SPIEF review

JUNE 2015

Time to act:
shared paths to stability and growth!

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Prepared by Daria Kichigina

Dialogue without Borders

Anton Kobyakov, Deputy Chairman and Executive Secretary of the St. Petersburg International Economic Forum's Organising Committee, Presidential Adviser, talks to The SPIEF Review about the SPIEF's evolution, new formats and numbers of participants.

This year's SPIEF, apart from being held under the generally difficult conditions dominating the global economy and finances today, is also influenced by the fact that Russia and many of its major companies are under American and the EU's sanctions. Russia, in turn, introduced its own countermeasures. How have these factors impacted on the preparations for the Forum?

Indeed, it would seem that all the aforementioned factors could have a certain negative impact on the preparations for the Forum in terms of the level and number of participants. Yet – as is proven by the numbers – this year we are not only maintaining a high level of participation (including by our foreign partners), but actually exceeding last years' results. This evidences that politicised attempts at restraining and isolating Russia by introducing the sanctions have been unsuccessful in this avenue of our cooperation with our colleagues. People are interested in attending the Forum and participating in it, including leaders of some European states who understand the harm the sanctions against Russia are causing.

What about the Forum itself? Will it retain its usual format and principles for interaction between its participants?

I would like to note that, over the years, SPIEF has evolved from a regional event into one of the world's major forums. It has become a highly visible brand for the international political and economic community. We put a lot of thought into the Forum programme and it is very well balanced. It is clearly structured and consists of four blocks. We have also built on the experience of previous forums in terms of keeping the debate lively by inviting participants representing opposing points of view, which will help maintain a high quality of discussions.

We have tried to build our programme to reflect issues of real concern to both the international and Russian business communities. These include credit and monetary policy topics, the search for domestic growth drivers, industrial policies, banking sector development and deoffshorisation. Many participants have been coming to the Forum for years, which means they would probably expect familiar formats. Some of these formats have been preserved but the audience is also in for some exciting novelties. For instance, the open debate format – a moderated direct debate between opponents. Participants will also be able to use the Forum's mobile app to make contacts, discuss sessions and debate.

This year, the Forum will be integrated for the first time with the SCO and BRICS business forums, as well as a B20 consultation forum. A media summit and a session of the Valdai International Discussion Club will be meaningful additions to the traditional business programme formats. Openness is an important quality of the Forum, achieved through its wide coverage in the Russian and foreign media, as well as airing of its events on its website and on social media. Even so, important as the Forum formats' effectiveness, its transparency and openness and adherence to the world's highest media support standards may be, the participants will mostly be attracted by the highly professional selection of topics proposed for discussion. These include some of the most relevant and urgent issues faced by the global economy, as well as issues of economic and technological development of Russia as an integral part of the globalised world.

The 2015 Forum's slogan is 'Time to Act: Shared Paths to Stability and Growth'. What did the organisers mean by 'shared paths'?

Despite some previously mentioned limitations, the organisers of the Forum and the whole of Russia aim for continued constructive dialogue, a search for mutual understanding, and restoration of an atmosphere of trust between the key players in today's economy. This dialogue will lay the foundations for a shared path to stability and more active economic growth. The modern world is interconnected, and only a shared path will lead to sustainably positive results in development of the global economy, of which Russian forms an integral part.

Will the Forum's participant mix change this year in light of Russia's 'pivot East'?

The Forum has a well-deserved reputation as a universal discussion platform. The geography of its participants keeps expanding every year. Traditionally, Asia and Africa are extensively represented at the Forum, both by official delegations and their business communities, which will remain the case this year. It is too early yet to predict any drastic changes. According to our most recent information, participants and delegations from over 90 countries have so far confirmed their attendance.

The Forum's programme includes presentation of the investment climate rating of the Russian regions. Can this serve as a viable reference for investors, Russian or foreign?

Given the size and diversity of our country, and the regional differences faced by businesses and investors, the national investment rating of the Russian regions is an initiative of great importance. Investors need information and references for risk assessment and valuations based on the actual situation in a region.

The initiative It is all the more important to develop and stimulate this initiative because country ratings provided by major international agencies can often be timeserving and differ from the situation 'in the field'.

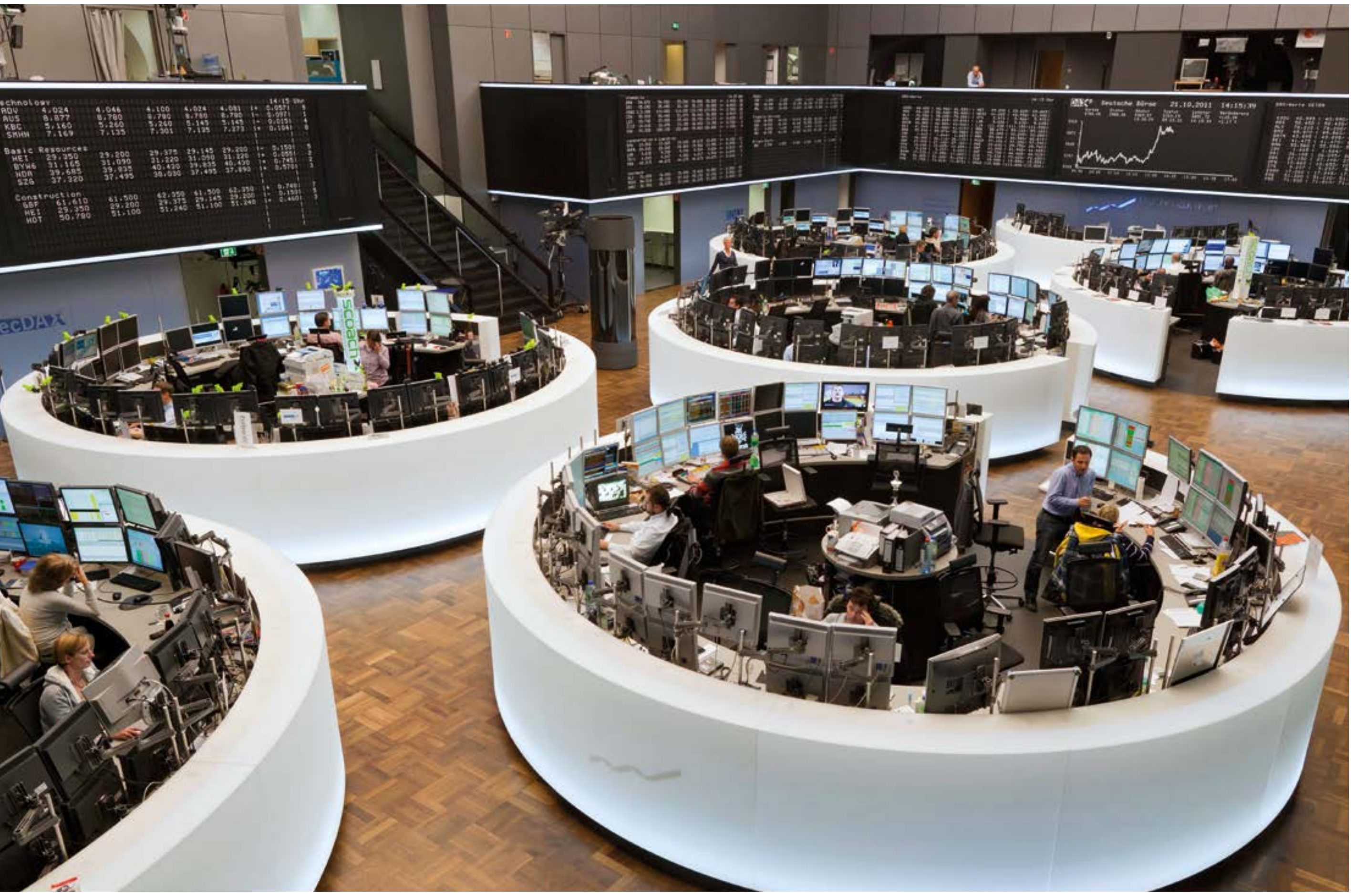
What is the Forum's role in building ties with global businesses?

Let me reiterate that the SPIEF is Russia's biggest discussion platform, which presents a great genuine interest to our foreign partners, in particular because it facilitates their direct contact with the key figures in the Russian economy and politics.

The Forum has been and will remain an apolitical dialogue platform. Its discussions are kept open, constructive and focused on global economic and financial development. It is hardly a surprise that SPIEF is on the agenda of heads of major global companies and business community leaders of both West and East. So the Forum's importance for establishing and reinforcing business links between Russian and global companies cannot be exaggerated.

Text by Barclays

Global Outlook



This is extracted from oil, the dollar and monetary policy: it's all (or at least mostly) good, Larry Kantor, Barclays Research. March 26, 2015.

Positive Changes

Markets and economies have been rocked by a number of major changes since November: the drop in oil prices and the rise in the US dollar became much more pronounced, and global monetary policy became significantly more supportive than expected.

While the Fed has opened the door to rate hikes later this year, it also confirmed that the pace is likely to be extraordinarily gradual. More broadly, a surprisingly large number of central banks around the world have cut interest rates, and the European Central Bank (ECB) embarked on a massive asset buying programme that will last at least 16 months and amount to more than EUR 1 trillion.

These changes are mostly positive, at least for the developed countries. The more than halving of oil prices, along with declines in many other commodity prices, has put further downward pressure on inflation, providing a net boost to global growth.

The surge in the dollar, meanwhile, has helped boost growth and stem deflation in some of the countries that need it most, particularly the euro area and Japan. It moderates growth and inflation in the US. The story is more complicated and country-specific in emerging markets.

The plunge in oil prices reflects a large supply increase in North America, the unexpected decision by OPEC not to reduce output, and a multi-year slowing in demand. None of these developments is likely to change significantly for the remainder of this year.

With respect to the dollar, the recent strength reflects the improved relative performance of the US economy and the associated divergence in relative monetary policies, which is also not likely to change in the foreseeable future.

Regional economic performance continues to evolve, as the changes in energy prices, currencies and central bank policies have different effects on various countries.

The most striking development is that the euro area finally seems set for a period of genuine recovery, as it is among the largest beneficiaries of the recent changes in markets and policies:

(i) the most obvious is the aggressive ECB QE programme that has already pushed bond yields there to historic lows;
(ii) the drag on growth from fiscal tightening has eased significantly;
(iii) credit conditions have finally begun to improve;
(iv) the euro has declined significantly, which should boost trade;
(v) euro area stock prices have risen sharply (up more than 15% just this year);
(vi) lower energy prices have boosted consumer spending.

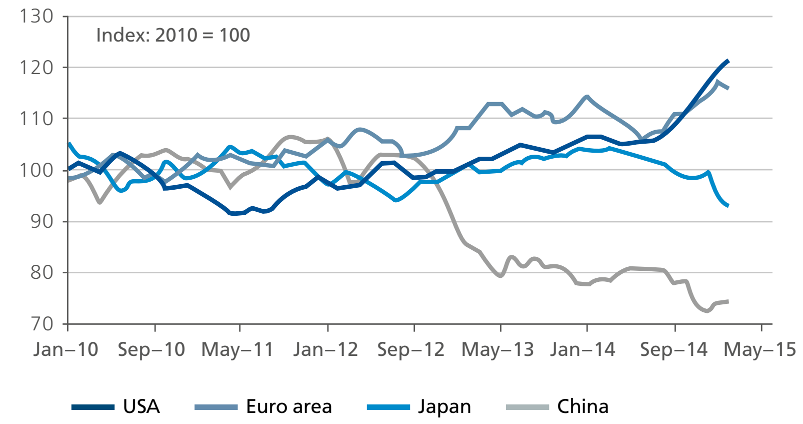
One risk that continues to hover over the euro area is the potential for Greece to exit the euro zone.

ECB
16 month
asset buying programme amounts to
€1 billion

Reversing the Trend

US dollar and Chinese yuan up, euro and yen down

Real trade-weighted exchange rates



These changes moves in markets and policies produce winners and losers among various countries and regions. The biggest losers are the countries that depend most on oil revenue. The euro area and Japan are clear beneficiaries: both are major net oil importers, have experienced huge currency depreciation (Figure 1), and have central banks that are committed to maintaining zero policy rates and pursuing massive QE programmes for at least the remainder of this year. The moves in oil, the dollar and policy are not as unambiguously positive for the US. It is true that as the biggest oil consumer in the world, the plunge in prices has given US consumers a major lift (real spending in Q4 rose sharply). But the bulk of this boost has probably passed, and the US has also become one of the biggest producers of energy. Moreover, the sharp rise in the dollar is reducing the value of foreign profits earned by US multinationals and rendering US products less price competitive on international markets.

Source: Barclays

It is difficult to assess the implications, given the lack of any precedence, but it is worth noting that the euro area is much better prepared to limit contagion from such an event because of the various firewalls put in place over the past several years (European Stability Mechanism, banking union, Outright Monetary Transactions, Public Sector Purchase Programme and ECB QE).

Moreover, an exit would be very damaging, and so far it has paid off for investors to assume that euro area officials will find a solution before the breaking point.

The US recovery finally achieved lift-off last year, as Gross domestic product growth averaged more than 3% for the five quarters through Q3 and the labor market showed impressive strength.

Growth has slowed over the past two quarters, however, back down to around a 2% pace. The dollar has appreciated sharply, and this is already depressing United States exports and foreign profits at multinationals; the Fed ended QE last October and is expected to hike rates later this year; stock and house prices are rising more slowly; and the shift in fiscal policy from significantly restrictive in 2011–2013 to roughly neutral has mostly played out.

US growth is expected to settle at around 2.5%, better than the pace of the recovery through 2013, but somewhat more moderate than what was achieved last year.

Expectations and Reality

Prospects for Japan look considerably better for the immediate future. Japan should be a major beneficiary of the plunge in energy prices and the strong dollar, as the yen has fallen sharply in trade-weighted terms and Japan is a major net importer of energy, even more so since it reduced domestic production of nuclear energy in the wake of the Fukushima disaster.

The growth outlook for emerging market countries is a mixed bag, but the general tone has been negative. Growth in China continues to slow somewhat more than expected, and is projected to continue through the first half of this year – at about 5.7% and 6.6% for Q1 and Q2, respectively. Financial conditions in China have tightened.

The yuan has depreciated much less than most other currencies against the dollar. In addition, the drop in interest rates has lagged the reduction in inflation, so real rates have increased.

And while lower oil prices are a net benefit, the boost is moderated by the relatively small response of retail energy prices to the drop in crude because of government subsidization.

Policymakers' efforts to restructure and reform the economy are producing a drag on growth in the near term. This process involves letting the air out of the property bubble, reducing the amount of credit that flows through the shadow banking system, withdrawing support for big state-run enterprises and lowering the economy's dependence on investment and exports.

The prospects for emerging Asia outside of China look somewhat better. India continues to stand out, as the combination of structural reform, lower inflation and monetary policy easing has improved growth prospects over both the near and medium term.

While Russia is expected to remain in recession this year, some of the countries in Eastern Europe such as Poland and Hungary should benefit indirectly from the ECB QE programme, as well as the nascent rebound in euro area growth. Meanwhile, the Latin American block has weakened further due to its exposure to lower commodity prices.

For analyst certification and important disclosures, please see http://investmentbank.barclays.com/our-insights/oil-the-USD-and-monetary-policy-its-all-or-mostly-good.html

One notable feature that is pervasive across the global landscape is low and declining inflation. In fact, headline inflation has turned negative in many parts of the world – including the US and the euro area – due mostly to the plunge in global energy prices. Given that the trend in inflation has been generally downward for the past 30 years, it is reasonable to ask whether we are heading into a period of outright deflation. This is unlikely to happen. Even in places where headline inflation has turned negative, core inflation has not. The surge in the dollar has been fortuitous in this respect, since the US is much less vulnerable to deflation than many other areas of the developed world, given that its economy is operating closer to full capacity. Regions that are more vulnerable to deflation, the euro area and Japan, for example, have seen their currencies fall sharply and this, along with prospects for better growth, should be sufficient to stave off deflation. Currency values have also fallen sharply in many parts of the EM world, with the notable exception of China, which has seen a sharp fall in inflation.

Larry Kantor,
head of Barclays Research

Prepared by Ekaterina Pronina

The World in 2020:

Is global growth to be expected?

The stability of the global financial system is facing a number of challenges today. These include changes in national monetary policies, decreasing oil prices and geopolitical factors. Undoubtedly, all of these factors will have an impact on the investment climate, generate new market development trends and influence the pace of economic growth. What will the world be like in 2020, and what will happen over the next five years to the financial systems and economies of developed and emerging nations? Russian and international experts shared their medium-term forecasts with SPIEF Review.

Renowned American academic Kenneth Rogoff, who served as Chief Economist at the International Monetary Fund, focused on the debt super cycle that affects the path of global economic growth.

How will monetary policy affect economic growth in the medium term?

The United States will start lifting policy interest rates later in 2015, but they are likely to remain near zero in Europe and Japan for at least a year after the US lifts rates. Monetary policy will continue to support growth, as inflation is not on the horizon.

It is very misleading, however, to look only at the interest rates paid by governments and high-grade corporates. Heavy new financial regulation has effectively shut out many small and medium size borrowers, and those that are able to borrow, often have to put up much more collateral than before. The overall credit surface in the economy is elevated, not flat.

What about oil prices in the medium term?

Oil prices will always be highly volatile and unpredictable. Countries that rely on energy resources for large portions of their government revenue need to be prepared to deal with volatile revenue streams. The ideal approach is to develop a more diversified economy. New drilling technologies are likely to continue to undermine the monopoly position of the largest producers.

How would you estimate the impact of political developments on the global economy?

Usually, internal politics everywhere, certainly in Europe, in China, in the United States, and in Russia, play a much larger role in determining national growth (and together by construction global growth) than do geopolitics. Nevertheless, concern over outside risks of 'tail events' (including geopolitical risk) is probably more important than is commonly understood.

One suspects that the notable elevation of geopolitical risks this past year (for example due to events in the Ukraine or the rise of ISIS), is probably weighing down both trade and investment.

Can the past decade be considered 'lost' in terms of economic growth?

As I have argued elsewhere, it is more accurate and more useful to think of the last decade as part of a debt super cycle rather than secular stagnation. As public and private debt overhang abates, the world will resume a more normal growth path. Demographics are challenging but continuing innovation provides some counterweight. At present, the US appears nearing the end of its debt deleveraging cycle, Europe still has a long ways to go, while China appears to be entering a potentially challenging adjustment phase.

Alexey Ulyukaev, Russian Minister of Economic Development, spoke about the potential implications of a 'Grexit', the outlook for geopolitical tensions, and the importance of structural reforms.

For how much longer will the West maintain a soft monetary policy?

So far as monetary policy is concerned, the cycle has reversed in the US. The Fed ended its asset-buying programme as far back as last year, and is expected to start raising its key rate this year. This carries certain risks of financial market destabilization.

Europe has only just embarked on its own asset-purchasing programme, so soft monetary policy there could continue for a long time to come. Greece's potential exit from the euro zone is the key risk for that region, as it could disrupt financial markets and force the ECB to take additional steps to further accommodate its monetary policy and possibly expand its asset-purchasing programme.

Overall, it is evident even now that the ECB's actions have had a stimulating effect on the region's economy, above all through the mechanism of weakening of the European currency. To a certain extent the ECB is repeating what the Bank of Japan started doing a year ago.

The initial effect of the yen devaluation on Japan was positive, as economic growth accelerated and the consumer price dynamic moved into positive territory. However, a sales tax hike coupled with steps taken by Japan's trade partners to weaken their own currencies slowed down the economic recovery. The threat of deflation is as present as ever. Given all that, the BoJ is likely to continue an accommodative monetary policy and undertake additional measures should economic growth slow down considerably.

How will declining oil prices affect the economy?

Oil prices encourage demand for oil while slowing down supply. The longer the period of low prices, the bigger the underinvestment in the oil industry. Given that cheap extractable oil reserves are declining, any protracted pause in investment could mean a price spike in the future.

Under current circumstances, both consumers and producers should be interested in a more balanced oil price, perhaps at around USD 80 per barrel. This price would enable long-term investment in costly projects, including in offshore projects, and help avoid oil shortages in the future.

Will geopolitics have a substantial adverse effect on economic growth?

There's no doubt that this factor is at play. It's absolutely clear that Europe, for which Russia is an important trade partner, has suffered because of the events in Ukraine and of the anti-Russian sanctions.

At the same time, Europe's weakened economic performance has impacted trade in the US and China too. Admittedly, modern-day economies have learned to adapt to various types of shocks quickly, so if nothing changes, the negative effect of last year's geopolitical developments on the global economy will evaporate quickly enough.

