

## ***A Glance at Russia's Business Climate Beyond Moscow***

**Last month the World Bank reported that Russia's rank improved from 120<sup>th</sup> to 112<sup>th</sup> place in its annual Doing Business Index. The annual report, however, is based on conditions in Moscow and does not reflect the varied climate conditions within the country, nor the changes taking place.**

### *Monthly Overview*

Business Climate Change across and within countries is both real and a natural process. In part, this is due to natural economic forces. As people move to locations that are more attractive in terms of costs and qualities to invest, produce, live and work, they put upward pressure on prices, like office space and housing rents and locally provided services. They also add congestion as more people try to co-exist in a relatively limited space. This generally happens because a location has a certain capacity in terms of space and infrastructure for absorbing more people and activity, and unless investments and efforts are taken to expand that capacity, some of the original lower cost benefits of the location will naturally be eroded by rising costs. At the same time that there are tendencies for the best locations to become more expensive and thus, relatively less attractive, these same forces open the doors of possibility for those places that were once seen as less attractive. Costs there fall as people leave; rents drop, and capacity is freed up, making in some ways these locations relatively more attractive than before.

Business Climates can, however, also change for other reasons. People can take initiative and make efforts and investments into the quality of the Business Climate in their location. They can invest in expanding infrastructure, support relevant trade links, improve education and access to an adequately educated labor force, reduce corruption, as well as remove red tape and improve the costs of dealing with various regulations. Locations that appear viable and lower cost can take initiative to maintain their relative positions at the same time as less attractive places can do the same or aim to become even more attractive. For at least these two sets of reasons, natural market forces and serious reform efforts, changes in which countries, and locations within a country, appear most attractive should and do take place.

It should not be surprising that in a country as vast as Russia that there are signs of Business Climate change, with some regions losing some of their previous status and other areas showing great promise and progress. A recent survey by a consulting firm, CASE, reported in *Russia Beyond the Headlines* ([Source](#)) highlighted that despite a wage advantage in Moscow relative to other cities, other cost considerations, such as rent, already erode many of the benefits of moving to the city making other regions in Russia more attractive, especially for recent graduates. In June, the World Bank released its second *Doing Business in Russia* [report](#) focusing on the subnational level (The annual index and rank is based on conditions in Moscow) ranking 30 cities in the country based on indicators related to starting a business, registering property, dealing with construction permits, and getting electricity. After years of successful reform efforts and changes in governance, Ulyanovsk ranked in 1<sup>st</sup> place while Moscow was in last, 30<sup>th</sup>, and St Petersburg in 22<sup>nd</sup>. Considerable progress was also noted in Stavropol (7<sup>th</sup>) and Rostov-on-Don (4<sup>th</sup>), to mention but a few. For 10 of the cities covered in an earlier sub-national [report](#) in 2009, improvements were also noted. A joint NES and E&Y report ([Source](#)) in 2011 also shed light on the different business climate conditions and issues in Russia's regions. Further, during the past year, the World Bank has also carried out Business Environment and Enterprise Surveys ([BEEPS](#)) helping to further identify obstacles to firm performance in the general Business Climate across 38 regions (Figures 2 and 3).

**A country as vast and diverse as Russia will require an approach that is sensitive to regional variation in Business Climate conditions, not only to ensure that the right reforms are identified**

and implemented effectively in the right settings, but more importantly, to achieve a greater potential on a national scale.

### *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 in November was heavily dominated by the energy sector while there was a noticeable decrease related to retail and again none in tourism.***

