

Russia's Business Climate Takes Small Steps Forward

Russia climbed to 64th from 67th place since last year in the World Economic Forum's *Global Competitiveness Index* released at the beginning of September. The country remains, however, well behind most other Transition and BRICS economies.

Monthly Overview

Each year the World Economic Forum (WEF) ranks countries around the world in terms of competitiveness. This year, the WEF's *Global Competitiveness Index* (GCI) combined 114 qualitative and quantitative indicators across 12 pillars ranging from the quality of institutions, market size, health and labor market conditions to the quality of infrastructure to rank 148 countries. Generally, a country that is more competitive is able to use its scarce resources more efficiently and produce goods and services (public or private) at lower cost. This makes countries with higher levels of competitiveness more attractive to operate in and, in turn, attract higher levels of economic activity than those with lower levels of competitiveness. The overall aim of this type of exercise is to provide policy makers with a tool that can be used to identify where changes are needed to improve a country's productivity and, ultimately, enhance prosperity. Although the focus is slightly different, the GCI also provides insight into various qualities of a country's business climate and where changes are needed for achieving analogous types of outcomes.

In this year's GCI, Russia's position improved slightly from 67th to 64th position out of 148 countries covered. The country ranks favorably in terms of features such as its market size, well-educated population, general level of infrastructure development, and macroeconomic conditions, like the level of government debt, but lower in terms of the quality of public institutions and capacity to carry out innovative activity in production. Further, Russia continues to rank quite far behind other transition economies in Eastern Europe and Eurasia as well as BRICS countries (see [Figure 1](#) in the *Indicators*). The indicators used are also complimented by WEF's *Executive Opinion Survey* which shows that issues like corruption, tax rates and regulations and an inefficient government bureaucracy continue to be perceived as the most significant barriers for doing business in the country (see **Error! Reference source not found.**). Further, although there have been some changes in these perceptions since 2011, their relative importance and rank remain virtually the same.

Although the GCI, surveys, and rankings can provide insight into where improvements need to take place as well as providing an important stimulus for improving the country's business climate, caution is also warranted. All indexes suffer from typical drawbacks, such as whether the indicators work well and measure qualities accurately across countries, proper weights are used and how much improvement is required to enhance ranks. In addition to these, however, two other serious issues related to reforms are worth mentioning. Many indicators are related to each other and improvement is not so easy. Improving road quality, educational institutions, or virtually any aspect of government institutions, are likely to involve additional expenses (i.e. taxes), and thus, improvement in one indicator, road quality, may come at the expense of another, tax rates and regulations, leaving the overall impact on the level of competitiveness and rank higher, the same or lower. This can frustrate those involved in aiming for improvement and higher ranks and turn people off seemingly "pointless" reforms.

The second important concern is that the ranking of issues in the surveys and index might not correspond to their "economic" importance. A high ranking issue, such as road quality, might cost more to improve to achieve a higher rank and improved business climate conditions than dealing with corruption or trade barriers. Improving any aspect of the quality of the business climate is not costless and more research is required about the costs, benefits, and consequences of reforms to

prioritize where attention needs to be focused to achieve greater outcomes efficiently, whether they result in an improved rank or not.

Rather than aiming specifically, or only, for improved ranks, whether in the WEF's GCI or the World Bank's *Doing Business Index*, Russia needs to be more specific about the outcomes it is aiming for and use these rankings as a stimulus for a wider discussion on which of the qualities of the business climate matter most for improved performance before investing significant resources, time and effort to dealing with issues suggested by the indicators alone.

Monthly Highlights

BCDM's *Monthly 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.

In August, New Investment Announcement activity remained stable since July with a noticeable increase, however, in infrastructure-related announcements. There was no activity tracked related to tourism investments again this past month.

Energy

- **Exploration: Statoil** is planning to invest in two exploratory wells in western Siberia in 2014 while **Rosneft** will invest over RUR 1.5 bln to explore the Kara Sea;
- **Biofuel: Mitsui&Co** will invest RUR 988.5 mln to construct a biofuel plant to be operated by **Baikal Timber Company**, with the timber company investing an additional \$2.5 mln in a timber sorting facility, while **RT-Biotechprom** is entering an agreement with **Airbus** to invest in the production of aviation biofuel using only renewable resources;
- **Solar Power: Rusnano** and **Renova Group** will invest RUR 2.7 bln into the construction of solar power plants in Russia aiming to achieve over 600 MW of solar power facilities by 2020;
- **Pipeline: Gazprom** will invest RUR 6 to 7 bln to construct a gas pipeline for the fourth power unit of Perm GRES to be in place by the end of 2015;
- **Gas supply: Irkutsk Oil Company** will invest up to RUR 120 bln in the construction of a gas processing plant;
- **Inter RAO UES** plans to invest RUR 2 bln in building a coal-fired power plant with a capacity of 800 MW in the Kaliningrad Region;
- **Rosatom** plans to invest around RUR 28 bln in 2013, and RUR 46 bln in 2014, to launch the first unit of Novovoronezhskaya AES-2 in the Voronezh Region in late 2014.