Of course, any new source of tensions will do nothing to increase the stability of the global economy.

Have the predictions of a 'lost decade', such as those made by Alexey Kudrin in 2011, come true?

Globally, those predictions are mostly off the mark. While it has slowed down this decade, the global economy is still expanding. Experts blame the global economic slowdown on slower productivity gains – a phenomenon that is hard to explain. The economic expert community has yet to reach an agreement on this issue, and has offered no advice as to how to increase productivity gains.

So far as Russia's economy is concerned, if the 'coasting' development scenario prevails, real GDP in 2018 would be just 10% higher than in 2008. That is, real economic growth for the period would be less than 1% a year. At the same time, the target forecast assumes global average growth rates would be achieved.

Dominic Barton, Global Managing Director at McKinsey & Company, spoke about the disintegration of the Eurozone financial system, and stressed the importance of structural reforms.

What are your expectations regarding a transformation of the global financial system by 2020?

We have seen a significant transition since the 2008 crisis, and I hope to see us continue developing in the same direction through 2020. Global banks have become much safer.

They have significantly increased capital and strengthened their balance sheets. They have also reduced their global footprint substantially, especially in the Eurozone, where banks have sold nearly USD 4 trillion of 'foreign' assets. Not only are French banks selling their assets in Greece, but German banks are withdrawing from France, Italian banks from Germany, and so on.

Essentially there has been a disintegration of the Eurozone financial system, and this trend reflected in banks in the US and UK as well. Given new capital requirements, banks are rethinking the profitability of different business lines and geographies and significantly reducing their foreign operations.

In fact, profitability has been considerably reduced with increased capital requirements and regulations across the world.

Not only has there been a shift back to a smaller, more local banking system, but the whole industry is in the midst of a broader simplification of the business, not to mention the sweeping digital transformation.

At the same time, we have seen a shift towards raising capital through equity and, especially, in corporate bond markets. Since 2007, corporate bonds outstanding have increased by USD 4.5 trillion – three times the increase between 2000 and 2007.

This rapid growth in corporate bonds has come from both advanced and emerging economies. We expect both of these trends – increasingly cautious banks and rising non-bank lending – to continue through 2020.

Structural reforms are seen by analysts as the key growth driver. Can the unsolved structural problems be called the main factor impeding economic growth at the moment?

I believe one of the most critical structural reforms is to incentivize companies to employ the long-term unemployed or provide training and education for newer, more employable skills. Other reforms vary by country. For instance, Japan needs increased competition, a freer economy and liberalized labour markets.

China needs to provide support to businesses as it moves from an investment-driven economy to a consumer/service-oriented economy. In India, structural reforms are critical to building the necessary infrastructure and improving the business environment, both in general and specifically for start-ups.

It is also important for the new government to amend outdated laws related to corporate taxes, land acquisition for commercial purposes, caps on foreign investments and so on. In Europe, we see three main areas of reform: investing in the future (e.g., nurturing innovation, reducing the energy burden), boosting productivity (e.g., integrating markets in services and digital, expanding nations' openness to trade) and mobilizing the workforce (e.g., increasing female labour-force participation, enhancing labour-market flexibility).

If completed successfully, I believe such structural reforms (along with increased business investment and a renewed focus on job creation) have tremendous potential to revive economic growth in the coming years back towards 5% per year globally.

How do you estimate the impact of political events on the global economy?

Political instability is one of the key downside risks to global growth at the moment. Politically unstable situations significantly hamper investment while reducing business and consumer confidence.

At the moment, I think geopolitical instability is present in three areas – the situation in the Middle East, Ukraine, and Asia. These tensions could cause disruption in some of the world's largest, fastest-growing economies.

There is also the danger of domestic unrest in Africa and other developing countries, which stems from people with high expectations encountering limited economic opportunities and high youth unemployment rates.

Finally, while less tenuous than just a few years ago, the future of the euro zone is still not certain, and Greece's future is far from clear.

Prepared by Galina Fyodorova

Getting Rid of Disproportions

Chief Executive Officer and Chairman of the Board of Sberbank of Russia Herman Gref talks to The SPIEF Review about changes in the global financial system, forecasts world oil prices and identifies the structural reforms required for Russia's sustainable economic development.

The current monetary policy of the western economies is considered to be quite lenient. How long do you think it will last? What impact will it have on global economic growth in the medium term?

It is important that the period of soft monetary policy following the crisis of 2008–2009 has lasted a lot longer than after previous recessions, mostly owing to the intensity and scope of the crisis. Yet this period is coming to an end, at least in the most important country for the global financial system – the United States. In December 2014, the US Federal Reserve stopped expanding its balance sheet, effectively bringing the third round of quantitative easing, 'QE3', to an end. The Fed rates will most likely increase in the second half of 2015 but I believe this increase will be a gradual one and depend on the economic situation in the country. Most of the Federal Reserve directors do not believe interest rates will exceed 1% by the end of 2015 or 2% by the end of 2016. The situation is different in the euro zone, though.

I believe the European Central Bank took too long in implementing quantitative easing; moreover, it increased rates in 2011. The situation was different in the periphery countries and at the core, and approaches need to be different as well. The policy of high interest rates did not suit the weakened PIGS countries, which faced serious economic challenges.

As a result, the ECB had to reverse its policy, dealing with resistance from creditor countries led by Germany. The ECB launched a quantitative easing programme as late as March 2015. I believe interest rates will remain at their minimum level for at least another year and will depend on the economic dynamics of the euro zone, which are far from optimistic now.

As for the impact on economic growth, steps to tighten monetary policies will make loans more expensive and slow further growth in the medium term, all other factors being equal. Yet, less lenient policies make growth structurally healthier and more stable in the medium term, reducing the likelihood of credit bubbles. The crisis of 2008–2009 made clear the possible consequences of such bubbles. 2013 showed that the financial markets of developing economies are very sensitive to changes in monetary policies in large developed countries, even if only in relation to changes in expectations. The Fed is, therefore, trying to inform markets about its intentions in advance. This will enable them to allow for the impact of a future increase in rates even now, which means capital outflows from developing markets will be insignificant and will hardly prove critical for their growth.

Mr. Gref, what is your vision of the transformation of the global financial system by 2020?

The last two decades have showed that the financial sector can change very fast. Following the crisis of 2008–2009, tighter regulations and competitive expansion further accelerated the evolution of the global financial system. Essentially, it will remain unchanged, but its outward appearance will transform dramatically.

First, it is a matter of breakthrough technologies: they cut costs, improve the quality of a customer's dialogue with its bank, and reduce barriers to entry for new players. Banks face increasing competition from IT leaders capable of integrating financial services into their clouds, rather than from other commercial banks. Second, the structure of the banking business is changing. The crisis has shown that mixed systems, in which banking financing is complemented by stock markets, are more resilient to crises than a system in which banks dominate. Many countries will deliberately develop stock markets: this is something the ECB has been talking about lately. In Russia, creation of an International Financial Centre has been declared a state policy priority. Banks will thus have new competitors from that sector as well.

Third, slower global growth also encourages competition. Slow economic growth generates less demand for financial services, so many organizations from that sector will phase down their international presence. The financial sector will streamline costs and will partially return to local markets. Regulators advise many banks to consider this policy.

Finally, regulation also contributes to the development of the financial system. In my opinion, the wave of tightening rules at the national level is over. The next phase is to build a global regulatory system. The intensity of the crisis is largely attributed to the unprecedented globalization of financial flows. Hardly anyone now believes that the system can be stabilized without international collaboration. Building a transparent and comprehensible system will become a priority for central banks during the period up to 2020.

The drop in oil prices affects growth forecasts in all parts of the world. How do you think oil prices will change? What impact will this produce on the balance of economic powerhouses?

As we all know, you cannot accurately predict changes in oil prices. Hardly any analysts could have predicted the fall in world oil prices to USD 45–50 by the start of 2015. Experts are certain that oil prices will remain low, but no one can be sure. Most unconventional oil production projects will remain unprofitable if oil prices stay below USD 60–70 per barrel, whereas global economic expansion generates demand for energy. The likeliest scenario for the next few years is a gradual recovery of oil prices to a level of USD 70–80 per barrel, which will allow energy importers to keep growing while keeping their costs in check. On the other hand, this price level is favourable enough for oil exporters. The stability of state finances in exporting nations is a separate issue. In many exporting countries: Saudi Arabia, Iran, Venezuela, Russia, prices have exceeded USD 100, making state finances more vulnerable. Time has come for budgets to adapt to the new situation. Exporting countries will be unable to stay among the most dynamic economies of the world. Consumers have benefited from the drop in oil prices through lower petrol prices. Their combined benefit was estimated at USD 250 billion at the start of 2015. This process will continue, meaning that approximately 3% of global GDP will be transferred from oil exporters to consumers.

Some believe that the geopolitical situation is affecting global growth. What impact do you think political developments exert on the global economy?

Naturally, increasing geopolitical tension is a factor that affects both the economic situation and the financial markets. Ukraine has been added to the list of traditionally volatile regions, such as the Middle East; tensions have built up in the South China Sea, and the Islamic State of Iraq and the Levant has emerged.

According to a survey by Bloomberg, geopolitical risks are among the main threats to financial markets and financial stability. A WEF poll conducted in 2015 showed that most respondents believed interstate conflicts were the main global threat.

Naturally, the evident slowdown in global economic growth is mostly caused by structural problems and inappropriate choice of anti-crisis policies in some of the key regions of the world, including the euro zone, rather than geopolitical risks. Yet geopolitical tension does, at the very least, considerably reduce the appeal of the relevant regions as investment destinations. During acute phases of conflict, the high level of geopolitical tension results in victims, devastation and economic degradation, as has happened in Syria and Yemen.

The more geopolitical stability is lost in a region, the wider the gaps in the global trade network and the lower the capacity for growth on a global scale. It is hard to provide quantitative estimates of the impact of geopolitical uncertainty on economic growth; even so, according to the OECD, increasing risks cost the global economy 0.2% of its growth in 2014.

In 2011, Alexey Kudrin said that, in the economic context, the world is in for a 'lost' decade. Is his forecast accurate? What is lost during this decade? What can still be done by 2020 to restore global growth?

Alexey Kudrin was not the only one to predict a 'lost decade' for the global economy and the forecast turned out to be accurate. Many countries have failed to reach their pre-crisis growth rates over the last five years. Weak economic growth implies poor growth of wages and profits, loss of opportunities for improving livings standards and fighting poverty.

Economists are divided on the reasons for this, offering various versions: 'new normal', superfluous savings in the economy, and excess debt loads on states and companies. Growth recovery has become visible only recently and only in some regions: the economies of the United States and, possibly, the United Kingdom, are gathering pace.

At the same time, most of the European economies still need to address the consequences of the economic crisis. China, too, is facing difficulties, as its economy is going through structural changes and a gradual slowdown. It is possible that economic growth in China will slow down even more and the change to a new economic model based on consumer demand will take longer than originally planned.

Importantly, the current slowdown is a structural, not a cyclical phenomenon. There are several areas for reforms that could help deal effectively with the difficulties. First of all, there is a package of financial sector reforms. Adequate regulations, such as introduction of the Basel III regulations, banking supervision, systemic combatting of offshore business and the shadow banking system should restore financial health and help prevent such risks in the future. Second, there are arrangements for increasing productivity and the workforce. Finally, there are measures for making the national economy more effective: investments in education, better state management and encouragement of private investments. Growth recovery will also be facilitated by factors that cannot be directly controlled by state and business managers. For instance, the fall in the prices of energy and raw commodities over the past 12 months will support demand in most developed economies. Furthermore, this situation encourages structural reforms in resource exporting countries.

Analysts refer to structural reforms as the main growth drivers. Can unsettled structural problems be referred to as the main factor impeding global economic growth?

The world economy grew by 3.4% year-on-year in 2014 and is expected to expand by 3.5% in 2015. Growth remains positive and quite high. Yet it is lower than the average growth reported for 2010–2013, while the general trend towards slower potential economic growth remains.

The various reasons underpinning slower growth of potential output call for various solutions, all of them requiring active economic reforms. The IMF recommends developed economies, such as Japan and Eurozone countries, to put in place labour market reforms to boost economic activity, increase labour market flexibility, and step up financing of R&D and innovations. Developing economies, such as India and African nations, should focus on increasing labour productivity, which is impossible without higher infrastructure costs, reforms with a view to improving the business environment, and liberalization of trade practices and the investment climate.

Naturally, we will not see results of those reforms any time soon. As a rule, active budget and monetary policies help achieve faster economic growth sooner but, in order to have a long-term economic effect, structural limitations must be removed. Russia is a good example: its economy has faced an unfavourable combination of three factors: lower oil prices, limited access to global capital markets and an accumulation of structural challenges. The economy would be able to reach its pre-crisis growth rates quite soon if oil prices recovered to their 2012–2013 level or the sanctions were lifted. Even so, without implementing structural reforms and removing accumulated disproportions, 1%–1.5% growth is all we can hope for. Only investment climate improvements, which are impossible without public administration reforms, will enable Russia to achieve stronger growth in the medium term.

Prepared by Galina Fyodorova

Risks:

What are Businesses Concerned About?

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Executives of multinationals talked to SPIEF Review about their perspectives on global risks. We asked them about the biggest factors disrupting the global economy, what big business owners should be wary of, and the role political developments play in corporate investment activities. Our panellists shared their concerns about the signs of a crisis and suggested ways to respond to current economic challenges.

Mark Weinberger, Global Chairman & CEO of EY, spoke about the risks businesses face and noted that CEOs are never going to be able to anticipate every challenge.

In your opinion, what are the most important risks for global business?

To start with, there is the fragile and uncertain global economic recovery. And that slow recovery is causing attitudes toward trade and immigration to harden in many countries, leading to the rise of more isolationist political parties. This will exacerbate the problem, as isolation breeds stagnation. Another area that business needs to keep an eye on is the diverging monetary policies among big central banks and the resulting impact on currencies. The US Federal Reserve and the Bank of England are talking about tightening monetary policy while the European Central Bank and Bank of Japan are still expanding liquidity. This is causing a lot uncertainty, which is essentially like a tax on business.

There is also the threat of burdensome regulation that will hinder growth. One of the lingering effects of the global financial crisis has been added regulation in many markets and industries. And with each new country you operate in, that's a new set of regulations you need to navigate. It can become a complex, conflicting patchwork.

To what extent do you think global business is vulnerable today? What aspects of management should be addressed in particular by CEOs to prevent losing their market share, profit and staff?

The business world today is more connected, complex, and fast-paced than ever before. That means that business is vulnerable to sudden shocks from anywhere in the world. The 2011 Japanese earthquake disrupted supply chains globally. Social media can create a major reputational issue, seemingly overnight. The job of CEO has never been tougher. In this environment, CEOs are never going to be able to anticipate every challenge. So I think they should focus on three things, each of which sounds simple but can be tough to accomplish in practice: establish a clear, long-term vision; communicate (CEOs need to build more open, trusting relationships with shareholders, employees, regulators, governments and the public); and build a strong, diverse team (CEOs need to surround themselves with teams of people who have different views, different specializations and different backgrounds).

Following the previous economic crisis, you noted that there was a rise in tax conflicts all over the globe, so what risks in this sphere are anticipated by global business leaders now?

Governments around the world have struggled to keep pace with today's increasingly globalized and digital business world.

In terms of tax, this increases all kinds of risks for business, from double taxation to reputational damage as the public, media and policy makers all debate what is 'fair' for a multinational to pay, and where.

The Organization for Economic Cooperation and Development (OECD), with full support from the G20, is more than halfway through its Base Erosion and Profit Shifting (BEPS) project, which in October will result in a 15-action, internationally coordinated approach to dealing with multinational tax issues designed to protect countries' tax bases. At the same time, the European Commission is becoming increasingly active in tackling aggressive tax avoidance.

Among other things, we're seeing increasing transparency and disclosure requirements and a move to automatic exchange of information among tax authorities. This could well lead to greater disagreement and dispute over where and how much tax an organization pays.

In that environment, global business leaders really need to think about how they can be more transparent with the tax authorities around their organizations' tax affairs, and how they can proactively engage with revenue authorities wherever they do business.

EY's consolidated revenue for the 2014 fiscal year increased over 2013. Has the economic crisis had no impact on the company's work load?

EY isn't immune from the effects of the business cycle, but we're in a good place right now, with more people, helping more clients, in more places than in any time in our history. With our strong growth, we've been able to increase our hiring. Around the world last year, we hired 65,000 people – one person every eight minutes.

While we haven't been 'belt tightening' as such, over the past several years we have definitely been focused on managing our costs well. We've globalized many of our internal functions and reduced our management layers. That's allowed us to make investments in our future growth, whether that's in improving our IT systems to be able to collaborate more closely with our clients, or in transforming our audit processes, or expanding our practices in the emerging markets or in making acquisitions to strengthen and broaden the services we offer.

Stephan Leithner, Member of the Management Board, CEO Europe, Deutsche Bank, spoke about a paradigm shift in how multinationals do business.

What global business risks would you consider the most significant?

The major global risks are strongly intertwined and are resulting in huge migration flows which will confront the developed economies with major challenges. On the business side, the monetary policy measures of major central banks, which have resulted in record low interest rates, could lead to a collective underestimation of risks and financial bubbles.

Moreover, developed and emerging economies are still struggling to adjust to growth rates that are much lower compared to the years before the global financial crisis. For the European banking industry in particular, the pressure on interest margins and risks associated with record-level stock and bond prices are prominent challenges.

Beyond that, additional risks stem from ever tighter regulation particularly with regard to capital and leverage ratios, high expenditure levels, a lack of credit demand from clients and litigation and settlement costs.

Deutsche Bank reported a 2.5-fold increase in its year-on-year net profit for 2014. What measures were relevant with regard to minimizing costs and achieving positive results?

Founded in 1870 to advise and serve German Corporates in their most important markets, over the years Deutsche Bank expanded to equally demanding private clients and later to the globalizing capital markets. We have built a world class capital markets and advisory capability serving our clients around the world.

Deutsche Bank has become a better and safer bank over the last years, focusing on a client centric, global universal business model. We gained market share and reduced the size of our balance sheet in our investment bank.

Furthermore, we unlocked the potential of our asset and wealth management business. We strengthened our capital, boosting our key capital ratio. And we set out on a course of fundamental cultural change, based on our values and beliefs.

Multinational companies have significantly adjusted their long-term development programmes in view of the global economic crisis. What effect will this have on the technological and economic development of global companies? Can experience in anticrisis management open up new growth opportunities?

Today, our industry is in the midst of the next major paradigm shift. Digital technology is disrupting conventional business models. This is both a challenge and a tremendous opportunity. We have used digital technology to capture new revenues by offering clients online access to markets and investment advice.

We use digital technology to enable our platform and we have partnerships with more than 500 start-ups to identify new opportunities based on digital technology. Deutsche Bank will become, increasingly, a Digital Bank.

Dennis Nally, Chairman of PwC International, mentioned shifts in global economic power, technological advances and demographic changes among the risks that will be front of mind for CEOs.

As the Global Risks 2015 Insight Report published in the framework of the World Economic Forum indicates, geopolitical, social, and environmental risks are expected to be the main global challenges in years to come. Which global business risks would you consider to be the most significant?

Our own global survey of more than 1,300 CEOs earlier this year indicated that business leaders are grappling with a wide range of risks. Top of the list is still over-regulation, cited by 78% of CEOs. And national deficits and debt burdens along with rising taxes are still seen as top threats. But the range of risks is widening, with many anxious about geopolitical uncertainty and social instability – and concerns about cyber threats have shot up since last year. But looking ahead, I think it's the risks and opportunities posed by megatrends such as shifts in global economic power, technological advances and demographic changes that will be the focus for CEOs.

The interplay between these megatrends is transforming the landscape and disrupting the competitive environment across a broad range of industries. How to handle such disruption? I like the response of one CEO looking to pioneer opportunities for profitable growth: "I don't know of any way of managing a disruption – other than to be a creator of it."

In your opinion, how did the investment policy of global business change in 2014? What factors stand behind those changes? Did major investors step up their investment, or did they take a pause for international markets to become less uncertain?

Certainly, business investment has been markedly weaker in advanced economies after the global financial crisis than it was after previous recessions. The signs are that this remains a relatively fragile recovery and businesses remain somewhat cautious about making major investments in this climate.

There is a clear trend towards repatriation of investment, as it becomes harder to make money with global uncertainty, and as labour and other advantages begin to shrink. Total investment growth did vary considerably across the G7 economies in 2014 – relatively strong in the US, UK and Germany, but relatively weak in France and Italy in particular.

