

Russia's Business Climate Moves Forward, but Remains Behind

In the World Bank's latest Doing Business Index rankings, Russia has moved up from 112th to 92nd place out of 189 countries (185 last year) and appears to be plausibly on its way towards the goal of reaching 20 within years if the pace continues. However, the conditions reflect those in Moscow, probably understating the business climate conditions elsewhere across the country and there remain serious areas for improvements, especially related to start up conditions.

Monthly Overview

Earlier this year in May, the European Bank for Reconstruction and Development ([EBRD](#)) drew attention to setbacks in Russia's weakening economic performance and the impact this was starting to have on other countries in the region. According to their macroeconomic forecast, stagnation in commodity prices is linked with weakening demand and investment levels. Further, a slowdown in government social spending is not making the situation any better. However, the report also mentioned that lower levels of investments could be connected with setbacks in business environment reforms and the treatment of foreign investors. Given that government budgets (i.e. social spending) is highly reliant on energy revenues, this combination of conditions suggested that business climate reforms could play an important role in diversifying the economy away from over-reliance on energy prices and stimulate growth in non-energy sectors.

Within this context, the recent climb in rank from 112th to 92nd place in the World Bank's [Doing Business Index](#) is a welcoming sign. The index combines indicators across 11 pillars related to the ease of opening, operating and closing a business, such as the length of time it takes to register a business, the costs and procedures involved, and whether property is well protected. Comparing the results across countries provides some evidence about which environments are easier (less costly) to operate in than others. Since last year, Russia has made the most improvement in conditions related to getting electricity, registering a property and starting a business (see [Figure 3](#) in *Indicators*).

Despite this improvement, however, the country still remains quite far behind. First, relative to other economies (see [Figure 2](#)) Russia is near the bottom of the top 100 out of 189 countries covered and only ahead of Serbia (93rd), Ukraine (112th), Bosnia and Herzegovina (131st), Tajikistan (143rd) and Uzbekistan (146th) among transition economies. Other countries, like Kazakhstan and Azerbaijan, both of which have energy endowments, have fared considerably better in terms of improving their business climates and rank 50th and 68th respectively. Second, other conditions which remain relevant for starting a business, such as dealing with construction permits, getting credit and protecting investors remain very poor and could pose a barrier to new start-ups, which is especially important given the context of stagnation. Third, the index reflects only the conditions in Moscow and for a country as large and diverse as Russia, this is likely to be misleading about the quality of the country's business climate conditions in specific regions or areas, but also provide little insight into reforms and better practices that have been successfully implemented elsewhere across the country. A 2012 subnational [Doing Business Report](#) drew attention to the fact that many conditions were significantly better in 29 out of the 30 cities covered in Russia and Moscow was in last place.

Although Russia appears to be moving ahead with some business climate reforms and this progress should be noted, the country still remains far behind in the ranks relative to other transition economies. Further, much more attention is needed to improve specific conditions related to entering the market, particularly in non-energy related activities, to help diversify away from the risks associated with commodity prices, stimulate investments, and support alternative sources for growth in a stagnating economy.

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 October, New Investment Activity was noticeably dominated by large scale, multi –year announcements by Rosneft while other sectors, such as “metals, minerals and mining”, were noticeably up and “others” in retail slow.

Energy

- **Exploration:** A joint venture company, Caspian Oil Company, between **Rosneft** and **Lukoil** is expected to invest in exploring and developing the West-Rakushechnoye deposit in the Caspian Sea following the granting of a license from the government while **Rosneft** has announced that it intends to invest by 2022 about \$ 200 bln in on-land exploration and hydrocarbon production and an investment project worth RUR 470 bln to launch new primary oil refining equipment in Tuapse to increase capacity to 12 mln tons of oil from 4.5 mln tons;
- **Powerplant:** **TGC-7** will invest in launching a RUR 10.5 bln power facility in the Samara Region at the Novokuybyshevskaya plant with a total capacity of 231 MW;
- **Sovcomflot** is considering investing in establishing a joint venture sea drilling company focusing on development projects on the Russian shelf;
- **Slavneft** will start investing in the development of the Kuyumbinskoye field in the Krasnodar region in 2017 with an expected output of 295 000 tons of oil per annum peaking at 10.8 tons in 2029;
- **Rosneft** and **ExxonMobil** will invest in designing an LNG plant in the Sakhalin Region in early 2014 with construction commencing in 2015 with a projected capacity of 5 mln tons of LNG, investments are estimated at \$ 6.5 to 8.0 bln according to various reports.

