

Russia's Business Climate Immune to Global Warming

In September, the World Economic Forum released its latest *Global Competitiveness Report 2012-2013* ranking Russia in 67th place, just one spot below Iran (66th) and slightly ahead of Ukraine (73rd) and Georgia (77th) out of 144 economies, and down one spot from 66th last year.

Monthly Overview

According to conventional economic theory, the kind students learn in most university courses, a firm's ability to compete depends on how well it is able to combine its resources (land, labor and capital) to produce a good or service for market. Firms that are more productive, more efficient in using their resources, are able to produce at lower real costs than firms that are less productive and this allows them to compete more effectively for customers by being able to sell at lower prices.

Modern day economics along with Business Climate, Investment Climate, and Competitiveness Indexes go well beyond this simple theory. They recognize that location matters. The same firm with the exact same resources would perform differently depending on where it happens to conduct its operations. In other words, conditions outside the firm can have an important impact on firms' real costs of operations and thus affect how well it can compete in markets. Conditions like access to a well-educated, responsive and adaptable, population with relevant skills, a well-designed low cost infrastructure that operates regularly and predictably along with transparent government legislation, taxes, and a range of other conditions in the broader business climate affect a firm's costs of operations.

This also means that the state has an important role to play since the type of business climate it creates through its policy environment can impact production costs. Improving the climate is broadly more desirable since it helps attract and retain investments, it supports growth and development as well as opening more opportunities for firms as well as employees; it's about a better place for people to produce, work and live.

Although these concepts might appear simple and appealing, measuring and ranking the quality of a business environment is a complicated task and there is little agreement on what the correct approach should be. Despite this drawback, tracking Russia in the various rankings remains an important task. It provides people with a signal as to whether the country is concerned about its rankings and attempting to improve its environment. It also provides an important stimulus to government bodies to identify where improvements can be made as well as recognizing and monitoring progress where and when it happens.

Although Russia has only fallen one place in terms of rank in the Forum's 2012-2013 *Global Competitiveness Index* (GCI), to 67th place from 66th, Russia consistently ranks low across various Indexes (see the *Indicators*) and surprisingly low when compared to poorer transition economies and, more importantly, the potential the country has in terms of an educated labor force, domestic consumer population with growing incomes and abundant natural resources. According to the GCI, Russia ranks highly in terms of its market size (7th) and macroeconomic environment (22nd), but very low in terms of institutions (133rd), goods market efficiency (134th), financial markets development (130th) and business sophistication (119th).

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 remained noticeably stable in September from August, but with fewer retail expansion announcements and none related to tourism.

Energy

- *Exploration and Development:* **TNK-BP** plan to invest RUR 1 bln to carry out a seismic survey of its deposits in the Orenburg and Samara Regions in 2012 while **Rosneft** and **Gazprom** plan to jointly invest up to RUR 500 bln into the development of a seashelf by 2015;
- **Liquified Natural Gas:** **Alltech Group**, a Russian investment and construction company, plans to launch an LNG plant in the Nenets Autonomous District in late 2018 involving an estimated investment between \$ 6 bln and \$ 11 bln;
- **Upgrades:** **Rosneft** plans to invest RUR 108 bln to upgrade the Komsomolsk Refinery in the Khabarovsk Region by 2016 aiming to improve the quality of motor fuel and raise the output of light oil products by about 40% to 6.3 m t;
- Although investment sums have yet to be specified, **Transneft** and **Development Corporation** plan to invest in creating comprehensive infrastructure facilities for the Zapolarye-Purpe oil pipeline in the Yamalo-Nenetsk Autonomous District;
- **Rosneft** plans to invest in the construction of a 685-MW gas power plant in the Primorsky Region to supply the Eastern Petrochemical Company's petrochemical complex and citizens of the neighboring Nakhodka settlements;
- **Gazprom** plans to invest in constructing a plant to produce methane worth RUR 14 bln in the Tambov Region with a total capacity eventually reaching 1 m t annually and an additional RUR 4 bln over the next three years to organize gas supplies in the constituent Republic of Altai;
- **Lukoil** plans to invest an estimated RUR 90 bln to launch a hydrocracking facility in the Nizhni Novgorod Region allowing liquid fuels to be produced from bitumen with an expected launch in 2018;
- **Air Liquide** plans to invest RUR 1.8 bln to construct a technical gases plant in Kstovo in the Nizhni Novgorod Region to be commissioned in August, 2013;
- **Transneft** plans to increase its 2013 investments by 2.23% more year-on-year to RUR 110 bln and will invest RUR 97 bln on the construction of a 703 km long pipeline connecting Eastern Siberian oilfields with the Eastern Siberia-Pacific Ocean trunk pipeline between 2012-2016;
- **Ust-Luga** plans to invest in building an oil refinery worth \$ 10 bln in the Ust-Luga industrial zone ;
- **Gazprom Neft** intends to invest an estimated RUR 51 bln in its refining facilities in 2012 with the aim to reaching a refining capacity of 70m t of oil (40 m t in Russia and 30 from its facilities abroad) by 2020;