#### **Energy**

- **Russia's Shelf:** **Rosneft's** partners, US's **ExxonMobil**, Italy's **Eni**, and Norway's **Statoil**, will invest an estimated \$ 5 bln to develop Russia's shelf, which has an estimated reserve of 66.067 billion barrels and 8.863 trillion cubic meters of gas;
- **Renewable Energy:** **RAO ES Vostoka** is planning to invest RUR 1.989 bln in the Kamchatka Region by 2017 to develop renewable energy sources in the region with RUR 1.982 bln allocated for wind-diesel complexes and the remaining RUR 7.1 mln for solar power plants while **Avelar Energy Group**, a Swiss company, will invest EUR 70 mln to construct solar power plants in Orenburg with a capacity of at least 25 megawatts;
- **Hydro Cracker:** **TNK-BP** intends to invest a total of \$ 2.5 bln over the next three years in upgrades in its refinery in Ryazan aiming to boost oil refining, cut fuel extraction costs by almost 50%, increase light oil extraction and meet the Euro-5 emission standard, which will involve a \$ 57.8 mln investment in 2013 to construct a hydro cracker unit for the refinery out of a total \$ 1 bln required for the unit;
- **Hydropower:** **RusHydro**, a Russian hydropower group, is planning to invest in building seven large power facilities in the Far East although no investment sums were disclosed
- **Power Plants:** **Integrated Energy Systems**, a Russian power utility, plans to invest RUR 22 bln to build a gas-vapor thermal power plant in the Sverdlovsk Region with a capacity of 460 megawatts while **Fortum**, a Russian power producer, is considering investing RUR 20 bln to construct TETs-4 thermal power plant in Chelyabinsk and RUR 4 bln to construct two 110 MW gas powered units at TETs-1 plant in the city, Russia's **EN+** and Japanese **Itochu** intend to invest \$ 500 mln to build a gas powered electricity generator that will almost double the output of its Avtozavodskaya power station and **Inter RAO UES** intends to invest RUR 4.279 bln in the Tomsk Region's power sector over five years aimed at energy saving and efficiency;
- **Liquefied Natural Gas (LNG):** **Gaz-Oil**, a subsidiary of Gazprom, will invest an estimated RUR 3 bln to construct an LNG plant in the Novgorod Region over the next 3 years with a projected capacity of 7 tons of LNG per hour;
- **Lukoil** is planning to invest RUR 200 bln in oil production and processing projects in the Komi Republic over the next four years and is also planning to invest in building a deep oil residue refinement plant at its Lukoil-Permnefteorgsintez refinery;
- **TAIF-NK** has begun investing an estimated \$ 1.83 bln to construct a heavy oil conversion complex in Tatarstan with an annual capacity of over 3 mln tons to be launched in 2016;
- **Transnefteproduct**, Russia's oil product pipeline operator, plans to invest RUR 7.55 bln over the next two years in the Republic of Bashkortostan to repair and upgrade capacities of its unit that provides transportation, loading and storage of oil products;

- **Rosneft** intends to invest RUR 118.5 bln to upgrade its Komosomolsk Oil Refinery in the Khabarovsk Region in 2015.

### Autos and Aviation

- *Railway Cars*: After investing RUR 468 mln in opening a railway car depot in the Belgorod Region, Russia's **Rail Garant Group** plans to invest in creating more such facilities in Russia and the CIS although no further investment details were yet disclosed while **AKF Sistema** may invest RUR 14 bln to construct jointly with **US Albert Kahn Inc.** a railway car plant in the Lipetsk Special Economic Zone with an annual capacity of 12 000 cars;
- **Avtotor** and **Magna International** plan to jointly invest an estimated RUR 100 bln to build an automotive cluster in Kaliningrad with a projected output of 250 000 vehicles per year and will involve construction of up to six full circle auto plants and 15 plants for auto parts;
- Turkey's **Coskunuz** will invest RUR 2.3 bln in Tatarstan's Alabuga Special Economic Zone to build a stamping plant to provide auto components to the neighboring Ford Sellers assembly plant in;
- Russia's **Avtotor** is considering a EUR 350 mln investment to boost BMW production in a joint facility in Russia to 50 000 per year pending a final agreement with BMW.

### Metals, Minerals and Mining

- *Recycling*: Spain's **La Farga Group** and Russia's **RUSSKAT** plan to jointly invest an estimated EUR 50 mln to create a joint venture in the Tula Region that will produce copper rod from copper scrap to be launched in 2014 with an initial estimated output of 20 000 tons;
- *Gold*: UK's **Highland Gold Mining (HGM)**, which operates in Russia, is planning to invest in launching a processing plant in the Khabarovsk Regions Belaya Gora deposit in the Q1 of 2013;
- Bricks: **Ufimsk Building Company** intends to invest RUR 1.3 bln in a new front brick plant by summer, 2013, in Bashkiria with a projected capacity of 80 mln tons of brick per year;
- France's **Imerys** intends to invest EUR 10 mln for its first project in Russia to construct a plant in the Rostov Region to produce filter perlite powder to commence operations by mid-2014;
- **Region**, a Russian investment company, plans to invest EUR 1 bln in a forest and chemical complex in the Irkutsk Region comprised of two plants: one producing 700 000 tons per year of bleached coniferous pulp and the second 300 000 tons of chemical-thermomechanical pulp.