Autos and Aviation

- **Helicopter Center: NDV Real Estate** plans to invest \$100 mln with **Aerosoyuz** to construct a helicopter center in the North-west of Moscow Region over two years;
- After signing an agreement, **Rostec** will assemble Canadian Bombardier's Q400 aircraft in Russia, the total investment involved is estimated at \$100 mln;
- **Russian Helicopters** will invest almost \$ 12 bln to produce 870 helicopters before 2020 with the aim of exporting 200 of this inventory;
- **Danieli** is investing RUR 3.1 bln in a machine building plant in Dzerzhinsk, to be launched in February, 2014, with trial production in September;
- **Kamaz** will invest an unspecified amount to introduce a new truck model with the aim of increasing its freight truck market share to 25% from 5%.

Metals, Minerals and Mining

- **Nordgold** is considering investing in exploration and development in the Zhanokskaya area of the Buryatia Republic pending receiving a license;
- **Eurocement Group** will invest RUR 9 bln to upgrade Mikhailovskcement in the Ryazan Region aiming to raise output from 1.9 mln tons to 3.6 mln annually;
- **Alrosa** is planning to invest in the development of two placer diamond fields in the western part of the Sakha (Yakutia) Republic;
- **Eurochem** will invest in launching a new potash mine in the Gremyachinskoye field near Volgograd in 2017.

Transportation and Infrastructure

- **Rostelecom** will invest RUR 2.091 bln related to the construction of an underwater fiber-optic links at the bottom of the Okhotsk Sea between Sakhalin, Magadan and Kamchatka;
- **United Wagon Company** and **Amsted Rail** will invest in establishing a joint venture to develop and manufacture cargo railcar components;
- **Otto Group** is planning to invest EUR 50 mln to develop parcel delivery infrastructure in Russia and open its network to third party retailers granting access to the Russian online market;
- **Sheremetyevo Airport** will invest \$300 to 350 mln to construct a complex of terminals and a tunnel connecting it with the older buildings;
- **Gazprom** is investing \$200 mln in gas tankers built by Sovcomflot;
- **Basel Aero** is planning to invest RUR 30 mln in developing and designing Krasnodar's Pashkovsky airport with further plans to invest up to RUR 9 bln through to 2043 with its joint venture with **Changi** and **Sberbank** in the creation of a city around the airport;
- **AT Nedvizhimost** plans to invest \$600 mln to construct an industrial warehouse class A complex in the Sofyino Logistics Park in the Moscow Region, to be completed by 2018;
- **Vivat Trade**, a leading Russian retail company, will invest RUR 1 bln to launch a distribution center in two years;
- An additional RUR 68 bln will be invested in the construction of the **Moscow Central Ring Road** to speed up the completion of construction to 2018 instead of 2020, the total cost of the first stretch is estimated at RUR 300 bln;
- **Magnit** will invest RUR 1.27 bln to construct a 60 000 m² warehouse and depot for trucks in the Rostov Region to be completed in 2014;
- **Moscow's Metro** will invest RUR 15.5 bln for maintenance of 248 of the city's metro cars for the next 30 years, to be carried out by Metrovagonmash.

Agriculture

- **Cargill** is investing no less than \$200 mln to construct a sunflower oil factory in the Volgograd Region;
- **Metachem** is investing an estimated \$ 12 mln to build a PKS and NPKS fertilizer plant to be launched in early 2014;
- Russia's **United Grain Company** (UGC) is planning to invest up to \$1 bln to construct production facilities to start deep grain processing to produce protein and amino acids with the first \$300 mln for a plant in the Novosibirsk or Altai regions and a capacity of 500 000 to 1m tons.