Autos and Aviation

- *Production Capacity Increase:* **GM-Avtovaz** will invest an estimated \$ 200 mln to construct a new press, body shops and developing engineering supporting facilities to expand its production capacity by 25% to 120 000 cars by 2015;
- *Additional Airline Connection:* The UK's **Easyjet** carrier is planning to enter the Russian market with hope of launching its first flights from St Petersburg's Pulkovo airport to London next summer pending permission with regulating bodies to perform flights from Russia to the UK and Switzerland;

- **Volvo Group** will invest RUR 3.25 bln in Kaluga to construct a truck cab plant scheduled to be launched in 2014;
- Auto-components: After signing agreements with the government of Nizhni Novgorod, **Boryszew Plastic Rus**, **Matador Automotive Rus**, and **Magna Technoplast** will build three plants in the region for auto-components for GAZ and Volkswagen to be launched in 2013 requiring investments of RUR 600 mln and RUR 1.7 bln each respectively, while France's **Plasit Omnium** is planning to build a third plant in St Petersburg for auto components to be commissioned in 2013.

Metals, Minerals and Mining

- Russia's **Donelectrostal** plans to invest RUR 2.4 bln to build a rolling mill to be launched in 2015 in the Rostov Region with an expected annual capacity of 500 000 tons of unalloyed semi-finished steel products and 350 000 tons of rolled stock;
- **EuroChem** plans to invest \$ 100 mln annually in its Kovdorsky ore mining and processing works unit to increase output by 10 to 15% and ensure sustainable operations until 2040;
- **Norilsk Nickel** plans to invest RUR 11.35 bln in the development of its Taimyrgaz unit;
- Russia's **FGC UES** and the Russian-Belgian JV **Sim-Ross-Lamifil** have agreed to invest in the creation and development of localized production of energy efficient cables in Russia;
- After reaching an agreement with the Tula Regional government, **KNAUF USG Systems** plans to invest an estimated RUR 1 bln to construct a cement panel production facility there;
- Russia's **Eurocement Group** intends to invest RUR 15 bln to build a cement plant in the Stavropol region with an annual capacity of 1.3 mln tons.

Transportation and Infrastructure

- The **Federal Passenger Company (FPC)**, a subsidiary of Russian Railways (RZhD), expects passenger turnover to increase by 10% to 112.2 mln by 2030 and plans to invest RUR 774.5 bln in development in the interim, which includes acquiring 16 500 new railway cars along with hopes that **RZhD** will transfer over the Sapsan and Ellegro high speed trains to the company;
- *Railway Components*: **OJSC Kirovsky Plant** and Italy's **Euro Group** plan to invest several millions of Euros in Russia to construct a plant that will produce components for the high speed Lastochka train;
- **Summa Group** will invest an estimated \$ 1 bln in Russia's Far East over the next 3 to 4 years to construct a grain terminal jointly with the United Grain Company, construction of a coal terminal, and development of FESCO (the country's largest private intermodal transportation group) capacities, with roughly 1/3 going into each of these projects.