### Transportation and Infrastructure

- *Pulkovo*: **Northern Capital Gateway**, the operator of St Petersburg's Pulkovo airport, is considering a \$ 500 mln investment for the construction of a second stage of a new passenger terminal in the airport to begin operating by December, 2013, with a capacity of 17 million passengers per year that could reach 25 million by 2025;
- **RZhD**, Russian Railways, will invest an estimated RUR 17 bln into the development of Moscow's railroads in 2013 out of its planned RUR 411 bln investment plan for that year;
- After installing 56 charging stations for electric cars in Moscow and Moscow Region, Russia's **United Moscow Power Grid Company (MOESK)**, plans to invest in installing 2260 more over the next 6 years with the aim of supporting further expansion of electric transport development;
- **Aerofuels Group**, a leading Russian operator of air fleet fuelling systems, plans to invest RUR 300 mln to launch a fuelling complex in Nizhni Novgorod's International airport in 2013.

## Agriculture

- *Bread:* Russia's **Nastyusha Grain Company** is planning to invest \$ 300 mln to construct a bread production and logistics complex, the largest of its kind in Russia, on the New Moscow Territories located in Southern Butovo with a 150 000 ton grain elevator, a 1500 ton/day milling complex, and a 1500 ton per day bakery and transport logistics center;
- Russia's **Brack Capital** and **FGN** developer companies are planning to invest RUR 3 to 4.5 bln to construct a logistics agro center to be launched in 2014 that will become part of the Novaya Tura technopolis;
- **Cherkizovo** is considering investing RUR 300 mln to construct a meat processing plant to be launched in 2014 in Tartarstan's Alabuga Special Economic Zone with a capacity of 35 tons per day;
- A Dutch-Russian joint venture, **Farm Frites Belaya Dacha**, plans to invest RUR 3.5 bln to construct a potato processing plant in the Lipetsk Special Economic Zone in 2013 with a capacity of 100 000 tons per year to begin operations in 2015.

## Other Non-energy Sector Investment Activity

- *Pharmaceuticals:* Germany's **Bayer AG** and **Medsintez** plan to invest in pharmaceutical production in Russia, manufacturing and commercializing diagnostic imaging products and pharmaceuticals, while Israel's **Teva Pharmaceutical** plans to invest \$ 50 mln to construct a plant in Yaroslavl with a projected capacity of up to 8 bln pills annually by 2020 requiring an additional \$250 mln in investments during the next 8 years;
- Russia's **PM Packaging**, will invest \$ 40 mln in the Ulyanovsk Region to construct a corrugated cardboard plant with an annual capacity of 140 mln m<sup>2</sup> of cardboard;
- **Guardian Glass Rostov** is planning to invest an estimated RUR 4.6 bln to launch a float glass plant in the Rostov Region in early 2013;
- *A number of investment plans in consumer retail were announced:*
  - **Rostelecom** will invest an estimated RUR 4.2 bln to open 1700 rebranded retail outlets within a year;
  - **Maratex**, a Polish clothing retailer, and Italy's **Gruppo Coin**, plan to jointly invest in open 19 OVS branded shops by the end of this year;
  - **Vimpelcom** plans to invest an unspecified amount to launch LTE networks in Moscow and six other regions by the end of 2013 and increase the number of new mono-brand shops to 400 by opening an additional 180 in 2012 with plans to double the number in 2013.