Other Non-energy Sector Investment Activity

- **Timber:** **GS Group** will invest RUR 1.2 bln to launch a timber-based finishing materials plant with a capacity of 150 000 m³ of goods per annum in the north of Russia by 2015;
- **Fueling Stations:** **Gazpromneft-Aero** will raise investments to upgrade fueling stations by 50% to RUR 2.197 bln in 2013 with RUR 1.8 bln related to military airplane service stations while **Gazprom Gazomotomoye Toplivo** will invest RUR 13.8 bln including mobile gas filling stations;
- **Chemicals:** After an RUR 8.8 bln upgrade investment, **Sibur** will invest in launching an ethylene facility at a plant near Kstovo in the Nizhni Novgorod Region in 2013 with a future capacity of 450 000 tons and the company will invest in a joint venture with **Sinopec** to produce butadiene-nitrile rubbers at the Krasnotarsk Synthetic Rubber Plant with plans to expand capacity to 56 000 tons per year;
- *A number of investment plans in consumer retail were announced:*
 - **Shanghai Industrial Investment Holdings Co.** and **Finland SRV Group** will invest EUR 140 mln in a shopping mall in St Petersburg;
 - **Shokoladnitsa** will invest in launching the first outlets of Israeli café chain Max Brenner in Moscow in 2014, each café usually involving an investment of \$500 000 to \$1 mln.
 - **Debenhams** will invest in opening its flagship store in Moscow in 2014 with aims to open an additional 7 stores in the next five years;
 - **Lenta** will invest in launching 10-12 hypermarkets in 2013 and expand its chain to 72 to 74 outlets with expansion into the Perm and Sverdlovsk Regions as well as Republic of Udmurtia;
 - **Starbucks** is planning to invest in expanding its brand in south of Russia into Sochi, Rostov-on-Don and Krasnodar with each new store requiring about \$250 000.

Outward New Investment Announcements

Outward New Investment Announcement activity was noticeably up in August over July with much of it focused on energy and mining related activities.

- **Uralkali** is considering investing in expanding its distribution network for its products in China and Brazil aiming to directly oversee fertilizer shipments;
- **Alrosa** has signed an agreement with **Botswana Diamonds** to invest in a joint venture for investing in exploration in the country with an initial investment sum of \$1 mln;
- **Rosneft** has entered a strategic agreement with SOCAR to invest in a joint venture for exploring and developing oil and gas in various countries;
- **Gazprom:** plans to invest in entering the Italian gas-based fuel engine market and is considering building automatic gas-filling compressor stations with further plans to increase the number of stations in Germany and Czech Republic to 15 in each by 2015, the company has a further intention to invest about \$2 bln to develop the Badra oil field, will invest a further \$15 mln in exploration of the ShakhriNAV field in Tajikistan in 2013 and has an agreement with **Total** for a \$130 mln investment to explore the Azero gas field in south eastern Bolivia;
- **Rostec** and **Vneshekonombank** are investing in a \$300 mln project to develop Zimbabwe's Darwendale involving **Ruschrome Mining**, which is licensed to mine the field.

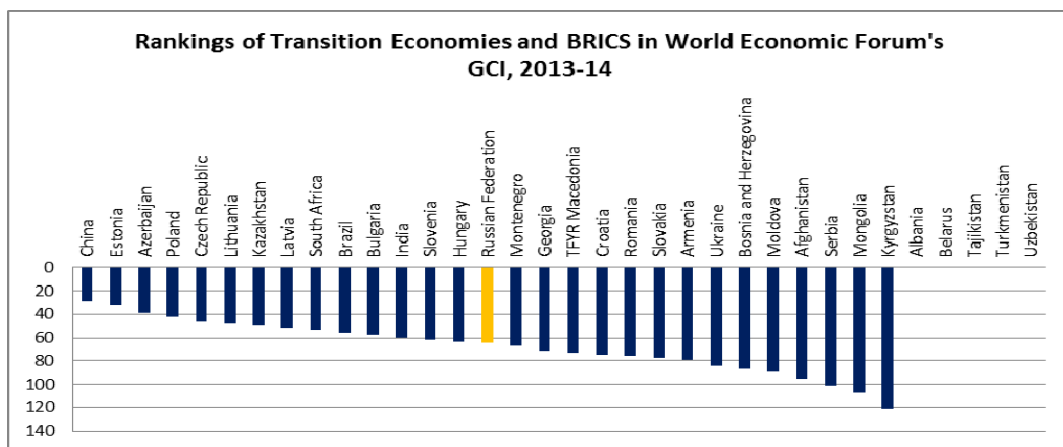
Business Climate Indicators

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

In early September, the World Economic Forum released the latest results of country rankings in its *Global Competitiveness Index, 2013-2014*. Russia has climbed slightly from 67th position last year to 64th this year, although it remains well behind many other BRICS and transition economies.