Agriculture

- *Sugar Production*: Russia's **International Sugar Corporation** and France's **Sucden Paris** plan to invest RUR 10.14 bln to build a plant in the Rostov Region within 30 months with a processing capacity of 12 000 tons of sugar beets per day while **LLC Buturlinovskiy Sugar** plans to invest RUR 1.6 bln to construct a sugar plant in the Voronezh Region to be commissioned by Q3, 2013, and Lithuania's **ARVI ir Ko** plans to invest RUR 5 bln to build a sugar production complex over the next three years in the Kaliningrad Region;
- *Fertilizer*: **East Group** is planning to invest an estimated \$ 1 bln to construct a fertilizer plant in the Leningrad Region;

- **Agro-Belogorye Group** will invest RUR 457 mln to build a waste products and meat production plant in the Belgorod Region to be launched in 2013;
- Russia's **Agro-Art Group** will invest RUR 1 bln to construct a vegetable production facility in the Kolomensk District;
- Although financial details are not yet known, **Rusagro** intends to create an agricultural cluster in the Amur Region which will have an oil-extracting plant and a pig factory.

Other Non-energy Sector Investment Activity

- *Pharmaceuticals*: Russia's **PharmSintez** plans to invest RUR 3.1 bln to construct new plants with intentions to launch a new production line in Irkutsk, commission a new facility in Bratsk and build a new plant in St Petersburg by the end of 2014 and **R-Pharm** and **ChimRar** plan to invest an estimated RUR 1 bln to construct a pharmaceutical production facility in the Yaroslav Region;
- *Electronics Cluster*: A unit of Russian Technologies, **Russian Electronics**, plans to invest an estimated RUR 2 bln to create an electronics and production cluster in Novosibirsk by 2014 based on its three existing production facilities: Vostok, NZPP OCB and Novosibirsk radiocomponents plant Oxide;
- *Timber Processing and Storage*: After investing RUR 2 bln into timber processing in the Tomsk Region, **AVIC Forestry** plans to invest an additional RUR 3 bln by the end of 2012 while Russia's **Tomlesdrev** plans to invest RUR 4 bln to construct a production plant with a capacity of 296 000 m³ of particleboard per year by 2015, Ulyanovsk Region-based **Lesnaya Niva** plans to invest over RUR 7.6 bln with Germany's **VanBeta Projekt** and Swiss **Global Project Management** to construct a wooden panels plant to be launched in 2014 and **Kronospan Group** will invest an estimated RUR 410 mln to create a chain of five storehouses for its products in the Rostov Region;
- *R & D*: **Lukoil** intends to invest in the creation of a research center in Skolkovo focusing on the fields of energy and energy efficiency, nuclear, space, biomedical and computer technologies: no sums have been disclosed;
- *Paint*: **Jotun**, a Norwegian group, plans to invest RUR 1.7 bln to build a paint coating plant in the Leningrad Region to be completed by mid-2014 with an annual production of 12 metric tons of liquid paints and 3 600 tons of powder coatings while Finnish **Teknos** plans to invest EUR 15 mln to construct a paint and varnish plant in St Petersburg to be launched in 2014;
- *Remote Telecommunications*: **MTS** intends to invest RUR 3.5 bln to develop telecommunications facilities in the Far East aiming to expand its GSM and 3G coverage in remote areas of the region and to increase data transfer speed;
- *Float Glass*: **SP Glass Holdings** intends to invest an estimated RUR 7 bln by 2015 to build a float glass plant in the Ulyanovsk Region while **Salavatglass** plans to invest RUR 6.6 bln to construct a float glass plant in the Rostov Region;
- Pending obtaining exclusive negotiating rights and reaching a successful agreement with Angara Paper, Japan's **Marubeni Corp.** intends to design, build and procure equipment to build one of the world's largest pulp and paper plants in Russia involving an estimated investment of \$ 3.5 bln aiming to be in full operation in late 2017;
- Russian Footwear Company **Obuv Rossii** plans to invest RUR 1.4 bln into a footwear factory in the Karachayevo-Cherkessia Republic producing 1 mln pairs of shoes per year;
- *A number of investment plans in consumer retail were announced:*

- **X5 Retail Group** plans to invest RUR 1 bln to open 40 to 50 stores in the Tula Region by the end of 2014 and a Karusel hypermarket in the region by the end of 2012;
- Russia's **Azbuka Vkusa** plans to increase its chain from the current 50 to 130 stores by the end of 2017 concentrated in the Moscow, Moscow Region and St Petersburg and Leningrad Region;
- **Billa**, a food retailer that currently operates 87 supermarkets in Russia, plans to invest in opening at least 10 to 15 stores annually in the country;
- After opening the franchise Fasol in Rostov-on-Don, **Metro Cash & Carry**, plans to invest in opening five more Fasol stores in the city;
- **Gazpromneft** plans to invest in developing a chain of cafes for its fueling stations under the Drive Café brand.