## 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.**

- *Fibre-Optic Cables:* **MegaFon** plans to invest in laying two fibre-optic cables between Germany and China via Kazakhstan in 2013 as part of its Diverse Route for European and Asian Markets (DREAM) project;;
- *High Speed Rail:* Estonia's **GoRail Company** and Russia's **Federal Passenger Company**, a subsidiary of Russian Railways, are considering jointly investing, developing and launching high speed trains between Tallinn, Moscow, and St Petersburg: no investment sums have yet been publicly disclosed;

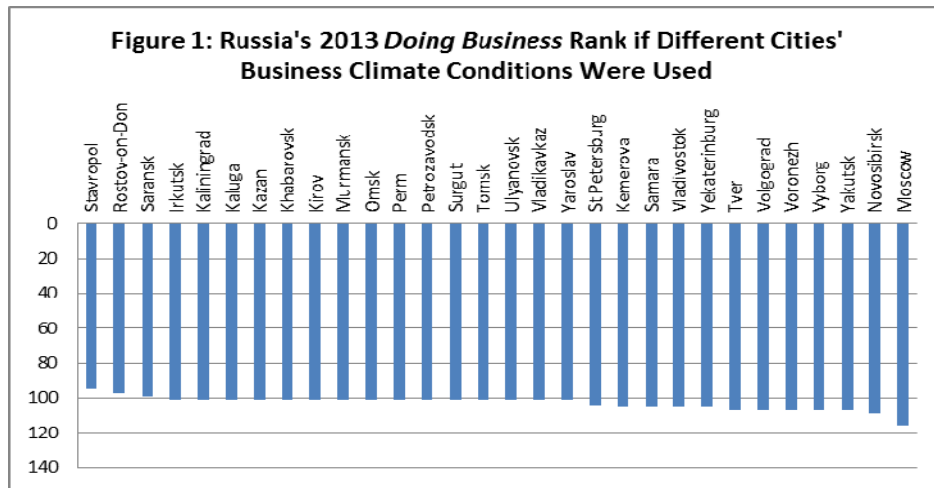
- **Gas Stations:** Russia's **TNK-BP** is planning to invest \$ 58 mln to create a network of gasoline fuelling stations in Ukraine in 2012-2013, opening 17 new stations by the end of this year and the remainder of a projected 35 in 2013. While **Gazprom Neft Kazakhstan** intends to invest \$ 170 mln to develop a chain of fuel stations in the country by 2015;
- **Gazprom** will invest an estimated \$ 2 bln to increase gas transit through Belarus including a 4% rise to 44.5 billion cubic meters through the country and a 10% rise to 22 billion cubic meters to the country;
- **Nova Medica**, a joint Rusnano-Domain Associated pharmaceutical company, intends to invest in opening an US office in Princeton, New Jersey.

### *Business Climate Indicators*

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

**Data available on a subnational basis from sources such as the World Bank's *Doing Business in Russia* and *Business Environment and Enterprise Surveys (BEEPS)* indicate a much broader range of Business Climate conditions within the country.**

- **Figure 1** shows how Russia would rank in the 2013 *Doing Business Index* if business climate conditions in different cities were used instead of Moscow. The annual *Doing Business Index*, in which Russia ranked 120<sup>th</sup> last year and 112<sup>th</sup> this year, relies on indicators reflecting conditions in Moscow only.
- A subnational report, *Doing Business in Russia 2012*, however, ranks 30 of Russia's cities across four of the ten usual dimensions: *starting a business, dealing with construction permits, getting electricity and registering property*. The indicators for each of the 30 cities across these four dimensions were then used to simulate how Russia's rank would change if the country were judged on any one of these cities instead of Moscow. The World Bank's [reform simulator](#) was used to evaluate the changes in rank.
- Figure 1 shows that if Stavropol, for example, had been used instead of Moscow, Russia would have ranked in 95<sup>th</sup> position rather than 112<sup>th</sup> and 101<sup>st</sup> place if many of the other 30 cities had been used. (*Moscow, in this simulation, ranks in last place out of the 30 cities and Russia would have been in 116<sup>th</sup> place in this case since the data used in this simulation reflect the cities conditions for these four pillars from a previous year, while the other six pillars remain unchanged. Note also that the rankings of the 30 cities in this case differs slightly from the Subnational Report rankings. This is due to slightly different weights used across these four pillars between the Annual Report and Subnational Report.*)
- This figure highlights several issues. **First**, that business climate conditions within a country can vary and annual indexes based on conditions in any one city, especially in a large diverse country such as Russia, may not paint an accurate picture. **Second**, the conditions in Moscow underrepresent conditions in 29 other cities surveyed and this suggests Russia may in fact be doing much better across indicators than the annual index would suggest. **Third**, carrying out successful reforms across just four pillars of indicators, as has taken place in many of Russia's cities, can significantly improve rank. **Fourth**, it suggests that if Moscow were able to replicate some of the conditions in Stavropol or other cities, Russia's rank should improve and this further draws attention to the fact that reforms are well underway within Russia and there is much to possibly draw upon from domestic sources in addition to cross country comparisons.