Autos and Aviation

- **Siemens Gas Turbines Technologies** is investing an estimated EUR 275 mln to construct a plant to produce gas turbines in the Leningrad Region, which is part of a total investment program of EUR 1 bln that includes injections in the manufacturing of trains and high voltage equipment;
- Mexico's **Nemak** will invest RUR 2.2 bln to construct a car component plant in the Ulyanovsk Region aiming to provide clients with high tech cylinder heads and engine blocks with a capacity of nearly 500 000 components per year;
- **Cordiant**, a Russian tire producer, plans to invest RUR 20 bln in developing its Cordiant-Vostok and Omskshina units by 2020;

Metals, Minerals and Mining

- **Lukoil** is investing an estimated \$ 1 bln in the development of the Grib diamond deposit in the Arkhangelsk Region;
- **Norilsk Nickel** plans to invest \$ 2 bln in development during the next two years and \$ 10 bln annually until 2018 with the aim of increasing annual nickel production to 230 000 – 240 000 tons by 2016 from the current 229 000;

- **Zoloto Kamchatki** plans to invest an estimated \$ 520 mln from 2013 to 2018 to boost gold production from 1.4 tons to 9.2 tons, with most investment in 2015 targeting the Ametistovoye deposit;
- **Sibur Holding** is investing RUR 60 bln to launch a polypropylene plant in Tobolsk, with two facilities with 500 000 and 510 000 ton capacities;
- **Behlen Industries** may invest \$ 30 mln to build a plant in Russia producing metal structures for sports facilities, aviation hangars, and road construction;
- **EuroChem** is investing more than RUR 15 bln to construct a potash mine in the Perm Region to begin operations in late 2016;
- **Alrosa** plans to invest an estimated RUR 256 bln in diamond mining between 2013 and 2021 with the bulk of the investment going to construct underground mines, with \$1.5 to 2 bln to be spent within the next five years.

Transportation and Infrastructure

- *Low Cost Airline:* **Aeroflot** has announced its plans to invest \$ 100 mln to launch a low cost airline, Dobrolet, next year;
- **TGC** and **PromSvyazCapital**, a logistics group of companies, will invest almost \$ 700 mln to build an A class logistics park in the Moscow Region;
- **MegaFon** will invest over RUR 5 bln to upgrade its 3G networks by the end of 2013, is considering investing \$ 50 mln in the construction of infrastructure at hi-tech cluster Skulkovo in 2014, and is planning to build a single mobile network with **Scartel**;
- **Summa Group** will invest about RUR 700 mln to construct three plants to produce asphalt concrete in the Republic of Dagestan;
- **Morton** will invest RUR 36.8 bln in the construction of the residential district in the Moscow Region, called Vostochnoye Butovo;
- **RZhD**, Russian railways, may invest nearly RUR 5 bln for the construction of a railway bridge over the Volga river in the Nizhni Novgorod region, with reconstruction scheduled for 2014-16;
- **Gazprom Gazomotomoye Toplivo** is planning to invest about RUR 13.8 bln to build almost 200 gas filling stations in 2014;
- **Gazpromneft-Aero** will invest more than RUR 6 bln in modernization and construction of refueling complexes and infrastructure at military aerodromes by 2015.