There is similar divergence within the BRICS, with China and India still growing at around 7% in 2014 and so providing a relatively favourable climate for business investment; though Brazil and Russia are heading back towards recession, which is very negative for business investment. But there is clear evidence of changing trends in investment, with a potential shift in emphasis from physical to digital investment. And it's evident that business leaders are seeing positive returns on their investment in digital technologies, both in terms of creating customer value and on their own cost structures.

Experts cite the national debts of some countries, the inability of businesses to pay their bills, and household debt to banks among the factors that have a negative impact on the global economy. Which steps should be taken to shrink the global debt? What losses might occur if no steps are taken?

On the debt side, there are clear divergences by country. It was very much a public sector debt problem in countries like Greece and Italy, but for countries like the US, UK, Spain and Ireland the initial problems were of excessive private debt due largely to debt-fuelled property bubbles that then burst in 2007–2009. Public sector debt rose as a consequence of the resulting recessions, as well as the cost of bailing out private banks. But the root of the problem was in the private sector. Progress has been made in clearing private sector debts in these countries, but banks generally remain reluctant to lend – at least compared to pre-crisis levels – and this has been a drag on the recovery and, hence, business investment.

China also now has problems with a rising debt burden linked to a property bubble. India and Brazil also have longer term problems with excessive public sector deficits, which have been a factor in keeping interest rates relatively high in those countries and acting as a drag on private sector investment to some degree as a result – though the outlook for India is better as stronger growth can help to reduce budget deficit problems.

For an economy to grow in a sustainable way, you need a balance between enough freedom to borrow for investment and to stimulate growth, and too much debt which will make a country unattractive to investors. As we have seen over the last few years, getting that balance right is a challenge.

Antonio Fallico, President, Conoscere Eurasia Association; Chairman of the Board of Directors, Banca Intesa; Head of the Representative Office of the Intesa Sanpaolo Group in Russia shared his view of the impact of geopolitical developments on economic processes, estimated the amounts of losses to sanctions, and evaluated the development of regional currency zones.

As the Global Risks 2015 Insight Report published within the framework of the World Economic Forum indicates, geopolitical, social, and environmental risks are expected to become the main global challenges in the coming years. What global business risks would you consider to be the most significant?

International conflicts, the destruction of state institutions, and risks of loss of power by national governments, including complete disintegration of states, have become the main threats in recent years. Look at the situation in Ukraine, the events in the Middle East – in Syria and Iraq, where authorities are struggling to contain the expansion of Islamic State into their territories, or in Yemen, where the national government has lost power. Besides, geopolitics is increasingly impacting events worldwide, as economic tools are being used more often to achieve geopolitical goals. On the one hand, states try to expand their geopolitical reach through the policy of interregional economic integration, the establishment of trade alliances or cross-border investment; on the other, they use such tools as protectionism or economic sanctions to project influence. Going forward, such actions could pose a threat to the very principle of global economic cooperation.

You have stated repeatedly that European countries have nothing to gain from imposing economic sanctions on Russia. How long will it take to restore the trade and investment ties between Russia and Europe, and can they be recovered in full?

Indeed, the sanctions are costing the EU dearly. Analysts estimate that European exporters lost between EUR 20 billion and EUR 40 billion in 2014 because of trade restrictions on Russia. Before the restrictions were introduced, exports of European goods to Russia, which used to be one of the EU's biggest trade partners, reached EUR 120 billion a year. Yet everything that it had taken years to build was all but erased over a short period of time. As a result, Europe is increasingly divided over relations with Russia.

In terms of Russia and Italy, Italian companies always considered the Russian market to be very important. This is borne out by statistics: Italian exports to Russia increased 327% between 2009 and 2013. However, because of the sanctions and Russian counter-sanctions, in 2014 trade between the two countries shrank by EUR 5.3 billion, or by 17%, from 2013.

The first months of 2015 also saw a considerable decline in Italian exports to Russia. The only industry that didn't suffer (and even grew) in 2014 was tourism. Still, even such a negative scenario does not rule out an improvement of the situation and a restoration of trade ties, because European businesses remain highly interested in Russia.

Russia and China are negotiating switching to national currencies in trade, with subsequent implementation of such settlements in Asia-Pacific too. How will the multi-currency system affect the financial sector in Europe and the United States?

The international financial system needs structural reforms. Modern development of regional currency zones will help increase industrial output and support domestic markets. The establishment of the Asian Infrastructure Investment Bank will create a serious alternative to the World Bank. BRICS countries will aspire to reform the IMF to achieve a fairer distribution of votes.

The strengthening of the Russian-Chinese ties will lead to a decreased dependence on the US dollar in bilateral trade. At the same time, the strengthening of the Russian-Chinese ties won't hinder the creation of a partnership between Europe, Russia and China.

Text by McKinsey & Company

Demography
and Productivity

SPIEF Review publishes an article by Vitaly Klintsov, Managing Partner at McKinsey & Company, Russia. He analyzes the impact of demographic trends and labor productivity on the global economy.

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Over the last 50 years the global economy has grown at an exceptionally high rate: total production output has increased six-fold since 1964. This rapid growth has been driven by two factors – a growing working-age population and improvements in labor productivity.

However, a recent research report by the McKinsey Global Institute, Global growth: Can productivity save the day in an ageing world?, shows that the extraordinary economic growth rates seen over the last half-century will come to a halt unless there is a step change in productivity.

The research focused on the economic performance of 19 of the G20 countries plus Nigeria. 63% of the world's population live in these countries, which account for 80% of global GDP.

If there are no radical changes in productivity growth rates, global economic growth is likely to fall from 3.6% per year to approximately 2%. In this new situation, the natural rate of economic growth will turn out to be lower than it was during the last five years, when the economy was recovering after the global crisis, and lower than in the previous energy crisis decade of 1974–1984. These changes will also result in lower per capita income growth rates and living standards.

This growth slowdown will affect both populations and businesses. The number of people who manage to make it above the poverty threshold will decline, repaying private and government debt will become more difficult, and there will be a drop in financing for large-scale projects such as combating climate change.

Nowadays, declining birth rates and an ageing population are weakening the positive impact of the demographic factor on the economy. Moreover, in a number of developed and developing countries this impact is already becoming negative.

As a result of the demographic changes the majority of countries will hit peak employment in the next 50 years. The number of employees has already peaked and started to decline in Germany, Italy, Japan, and Russia, and labor pools in these countries may shrink by up to one third by 2064. In China and South Korea, the peak is expected as early as in 2024, and China's labor force may decline by 20% in the next 50 years. Acceleration of the productivity growth rates required to make up for the demographic factor is achievable, but will be extremely challenging. Analysis of case studies in five sectors of the economy – agriculture, food processing, automotive, retail and health care – suggests that annual productivity growth could be as high as 4%, which is even more than needed to counteract the unfavorable demographic trends.

Three quarters of the existing potential could be tapped by applying the best practices of other countries in commercial companies and state-run organizations.

The majority of countries will experience **a peak level** of working population in the next **50 years**

There is some scope to limit the decline in the global labor force through policies to boost participation among women, the young and those aged over 65, but, even in the best case scenario employment growth would only hit 0.6%, which is three times lower than the average rate over the past 50 years. There is only one solution – to strengthen the productivity engine as much as possible. To compensate fully for weakening labor growth, productivity growth needs to be 80% greater, at 3.3% a year. And this in a context where the historical rate is already growing very rapidly – by 1.8% per year. Without such acceleration, the rate of global economic growth could be 40% lower in the next 50 years than it was in the past 50 years. In that event, the global economy will only grow threefold over the next 50 years, while in the past 50 years it expanded six-fold.

Vitaly Klintsov,
Managing Partner,
McKinsey & Company , Russia

These opportunities for boosting productivity include increasing the share of modern formats in retail and the scale of assembly plants in the motor vehicle industry, improving operational efficiency in the health care sector, and reducing waste in the food industry.

The remaining one quarter of the impact could come from technological, operational, and commercial innovations that go beyond today's best practice. The potential of innovations could prove even greater, since our estimate is based only on the achievements we can foresee.

A number of opportunities are associated with continued implementation of existing programmes, such as agricultural research aimed at tailoring and improving seeds and developing agronomical practices to increase crop yields, or technological programmes to increase fuel efficiency in the motor vehicle industry. Other opportunities are based on technological innovations such as introducing intelligent robots, which are already used in some retail warehouses, and mobile healthcare technologies, which are increasingly being used to provide medical assistance in remote regions.

It is essential to ensure that governments and business leaders have the incentives and tools they need to boost productivity. It is particularly important to take steps to increase efficiency in large and growing sectors of the economy, which mainly consist of state-owned businesses and which are traditionally characterized by low productivity rates, for example in the health care sector.

To make these radical transformations successful, it will be necessary to create the right conditions for productivity improvements and innovation. The report identifies four broad sets of actions for leaders of state-owned and private organizations. The first is increasing transparency and strengthening competition. The second is incentivizing innovation. The third is mobilizing new labor resources. And, finally, the last is making economics more open in order to facilitate cross-border economic flows, from trade in goods and services to flows of people. Being open and ready for global economic activity allows companies and even countries to benefit from competition, exchange of ideas and best practices, and personal connections.

The productivity improvement issue is very pressing for Russia. Incentivizing the participation of the young and elderly could partially compensate for the labor pool contraction. Over the last 50 years, growth of the Russian GDP has been primarily attributable to labor productivity improvements, which made it possible to almost double the yield per worker and accounted for 81% of the total growth in GDP. Since 1964, the total employed population in Russia has increased by only 20%, and this factor accounts for just 19% of economic growth. But in the next 50 years the number of people in employment is projected to fall by 29%.

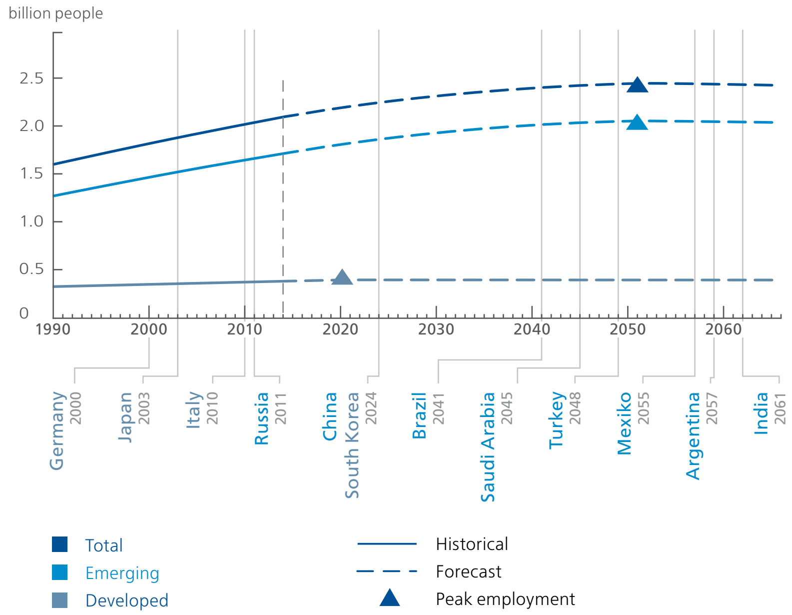
Among the measures that should be taken to facilitate an increase in labor productivity in Russia, one could single out increasing the geographical and industry-specific mobility of the labor force by creating social infrastructure and providing financial support for relocation and professional retraining. In addition, it is important to ensure workers can move from low-productivity sectors to high-productivity sectors and to draw up a professional migration policy.

The growth potential will only be realized if all economic entities make targeted efforts to increase productivity. We should not shift all the responsibility to the government – it is companies that will play the crucial role here.

They should actively improve the structure of their capital, introduce new technologies, take risks by investing in research and development and new unproven technologies and processes, and mitigate the erosion of the labor pool by providing flexible working conditions for women and elderly people, and training and mentoring for young people.

In the context of a potential slowdown in global economic growth and the obvious changes in growth dynamics, executives should promptly identify sources of market opportunities and understand who they will be competing with. Above all, companies need to be competitive in a world where productivity will be the main factor determining their success or failure in the market.

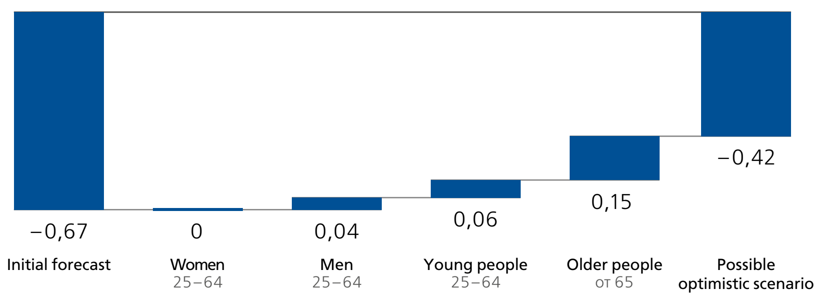
Globally, the number of employees is likely to peak around 2050
Employed population in G19 and Nigeria, 1990–2064.



Note: assuming the highest level of economic activity among the population in 2007–2012 and the lowest level of unemployment

Source: The Conference Board Total Economy Database; UN Population Division; World Bank; International Labour Organization; McKinsey Global Institute

Incentivising the economic activity of young people and older people will make it possible to partially compensate for the numerical reduction in the workforce in Russia.
The impact of an increase in economic activity and the level of employment on the forecast total population in employment.
Russia, 2014–2064 (estimate).
Average annual rate of growth (percent).



Note. The optimistic scenario assumes that among women the proportion of the economically active population will be a minimum of 75% and the level of unemployment will be less than 5%. Among men, it is assumed that the proportion of the economically active population will be a minimum of 90% and the level of unemployment will not be more than 5%. Among young people the proportion of the economically active population will be not less than 55% and the level of unemployment will be less than 10%. Among people aged 65+ the figure for economic activity will be in excess of 25% and the level of unemployment will be less than 10%. Rounding may mean that the sum of the figures may not coincide with the total value.

Source: UN Population Division. McKinsey Global Institute.

Prepared by Galina Fyodorova

Oil:
How Feasible are Alternatives?

The central place of oil as the main energy source, increasing importance of natural gas, nuclear power economics, development of alternative energy and energy efficiency – such are the factors outlining the energy sector today. SPIEF Review presents the vision of Russian and foreign energy experts on the outlook for the balance of energy sources.

Chairman of Cambridge Energy Research Associates (CERA) and author of two oil bestsellers Daniel Yergin noted that oil will remain an important element of the global economy.

Mr Yergin, your Pulitzer Prize-winning book The Prize: The Epic Quest for Oil, Money, and Power spans the period from the 1950s to the 1990s.

Two decades have passed since the book was published, yet no dramatic change can be observed: oil remains a key influence on global politics and economics. Do you think oil will ever lose its influence on most economic sectors?

Oil is as central today as it was in the 20th century. I think it will continue for many decades to be highly influential for the world economy and global politics, with continuing 'surprises' along the way.

I expect world oil demand to peak in about 25 years but oil will remain influential for some time after that. As to beyond that, let's see what technology has to offer and how the world changes. One other striking change is that natural gas will probably overtake oil and coal as the world's number one energy resource in the 2040s.

Do you think the instability in the oil sector could have a positive effect on alternative energy?

Some of the alternative energy resources are no longer 'new'. The modern solar and wind industries have their origins in the 1970s. But they don't really compete with oil, which is so centred in the transport sector.

Meanwhile, a lot of technological innovation in both conventional and alternative resources is going on all across the energy industry. High prices, instability and volatility certainly encourage investment in alternatives and new technologies, as well as policies supporting them.

We're continuing to see the impact of 2007 and 2008 on technologies today. The main question for oil's role is the degree to which electricity will replace oil as a transport fuel. It is getting a lot of attention, but it's still early days.

Continuing the discussion of alternative energy, Chairman and CEO of Schneider Electric Jean-Pascal Tricoire emphasised that energy efficiency in this sector would help reduce national energy budgets considerably.

Mr Tricoire, energy efficiency has been gaining prominence on the energy agenda. In your opinion, what impact will this trend have on the energy balance and economy as a whole?

At the utilities and regional level, energy efficiency enables increasingly reliable supply and provides hedging against blackouts. It also saves significant investments costs by obviating the need for new plants.

At a country level, higher energy efficiency levels create an economic opportunity for reduced public expenditure as Governments balance their energy trades, which are causing major strains on the economy. The EU energy balance has multiplied by 6 in 10 years, with oil imports alone reaching USD 500 billion in 2012.

The Efficient World Scenario put forward by the World Energy Outlook of the IEA highlights that there could be a USD 570 billion positive effect of the Energy Balance of 5 key regions, with China seeing USD 190 billion and India USD 110 billion in positive effect through implementation of a higher energy efficiency scenario; as well as a huge potential for job creation, with estimates ranging from 800,000 to 1 million jobs by 2025 in a country like France.

What impact will worldwide use of energy-saving solutions produce on the development of resources and generation of energy?

Despite the huge potential of energy efficiency, the energy demand will continue to grow, but the energy mix is changing. From the shale gas boom in America, to the rise of renewables in the energy mix, energy sources are widening and reaching scalability.

The price of crystalline silicon photovoltaic cells for instance, has gone from USD 78 per watt to USD 0.72 in less than 4 decades. Policy-driven markets have facilitated deployment of these technologies that are reaching grid-parity on many markets.

As of the first quarter of 2014, there were 79 countries where the price of photovoltaic electricity is equal to or less than the average grid price. This wider choice of energy generation sources, combined with the emergence of information technologies in the energy sector, are redefining the energy ecosystems on the demand and supply side, and creating opportunities for increased efficiency at all levels, from people to power plant, to ensure complete optimisation of the supply chain.

General Director of the Rosatom State Nuclear Energy Corporation Sergey Kirienko said that nuclear energy had gained a strong footing in the current energy balance.

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You have recently stated that Russia is currently the only country capable of building a comprehensive nuclear partnership. What is the current nuclear market like?

For us, a major competitive edge is that Rosatom is now the world's only company offering a full product line-up covering the entire nuclear energy process chain, from natural uranium mining to nuclear decommissioning.

Rosatom is unrivalled in this sense. In Russia, we have all types of nuclear energy project: not just construction and operation of nuclear power plants, but also nuclear fuel preparation and the creation of new generation energy technology, all brought under one roof, which lends us global advantages that cannot be exaggerated, especially in the eyes of those of our partners who are just making their first steps in nuclear energy.

It has been four years since the Fukushima Daiichi nuclear disaster. What security requirements are now in place for nuclear technology?

The Fukushima disaster drastically changed the path to the nuclear future. While it did not curb the trend towards expansion of nuclear power globally, it brought security requirements for nuclear power plant construction projects to the top of the agenda. This is an absolute priority now. Where, some five or seven years ago, clients would still consider a choice between second, third or third generation advanced reactors, this is out of the question now.

We are now talking only projects meeting cutting-edge security requirements, including robustness against not only magnitude 9.0 earthquakes but also against heavy aircraft crashes and external water supply cuts.

Can nuclear power, with its relatively low production and high construction costs, replace hydrocarbons to a certain extent?

It certainly can, and this is already happening. Nuclear power is already an essential element of the current energy mix. It helps resolve many issues, most importantly, reducing spending on hydrocarbon fuels. The figures speak for themselves: a power generation facility with an installed capacity of 1,000 megawatts requires 24 tonnes of low-enriched uranium against 1.7 million tonnes of oil or 2.7 million tonnes of coal or 2.4 billion cubic metres of natural gas. If we take into consideration the high volatility of fossil fuel prices seen in the past 20 to 30 years, the fuel requirement factor becomes a crucial advantage.

The truth is that fuel accounts for no more than 25–30% of total operating costs in the nuclear industry, unlike 'traditional' gas or coal-fired power plants, where the relative figures reaches 80%. Clearly, fuel price fluctuations have the least impact on the product end cost: in the past three years, nuclear power plants have reported a production cost volatility of 7%, compared to 61% at thermal power plants. This low volatility certainly attracts both investors and end consumers.

The price advantage has become even more obvious since the world gained the opportunity to compare price dynamics in Japan and Germany before and after complete or local nuclear plant shutdowns. Compared with 2010, when all the nation's nuclear power plants were still in use, end consumer prices grew 20% in Japan, while prices for businesses soared 30%. A similar effect could be seen in Germany: according to Eurostat, end consumer prices grew 20% over the same period (from EUR 0.24 to EUR 0.29 per kilowatt-hour), and prices for businesses rose 25% (from EUR 0.15 to EUR 0.19). This is all quite obvious to countries in need of a comprehensive solution for satisfying the demands of a growing economy.