- Figure 1 below shows the rankings of transition and BRICS economies in this year's World Economic Forum *Global Competitiveness Index (GCI)*. The GCI uses 114 indicators across 12 pillars with the aim of providing policy makers with a tool that can be used to indicate where changes are needed to improve a nation's level of productivity. The premise of the Index is that countries which are more productive will attract and retain greater levels of economic activity leading to greater growth and, ultimately, prosperity.
- Figure 1 shows that Russia, despite a slight improvement since last year, remains well behind other transition and BRICS economies in 64th place, such as the Baltic countries, China, South Africa, India and Brazil, but also a resource rich transition neighbor, Kazakhstan.
- Russia's progress across a wide range of indicators, which reflect various qualities of the country's business climate, remains slow.

Figure 1

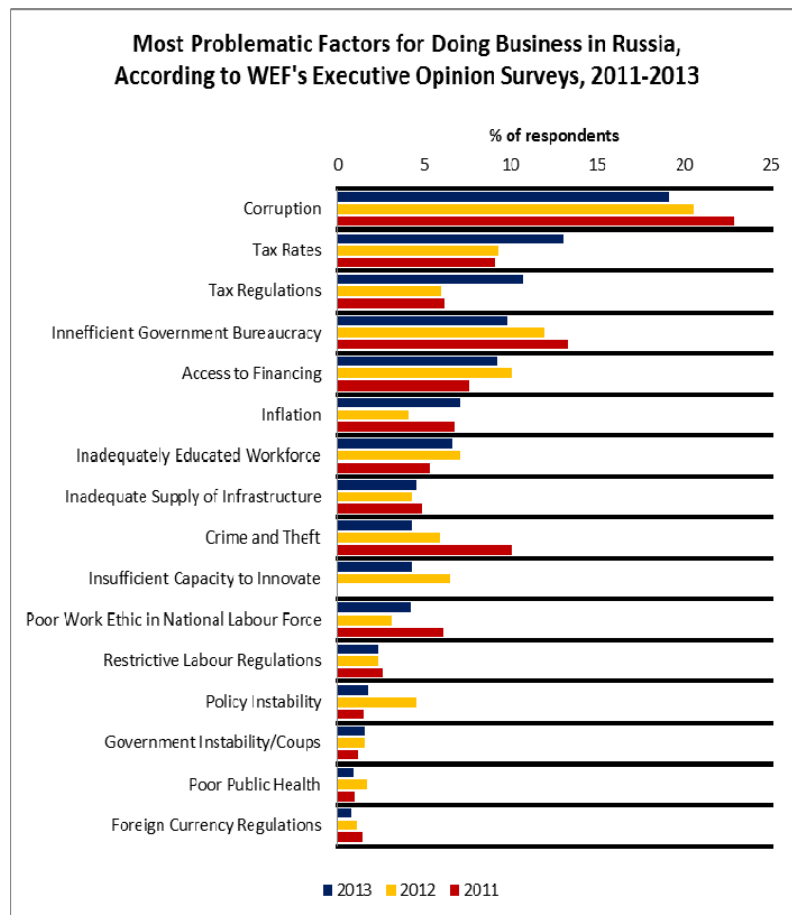


Source: World Economic Forum, Global Competitiveness Report, 2013-14

- Error! Reference source not found. below shows the results from the World Economic Forum's *Executive Opinion Surveys* during the last three years. In 2011, 2012, and 2013, 377, 414, and 294 business leaders were surveyed respectively and asked to select the five most problematic barriers for doing business in the country from a list of 16 (15 in 2011), and rate them in terms of importance.
- Corruption, tax rates and regulations, inefficient government bureaucracy and access to financing were generally rated at the top of the list, in that order, as the worst problems for doing business in Russia. However, perceptions of the importance of corruption have improved slightly over this period as well as inefficient government bureaucracy while tax rates and regulations appear to worry business leaders relatively more than before.

- The overall results show that during the past three years, respondents ranked these problems with some change within each category across years. This suggests that many of the problems continue to be perceived as relatively stable and that it might take serious levels of commitment to deal with these issues before business leaders perceive improvements.

