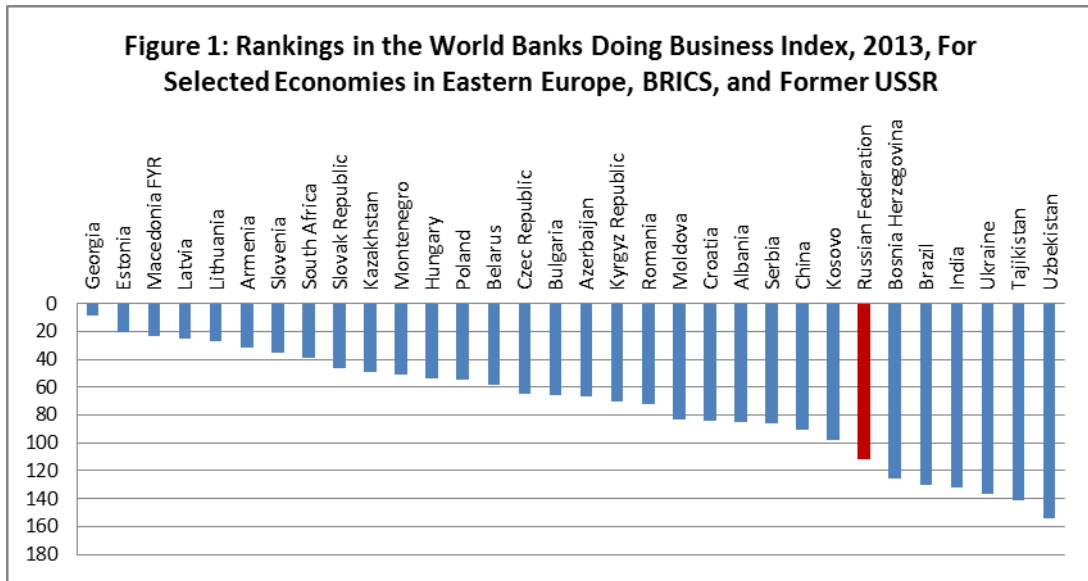
## Business Climate Indicators

BCDM's indicators aim to provide a monthly snapshot reflecting important trends, challenges, and changes related to Russia's business climate.

**According to the latest World Bank Doing Business Report 2013, Russia has lagged behind almost all of the other Post Soviet countries in overall rankings and its climb of 8 ranks this past year is mostly due to relative improvements in *Paying Taxes* and *Resolving Insolvency*.**

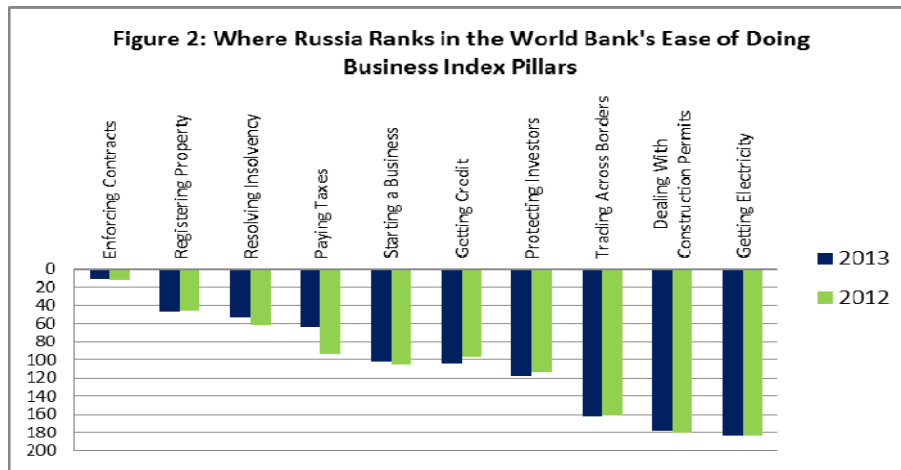
- **Figure 1** shows the rankings for 14 former Soviet Republics (Turkmenistan was not covered in the Index), the other BRICS, as well as transition economies in Eastern Europe in this year's *World Bank Doing Business Index, 2013*. All 14 Republics faced similar fundamental challenges after the collapse of the USSR in terms of implementing reforms to move away from central planning towards markets. Comparing Russia's current ranking with other countries can provide a useful perspective on how well Russia has done during the past 20 years, but also what is possible by comparing progress made in other countries facing similar conditions.
- In last year's Index, Russia ranked 120<sup>th</sup> and has now moved up to 112<sup>th</sup>, ahead of Ukraine (137<sup>th</sup>), Tajikistan (141<sup>st</sup>), and Uzbekistan (154<sup>th</sup>). However, Russia's business operating

environment ranks lower than all of the Baltic Republics, the Caucasus, and countries facing considerable hardship and poverty such as the Kyrgyz Republic (70<sup>th</sup>) and Armenia (32<sup>nd</sup>).



Source: The World Bank, Doing Business 2013

- Further, Russia has ranked lower than virtually every other transition economy in Eastern Europe with the exception of Bosnia and Herzegovina (126<sup>th</sup>) and below China (91<sup>st</sup>) and South Africa (39<sup>th</sup>) but ahead of the remaining BRICS, Brazil (130<sup>th</sup>) and India (132<sup>nd</sup>).
- **Figure 2** provides a closer look at how Russia ranks across the ten pillars used in the *Doing Business Index* for 2012 and 2013. More specifically, this view can provide more information on which areas hold Russia's ranking back from achieving higher rankings as well as in which areas Russia performs relatively well. The indicators, however, in this year's report are based on conditions in Moscow and must be used with caution since they do not necessarily reflect the relative conditions that exist more broadly across Russia's regions. A subnational [Doing Business Report](#) on Russia was released this past June and provides more detail on the conditions across 30 cities within Russia.
- With the exception of *Paying Taxes* and *Resolving Insolvency*, **Figure 2** shows that there has been little change in how Russia performs across 8 pillars in 2013 relative to 2012 compared to other countries. Second, the issues where Russia ranks lowest are related to getting electricity, dealing with construction permits, trading across borders, and protecting investors.



Source: The World Bank, Doing Business 2013

- Further, the report contains specific areas where Russia lags far behind other countries. In *Dealing With Construction Permits* (178<sup>th</sup>), Russia has 42 procedures relative an average of 19 in Eastern Europe and Central Asia (EECA) and 14 in the OECD and it takes nearly a year to process permits compared to just over half in EECA and just under half in the OECD. In *Getting Electricity* (174<sup>th</sup>), it takes almost 3 times as long in Russia to process access (281 versus 98 days) as in the OECD and the relative cost is far higher in terms of a share of GNI per capita (1573.7% versus 93%).

The right mix of high energy prices, abundant resources, and a growing consumer population has allowed the quality of Russia’s Business Climate to be overshadowed during the past decade as high growth and inward investment flows have taken place despite much progress in this field. Russia remains well behind almost all other Former Soviet Republics in terms of the relative quality of the business operating environment and much more aggressive attention will be needed to take the country to 20<sup>th</sup> place over another 5 years and, more importantly, help the country attract more diverse investments, improve efficiency, and make the country a better place to both live and work.