They opt for nuclear power not only for the sake of their energy needs, but for bringing about intensive high tech growth. Meanwhile, there is an important factor to be considered. A key condition for the demand for new nuclear power plants to grow is that they must be commercially competitive. The contemporary energy market relies, above all, on the price per kilowatt-hour and customers are more concerned about power rather than a nuclear station. Consequently, the management of price per kilowatt-hour – that is, guaranteeing the price – has come to the fore. In this context, nations are increasingly going after a company that would not only provide a technology, but also co-invest in the project.

Text by non-profit partnership 'Industry round table for cooperation with the European Union'

Investing in the Climate

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Experts from the non-profit partnership 'Industry round table for cooperation with the European Union' have prepared an analytical material for The SPIEF Review on climate investments.

The reduction of global greenhouse gas emissions in order to mitigate climate change has been recognized by the international community as one of its priorities. The risks associated with global climate change and its socio-economic, demographic, geopolitical consequences have been ever more accurately estimated by experts and have become an important factor for international relations. An anthropogenic increase in the global surface temperature, to the range of 2° C range, in comparison to the pre-industrial level, is considered to be an indicative target. Society has recognized the need to stabilize global greenhouse gas emissions as soon as possible, given that the 'peak' of emissions in developing countries will be surpassed at a later date than in developed countries. It is expected that the international community will decide about the limit of greenhouse gas emissions in the long-term at the Conference of the Parties to the UN Climate Change Conference, which will be held in Paris, in December 2015.

Russia is one of the most interested parties in the success of the Paris Conference. According to data from Roshydromet, a sharp increase in the number of severe weather events is now a reality, which has been confirmed by observations in the recent years. An absolute record on the number of hazards since records began in the Russian Federation was established in 2014. In total, 569 floods, heavy rains and showers of hail, squalls and gales, heat waves, blizzards were recorded. In 2013 and 2012, these phenomena were observed 545 and 536 times respectively, while 15–20 years ago, the range was from 150 to 250. The key issues of future agreements must be to find solutions to reduce the negative impact on the climate system, how to adapt to existing climate change, as well as agreements on the financial costs, which should be covered by developed and major developing countries in order to overcome climate change. According to expert estimates, the cost of adapting to climate change for developed countries can range from between 1 to 5% of the GDP. In this case, the total amount of 'adaptation investments' will largely depend on to what extent and how quickly the 'two degrees' emission control scenario can be implemented. However, in any scenario, the costs of adapting to climate change are significantly lower than eliminating the consequences, but much greater than the cost of limiting emissions of greenhouse gases. The key factor here is the targets to reduce greenhouse gas emissions for developed and major developing countries. In accordance with decisions made at the Climate Change Conference 2014 (Lima, Peru), a number of countries and entities, including the USA, EU and Russia, submitted their intended nationally determined contributions (INDC) to limit their greenhouse gas emissions. A preliminary assessment of these indicators has produced two conclusions. Reducing the emissions produced by developed countries is likely to be insufficient to limit global warming to two degrees (more accurate conclusions can be made after all developed and major developing countries have submitted their targets).

The cost of adaptation to climate change for **developed countries** can range **from 1 to 5%** of GDP

It should be noted that, in 2009, the OECD recommended that Russia introduce an effective policy tool for environmental protection and energy efficiency, in order to introduce carbon regulations.

The indicators submitted are ambitious, but achievable and realistic. They require an intensification of efforts by all countries which submitted their targets, at both a national and international level. The current experience in controlling emissions in developed countries over the last few years has convincingly demonstrated the effectiveness of integrated approaches to regulating greenhouse gas emissions, including the use of market-based tools to achieve significant environmental effects (not only the reduction of greenhouse gas emissions, but also the reduction of other pollutants), as well as creating incentives to advance the development of 'green' sectors of the economy. In this regard, adopting sufficiently ambitious (in terms of the previous experience in carbon regulation), but relatively 'moderate' (to reduce the negative impact on the climate system) restrictions on greenhouse gas emissions, is considered both as a way of achieving purely 'climatic' goals, and as a way of accelerating economic growth by major developed countries. The US declared its readiness to cut emissions by 2025, to the level of 72–74% from the 2005 levels, and the EU intended to limit emissions by 40% by 2030, compared to 1990. Norway has similar plans to reduce emissions and Switzerland has even more ambitious plans for reducing its emissions by 2030 (50% compared to 1990). China declined its earlier plans to build a system of emissions control over the relative energy intensity criteria. Instead, it decided to launch a pilot phase for emissions trading based on absolute terms in 2013, and after 2015 launched the full-scale system. China has chosen a policy which sets absolute targets for CO_2 emissions despite the fact that the nationwide target is formulated in relative terms; a 40–45% reduction of the economy's carbon intensity by 2020 compared to 2005. A system with absolute targets for limiting emissions was considered to be the most effective tool for reducing the energy intensity of the economy, improving its efficiency and improving the competitiveness of the Chinese economy in general. Alongside this, issues on exporting technology for energy conservation, energy efficiency and renewable energy sources have been tackled.

Russia's plans to limit emissions were calculated by the long-term projection of Russia's socio-economic development by 2030, and are also quite ambitious. The level of greenhouse gas emissions by 2030 should amount to no more than 70–75% of the 1990 levels. In this case, according to the Russian Ministry of Economic Development, a temporary decline in GDP growth over the next year or two (up to 3%), will not have a significant impact on meeting the target in the long term. These optimistic governmental projections are not only based on the rate of energy intensity reduction which has been demonstrated in recent years, but rather on the understanding that allowances for the economy's extensive growth in the face of the world economy's continuing decarbonization are extremely limited. An assessment was conducted by individual researchers (Bashmakov, Pluzhnikov and others) about the measures which were implemented over the years by the Russian government in order to reduce the GDP's energy intensity. This assessment indicated that the measures had not been particularly efficient. While Russia had no issues working within the framework, which had been laid out at international and national levels to limit greenhouse gas emissions, some of the more ambitious targets to improve the economy's energy efficiency appear to be unattainable.

The key problems are still financial and organizational; the de facto absence of state support and well established ideas for project development and financing in both the public sector and private companies. However, it must be noted that Russia has of late lagged far behind the other developed countries and major developing countries in its application of market-based tools for carbon regulation. Although there have been relative successes in the use of administrative tools to regulate energy efficiency, such as implementing energy efficiency measures in organizations with state participation, as well as in various Russian regions, and improving energy efficiency by using energy service contracts in budget organizations, the overall results of energy audits were unsatisfactory. Trying to increase the quantity of energy audits affects their quality. Moreover, in industry, tools to improve energy efficiency have almost never been used for electricity production, and in 2015 subsidies for administrative regions in Russia were cancelled. This has ceased regional activities to improve energy efficiency and reduce greenhouse gas emissions. In fact, the only tool to support energy efficient projects in the private sector was a 'climate' support initiative; the Kyoto Protocol.

EU intended to limit emissions by
40%
by 2030
compared to
1990

For the Clean Production

Economists' views from the 1970s on the issues of a tough and direct relationship between economic growth and environmental constraints have been completely refuted by the practice of developed countries during the 1990s and at the beginning of the 2000s. The development of carbon regulation systems in EU countries at the end of the twentieth century and the subsequent further restrictions and rights on emissions trading in other developed and developing countries does not cause the economy to stagnate, but in fact contributes to the rapid development of clean production, innovation and improvements in energy efficiency. Carbon regulation tools applied in developed and major developing countries have proven their 'environmental efficiency,' and now, establishing a price on carbon is the main way to improve energy efficiency and innovating development in these countries. It is important to note that all the countries which have introduced 'carbon' regulation systems conducted a preliminary assessment of the possible impact of these systems on economic development. For example, before Australia decided to introduce a 'greenhouse' tax and since 2015, the emissions trading system has analyzed the 'extreme' scenario commitments to reduce greenhouse gas emissions by 60% or more (up to 100%) from 2030–2050. The modeling showed that the GDP doubled by 2030 and tripled by 2050, with a simultaneous increase of per capita income by 150%, while the number of jobs increased by 70%.

The Russian Ministry of Economic Development has approved 108 emission reduction projects (by 9 ministerial orders) between 2010 to the end of 2012. The largest volume of the emission reduction units, according to the approved emission reduction projects is in the oil and gas sector (119 million units), followed by chemistry, steel and energy sectors (55 million, 56 million, 46 million units respectively). The Russian government has set an exhaustive limit of 300 million tons. Given that the limit of 300 million tons that had been established by the Russian government was eventually used up, the Russian Ministry of Economic Development suspended their approval of follow-up projects.According to the Sberbank of Russia, at the end of 2012 the total volume of 'Kyoto subsidies' to the project amounted to about EUR 420 million. As of December 2012, about 218 million tons of CO_2-equivalent were transferred by the Russian Registry to the accounts of the purchasers of emission reduction units. 62% of the projects were related to increasing energy efficiency, energy conservation and renewable energy. Each rouble received by carbon investments has led to additional investments through the multiplier effect. According to investment declarations, which were officially submitted to the Sberbank of Russia, the amount of 'carbon' income to be reinvested, taking into account co-financing, amounted to RUB 240 billion by 2020. According to an analysis of the available information, tax revenues from ongoing projects, including VAT receipts, import duties, taxes on profits, income tax and other tax payments associated with producing carbon revenues, all amounted to more than RUB 10 billion. Revenues from the pension and other social funds totaled more than RUB 2.2 billion. It is particularly significant that from 2010 to 2012 the use of 'carbon certificates' facilitated the building of a complete business environment, which was required for the project to be implemented. The system of project preparation and selection, as well as monitoring, determination and the verification system were built using international practices and organizations-auditors which were accredited by the UN.

Given Russia's withdrawal from the second period of the Kyoto Protocol and the stalling of the 'non-carbon' energy efficiency tools, it became apparent that there was a need for a critical analysis of the international experience in using market-based ways of improving energy efficiency, in order to reduce greenhouse gas emissions and develop a national system of regulating the emissions. It should be noted that, in 2009, the OECD recommended that Russia introduce an effective policy tool for environmental protection and energy efficiency, in order to introduce carbon regulations. The economic ways of regulating should include the possibility of introducing quotas and the assignment of emissions, as well as developing national environmental markets. In this case, it appears that creating ways to promote carbon investment is advisable, and should be carried out by modernizing the entire system of state regulations on environmental protection, using the best technology available. The introduction of a regulatory system for greenhouse gas emissions would be effective from an environmental and economic perspective and would create an efficient market for energy efficient technology, as well as a substantial demand for investment resources. However, this remains one of the main challenges of future environmental reforms. Therefore, the following suggestions could be implemented to this end:

I. It should be deemed appropriate that significant amendments to environmental regulation should be introduced. This could be a reduction in the list of regulated substances and indicators, whilst at the same time creating a carbon accounting system (possibly within the non-financial reporting system). This could also be done by introducing the emission of pollutants into the list of the best technology available, in order to establish a state support system for energy efficiency projects, using the existent system of carbon certificates. A step by step Russian greenhouse gas emission regulation system should also be established, based on the quotas scheme and the assignment of rights to atmospheric emissions.

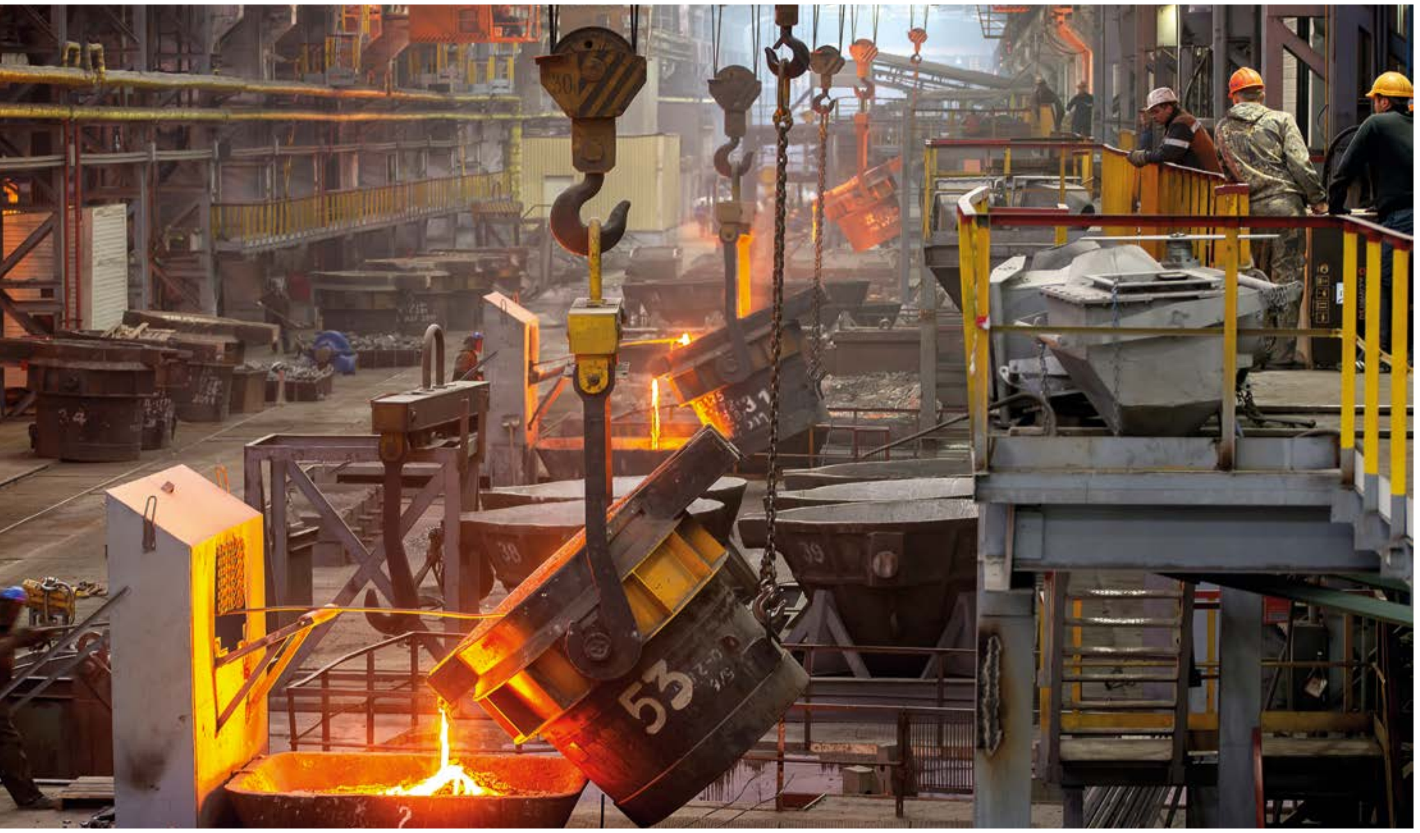
II. Specific dates should be set for the test (pilot) phase, providing easy access to investment resources and the full introduction of market regulations on greenhouse gas emissions. Accounting for the time taken to prepare a new international agreement, the pilot phase should be completed by 2018.

III. The qualitative and quantitative characteristics of the regulation system should be established, in accordance with international standards and Russia's environmental, social and economic priorities.

According to investment declarations, the amount of 'carbon' income to be reinvested, taking into account co-financing, is amounted to RUB 240 billion for the period up to 2020

Text by EY

An Investor for Every Region



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EY's Managing Partner for Russia, Alexander Ivlev, comments on the results of a survey regarding Russia's industrial and innovation infrastructure and its impact on improving the investment attractiveness of regions.

Today's economy is becoming less dependent on commodity prices as new economic growth factors come to the fore. Rapid-growth markets are steadily moving into dominant positions in the global economic system and increasing their share of capital and investments.

According to the World Bank, by 2030 rapid-growth markets will account for 47% of the world's capital, up from 23% in 2010, and China and India will be the world's leading investors. The availability of developed infrastructure makes it much easier for the region to attract investors willing to set up new enterprises. In addition, it stimulates the formation and expansion of business among local producers, leading to the creation of clusters and associated production facilities.

EY's 2015 survey, 'Russia's Industrial and Innovation Infrastructure' confirms that in recent years many regions have been successful in forming an infrastructure and conditions which are attractive for businesses. One problem is the uneven geographical distribution of infrastructure and resources. Industrial parks are mainly concentrated in the European part of Russia. Almost 40% are in regions of the Central Federal District and around a quarter in the Northwestern and Volga federal districts.

At the start of 2015, Russia had 366 industrial parks in various stages of development. One positive development is a substantial improvement in these sites' level of completion over the last five years. The percentage of completed sites has risen dramatically – from 29% in 2010 to 42% in 2015.

In addition to sites which support industrial enterprises, Russia has long made use of the special economic zone (SEZ) format, which provides the infrastructure needed to start production as well as tax benefits and customs and administrative regimes. However, not all SEZs have been successful: only eight of thirty have a completed infrastructure and residents. According to the Special Economic Zones OJSC, investments into approved sites announced by residents total around RUB 500 billion, while over RUB 145 billion in investments have actually been made.

The advanced development zone (ADZ) project has given a new impetus to the SEZ idea. In February 2015 a short list of three candidates for ADZ status was approved: Khabarovsk, Nadezhdinskaya and Komsomolsk. The ADZ project gives broader urban planning authority to the Ministry for the Development of the Russian Far East as well as offering a completed site and a list of residents willing to participate. Over RUB 50 billion in private investments have been planned.

According to the Ministry for the Development of the Russian Far East, each public rouble invested in an ADZ could bring on the order of nineteen roubles in private investments. These zones will also support plans for non-resource production in the Far East and Eastern Siberia, including for export, as well as for the creation of business conditions on the level of key centers in the Asia-Pacific Region.

As the global economy begins to recover, investment activities in rapid-growth markets are also getting back on track. If the wave of investments is not to bypass Russia, efforts must be made to leverage the country's strong points – its unique resources and geographical position – and to enhance the business climate by giving the regions a greater role in Russia's economy and foreign trade. With its vast territory and considerable regional diversity, Russia is not an easy place when it comes to choosing a good location for your business: one region may have unique infrastructure, while another offers great human resources or interesting opportunities for growth.
The creation of infrastructure, special economic zones and public-private partnerships; institutional support; collaboration with banks, investment funds and development institutes; opportunities created by the 'turn to the East'; support for entrepreneurship – all of these measures help to form new centers of growth in order to bring investments into the regions and make maximum use of the existing possibilities.

Alexander Ivlev,
Managing Partner for Russia, EY

Each public rouble invested in an ADZ could bring **19 roubles** in private investments

Innovation infrastructure sites such as technoparks and business incubators are capable of playing a significant role in regional innovation ecosystems. The survey 'Challenges and Solutions: Business Incubators and Technoparks in Russia,' conducted by EY in cooperation with the Russian Venture Company, shows that some innovation infrastructure sites are already achieving results comparable to those of their European and American counterparts.

According to the EY's survey 'Russia's Production and Innovation Infrastructure,' Russia has 117 technoparks. The majority is in the high-tech area, and 26% indicate specializations in the area of information and communication technologies, including data processing, storage and analysis, computer technology and telecommunication systems. Some 25% are involved in electronics and instrumentation, and 13% specialize, among others, in biomedicine, including genetic engineering, pharmaceuticals and microbiology. Another 12% specialize in chemicals and petrochemicals.

It should be mentioned that despite Russia's long history of developing technoparks and business incubators, few of the facilities now operating conform to their designated purposes. A number of objects formally called 'technoparks' or 'business incubators' mainly focus their activities on leasing out their premises instead of providing quality support to their residents in achieving their business goals.

The range of specializations reflects the diversity of Russia's regions. An analysis of projects carried out in the last ten years shows that the areas with the greatest investment appeal were the extractive industries, agriculture, timber and wood processing, food processing, construction materials, metallurgy and chemicals.

The extractive industries accounted for the greatest number of projects, with agriculture coming second. Both of these areas are being developed in nearly every federal district, but the regions with the chief deposits of oil, gas and minerals – the Siberian, Far Eastern and Southern federal districts – have attracted the bulk of investments in the extractive industries.

The Murmansk Region and Kamchatka Territory have raised the largest investments in fishing projects, and the Voronezh and Belgorod regions lead in the area of livestock farming. Projects in the Central Federal District focus on food production, and the largest projects are in the Tula, Orlov and Vladimir regions.