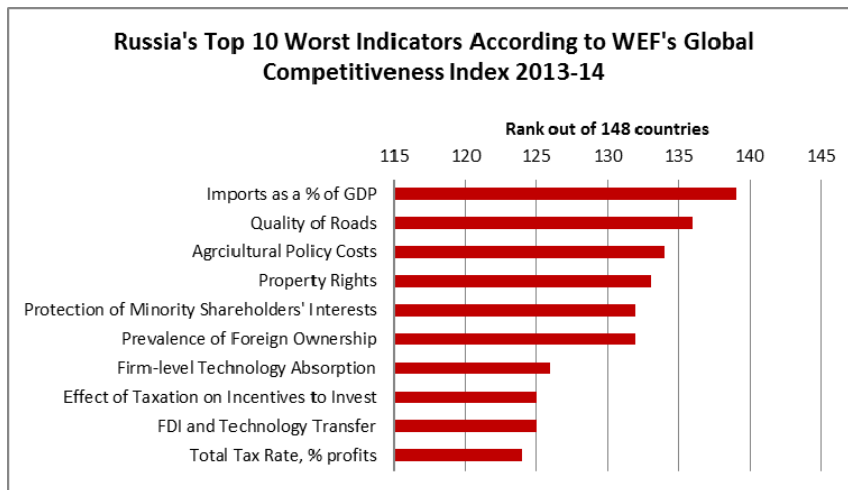
Figure 2



Source : Global Competitiveness Reports, Executive Opinion Surveys, 2011-2013, World Economic Forum.

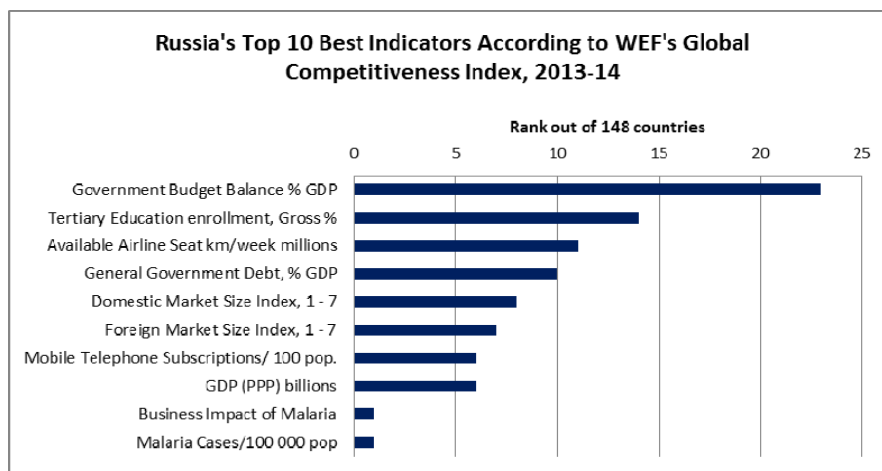
- Also noteworthy in these surveys is that those businesses surveyed did not cite political instability or work ethics, health and labour regulations as worrisome as corruption. This does not mean that political instability is not an issue or challenge facing Russia, but rather, than corruption is seen as a relatively more serious barrier for doing business in the country. It worth to mention that other surveys in Russia, like BEEPS, also rank corruption as the most problematic one in terms of costs for business.
- **Error! Reference source not found.** below shows the top ten indicators, out of 114, in the *Global Competitiveness Index* for which Russia ranks the worst out of 148 countries in relative terms.
- Although interpreting the rank and what it means must be done with caution, these ten indicators suggest Russia faces a range of challenges in terms of infrastructure (namely, road quality), implementing innovation and better production methods, and institutional issues such as ownership and investment related protections and regulations.

Figure 3



- **Error! Reference source not found.** below shows the top ten indicators in the *Global Competitiveness Index* where Russia ranks its highest relative to 148 countries.
- These indicators suggest that overall, the government is in a relatively strong financial position (although buoyed by oil), with an attractive market size and well-educated workforce.

Figure 4



- This mix of indicators along with results from the executive opinion surveys can provide some guidance over where strengths and weaknesses are in Russia’s business climate relative to conditions in other countries despite the fact that there are limitations with this approach in terms of how well the indicators work, how they are measured and weighted, and how much progress needs to be made in the country to improve its overall rank. All indexes, however, share these basic issues.
- Another important concern is that the ranking of issues in the index and surveys are unlikely to correspond to their ranking in terms of “economic” significance. It might require, for example, more costs to deal with corruption, a higher ranked issue in the survey, than changing tax codes, and the latter might improve the business climate relatively more in

terms of attracting investments, supporting growth, employment, and a wider range of outcomes. Further, improving virtually any of the qualities across 114 indicators would require government resources (i.e. taxes) and thus, an improvement in one indicator, such as road quality, would to some degree come at the expense of another, tax rates.

Although Indexes, such as the recently released *Global Competitiveness Index*, may provide insight into the strengths and weaknesses of Russia's Business Climate, the results need to be used with caution. Efficiently using the country's scarce resources to identify, prioritise and implement reforms to achieve better outcomes requires also looking at the costs, benefits and consequences of dealing with any of the indicators. Although the aim of improving rank is an important stimulus for reform, achieving progress and improved outcomes efficiently is going to require the type of analysis that comes from wider participation in private-public dialogues.