Agriculture

- **Miratorg** is investing in a new RUR 120 mln farm in the Kursk Region and building another four farms with a total annual capacity of 33 000 tons of pork, live weight;
- Russia's **AgroPromkomplektatsiya**, a pork producer, is investing RUR 2.2 bln in the construction of a farm in the Kursk Region to be launched in 2014;
- **Danone** will invest RUR 450 mln to modernize its Krasnodar Region plant in 2013-14 with further plans to invest \$ 700 mln within 5 to 7 years to increase production capacity;
- **Tander**, an affiliate of Magnit, will invest RUR 1.8 bln to construct a distribution center in the Perm Region by August, 2014.

Other Non-energy Sector Investment Activity

- *Start Ups:* **Flint Capital**, a US high tech fund, is planning to invest part of its \$ 30 mln fund in 15 projects before the end of 2014 targeting Russian start-ups ranging from \$0.5 mln to \$ 2 mln each, with the first project named as Youdo.com, which matches clients with freelancers;
- **Scartel** has recommended that **Rostelecom, MTS, MegaFon** and **VimpelCom** invest in a project to introduce a digital signature to allow mobile users to identify themselves through mobile devices;
- *A number of investment plans in consumer retail were announced:*
 - **Moncler** is investing in its first outlet in Russia in 2014;
 - The **Walt Disney Company** plans to invest in opening three of its brand stores in Moscow and St Petersburg next year in addition to launching toy and garment retail networks, each site is estimated to require an investment of \$ 2.7 mln;
 - **A5**, a Russian pharmacy chain, is investing in the development of the Norma drugstore, which will be in the cash desk areas of grocery stores.

Outward New Investment Announcements

Outward New Investment Announcement activity was up during the month of October and was dominated by energy related activity although some agricultural related announcements were noted.

- *Exploration:* **Gazprom Neft** will invest in drilling two exploratory wells at the Shakal block in Iraqi Kurdistan in 2014, which has a potential 500 mln tons of oil equivalent reserves, while **Rusgeology** is considering investing in participating in geological exploration and mapping of Ecuador and cooperating with South Africa's **PetroSA** to explore fields on land and shelf of the country;
- **Rosneft** and **Transneft** will invest in upgrades to the pumping station of the ESPO oil pipeline to China with the aim of increasing pumping volumes;
- **Gazprom** and **Rosneft** are considering investing in developing Ecuador's hydrocarbon resources;
- **EuroChem** has begun investing in developing the Kok Dzhon phosphate mine in Kazakhstan with production of rock phosphate meal being launched in 2014 with an annual capacity of 640 000 Tons;
- **PhosAgro** is considering investing in a trader in Latin America in 2014 for facilitating the sales of 500 000 to 1 mln tons of fertilizers;
- **Inter RAO UES** and **Union Electrica**, a Cuban State Company, are considering investing in a joint project to upgrade thermal power plants in two Cuban cities;
- **Atomstroyexport** may take part in an investment to construct the Akkuyu NPP in Turkey in early 2015, which will have four power units with a combined capacity of 4.8 GW;
- **Alrosa** plans to invest an estimated \$ 10 to 20 mln annually on exploration operations in Angola within a joint venture with the country's **Endiama EP**;
- **South Stream Transport B.V.** intends to invest an estimated EUR 10 bln for part of the pipeline that stretches under the Black Sea from Russia to Bulgaria.