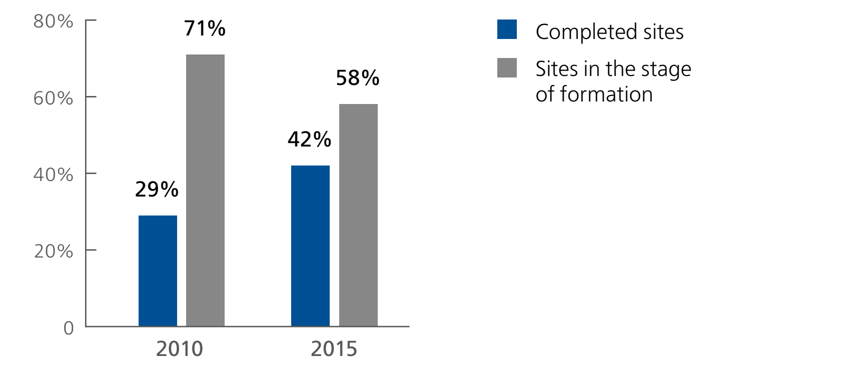
The timber and wood processing industry has two subdivisions: pulp and paper production and wood processing and woodwork. The main investments in enterprises producing paper pulp, paper and paper goods are concentrated in the Central and Northwest federal districts. The largest projects are in the Moscow and Tula regions. The wood processing and woodwork sector also has investment appeal in the Republic of Khakassia, the Tomsk and Krasnodar regions.

Construction materials tend to be close in proximity to the sources of the natural materials required. Investment projects in this area are under way in many regions of the country, with the greatest number in the Central and Urals federal districts. The largest capital investments in the last ten years were made in the Republic of Mordovia and the Rostov Region.

In the last ten years, large investments have been made in the chemical industry, which is developing thanks to growing state support and investments by private companies. Key investment areas are fertilizers and plastic and rubber goods. The chemical industry is well-developed in the Volga and Urals federal districts. Large-scale projects have been implemented in the Tyumen region and Primorsky Territory.

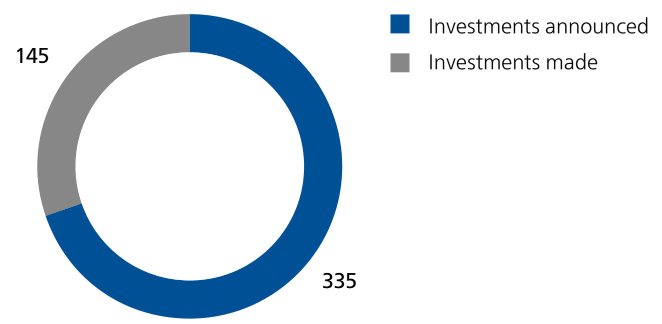
Despite a certain slowing of Russia's economic growth rates, successes in developing regional innovation infrastructure have already been noted internationally. Specific projects, for example, are featured in 'Russia's Regions, Drivers of Growth: 4x4,' a report by the World Economic Forum's Global Agenda Council on Russia. Best management practices and the generation of investments must always contribute to the balanced development of the business environment, and therefore, growth in private enterprises must be stimulated at a regional level. All support measures must be integrated to enhance the investment climate in the regions and encourage them to be a driver of the country's economic development.

Stage of readiness



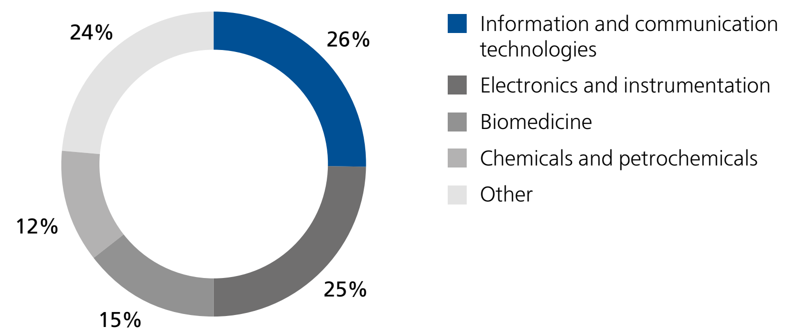
At the start of 2015, Russia had 366 industrial parks in various stages of development. The percentage of completed sites has risen dramatically – from 29% in 2010 to 42% in 2015

Investment



Investments into approved sites announced by residents total around RUB 500 billion, while over RUB 145 billion in investments have actually been made

Technological parks



Russia has 117 technoparks. The majority are in the high-tech area, and 26% indicate specializations in the area of information and communication technologies

Source: EY

Text by non-profit partnership 'Industry round table for cooperation with the European Union'

Sanctions vs Countermeasures

Experts from the non-profit partnership 'Industry round table for cooperation with the European Union' prepared analytical material for The SPIEF Review on the influence of the sanctions which had been imposed on the Russian economy by the EU and the US.

Firstly, existing statistics do not fully account for the impact of the sanctions. The most vivid example is the data on trade with the US, which showed an increased turnover. The reason for this was the purchase of airplanes by Aeroflot, through a contract signed in 2011. Secondly, it is hard to separate the effect from sanctions from general the downturn in the Russian economy and the impact from falling oil prices.

The Russian officials give the following estimates: Russia lost around USD 40 billion (and USD 100 billion more from the fall in oil prices), while the EU economy lost USD 40 billion in 2014 (and will lose USD 50 billion more in 2015). According to EU data, Russian losses amounted to EUR 23 billion and EUR 75 billion in 2014 and 2015, while for the EU these values totalled EUR 49 and EUR 50 billion (including EUR 5 billion a year of direct losses from the Russian embargo on agricultural products). Spain assumed that the European economy suffered a loss of EUR 21 billion due to the sanctions. In most cases, however, the estimates only account for missed profits, disregarding for instance higher unemployment, lower prices for agricultural products in the EU and stronger deflation trends. The damage to the US from the Russian sanctions is estimated at USD 1 billion, while Russia lost USD 140 billion because of the US sanctions.

Some sources also note a number of other negative impacts for Russia, such as the depreciation of the rouble, inflation, a fall in personal income, the worsening of the investment climate, a decrease in consumer demand, the exodus of capital from Russia (totalling, according to various estimates, around USD 130–151.5 billion, and foreign companies leaving the country. In addition, we noted a downgrading of Russia's sovereign ratings, followed by a downgrading of Russian regions and stand-alone companies.

Finally, there is a banking crisis, caused by a deficit of cash (after Russian companies lost access to western financial markets) and a tightening of the Russian Central Bank's monetary policy. In 2014–2015 the local banks and companies will have to redeem USD 160 billion of debt, while the total corporate debt amounts to around USD 731.2 billion. Its servicing in the light of the sanctions has become much more complicated. In July-September 2014, the number of Eurobond placements fell by half, compared to the same period of the previous year (4 against 8), the inflow of foreign direct investment stopped (while in the second quarter of 2014 the inflow was USD 12.1 billion, in Q3 the outflow was USD 0.6 billion, and in Q4, USD 3.4 billion). The volume of syndicated credit fell sharply, and the conditions for credit were tightened (in particular, the lenders started to supplement contracts with a provision of the early repayment of debt in case the borrower were to be included on the sanctions list). The hopes for substituting Western capital sources with borrowings from East Asia (namely China) were promptly dispelled, as the supply of capital there turned out to be limited, while the costs were considerably higher than in the lost European markets.

At the same time, up until the end 2014, the majority of small and medium-sized Russian companies were not directly affected by the sanctions. According to polls, more than 90% of the industrial enterprises in Russia did not link the problems they were experiencing to the consequences of the sanctions. Moreover, in a number of industries there were expectations related to tapping market niches left by foreign manufacturers. In the agricultural sector, these expectations were mainly due to the August embargo on imports of agricultural products and foodstuffs from countries that had imposed sanctions against Russia; in the metal industry this was due to Ukrainian exporters exiting the market, and in machinery this was because of a demand to provide equipment for oil and gas sectors for projects affected by the sanctions. In November–December 2014, these expectations were supported by the steep devaluation of the rouble. In business circles, there were talks of a possible replication of the 'industrial miracle' of 1999–2000, when the import substitution stimulated by the devaluation led to a growth in industrial output by 8.7–8.9% a year.

However, the situation deteriorated significantly at the beginning of 2015. On the one hand, the fall of real personal income in the first

> For our EU partners, the main **negative factor** is the fall in goods turnover with Russia by **€120 billion** in 2014

Stages of Introducing the Sanctions

Since March 2014, there have been four 'packages' of European sanctions imposed on Russia. Alongside the USA sanctions against Russia, 5 stages of sanctions can be identified since then, and until now. At the first stage, the negotiations between Russia and the EU about the new framework agreement and visa-free regime were halted, while the EU and the USA decided not to hold a top-level bilateral meeting. The second stage was made up of restrictive measures against individuals and legal entities. The third stage was introduced in June 2014 and elaborated on in December 2014. Its aim was to ban EU and US companies from conducting financial and economic operations with individuals and enterprises from the Crimea. These sanctions in particular, excluded Crimea from MasterCard, Visa, PayPal, Skrill, Payoneer payment systems, Google, Apple, HP, Dell services and systems for domain registration (ICANN and GoDaddy). The fourth stage included full-scale sanctions against certain sectors of the Russian economy. Russian banks with a share of state capital greater than 50% lost the right to receive credit for longer than 30 days, and could not place their new shares and bonds in the EU or the US. The export of dual-use products to Russia was limited, while the export of energy and military technology was banned. Finally, in December 2014 the US allowed the sanctions to be applied to any Russian individual or legal entity suspected of transferring arms to Syria, the CIS or Baltic states and Poland, and to punish any entities or individuals around the world that cooperate with Russia in sectors affected by the US sanctions.

quarter and capital investment forced the economists to cut forecasts which predicted that the narrowing consumer and investment demand would be satisfied. On the other hand, a lack of access to foreign capital and a sharp growth in borrowing costs on the Russian market, given the persistently high Central Bank's key rate, all hamper the prospects for output expansion in 'import substituting' products. The overall result of these factors was a fall in industrial output (which was especially steep in February, at 1.6%) and retail sales (by 6.7% in the first quarter compared to the same period during the previous year).

In the medium term, we can expect to see the consequences of a decrease in investment in the oil sector caused by a limited access to Western technology. In certain areas, they are of critical importance (for instance, in shale oil and gas extraction projects, where reliance on foreign companies is up to 93%). As a result, the sanctions will lead to a fall in oil production volume by 5–10%, which means a decrease of income for the federal budget. Another problem is obtaining licenses to export dual-use goods. The corresponding agencies in the EU and the USA are filled with work (the number of requests has increased by 40% since the sanctions were introduced), while the review periods often exceed one month. For the same reasons, even those companies willing to work in Russia find it hard to find financing. There is yet another issue, as Western deals with Russian companies which are not on the sanctions list have slowed down due to a lack of certainty as to whether they may be imminently included on the list. For our EU partners, the main negative factor is the fall in goods turnover with Russia by EUR 120 billion in 2014. The agricultural sector took the worst hit, as 43% of European exports were affected (EUR 5.1 billion). There are growing concerns related to the growth in unemployment, caused by a contraction in outlet markets. There is a risk of losing the Russian market to other countries, especially China.

The damage to the USA is less pronounced, as it accounts for just 2.7% of Russian exports and 5.6% of imports (for the EU, the numbers are 52.1% and 45.7% respectively), while exporting US agricultural products to Russia makes consists of only 1% of American farmers' total overseas supplies. In the meantime, certain American companies have sustained significant losses. For example, for ExxonMobil has invested in joint shelf projects with Rosneft and the losses are estimated to be greater than USD 1 billion. Visa and MasterCard were also affected (because of the introduction of the national payments system in Russia), as were Halliburton and National Oilwell Varco (due to the limitations on supplies of energy technology to Russia), the fishermen of Alaska and farmers of Washington, and Caterpillar (namely by losing a contract with Uralvagonzavod). The American companies have voiced concerns over possible caps on the imports of strategically important goods from Russia, such as rocket engines and titanium for Boeing, palladium for catalytic converters used in cars, steel, enriched uranium, fertilizers and fish.

Another potential threat to the west lies in the risk of Russia's problems spreading beyond its borders. According to Kirill Dmitriev, head of the Russian Direct Investment Fund, the damage to Europe from the economic crisis in Russia may be up to USD 300 billion. These losses will be smallerfor the US, as they account for just 12.6% of Russia's foreign borrowing (for the EU the number is 75.1%). It is also expected that the adverse sentiment will also affect Ukraine and Belarus, as well as the business climate in the European Union.

What are the prospects for import substitution, stimulated by the effect of the economic sanctions and coupled with the devaluation of the rouble? In order to answer this question, we ought to examine the economic prerequisites for successful import substitution. Traditionally, the fastest and most impressive results of substituting import are achieved when a considerable fall in imports (in 2014 it fell by 9.2%) is accompanied with a low utilization of output capacity and the workforce. In order to extend the effect of this substitution so that it can produce sustained results over the next 3–5 years, local companies must be able to invest in expanding output, technological modernization and increasing performance efficiency.

While analyzing the above factors for the Russian economy, it becomes clear that in the near term, the greatest opportunities for substituting import using existing production capacity are in the agricultural and metallurgical sectors, where the contribution of the import substituting processes to the growth of industrial output, given the best possible conditions, may amount to 5–6 percentage points per year. A more complicated situation can be seen in the machine manufacturing sector; despite the potential for the quantitative substitution of imported merchandize, the quality of Russian products often cannot be compared to their foreign counterparts, and given the intensive intra-sectoral ties (when one branch of machinery uses the products of another), this may lead to a slower overall pace of production growth.

The results of the scenario analysis on the prospects for import substitution can be summed up by the graphic below. As we can see, the main opportunities are concentrated within the 'big three' (agriculture, metallurgy and machine manufacturing). The potential of other sectors is more modest and requires all-round support. In general, when discussing import substitution as a key element of anti-sanctions strategy in the short- and medium-term, as well as the foundation of the long-term development of the Russian economy, proactive measures ought to be taken, to avoid self-isolation and total protectionism. As is commonly known, in a closed system the administrative resources become the main competitive advantage, and with aggressive media support it could be capable of overtaking most innovative projects and business solutions.

Russia's Countermeasures

In August 2014, Russia introduced restrictive measures in response to the third stage of the EU sanctions. A decree from the President of the Russian Federation 'On the application of certain special economic measures to ensure the security of the Russian Federation' stated that, within one year of the decree coming into force, foreign economic operations which imported certain agricultural products, raw materials and foodstuffs into Russian territory, but which had originated in those states that decided to impose economic sanctions against Russian legal entities and (or) individuals or joined such decision, would be prohibited or limited. The Russian government issued a decree 'On ways to implement the Presidential executive order on adopting special economic measures to ensure Russia's security.' The practical measures which implemented the Russian sanctions are stated in the Order of the Russian Federal Customs Service, 'On ways to implement of the decree of the Russian Federation's President, dated August 6, 2014, No. 560.'

Some proposals for retaliation measures included restrictions on repayment of (corporate) debt to the West, the seizure or arrest of foreign property to compensate those affected by the sanctions, limiting access to space technology and the storage of radioactive waste in Russia, a ban on returning already shipped equipment, the diversification of oil tariffs and introducing an 100% down payment for natural gas supplied to Europe. None of these measures gained support, which highlights Russia's choice in favour of sustained regulation. However, this does not mean that there is a willingness to compromise in order to lift the EU and the US's sanctions as soon as possible.

Text by PwC

Business after the Crisis

PwC Russia's Managing Partner Igor Lotakov comments on the findings of the Annual Global CEO Survey. CEOs spoke about current opportunities for business development.

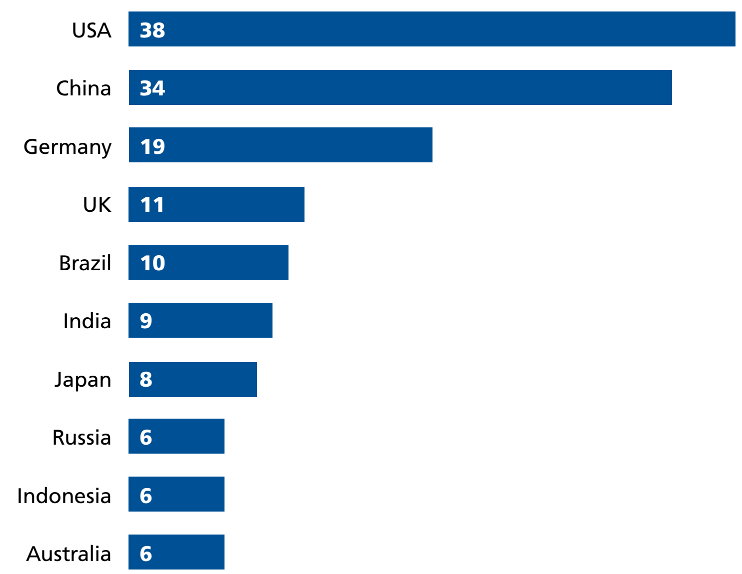
The data from the latest global CEO review and survey of directors of major international companies, including ones operating in Russia, are quite interesting. The most recent survey shows that geopolitical tension has been shaping the mood and expectations of the respondents. Seventy-two per cent of CEOs spoke of geopolitical uncertainty as a potential risk, whereas, back in 2014, the geopolitical factor was not mentioned at all.

Only 37% of the respondents (and only 14% of Russian CEOs) believe that global economic growth will improve over the next 12 months. Heads of companies from the Asia-Pacific Region are quite optimistic about growth prospects. Interestingly, only 16% of CEOs from Central and Eastern Europe share their optimism.

Many CEOs admit they have no idea what their profitability will look like in five years' time. Yet, when commenting on forecasts for 2015, 64% of CEOs expect at least marginal profits. At the same time, most of the respondents – 84% – expect revenues to grow during the next 12 months. Forty-nine per cent of the questioned CEOs think that the main objective now is to adapt to the new reality in order to survive. Thirty-four per cent of CEOs have a more positive vision and will try not to miss the chance offered by the recession. Consequently, it is becoming increasingly important to develop an effective strategy: 83% of CEOs already revised their strategies in 2014 or are doing so now.

Ten Countries Significant for Developing Business

Question: which three countries, aside from the one in which your company is based, do you think are the most important in terms of the growth of your business during the next 12 months?



Respondents from all countries: 1,322

Russia has retained its place on the list of countries that global CEOs believe to be important for doing business; even so, they remain rather cautious about the Russian market because of the high inflation and slow growth, as well as the West-led sanctions. According to 71% of CEOs, the rouble depreciation is having a seriously detrimental (26%) or just negative (45%) effect on their companies' business. Only 8% believe this influence is positive. The depreciation of the rouble has created new opportunities for metal and mining companies (most of them are exporters) and the domestic automotive industry (prices of foreign-made cars have almost doubled, making them too expensive for Russian consumers). Yet many of these companies need to pay debts and operating costs in foreign exchange, which might fully or partially neutralize the positive effect.
Possibly the most serious consequence of the anti-Russian sanctions and second most significant factor forcing CEOs to think about making significant changes to their strategies is limited access to foreign capital markets (mentioned by 58% of the respondents).

Source: PwC

Now that the geopolitical situation is shaping the development of national economies, business will undergo serious tests. The sanctions, depreciation of the national currency, fall in global oil prices and restricted access to capital cause 'turbulence' and make it hard to predict which development path the Russian economy will follow.
Nevertheless the overall unfavourable geopolitical situation (specifically, the sanctions) offers unique opportunities for local import-substituting companies and whole sectors of the national economy. Agriculture is a vivid example: producers of meat, vegetables and other foods are benefiting from the import restrictions and hikes in prices on imported foods resulting from the falling rouble. Yet this positive effect might be cancelled out by the weaker rouble, because producers might incur costs denominated in foreign exchange. Interestingly, more than a quarter of CEOs have considered business localization projects lately.

Igor Lotakov,
PwC Russia's Managing Partner

The challenges that Russian business is facing now encourage leaders of major companies to seek new ways to increase efficiency by cutting costs and using innovative solutions. According to the respondents, many companies are already taking anti-crisis measures (40%). Of the total number of CEOs, 38% have been forced to suspend major investment projects or give up on them altogether. At the same time, companies are seeking maximum adaptation to the current market environment and are making efforts to diversify their products and services (38%), introduce innovations (32%) and develop business in related sectors (32%).

When it comes to the answers given by CEOs of major international companies, amid the geopolitical uncertainty and slower economic expansion in 2015, most of them – 71% – are planning to cut costs. In Russia, 75% of CEOs are planning to take cost-cutting steps. Fifty-one per cent of CEOs globally (and 24% of those in Russia) said they were planning new strategic alliances or joint ventures. Of all the respondents, 29% internationally (15% in Russia) mentioned M&A plans at the national level and 27% (5%) spoke about international M&A plans. Thirty-one per cent of the respondents globally plan actively to outsource business processes and functions (22% in Russia).