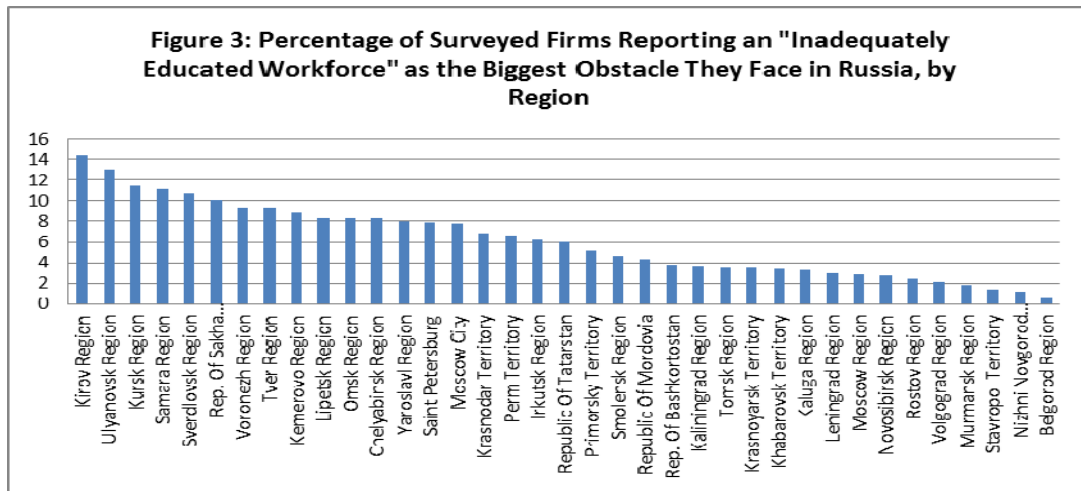
Source: World Bank, *Doing Business in Russia 2012* and World Bank *Doing Business 2013 Reform Simulator*

- **Figures 2 and 3** show selected results from the *Business Enterprise and Environment Surveys* (BEEPS) conducted between August 2011 and June 2012 across 4220 manufacturing firms in Russia concerning a range of Business Climate related conditions from corruption and the impact of crime to taxation, transportation, and trade.
- **Figure 2** shows the percentage of surveyed firms which identified corruption as the biggest obstacle they face in terms of operating in Russia. The results are broken down by region to show that there is considerably wide variation in how relatively important firms view the issue of corruption, from a high of 28.3 % of surveyed firms in Smolensk to a low of 0.9% in the Republic of Sakha.



Source: Enterprise Surveys (<http://www.enterprisesurveys.org>), The World Bank

- **Figure 3** provides a glance at the results for firms indicating an inadequately educated labour force as the biggest obstacle they face. The range is much narrower than for corruption across the 38 regions surveyed from a high of 14.4% of firms in Kirov to a low of 0.7% in the Belgorod Region.



Source: Enterprise Surveys (<http://www.enterprisesurveys.org>), The World Bank

Although aiming to take the country from the current 112<sup>th</sup> place to 20<sup>th</sup> in the World Bank’s *Doing Business Index* within 5 years is an important aim and stimulus for Russia’s government to improve the quality of the country’s Business Climate, the diverse range of conditions beyond Moscow, (which is the focus of the annual Index) means that a much more broad approach for monitoring, identifying, implementing and supporting Business Climate reforms is needed if Russia and its regions are to achieve their greater potential. Further, there is evidence that business climate improvements are underway in cities across the country and that conditions in Moscow likely underrepresent both the progress in and quality of the nation’s Business Climate.

### ***The First BCDM Annual Report***

More details on New Investment Announcements by sector and Business Climate Conditions across regions will be available in our upcoming first annual report in early 2013, to be released at the [World Economic Forum](#)’s FIAC session in Davos, Switzerland.