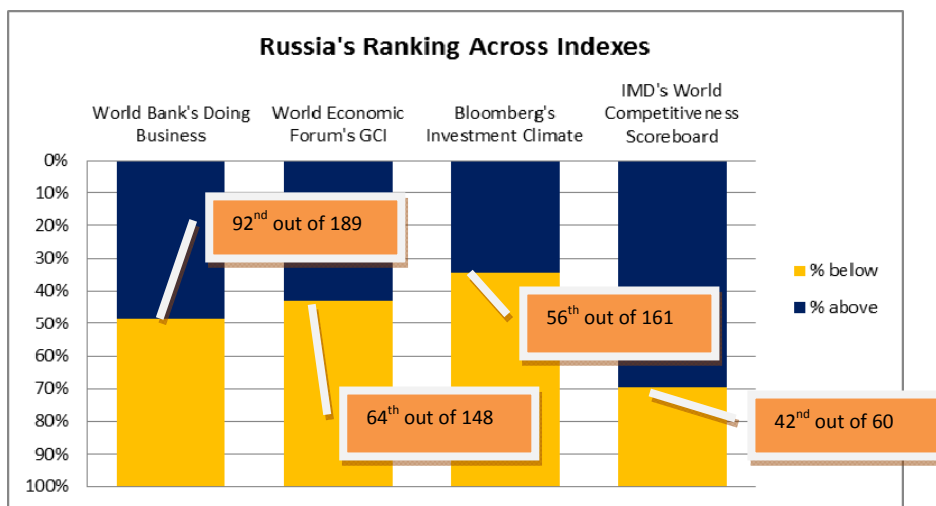
Business Climate Indicators

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

At the end of October, the World Bank released its latest *Doing Business (2014) Report* and rankings. This year Russia ranked 92nd out of 189 economies, up from 112th last year out of 185. Although some dramatic improvements were made, the country continues to rank well behind other transition economies; a consistent relative position compared to other recent rankings in the IMD, Bloomberg, and World Economic Forum Indexes.

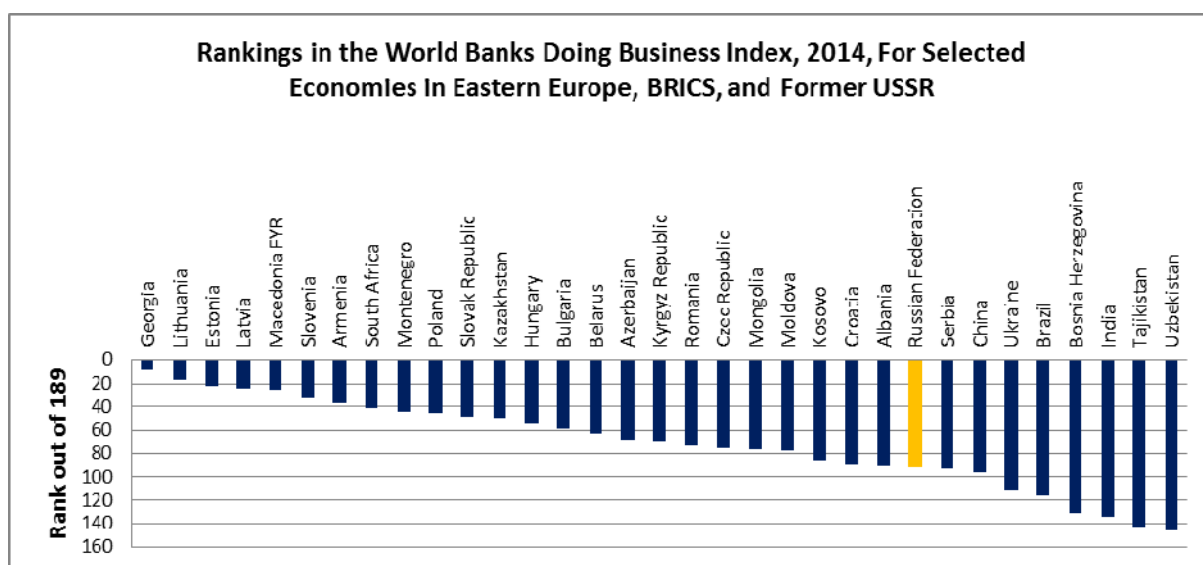
- **Figure 1** shows how Russia ranks across Indexes that include indicators and approaches related to the quality of countries' business climates. For each index, the percentage of countries ranking above Russia are in blue while the percentage below are in yellow. The actual rankings out of the number of countries included for each are shown in bubble captions.
- Although Russia has improved this year in the World Bank's *Doing Business Index* to 92nd from 112th, the country still ranks consistently low across diverse indexes comprised of different indicators and approaches (although there is some overlap). Russia remains roughly in the top half to almost the top third (Bloomberg) of the included indexes.