More than a third of Russian CEOs (36%) confirmed that they had revised their business geography priorities. Most of the respondents (55%) tend to expand operations on the domestic market, whereas 28% look to increase their presence in Asia. Commenting on the factors making companies revise their plans, only 23% of the respondents mentioned the sanctions.

A third of the CEOs (38%) of the world's biggest companies believe their most important market is the United States, where GDP is currently 7% above the pre-crisis level.

China is the second most coveted market for investment and development, mentioned by 34% of the respondents. Growth prospects in major European economies, specifically in Germany (19%) and the UK (11%), are considered more likely than in India (9%), Brazil (10%) and Russia (7%).

Strategic planning remains the top priority for Russian CEOs for the fourth year in a row – 85% of the respondents would like to spend more time on developing strategies (62% of CEOs globally mentioned the same priority). The second most relevant issue this year is anti-crisis management: the share of the respondents wishing to focus more on this increased from 26% in 2012 to 81% in 2015. The figures speak for themselves.

The title of the Russian CEO survey – 'Through the prism of the crisis' – calls for heads of companies to look to the future. Even when companies face challenges, their boards should focus on long-term plans and, from this perspective, Russia remains a country of incredible opportunities.

Text by TASS

Between Business,
Government and Society

Sergey Mikhailov, General Director of TASS, prepared a survey for The SPIEF Review on the role played by the media as a channel for building effective communications between businesses, government and society.

"In a sense, man first spoke – and wrote – in response to an economic want: a desire for food, drink, or warmth. As his needs became more complex, so did his communications; all kinds of written commercial messages resulted," US scholar David Forsyth says in his book on the history of the business press in America, going back to the caveman era. Following in Forsyth's footsteps, many scholars have found direct links between ancient documents and the writings that can already be seen as the beginnings of the business press – so-called English price-currents of the 17th century and, later, the American editions modelled on them.

As early as from the mid-16th century, two types of business news infrastructure began to develop in European cities that were centres of capital concentration and business activity: private news networks run by influential merchants and businessmen, and public editions providing economic information. Both types of these earliest business editions reported the most important economic events, giving only general information about what happened, with very little attempt to analyze and interpret facts. In the 17th century, Amsterdam was the economic centre of Europe, while Venice, Antwerp and Geneva lost their importance. And it was in Amsterdam that the system of collecting, processing and disseminating information became one of the cornerstones of the market – just as before that it was in Venice and Florence, and after that in the Anglo-Saxon economic centres.

In the latter half of the 18th century and first half of the 19th century, the system of business information developed and transformed, and new types of edition arose. This process took place in many countries and, as a result, a quite harmonious structure of business editions began to be shaped towards the beginning of the 19th century. Throughout the 19th and 20th centuries, it developed particularly rapidly in the United States.

In Russia, the first business publications appeared in the second half of the 18th century, in the form of popular science and literary journals containing materials about economics and trade. A new era for the Russian press came with the reign of Alexander II, when many business magazines were established to protect the needs and wants of the country's emerging commercial and industrial bourgeoisie, and to promote the construction of the railways, and the manufacturing and banking business.

At the end of the 19th century, Russia saw an industrial boom. It was then that a type of a national business edition took shape, serving the interests of businesses, the government elite and professional communities; there were several private telegraph agencies, of which the largest was the Russian Telegraph Agency. In 1902, Finance Minister Sergey Witte offered to establish Russia's first Commercial Telegraph Agency based on the Commercial and Industrial Newspaper. The new institution was to 'satisfy the needs of commerce, industry, lending and agriculture", or, as we would say today, to boost Russia's investment appeal.

A harmonious structure of **business editions** was shaped towards the beginning of the **19th century**

In 1902, Finance Minister Sergey Witte offered to establish Russia's first Commercial Telegraph Agency based on the Commercial and Industrial Newspaper. The idea was supported by Emperor Nicholas II. Later, the Commercial Telegraph Agency was to become the TASS news agency.

The idea was supported by Emperor Nicholas II. Later, the Commercial Telegraph Agency would become the TASS news agency.

Over the past few decades, business in Russia has come to the fore once again. The mass communications systems, including the media, have acquired great importance for the function and development of business. Over the past 25 years, the Russian media have changed considerably as the planned economy has given way to market relations. In particular, this led to the return of the business press to the Russian media market. It came to play a vital role for the business community, serving both as a source of important information for a more successful and profitable business and as a way to transmit information about one's company, goods and services to consumers, colleagues and rivals.

During this time, the interdependence between journalism and business in Russia became so significant that the business press began to shape and introduce standards of high-quality journalism in the new Russia. In the meantime, the global media industry has also undergone important changes, with the so-called new media gathering momentum, social networks playing an increasing role in the creation and dissemination of information, and with new ways of communicating directly between the authorities and business becoming ever more popular. In this situation, the gradual decline in the traditional media has come to be seen by many as something inevitable. And it is during debates over strategies for business communications that this issue becomes particularly accentuated. Among other things, concerns have been voiced that cooperation between business and the government is largely conducted through GR instruments, while online channels, especially social networks, are increasingly seen as a priority in communications between business and the public.

While acknowledging the need for new communications channels, we may say with confidence that the media, at least in Russia, continue to play a key role in the 'triangle' of relations between business, government and society, both as the 'producer' of information content and as a channel for building effective communications. This has been confirmed by many opinion polls. For instance, according to the Levada Center, 75% of Russians obtain their information exclusively from the media, whereas only 24% use social networks as a source of information. According to an opinion poll carried out by the VCIOM agency in March 2015, 64% of Russians generally approve the media's performance and 62% trust government-owned media more than private ones. This is no surprise: in today's Russia, government support for the media is often seen as a guarantee that the audience will receive high-quality journalism in its initial, higher meaning. At the same time, the media remain the key supplier of information and news content on the Internet, and this is subsequently disseminated through social media. This is not a particularly Russian situation, but rather reflects a global trend, as is also confirmed by the fact that the new media today are trying to achieve maximum integration with the traditional media as key content suppliers. Facebook, for instance, has recently approached the world's leading media groups proposing to publish their materials in full using its own platform. Facebook managers hope to attract the content of the largest US media, offering them the opportunity to post their materials on Facebook pages. However, despite the temptation to boost their audience, several leading media groups have already declined the proposal, saying that they deemed it important to control advertising in their materials and that they were not eager to strike a deal with the social network. Another online giant, Google, ignoring complaints from some publishers over its practice of posting free news content on the Internet, plans to invest some USD 160 million in new digital projects to boost the promotion of advertising and develop fresh news supplements for a number of Europe's news publishers in order to help them earn more money via the Internet.

The company's new project has already received support from the Financial Times, the Guardian, El País and Die Zeit. Signing these of such deals between the traditional and new media appears to be almost inevitable in the short term, confirming that the new media may still turn to the well established, traditional media for reliable content. In addition, it is the traditional media, with their reputation as reliable suppliers of information, which will continue to be one of the most required channels for building effective communications between businesses, the government and society.

64% of Russians approve **performance of the media**

Text by KPMG

The Asian Manoeuvre

© SHUTTERSTOCK.COM

Consultants from KPMG in Russia and other CIS countries have analyzed the potential for Russia-Asia economic cooperation and have produced a forecast outlining export activity between the Russian Federation and Asian countries in the near future.

Eastern Drivers

The turn towards Asia could have been observed long ago, yet the current geopolitical pattern has made it more obvious that the Asian markets will become key growth drivers for the Russian economy.

Since the early 2000s, the Cumulative Aggregate Gross Revenue (CAGR) from Russian exports to Asia has grown by more than 17%, which is a lot higher than the growth in export supplies to other markets. Moreover, during the crisis of 2008, exports to Asia appeared to be more resilient than those to other countries, falling by 20% compared to 37%.

Exports to Asia had fully recovered by 2010 and exceeded the level reported in 2008, whereas for other regions, the pre-crisis exports level was reached as late as 2011.

At the same time, Russia accounts for up to 2% of total import supplies to Asia, the same as tiny Switzerland and a lot less than the Middle East, the United States, Germany and Australia. Energy products make up more than 70% of Russian exports to Asian markets.

Oil exports to Asia totalled USD 676 billion in 2013, although Russia met only 6% of Asia's oil requirements.

Even so, the capacity for further growth in exports of traditional resources is limited by both internal and external factors.

The former include the need for substantial infrastructure investments: oil and gas mains, roads, ports and power lines.

The latter depends on competition with the Middle East, Australia and Indonesia. The economic and social processes taking place in Asia also call for significant changes in the structure of Russian exports.

More than Oil

It is ultimate consumption that will be the main driver of economic growth in Asian economies and, by 2030, the structure of consumption in the region will shift from raw materials and equipment to consumer goods, food, services, and infrastructure, meaning that non-resource exporters will be the most important partners for Asian economies.

Unfortunately, the Russian economy produces virtually no competitive goods for the Asian market and has limited technologies capable of competing in Asia.

Yet this fact should not be regarded as an insurmountable obstacle to exploiting the vast potential for trade and investment relations with Asia, but as an incentive requiring a package of arrangements to achieve the intended effect.

The first and most difficult challenge is to make a crucial competitive breakthrough and improve the efficiency of Russian companies, which can only be done by fostering

CAGR from Russian exports to Asia **has grown** by more than **17%**

Major changes associated with global trends will completely reshape the world by 2030. The economic centre will shift from the northern to the southern hemisphere, the role of developing nations will increase, and Asia will have a special place in the new economic landscape. According to forecasts, Asia's share in global export supplies will reach 34.6%. Asia will become the world leader in terms of population, with fast growing consumption (up to 5–6% annually); India and China will account for 35% of the global population and 25% of the world's GDP by 2030. Given these figures, it will be very hard for Russia to develop successfully without cooperating with the Asian region. The traditional growth model for Asian economies has been built on significant investments in fixed assets in order to create manufacturing facilities for producing export products; in recent years, however, a long-term trend has been reported towards a drop in the contribution of these investments to Asia's combined GDP. The largest Asian economies are in the process of changing from the investment model for GDP growth towards one based on internal consumption in the context of considerable increases in personal incomes by 2018, household incomes will have increased by an average of 160% from the 1999 level.

Oleg Goshchansky,
Chairman and Managing Partner,
KPMG in Russia and the CIS

competition in the economy, including by promoting small and medium-sized businesses.

Given the role of companies with a state shareholding in the Russian economy and in the development of cooperation with Asia, introduction of efficiency targets for leaders of state-run companies is a very important initiative as well.

Russia also needs to close the gap with the leading partners in Asian economies when it comes to think tanks specializing in Asian studies and forecasts.

It is important to restore the cross-cultural school and put together a group of experts in Asian economies and regulatory frameworks, as well as the specifics of doing business in Asia, on local stock markets, etc.

Scientific and technical cooperation must be built on international best practices, including the experience of the United States and the European Union, which emphasize these areas for cooperation by making them commercially viable.

Technology cooperation should be pursued by creating a system of concerns including companies from selected industries that are deemed capable of becoming attractive partners for Asian innovation and technology leaders.

Despite the current challenges we will need to address, Russia has an undeniable major advantage that makes several sectors of the national economy very attractive to Asian partners: the short logistics and transportation distance. Combined with vast uncultivated areas that can be used in agriculture in the Far East and Eastern Siberia, this factor creates substantial competitive advantages for our agribusiness: meat farming and crop production.

As of today, some projects are under way to enhance the export potential of the agricultural sector of Eastern Siberia and the Far East. One of the most dynamic projects in this area is development of farmland in the Jewish Autonomous Region, envisaging involvement of 22 agricultural companies from China's Heilongjiang.

Siberian and Far Eastern clusters may also be used for chemical projects – their main advantage being proximity to sources of raw materials, gas and oil deposits, and sales markets. The short logistics distance also creates favourable conditions for Russian wood-processing companies in those regions, which can pursue joint projects with leading Asian woodworking and construction companies.

Construction of the Amazar pulp and paper mill is one of the biggest projects currently under way and it will enable Russia to increase its exports of wood products significantly.

Logistics projects: promotion of the Northern Sea Route, reconstruction of the Trans-Siberian Railway and the Baikal-Amur Mainline, modernization and expansion of the Far Eastern port area, also hold great promise not only as far as Russia's relations with Asia are concerned, but also for improving the country's regional infrastructure.

Over the next few decades, development of this and many other sectors of the Russian economy will inevitably depend on its partnership with Asia.

Yet it is up to us whether our country enjoys mutually beneficial cooperation with Asia on an equal footing or becomes an involuntary supplier of raw materials.

Boosting Internal Effectiveness

It is important to retain our key niches (resources, peaceful uses of nuclear energy, and the military-industrial complex) and break through into new areas.

A key to success is improvement of the internal effectiveness of the national economy with a view to making high quality, value-added products that will be in demand on both domestic and international markets, and elaboration of cooperation strategies for the Asian region with specific effectiveness indicators, responsible decision makers and implementation deadlines.

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As of today, some projects are under way to enhance the export potential of the agricultural sector of Eastern Siberia and the Far East

Text by EY

The Silk Road of the 21st Century

Joe Watt, EY Chairman of the Management Committee and Managing Partner for the CIS, comments on the results of a report on Chinese outward foreign direct investment, addressing its new industrial shift and geographical focus.

Over the past decade, Chinese investors have grown increasingly active on the global market. Thanks to government support and increasing domestic demand stemming from an expanding middle class, China is on its way to going from the world's largest manufacturer to its biggest investor.

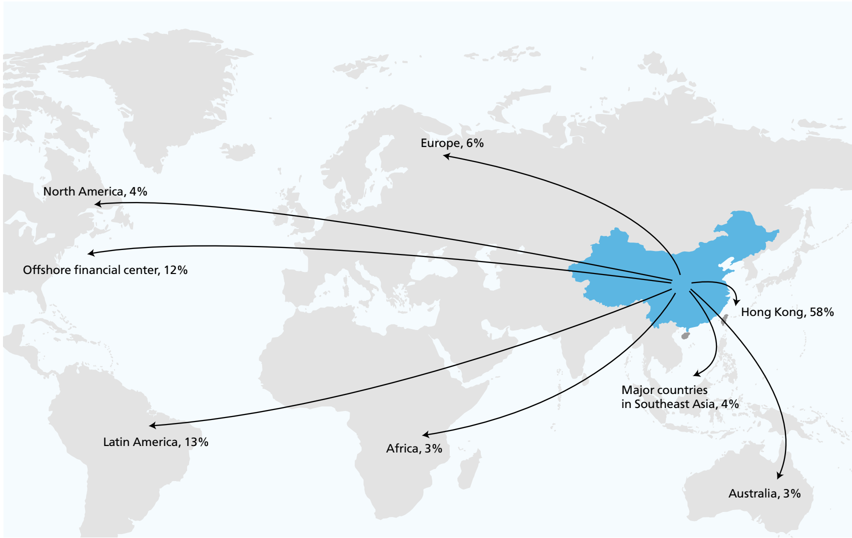
For Russia, strengthening ties with its neighbor to the east has always been a key priority in terms of foreign policy and the economy, and it's clear that China remains important to it as a strategic investor.

Successful companies are those that follow the Know Your Client rule and place the required surveys at the top of their agendas. This is also true for effective communication with an investor, especially when that investor is a nation – in order to attract one, you have to understand how their investments are structured, what sectors are the most lucrative, and what factors have an influence on the deal.

EY's new survey Riding the Silk Road: China sees outbound investments boom helps answer many questions and clarifies what Russia can offer to Chinese investors in the context of recent trends in the Chinese economy. In addition, it takes a look at what working with Chinese investors might entail.

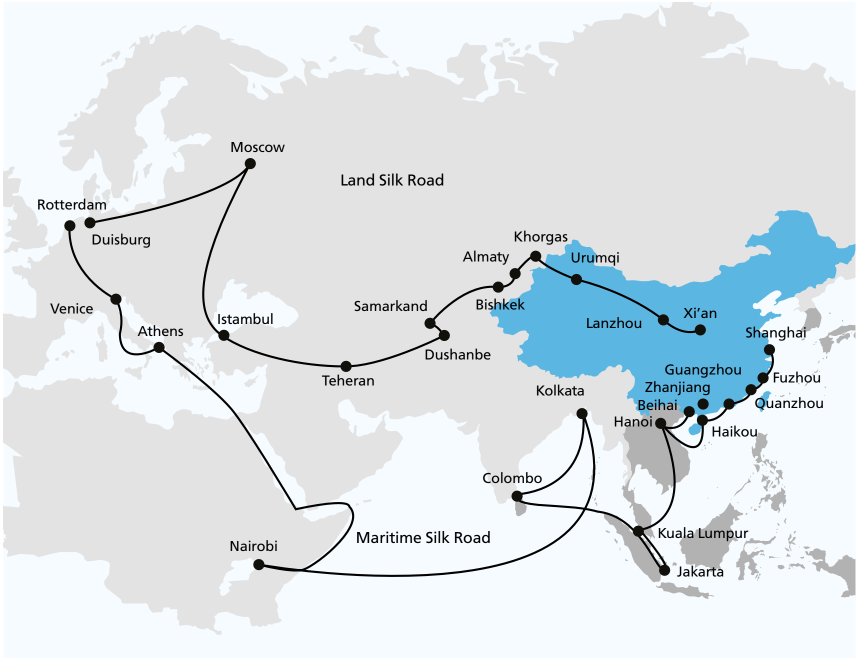
China is becoming more of a consumer economy as its development emphasis shifts from 'Made in China' to 'Made for China'. This has opened up new opportunities for cooperation with neighboring

China's outward FDI footprint



Source: National Bureau of Statistics

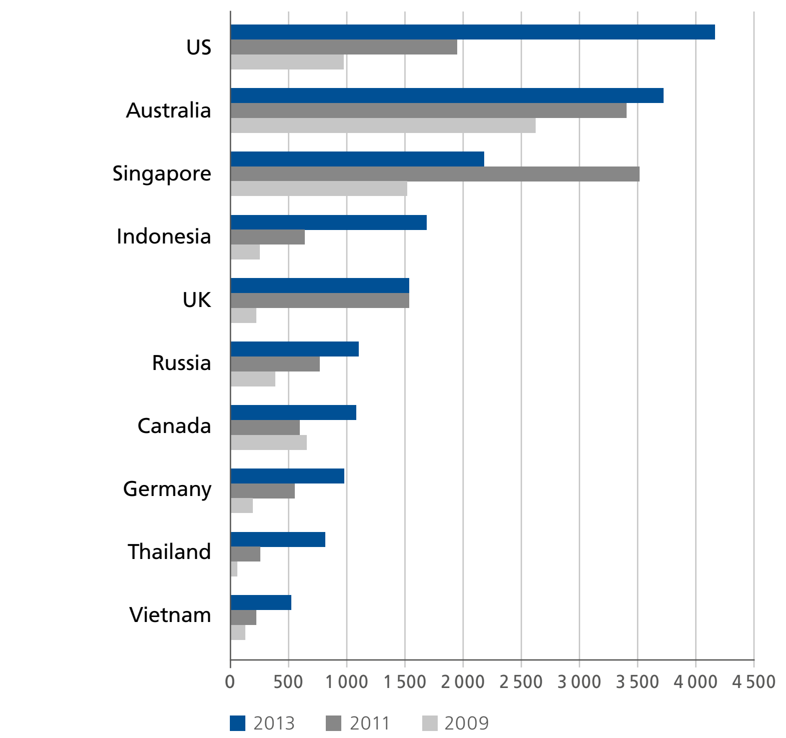
The Silk Road



Source: Xinhua news agency

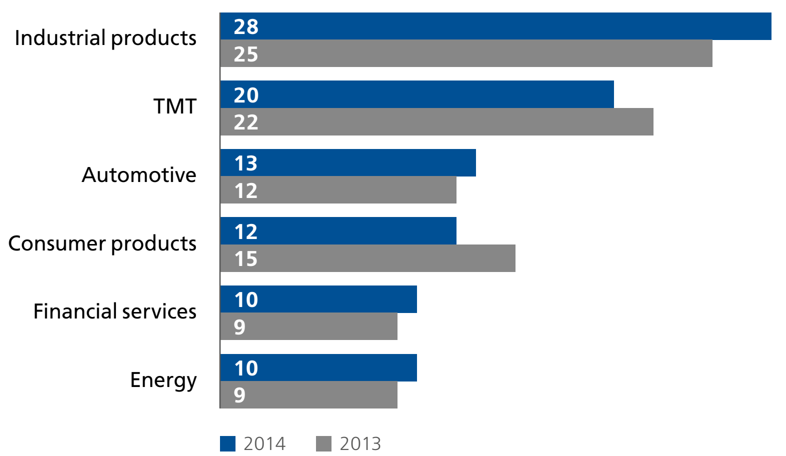
Information by EY

Top 10 destinations of China's outward FDI (USD million)



Source: Ministry of Commerce, data excludes Hong Kong, the Cayman Islands and the Virgin Islands

Volume of Chinese M&A transactions in Europe (by sector) in 2014 and 2013



Source: EY

countries, where Chinese companies are investing not only to expand their access to foreign markets and resources, but also to bring in products and services to meet the growing domestic demand.