Outward New Investment Announcements

There was a noted increase in outward announcements in September, particularly in non-energy related activities such as insurance, aviation and autos

- *Activities in Indonesia:* Russian Railways, **RZhD**, is planning to invest an estimated \$ 2.4 bln in constructing a railway line in East Kalimantan to support coal delivery to begin operations in 2017, **Norilsk Nickel** is considering investing up to \$ 2 bln to build a copper smelter and non-ferrous metal smelter, and **Rusky Aluminii** is considering investing in setting up a bauxite and other non-ferrous metals refinery with supporting infrastructure such as power plants, with local partners;
- *Exploration:* **Rosneft** has agreed to establish a joint venture with **CVP**, a subsidiary of Venezuelan PDVSA, to develop the Carabobo- 2 block in the Orinoco Oil Belt and plans to invest \$ 16 mln into its exploration of the block;
- A company owned by Russian businessman **Mikhail Gutseriev** along with the participation of **Sberbank** plan to invest an estimated \$ 1.5 bln in the construction of a potassium fertilizer plant in Belarus;
- Russia's **Uralvagonzavod** (UVZ) is planning to invest in the construction of a railway car-building and repairs plant in Latvia for an unspecified amount;
- **Gazprom** plans to invest \$ 14 bln to construct a natural gas terminal after signing an accord with the Japanese government;
- **Oboronprom**, the parent company of Russian Helicopters, and **Denel Aviation**, South Africa's largest defense equipment manufacturer, plan to invest in creating a servicing hub for Russian made commercial and military helicopters covering the Sub Saharan region, no financial details have been disclosed;
- **AvtoVAZ** and Kazakhstan's **Asia Auto** have reached an agreement and intend to invest in constructing an auto plant with a capacity of 60 000 cars per year in Kazakhstan, to be commissioned by 2014, that will supply markets in Middle Asia, Siberia and the Far East with AvtoVAZ cars;
- Russia's **Soglasie** (Concord), an insurance company, is planning to invest in opening an office in Baku, Azerbaijan, to provide re-insurance services for Azeri insurance companies;
- **RusHydro** and Kyrgyzstan's **Electric Power Stations** plan to invest \$ 410 to \$ 425 mln to jointly construct four hydropower stations in the Kyrgyz Republic over the next 2.5 to 3 years with a capacity of 191 MW each with an annual generation of 1055 GWh;
- **Tatneft** intends to invest in constructing 30 fuelling stations in Belarus;

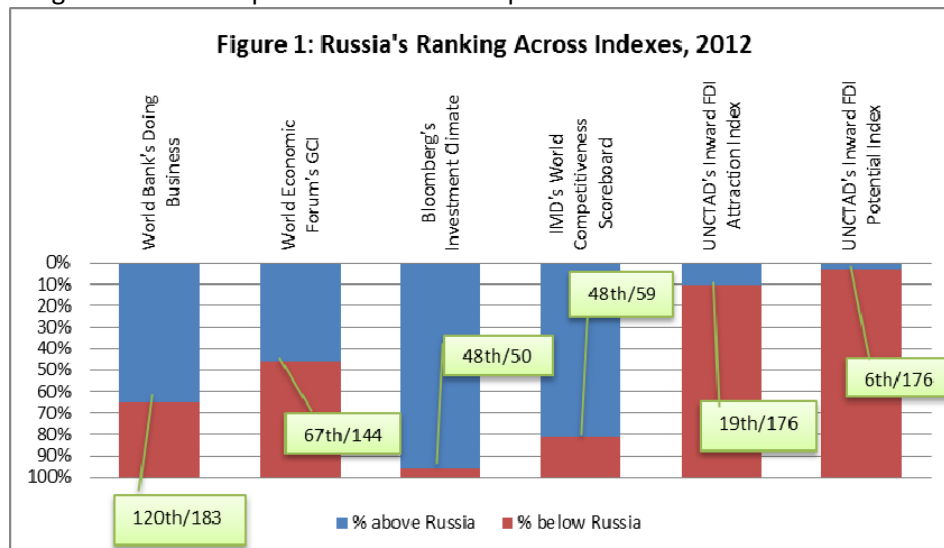
- **Lukoil** will invest \$ 1.1 bln to construct a new complex at its NeftoChim Bourgas oil refinery in Bulgaria;