Figure 1 – Russia's Business Climate Related Rankings



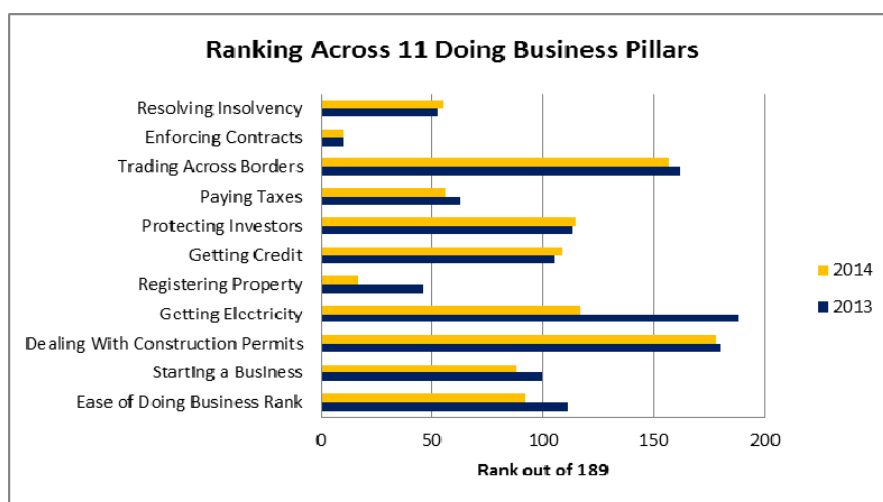
- This consistent low ranking, however, cannot be purely due to the severity of transition. **Figure 2** shows the rankings of selected transition economies and BRICS in the latest World Bank *Doing Business Index*. The further down the bar drops, in blue, the lower the rank out of the 189 economies covered. Russia's position is highlighted in yellow.

Figure 2 – Russia’s Relative Position in the Doing Business 2014 Index



- Although Russia has made some overall improvement in rank, climbing some 19 positions since last year (note that due to the inclusion of 4 extra countries in this year’s index, adjustments were made to 2013 rankings for comparison reasons. In the adjusted 2013, Russia now ranks 111th instead of 112th!) the country remains well behind most other transition and BRICS groupings, remaining ahead of China and India, for example, but well behind Kazakhstan, Azerbaijan and Georgia (which is in the top 10).

Figure 3 – Change in Russia’s Performance Across Pillars



- **Figure 3** above provides a closer look at how Russia has performed across pillars in this year’s *Doing Business Index*. Indicators across 11 pillars were used to examine various qualities related to opening, operating and closing a business (the lifecycle of a business). Examining how long it takes to obtain permits, and costs involved, for example, provide insight into which countries or business environments are relatively easier for operations (lower cost, more efficient).

- Since Russia ranks 92nd, roughly any bar in this graph which goes beyond 100 shows which features are dragging down the country's ranking relative to others. Further, both the rankings for 2013 and 2014 are shown to provide insight into where changes took place.
- During the past year, the most improvement took place in “Getting electricity”, “Registering Property”, and “Starting a Business.”
- With the exceptions of resolving insolvency, enforcing contracts, paying taxes and registering property, however, most of the remaining pillars remain problematic, especially dealing with construction permits, starting a business and trading across borders.
- Note also that as mentioned in previous BCDM reports, one of the drawbacks of the *Doing Business Index* is that it is based on the conditions in the capital city of each country. For a large and diverse country like Russia, this means that the Index is less likely to reflect conditions, better or worse across indicators, that could be experienced outside of Moscow. It is also possible that conditions in the rest of the country could actually be better than they are in Moscow, and this is even more probably given that all other cities ranked better across four pillars included in the [Subnational](#) report last year.

Although Russia has begun to climb the rankings in the *Doing Business Index*, the country remains well behind other transition economies, and even those with similar resource endowment challenges, such as Kazakhstan and Azerbaijan. Further, the lack of progress made across specific pillars related to trading across borders, starting a business, dealing with construction permits, protecting investors and getting credit are likely to pose serious barriers to the entry of new start ups; given the recent slow down coupled with the need to diversify, these remaining pillars could play an important role in further stimulating the economy and hedging against risk in energy dominated activities.