The 'One Belt, One Road' strategy will encourage China's advanced industries and their overcapacity to move into neighboring countries along the new Silk Road.

Although Chinese investments are becoming increasingly diverse in terms of geography, Russia plays a huge role as part of that strategy. In 2014, Russia made the list of top 10 priority destinations for Chinese investors, ranking sixth in amount of outbound Chinese investment. This amount has grown steadily since 2009.

As part of the 'One Belt, One Road' strategy, in January 2015, China proposed the construction of a 7,000km high-speed rail link from Beijing to Moscow that would pass through Kazakhstan. The project would require an investment of RMB 1.5 trillion.

China's outward investment has clearly become more sophisticated as companies shift their focus from seeking natural resources toward creating a global strategic presence. Investment activities have recently expanded into the technology, media and telecommunication (TMT), real estate, finance, agribusiness, and health care sectors. The European M&A market also shows clear diversification: in 2014, Chinese investors closed only 10 deals in the power and mining industries but 28 deals in the industrial products sector.

At the same time, privately owned enterprises (POEs) have started to invest more actively in international markets, but they still experience many difficulties in being able to 'go out,' especially compared to state-owned enterprises (SOEs). The chief reason for this is a lack of financing: POEs are rarely supported by China's policy banks, and commercial banks prefer large SOEs. POEs also have problems with strategy and management. For example, many of them lack long-term strategy development and risk awareness, an understanding of the investment environment and cultures of host countries, and experience with overseas investment.

Though Chinese investors have made progress in expanding to major global markets, they need to be aware of the difficulties of 'going out' – namely, increasing geopolitical risks, 'neocolonialism,' turbulent global markets, and fierce competition. Learning how to control and navigate through risk is vital to successful overseas investment.

Considering the shift in industry focus of Chinese foreign direct investment, Chinese companies need to adopt the more holistic approach used by leading international companies on the M&A markets in new sectors like technology.

Chinese acquirers have continued to view a technology M&A transaction purely as an asset acquisition (a technology with intellectual property), but the core value of any technology company actually lies in its workforce – from management and R&D to production and sales.

Having a sensible human resource strategy is important for Chinese investors looking to maintain their attractiveness when competing with other buyers for a limited target pool.

In the coming years, a new wave of internationalization will be unveiled and China's outward FDI will reshape the global economic landscape, as it is expected to grow more than 10% and continue to surpass the amount of foreign investment into China, leading it to eventually become a capital-exporting country.

Russia may well expect the 'One Belt, One Road' strategy to boost its investment cooperation with China in a number of areas, primarily in the development of infrastructure. Because attracting investment is in Russia's interest, it should work hard to create a good investment climate, minimize administrative barriers, and reduce bureaucracy.

Over the next 5 years, China will embark on a new wave of foreign outward investment driven by its accelerated economic transformation and gradual policy liberalization. The structure of this investment has also begun to change: we have already witnessed a shift in focus to upstream services and industries in order to boost M&As in the high-tech and agribusiness industries. We are also seeing a change in investment geography, as Chinese investment destinations are being diversified – extending from Asian, African and Latin American countries to developed economies in Europe and America – which appears to be to optimize asset allocation and to diversify risk across the globe. The Chinese consumer market is growing, making it necessary to not only produce in China, but for China, and leading Chinese companies, to buy assets, including technology and resources, in developed economies and to diversify the location of production to meet that domestic demand. It's interesting that the new Chinese policy has enabled privately owned enterprises to grow and embark on an investment journey by either competing with Chinese state enterprises or using joint efforts via public-private partnerships. Considering these powerful trends, we can expect China's outward FDI to reshape the global economic landscape.

Joe Watt,
EY Chairman of the Management Committee and Managing Partner for the CIS

Text by non-profit partnership 'Industry round table for cooperation with the European Union'

EU-EEU:

New Relations Format

© VALERY SHARIFULIN/TASS

Experts from the non-profit partnership 'Industry round table for cooperation with the European Union' prepared analytical material for The SPIEF Review on the role that the Eurasian Economic Union plays in EU-Russia relations

EEU: European Experience and Personal Success

The Eurasian Economic Union, which is made up of Russia, Kazakhstan, Belarus and Armenia has been functioning since January 1, 2015, through the Customs Union and the Common Economic Space. It has become the most successful integrative entity in the post-Soviet space, due to its deepening (from customs union to the economic union) and expanding integration, with Kyrgyzstan as a prospective member. The success of the integrative entity is largely due to a replication of the European experience (including giving up part of its sovereignty in favour of common regulations, institutions and the joint process of defining the stages of integration) and accounting for and overcoming its mistakes (e.g. introducing a common currency without the proper macroeconomic convergence).

However, the two entities do differ from one another in various ways. For Eurasian integration, the volume of mutual trade between the member states is negligible; merely USD 52.8 billion for the 11 months of 2014, which is still falling. It is worth noting that in 2014, Russian trade with its partners from Eurasian integration fell less than its trade with the EU member states (8.6% against 9.7%), but the decrease was greater than the contraction of the total foreign trade volume (7%). In 2014, the share of mutual trade in the EEU's total trade volume was slightly higher than 6% (for comparison, in the EU the corresponding value is greater than 60%). That said, the mutual trade is dominated by minerals, metals and metal appliances (more than half of the total mutual trade volume in 2014). Machinery, equipment and transportation vehicles made up 14.3%. Trade within the EEU is of the greatest importance to Belarus (29.8% of the total trade), while for Kazakhstan and Russia the shares are 5% and 4.5% respectively. Belarus also plays a considerable role in exporting machinery, equipment and transportation vehicles within the EEU (around 25%). It ought to be mentioned that, given the characteristics of historical development and the economies of the EEU countries and despite the abolition of tariffs on mutual trade, the level of non-tariff barriers in the EEU remains relatively high. Solving this problem will open the door for greater integration within the EEU.

'Cold' Competition

The EU's initially reacted negatively to a proposal to establish contacts with the Customs Union and the Common Economic Space. This was a complete departure from the traditional EU approach, which involves endorsing integrative associations around the globe and a willingness to share its experience in cooperation. As a subject of international law, the European Union interacts with other international organizations and participates in their activities as a member or as an observer, and establishes 'appropriate forms of cooperation' with a number of organizations, including the UN, its institutions and specialized agencies; the OSCE, the Council of Europe and the OECD.

For Eurasian integration, the volume of mutual trade between the member states is negligible; merely **$52.8** billion for **11 months of 2014**

In 2014, the share of mutual trade in the EEU's total trade volume was slightly higher than **6%**

The EU maintains 'appropriate relationships' with other international organizations, and has the opportunity to establish partnerships with universal international organizations (see articles 220 and 221 of the Treaty on the Functioning of the European Union).

Unfortunately, these opportunities were not taken by organizations dedicated to the post-Soviet space. The EU never recognized the Commonwealth of Independent States, and never showed any interest in the Union State of Russia and Belarus from the Eurasian Economic Community. The EU has no diplomatic ties with any of the international intergovernmental organizations in the post-Soviet space. We can observe a repetition of the Cold War situation, when the members of the Council for Mutual Economic Assistance and the European Economic Community ignored each other's political decisions until 1988, while both organizations were in desperate need of legal guarantees for cooperation on mutual trade.

The current situation bears signs of a burdensome 'cold' confrontation and competition, with both sides offering the post-USSR states essentially the same thing, i.e. integration. Whilst Brussels promotes the Eastern Partnership, Moscow advocates the Eurasian Economic Union. Here it is important to mention that the EEU focuses on full membership, while the EU is willing to offer cooperation according to the so-called 'neighbourhood' model, so-called is an unequal partnership even from a formal perspective. For a while, the two projects were seen as mutually exclusive, serving as one of many reasons for the Ukrainian conflict.

Currently, there is no consensus within the EU on how to build relations with the EEU. Therefore, there has been no clear reaction to the suggestions for establishing formal contacts between the EU and the Eurasian organization, which were made by Vladimir Putin in February 2014 and repeated by Russian diplomats after the EEU was officially established at the beginning of 2015.

However, the Ukraine crisis led to a correction in the EU position on Eurasian integration. On the one hand, it became clear that a long-term solution to the conflict in Ukraine is impossible without Russia and without taking into account its strategy on the post-Soviet space, a facet of which is Eurasian integration. On the other, the crisis and the sanctions imposed on Russia decreased the frequency of official and expert contacts between Moscow and Brussels. In this situation, the start of an EU-EEU dialogue becomes a compensatory measure, a way of maintaining contacts between the two largest partners in Europe.

Numerous signals from Brussels and other European capitals (such as the statement of the European Parliament on September 18, 2014, which urged the European Commission to look into cooperating with the EEU, the call of the German government to establish relations with the EEU and initiate trade negotiations with it, the appearance of business associations in Italy in Greece to promote contacts with Eurasian organizations, etc.) indicate that EU-EEU contacts will eventually develop. According to Gunnar Wiegand, the European External Action Service (EEAS) Director for Russia, Eastern Partnership, Central Asia, Regional Cooperation and OSCE, 'the Eastern Partnership and the Customs Union/Eurasian Union are perfectly able to coexist without breaking the strong traditional trade and economic ties with the EU and Russia.'

A New Model for Mutual Cooperation

The opportunities for the qualitative development of economic ties between the EU and the EEU depend on the general context of relations between Russia and the European Union, on the situation in Ukraine. They are also constrained by the fact that Belarus and Kazakhstan are not members of the WTO. Moreover, engaging Eurasian organizations in the EU-Russia negotiations process has so far been tactical rather than strategic.

Formally, Russia has suggested creating a free trade area made up of both the EU and the EEU, which is generally in line with the EU's actions to liberalize global trade. The EU de facto proposes two models of trade liberalization. Model One (the major league, or exclusive club), is designed for countries enjoying deep mutual trust, and was used in preparation of the agreement between the EU and South Korea. It is currently being used for negotiations with the United States. It implies lowering non-tariff barriers by mutual recognition of standards. This allows the parties to grant each other access to the markets for state orders and services, including financial ones, to ensure better protection of intellectual property rights. This model does not involve the EU forcing its partners to accept its norms.

Model Two (paternalistic) is used for neighbouring states and implies, by contrast, the acceptance by the partners of a large portion of the EU legislation (the agreement with Ukraine, for instance, contains 300–400 EU directives), and consequently, convergence with its norms and standards. This model was intended for Russia for a long time, but is now unacceptable for the country whose main aim in foreign policy is equality with the EU.

It is quite clear that when discussing the prospects for cohesion of the Russian and EU economies, an entirely new model of future interaction ought to be suggested. This model should take into account not only the history of relations and the economic power of both two parties, but also the increasing role of new integrative associations, creating stable global economic ties and strengthening the system of international security. Implementing a project like this would be impossible without the participation of representatives from all interested parties, including diplomats, politicians, scientific experts, businessmen and media professionals.

Trade within the EEU is of the greatest importance to Belarus: **29.8%** of the total trade

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Prepared by Anna Polunina

Interest is Back

SPIEF Review discusses prospects for developing relationships between Latin American markets and the EEU with Sergey Brilev, Founding President of the Bering-Bellingshausen Institute for the Americas.

Mr. Brilev, as the founder of the Bering-Bellingshausen Institute for the Americas, you put in efforts to promote collaboration between Russia and Latin America. What do you think facilitates and impedes this process at the current phase?

You have to fly at least once from Moscow to, say, Havana (not to mention Buenos Aires or Santiago) to understand the enormous distance between Russia and Latin America. The times when Nikita Khrushchev could easily send the Baltic fleet to Latin America (as well as state commercial ships) are long gone. Therefore, we should not overestimate anything. The 'unmobilizing' Russia and Latin America are too far from each other in today's globalized world. The distance will always remain an obstacle to routine exchanges – of visits, not ideas. On the other hand, last year Latin America hosted the session 'Globalization and New Powerhouses' of the constituent assembly of our Bering-Bellingshausen Institute, where I acted as the moderator. The number of delegates representing the business, banking and the academic communities, as well as the media was truly impressive. Some 40% of conference participants still keep in touch with our organization, which is quite good when you take what I said earlier into account.

Our institute's model – making money for humanitarian projects by preparing business matrices – shows that we have a lot to offer each other. Naturally, the sanctions and rouble depreciation have also generated additional interest – for importers and exporters, respectively.

Do you think some commentators have a point when they say that pressure from sanctions became the main factor that brought the EEU and Mercosur closer?

Yes and no. Mercosur is an association of countries where governments traditionally influence the economy; therefore, infrastructure and economic projects can be launched there wherever Russia has something to offer and complement Latin American expertise and production practices. Consider the results of the latest meeting between the presidents of Russia and Argentina, Vladimir Putin and Cristina Fernández de Kirchner. Incidentally, when it comes to appeals to switch to national currencies in bilateral trade, there is no 'making the best of a bad bargain' for Mercosur. Uruguay made the Soviet Union the same offer back in 1935. Our recent report provides evidence that one-fifth of trade within Mercosur (between Argentina and Brazil) is carried out in national currencies. To tell you the truth, I have some reservations about settlements in national currencies, but I must admit that this model creates additional guarantees that jobs will be preserved even during severe exchange rate fluctuations, which are typical of both Argentina and Brazil.

What are the main possibilities for taking advantage of investment and technical cooperation potential between Russia and Latin America?

The most obvious sectors are nuclear power, water power, arms production, food processing, pharmaceuticals, and cosmetics. I believe we will see lots of exciting things in the banking sector as well.

What opportunities for social and cultural cooperation are created by the establishment of partnership relations between the EEU and Mercosur?

In 2014–2015, our organization put together a series of very successful events celebrating the 70th anniversary of Victory Day, which featured non-commercial screenings of the movie Stalingrad. It was shown to various audiences and in various locations: in the General Staff of the armed forces of Honduras in Tegucigalpa; in the Belgrano hall of Argentina's Foreign Ministry in Buenos Aires; in the concert hall of South America's best-known Conrad Casino in Punta del Este, Uruguay; at the movie centre of the presidential La Moneda Palace in Santiago, Chile; and even in Antarctica (in the area where Russian, Uruguayan, and Chilean polar explorers work together). I wonder why Stalingrad was never released in those countries, because the local audiences appeared to be very much interested in the movie. This is one example of why Latin America should not be brushed aside. Incidentally, well-packed cultural products are another example of something that can potentially exported from Russia to that region.

Text by the Ibero-American Studies Centre
of St. Petersburg State University

MERCOSUR
and New Horizons

The Ibero-American Studies Centre of St. Petersburg State University has researched the prospects for cooperation between the EEU and Mercosur. The author Victor Heifetz, Director of the Centre, with the assistance of his colleagues and specialists from the Uralsib company analysed ways in which the two institutions could come together to build an effective partnership.

Commenting on foreign policy cooperation, Brazilian economist Ariel Noyola Rodriguez noted that the strategic relationships between the Eurasian Economic Union and MERCOSUR provide a unique opportunity to become an example of a successful solution amid the worsening economic crisis, thus making a decisive contribution to the weakening hegemony of the US dollar.

The two expanding integration blocs – the Eurasian Economic Union (EEU) and Mercosur – cover a total area of 33 million square kilometres, with a population of 450 million and a combined GDP accounting for 11.6% of the global figure. A strategic partnership between them could be a project for achieving intercontinental economic integration, similar to the planned Transatlantic Partnership between the United States and the European Union.

There is already some basis for economic cooperation between the two regions and expansion of this would offer significant advantages to all participants, helping to diversify the hitherto unvaried product range (more than half of Russian exports to Latin America are mineral fertilizers, while agricultural products and meat account for much of the imports). Broader cooperation in the scientific and technical sphere would help advance the industrial development of Mercosur, also diversifying the EEU's exports. Plans have already been made for developing the energy sector with regard to oil production and the refinement and construction of nuclear power plants.

Investment projects are being considered for the National Oil Consortium, joined by companies from Brazil, Venezuela, Guyana, Cuba and other countries; Russia is to participate in the construction of the Atucha IV and Atucha V nuclear power plants. Russia's expansion on to the Mercosur market will focus on the following five countries:

Brazil

Prospects for exporting to this country are linked to deliveries of transport engineering and defence products. Though Brazil's exports to the EEU currently consist almost entirely of food products (94.5%), there are plans to sell small shipments of Embraer jets.

Argentina

This country is interested in Russian technology in the nuclear sphere, the defence industry and transport development. A visit by Argentine President Cristina Elisabet Fernández de Kirchner to Moscow in April 2015 resulted in a number of cooperation agreements in agriculture, trade, energy, military projects and the environment. This clearly demonstrates the development of high-quality Russian exports.

Uruguay

The EEU exports chemical products, engineering, rolled metal, and potash fertilizers, receiving agricultural products in return. Local free economic areas are attractive for the development of trade and economic relations and may be used to set up joint enterprises, consignment warehouses and deliveries of machines and technical equipment, as well as for expanding on to Uruguay's financial market through establishment of offshore banks.

Venezuela

Russia exports defence systems, transport, various equipment and devices. Imports are dominated by ethanediol, containers for transporting liquids and gases, lifting and handling equipment. Since the new system for controlling the exchange rate was introduced, Russia's exports have increased by more than 2,000%. In particular, a marked growth can be seen in deliveries of gas-turbine jets and power generating equipment. In January 2015, the leaders of Russia and Venezuela agreed to increase Russia's investment in joint oil producing and refining companies, as well as equipment for oil-field development.

Paraguay

Russia mostly exports energy equipment, road engineering products, water transport, mineral fertilizers and auto- and motor vehicles to Paraguay.

The EEU and Mercosur have a total area of **33 million** square kilometres and a population of **450 million**

Since Venezuela introduced the new system for controlling the **exchange rate,** Russia's exports have increased **by more than 2,000%**

Imports from Paraguay are dominated by meat, soya oil and coffee. On the whole, cooperation in the trade and economic sphere remains insignificant, though the possibility for Russian companies to take part in building a number of gas pipelines, constructing and modernizing hydroelectric power plants is being considered.

Russia's partners in the EEU are also accelerating their cooperation with South America. Belarus, for instance, has shown impressive progress in trade with Venezuela, hiking the turnover from USD 6 million to USD 500 million. Caracas has become a Minsk creditor, lending the Belarus partners USD 500 million. At this stage, Belarus and Venezuela have over 80 joint projects in the areas of housing construction, oil production, gasification, energy, agriculture, manufacturing and science. At the same time, the political and economic destabilization in Venezuela following the death of Hugo Chavez has led to a sharp decrease in the trade between the two countries. Kazakhstan has been thus far more preoccupied with humanitarian matters and development of a visa-free/facilitated visa regime for its citizens.

The EEU and Mercosur are only just launching their full-scale economic cooperation. The next stage in boosting construction of a multi-polar world is to prepare a legally binding agreement between both blocs. It is also important that the parties agree to exclude currencies of other countries in their mutual settlements. In this respect, Russia's efforts to create an alternative payment system are rather interesting, as well as the successful experience of some Latin American countries in forming the Unified System for Regional Compensation (SUCRE). Finally, Mercosur's experience is important in terms of its projection on to the post-Soviet space.

Mercosur's market is traditionally dominated by foreign trade (in Paraguay, intrazone trading accounts for just 33.4%, in Brazil – 29%, in Uruguay – 24.8% and in Argentina – only 12.8%), though this is 12 times more than when the bloc was created; the current level is estimated at USD 60 billion. At the same time, the continuing domination of industrial products in the intrazone trading, as well as fruitful cooperation in the energy sphere, are positive signs. Real steps towards integration, alongside efforts to harmonize customs tariffs and liberalize trade, combine with the methodical development of exceptions to this rule at a national level. The accumulating outstanding problems arouse discontent in relations between the member states. Taking note of the South American experience, the EEU should pay close attention to the speed at which the signed initiatives are implemented. The declaratory nature of some solutions is fraught with irreconcilable future differences. In itself, the introduction of a single external customs tariff for third countries would lead to serious disagreements within the Customs Union, while dynamic integration might, in 5–7 years, give way to political differences prompted by the development gap between the region's countries and the uneven distribution of the benefits from integration.