Business Climate Indicators

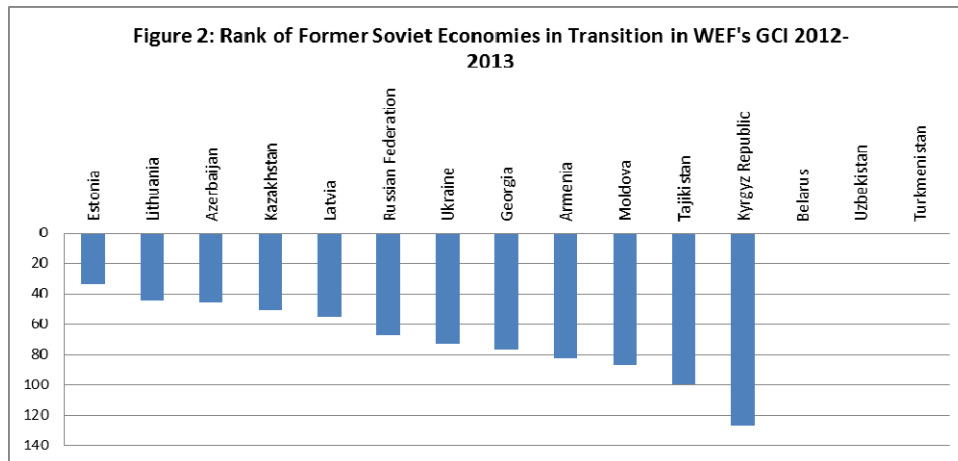
BCEM's indicators aim to provide a monthly snapshot reflecting important trends, challenges, and changes related to Russia's business climate.

Despite difficulties in measuring the quality of a Business Environment or Climate and different approaches in use by various organizations, Russia consistently ranks poorly across indexes relative to other transition economies and given its potential in terms of market size, labor resources and abundant natural resources.

- **Figure 1** provides a glance at how Russia ranks in terms of various indexes aiming to assess the quality of the production environment. To make it easier to compare, for each index the % of countries ranking higher than Russia and below Russia has been used. The actual rank out of the number of countries included in each index has been indicated in a bubble for each column.
- While the specific aims and approaches differ, as well as the coverage in terms of countries with which Russia is compared, Russia generally ranks low. According to the **World Bank's Doing Business Index**, Russia ranks 120th out of 183, in the **World Economic Forum's Global Competitiveness Index**, 67th out of 144, and the **Bloomberg Investment Climate Index**, 48th out of 50.
- **UNCTAD's Inward FDI Potential Index (2011)**, however, ranks Russia in 6th place out of 176 in terms of its potential to attract foreign domestic investment based on its market attractiveness, low cost skilled labor, enabling infrastructure and natural resources, but in 19th place in terms of its actual ability to attract FDI relative to the size of the economy; although a dramatic improvement from 95th place in 2002.



- **Figure 2** shows how Russia ranks relative to other Former Soviet economies included in the **World Economic Forum's Global Competitiveness Index 2012-2013**. Although Russia generally ranks higher than lower income economies also experiencing transition, it ranks lower than the Baltic countries, but more interestingly, also lower than other economies with natural resource endowments, such as Kazakhstan and Azerbaijan.



Although many of the Former Soviet economies continue to experience low rankings in terms of the quality of the production environment some 21 years into transition, Russia ranks very high in terms of its potential due to its sizable domestic market, educated population, infrastructure and natural resources. That other economies, such as Kazakhstan and Azerbaijan rank higher on this year's *GCI* suggests that despite the hardship involved in transition, Russia could be ranking higher. Ultimately, regardless of the Index and ranking, improving the production environment overall will make the country a better place to both produce and work.

Next Quarterly Issue

The BCDM's Third Quarterly Issue will come out later this month and provide further details on the specific areas where these indexes suggest Russia is performing well and poorly.