Considering the positive experience of integration processes within Mercosur, attention should be paid to the industrial diversification of integration issues. Since Mercosur's inception, trade and economic integration initiatives have been implemented in the following areas: financial integration (creation of a fund for the bloc's structural convergence), physical integration (infrastructure, logistics, energy integration duplicated by IIRSA initiatives within the bloc of South American nations) and currency integration (inter-country non-cash settlements in national currencies). The bloc's countries have formed investment regimes and provided the basis for developing transnational Latin American companies.

As the trade ties develop, the poor transport infrastructure remains a stumbling block at a regional level, leading to higher transport costs. The problems of economic harmonization on Mercosur's agenda have given way to competition among them.

Mercosur's remaining political and social problems, the absence of a single foreign policy vector, slowly progressing cooperation in the social and humanitarian areas, and the population's poor awareness all impede the transformation of the integration bloc into a clear, sustainable project which would be attractive to both people and businesses. The EEU should pay attention to this already now, to prevent the Customs Union from becoming an end in itself but rather a thoroughly considered tool for modernizing the Bloc countries.

Russia's activities in creating an alternative payment system, along with the successful experience of some Latin American countries in the formation of the Joint Regional Compensation System, has attracted the attention of experts as a step towards eliminating the use of third-party currencies in mutual settlements.

Text: Ekaterina Pronina

Discussion in a Broad Context

The annual meeting of the Valdai International Discussion Club will be held as part of this year's St. Petersburg International Economic Forum. The debate 'Economic Interdependence vs. Political Disintegration' will focus on the correlation between politics, geopolitics and the economy in the modern world.

Eminent scholars and politicians from Russia and abroad have been invited to take part in the debate. According to Andrei Bystritsky, Chairman of the Council of the Foundation for Development and Support of the Valdai Discussion Club, it is during such events as SPIEF that real dialogue is possible.

"We hope our discussion will appeal to many Forum participants. What distinguishes SPIEF, in our opinion, is the way it combines practical economic problems and global prospects, placing urgent problems in the broader context of debate about the world's future," Bystritsky added. Experts at the event will discuss whether politics or economics are more important today. They will also consider the apparent interdependence between different parts of the modern world and whether it is a deterrent in global relations or a catalyst to conflict. The speakers will also touch upon the theme of global leadership: what happens if the centre of global power shifts to Asia? Are new models of political and economic development possible?

"In St. Petersburg, we plan to focus on the correlation between economics and politics. We want to understand the extent to which the business interests are able to overcome or even shape political preferences: for example, how far can political borders coincide with economic borders? And what happens if they do not coincide for a long time," the Chairman of the Foundation Council stressed.

In the run-up to the St. Petersburg Economic Forum, the Valdai International Discussion Club held a large conference in Berlin on energy security and prepared a report which was presented at the 'Creating Eurasia: Silk Road Economic Belt' international conference in Astana, Kazakhstan. These subjects will be developed further at SPIEF 2015, as "they touch upon a number of fundamental economic and geopolitical problems," Bystritsky stressed.

The Valdai International Discussion Club was established in 2004. Its first meeting was held in Veliky Novgorod close to Lake Valdai, hence the name of the Club. The founders of the Club include the Council on Foreign and Defence Policy, the Russian International Affairs Council, MGIMO University and the Higher School of Economics.

The Valdai Club has shifted its focus from Russia-related problems to the global agenda. Today, its research projects, events and the foreign experts involved in its work are mainly orientated on research into and discussion of the key international processes. Over 850 foreign experts, scholars, politicians, public figures and businessmen have taken part in Valdai Club debates.

"We see the Valdai Club as an international community of scholars, a research and discussion centre concentrating on key issues for development of the modern world. We are, of course, a Russian organization and we hope that Russian scholars and thinkers will make a tangible contribution to understanding the specific features of the world order," Bystritsky explained.

The Club has held 11 annual meetings since its foundation in 2004. St. Petersburg has hosted a Valdai meeting before; in 2010, Valdai experts gathered in Russia's northern capital to discuss the topic 'Russia: History and Future Development.' The agenda included visits to Kizhi, Kronstadt and Valaam, along with debates on the country's innovative development.

The Club's annual meetings are traditionally attended by Russian President, members of the Presidential Administration, the Government, ministers, as well as high-profile political and public figures of Russia and the world. Speaking at the Club's meeting last year, President Putin pointed to the positive changes in the Club's activities, including the renewed structure of its founders and the appearance of new, promising areas of work.

'The idea was also raised of broadening the discussions to include not just issues related to Russia itself but also global politics and the economy. I hope these changes in organisation and content will bolster the Club's influence as a leading discussion and expert forum. At the same time, I hope the 'Valdai spirit' will remain: this free and open atmosphere and the chance to express all manner of very different and frank opinions", Putin underlined.

As for the shift in the Club's focus from discussion to research, there are several topics on which we plan to concentrate. We are concerned, for example, about the evolution of modern nations, the changing role of institutions such as the state, and the limits of their powers and possibilities. Equally important is the discussion about the ideological content of the world: what happens to ideologies? What ideologies exist today? This topic is largely related to the issue of understanding people's identities today.

To a certain extent, this theme overlaps with one of our key research avenues – globalization or, more precisely, how to understand globalization and what it implies. Another topic is the nature and dynamics of conflict that ultimately give rise to war. We believe that all of our research areas will be reflected in the conferences, round table discussions and seminars, which I hope will also help us prepare a number of interesting and informative reports and, eventually, books.

Andrei Bystritsky,
Chairman of the Council of the Foundation for Development and Support of the Valdai Discussion Club

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Prepared by Darya Kichigina

More than Just Partners

Prior to the BRICS and SCO Business Forums in St. Petersburg that will take place as part of SPIEF, President of the Chamber of Commerce and Industry of the Russian Federation Sergey Katyrin expounds on the priority topics the participants are scheduled to discuss, as well as on key areas of cooperation.

Mr. Katyrin, in light of the BRICS and SCO summits coming to Russia in July, the St. Petersburg business forums will serve as an overture to the bigger events in Ufa. What goals do you think the organizers of the St. Petersburg Forum are pursuing? What issues are on the agenda?

The business forum is a much broader event that provides a platform for BRICS and SCO business representatives to discuss specific projects. The upcoming discussions will address global economic issues, ways of resolving the crisis – a vital subject for many regions.

The forums will focus on the economic modernization of BRICS and SCO member states, and on the transition to innovation-driven development. Members of the BRICS Business Council have already submitted their proposals for topics for discussion, including a number of global-scale projects that would benefit both Russia and our foreign partners.

No other platform is better suited for a presentation of such projects than the St. Petersburg International Economic Forum.

Will the geopolitical situation interfere with the plans of SPIEF members, observers and partners this year? How would you describe the degree of trust between BRICS and SCO countries?

Our partners have shown serious interest in all events scheduled within the period of Russia's presidency in BRICS and the SCO. We have not seen any negative impact of the geopolitical situation. It must be said, though, that while business councils are usually driven by representatives of big business, they are on very tight schedules, so not all of them will be able to attend both the St. Petersburg and Ufa events. As for the degree of trust built up over the history of the SCO and BRICS business councils, we can confidently say that now we are more than just partners – we even think alike.

Are there any plans in the pipeline to agree on settlements in national currencies with any countries at the SPIEF or the Ufa business summit?

Russia and China are certainly pioneers in this sense. Just as President Vladimir Putin noted during the bilateral meetings held during the visit of the President of the People's Republic of China Xi Jinping, national currencies already account for 7% of bilateral trade turnover. Russian business is certainly looking to extend the model to other BRICS and SCO partners.

The SCO declared itself an open organization from the outset. Are any decisions to expand the SCO to be expected this summer? What will the discussions with the representatives of states concerned address at the SPIEF?

The matter of SCO expansion is related to the competence of the leaders of SCO member states. As for SPIEF events, we have, in anticipation of our policy makers' decisions, invited business representatives of not only member states, but also SCO observer states and dialogue partners to take part in both the SCO Business Council meeting and the Business Forum. We are positive that their active participation will lay the groundwork for important political decisions.

Will BRICS Business Forum participants consider any new investment projects in St. Petersburg? What areas are seen as the most promising?

Investment projects are actually the core of the agenda. The upcoming summit will address the economic partnership strategy and the investment cooperation roadmap worked out with input from, among other collaborators, the BRICS Business Council. It is quite obvious that the list of projects on the roadmap is open to further updates and additions. It is hard to pinpoint any priority areas for cooperation, but they must include infrastructure, transport, the high-tech sector, pharmaceutics and agriculture.

How realistic is the idea of setting up a BRICS rating agency in the near future?

The issue is certainly a relevant one. If regulators are able to agree on the matter, business representatives will surely be interested in establishing a fully operational rating agency. We are certain that both Russian business representatives and our partners are ready to support the idea. Meanwhile, we also understand that it will take a long time for a rating agency to establish itself in the industry in order to perform on equal footing with existing institutions.

What new promising areas of cooperation outlined for BRICS in 2015 will come into spotlight at the SPIEF? What areas of economic cooperation within the SCO are to be discussed during the Forum?

We chose to focus on more relevant issues of cooperation. For BRICS, this means reducing administrative burdens, cooperation within the current economic situation, ways to resolve the crisis in BRICS countries, investment, trade and economic cooperation opportunities.

As for the SCO, top priorities are slightly different. Regional integration processes taking place in the SCO space cannot be ignored, so the SCO Business Forum will entail discussions on ways to establish economic cooperation in the context of the opportunities presented by the Eurasian Economic Union. We will also discuss matters of project-based cooperation, factors that slow it down, and decisions that are called for to reverse the situation.

Last year, representatives of the Chinese delegation at the SCO offered their suggestions regarding the Silk Road Economic Belt. How is the project moving along?

After the President of China's visit to Moscow, the leaders agreed to integrate two projects – the Great Silk Road and the Eurasian Economic Union. Furthermore, we believe many other bilateral Sino-Russian agreements signed in Moscow can be viewed in this light.

I am certain that the Great Silk Road project can serve as a driver for SCO economies and strengthen mutually beneficial cooperation between Russia and China. Russia has already signed up for the project by opting to join the Asian Infrastructure Investment Bank.

Text: Darya Kichigina

The 'Oscar' for the Best Projects

The traditional annual Development Prize awards ceremony will take place at the St. Petersburg International Economic Forum in June of this year. One of the most prestigious Russian business awards will be given to the best investment projects.

Since the Development Prize contest was established three years ago, its figurine has been awarded to eight companies. The winners have not only strengthened their positions, but have also managed to expand production. Success in the contest means not only recognition, but also real investment preference from Vnesheconombank, which founded the award in 2012. The Development Prize has since become an award of national importance recognized by the expert community.

The number of applications has grown from 200 to almost 300 over the course of three years. Tatarstan is the leader in terms of the number of nominees – some 39 companies from that region sought the professional award this year, and four have made it on the list of nominees. The republic's investment climate allows businesses to accelerate development. A look at the National Rating of Investment Climate in the Regions reveals that almost all of its leaders, except the Ulyanovsk Region, are among the award nominees. The number of regions filing applications remains stable as well, with 85% of participating regions doing so on a permanent basis. The economies of those regions are developing rapidly, creating new business projects and large numbers of jobs. "In spite of talks about the unfavourable investment climate in our country, the results of the 2015 Development Prize contest demonstrate just the opposite. The number of applications received exceeded all expectations. Business in Russia is growing and the numbers of those willing to invest actively are increasing year after year," said Sergey Vasiliev, Deputy Chairman – member of Board, Vnesheconombank.

This year nominees' home regions included the Leningrad, Lipetsk, Kirov, Belgorod, Tula, Samara, Nizhny Novgorod, Moscow, Vologda, Voronezh, and Saratov regions, the Republics of Tatarstan and Altai, the Khanty-Mansi Autonomous District, and the Krasnoyarsk and Krasnodar Territories. Projects from those regions don't simply exist on paper – they are already being implemented. The jury also took into the intellectual and innovative value of the proposed projects. This year The Development Award's workgroup decided to expand the number of nominations from four to eight: 'The Best Infrastructure Project,' 'The Best Industrial Project', 'The Best Environmental and Green Technology Project', 'The Best Comprehensive Territory Development Project', 'The Best Innovation and Hi-Tech Project', 'The Best SME Project', and 'The Best Export Project'.

All nominations target areas that are particularly important today, such as import substitution, modernization of the country's industrial and social potential, increasing the competitiveness of Russian business, improving Russia's investment climate, small and medium business development, increasing the efficiency of use of natural resources, environmental protection, improvement of the ecological situation, and support for agricultural and industrial exports. All of this serves as a basis for the development of Russia's economy.

Despite the changes in the geopolitical situation, a sufficient number of this year's applications had to do with exports and foreign investment. The latter has been given a separate nomination. "The 'Best Foreign Investment Project' nomination was established at the end of 2014 as part of the Development Prize contest to attract more participants, and because of the need to encourage inbound foreign investment in Russia," Sergey Vasiliev said.

According to VEB's Financial Policy Memorandum, industry project priorities include aerospace, shipbuilding, electronics, nuclear power, transport, special and energy machine engineering, metals, timber processing, defence, agroindustrial, strategic computer technology and software, information and communication systems, medical devices, and pharmaceuticals.

The Development Prize is given to the most successful projects carried out by Russian entrepreneurs. The award ceremony takes place at the St. Petersburg International Economic Forum and is attended by business community representatives, including heads of major companies and financial institutions, representatives of small and medium business, and public figures. "Is this not evidence of the fact that best practices of Russian entrepreneurs are being properly recognized," says Sergey Vasiliev.

Vnesheconombank initiated the expansion of the 2015 Development Award nominations by including additional categories. Two of these – 'The Best Innovation and Hi-Tech Project' and 'The Best Export Project' – are priority spheres not only for the bank, but also for the nation's economy. VEB is planning to increase its role in carrying out large-scale investment, innovation, import replacement, and infrastructure development projects. The Bank's operations cover a wide range of interested parties and have a substantial impact on the development of entire industries and regions. This means that the Bank has a special responsibility to improve social and economic living standards and environmental protection, which requires a balanced approach to the Bank's operations management. The Bank carries out a broad range of sustainable development and responsible financing initiatives, and participates in the United Nations Environment Programme Finance Initiative. This is why the Bank initiated the inclusion of the 'The Best Environmental and Green Technology Project' nomination.

Sergey Vasiliev,
Deputy Chairman – member of Board, Vnesheconombank

Text: Galina Fyodorova

Russian Start-ups

will teach the world to keep both eyes open for both displays

Developers have invested USD 25 million in two generations of the Russian YotaPhone, compared to the USD 150 million that Apple spent on the first iPhone and USD 200 million that Nokia pays for each new model. The effective use of resources, thinking outside the box and innovation enabled a small start-up to make a respected name for itself internationally and make plans to expand into China, the world's biggest technology market.

In 2010, a prototype model of the YotaPhone was presented to Dmitry Medvedev and, in 2013, before the official presentation of the smartphone, it won a Best of CES Award 2013 in Las Vegas and took a Golden Lion prize in the Innovation category at the Cannes Lions International Festival of Creativity. In December 2013, the Wall Street Journal referred to the YotaPhone as 'an engineering feat on the crowded smartphone market' and Forbes named it 2014's Most Disruptive Smartphone.

The YotaPhone features a unique dual-screen design. One display is a traditional LCD touch-screen and the second one is a low-power electronic-paper display.

Its two screens are protected by layers of Corning Gorilla Glass, which has passed multiple tests, including a free-fall drop test (it was dropped on to a wooden floor) and an abrasive wear test (160 steel brush runs and six hours of scratching with a hard pencil). The industrial design and architecture of the phone were developed in Russia. Yota Devices have patented more than 35 solutions used in the phone, including software.

The developer of the phone Yota Devices, originally a branch of Yota, presented the YotaPhone on the Russian market in December 2013. A few months later, sales were launched in 20 countries. A year later, the company presented the second generation of the YotaPhone and immediately sold 30,000 units. The unique smartphone is available in 22 countries. It is expected to turn to China, the world's biggest market, and Latin America very soon.

Yota Devices shareholders Telconet and Rostec invited Vladislav Martynov, who at the time worked for Microsoft and had more than 20 years' experience in the IT sector, to run the new company.

When Vladislav Martynov came to Yota Devices, the company only employed six people. Now more than 100 employees are working on the smartphone at the company's offices. The company did not hire expensive specialists to create the phone but hired them only to deal with specific problems. This strategy enabled the developer to increase spending efficiency and cut personnel costs. Representatives of the expert community and consumers contributed generously to the development process.

The company has a global vision of its business and pursues close international cooperation. Furthermore, the smartphone is offered at a competitive price owing to economical, high-quality assembly in East Asia.

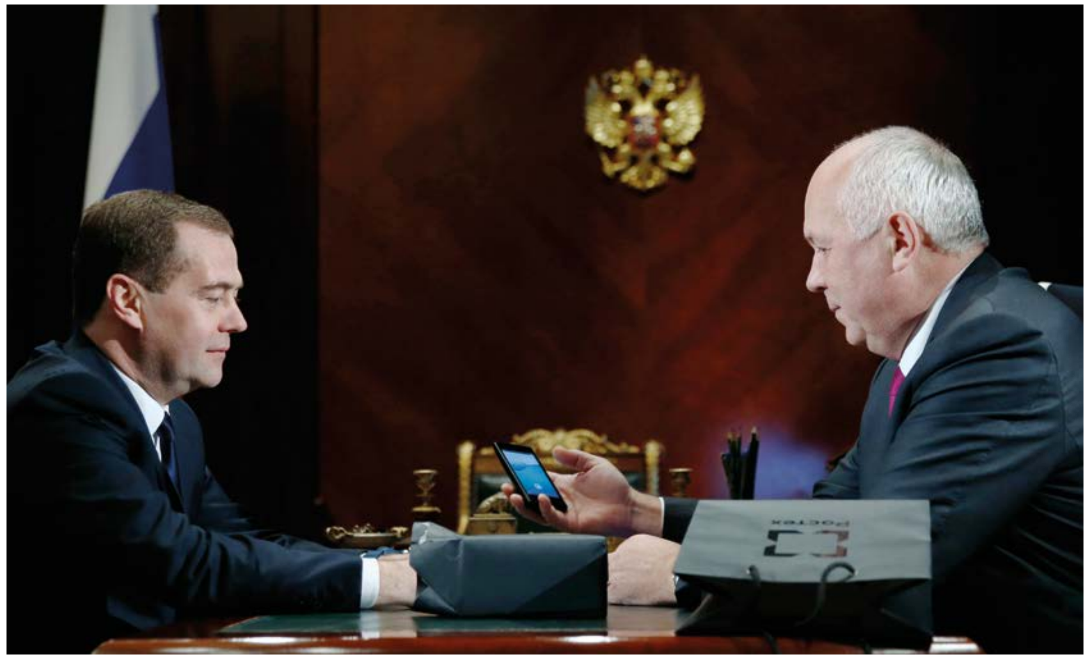
The YotaPhone is currently available in 22 countries. In 2015, sales will begin in Latin America and China. The company believes sales on the Chinese market to be a serious challenge and is planning to compete with the largest smartphone makers.

The company's headquarters are in Moscow. One of the engineering centres is based in Finland, where Nokia used to have its central office, although the device is assembled by Hi-P International in China. Incidentally, Vladislav Martynov lived in Singapore for six months whilst he searched for partners and came up with the manufacturing process.

Spokespeople for Yota Devices say they do not know why Russian President Putin gave his Chinese counterpart Xi Jinping a YotaPhone as a gift last November. They believe the device had become a symbol and the gift was a result of successful cooperation between Russia and China.

The YotaPhone is becoming increasingly popular with international celebrities. Steve Wozniak, a co-founder of Apple Inc., flew into Moscow for one day, familiarized himself with the Russian device and had dinner with Yota Devices CEO Vladislav Martynov to discuss the innovation. Wozniak was full of praise for the dual-screen smartphone, said he was willing to act as a beta tester for the YotaPhone and that he definitely would want one. He returned to the United States with a test model.

The list of top-ranking Russian officials who have tested the gadget includes Dmitry Medvedev, Igor Shuvalov, Nikolai Nikiforov and Denis Manturov



At the end of March, Igor Shuvalov announced at the Boao Forum for Asia, the largest economic forum in Asia, that the YotaPhone laid the foundations for a new industry in Russia – development of high-tech gadgets – and might catalyze the development of the personal electronics sector. He also said that the YotaPhone could be justifiably called a national telephone.

The Editors would like to thank

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