

The Saint Petersburg International Economic Forum 2013

View from the ground

10 July 2013

The agenda for the Saint Petersburg International Economic Forum this year focused on Russia's economic slowdown. A number of large-scale deals and initiatives aimed at boosting the country's economic activity were announced at the Forum; however, many observers questioned the sufficiency of such measures. Instead, the discussions between the sessions were filled with worries over the main factors that chill the business climate in Russia: rising inflation, dependence on the oil sector and low investor confidence. These should be viewed in the context of the overall global economic conditions, with all the G20 severely affected. However, the Russian government laid out a strong investment agenda to stimulate the economy.

Introduction

The Saint Petersburg International Economic Forum (SPIEF) is the premier event for foreign and domestic investors and is used by the Russian government to make strategic announcements. This year's SPIEF held between 20 and 22 June was headlined "Prospects for the Global Economy: Time for Decisive Action". President Vladimir Putin – now in his thirteenth year as the country's leader – made a stimulus plan the centrepiece of his annual speech at the event. With slowing economic growth a primary concern, this year's agenda focused on boosting economic activity and once more emerging from the global financial crisis.

Despite the ambitious stimulus plan, the Russian government sent some conflicting signals to the business community. We discuss below what these signals might mean for the Russian economy and foreign investors.

Main outcomes of SPIEF – 2013

This year's Forum saw a number of developments which were ostensibly positive for the Russian economy.

First, President Putin pledged a US \$43 billion investment for three large-scale infrastructure upgrade projects (the country still suffers from Soviet-era dilapidated roads and railways):

- the Trans-Siberian railway, which runs between Moscow and Vladivostok;
- a 500-mile high-speed rail line between Moscow and Kazan; and,
- a superhighway ring-road around Moscow.

Second, a number of large-scale energy deals were signed at the Forum.

- Rosneft agreed to supply 365 million tonnes of oil over 25 years – worth \$270 billion – to the state-owned Chinese National Petroleum Corporation (CNPC);
- Novatek and Rosneft also signed a number of LNG deals, in which Gazprom plays no intermediary role. This is unusual as Gazprom has a legal monopoly on gas exports in all forms, including LNG.

These latter energy deals show that Russia's leadership is finally activating its LNG sector and is taking steps towards breaking Gazprom's control over the gas supply. They also suggest that those in charge of Russia's energy sector (and close to the Kremlin) are at last opening up to fast-growing markets in Asia-Pacific and reducing the country's dependence on flagging European demand.

Third, Putin approved a plan to grant an amnesty to thousands of white collar criminals. The draft law is aimed at businessmen caught up in the turmoil of the 1990s and 2000s and currently serving jail sentences. The law, however, will not apply to high-profile and politically sensitive cases. The amnesty was widely viewed as a signal from the Russian government that the legal system is becoming more proportionate in the way it treats local business. Russia's First Deputy Prime Minister, Igor Shuvalov, further stressed that President Putin believes that the "security of entrepreneurs and businessmen is an integral part of creating a good investment climate."

Finally, President Putin proposed to unite the Russian Supreme Court and the Supreme Arbitration Court into a single body, in order to bring uniformity to the judicial process. In this context he has instructed his administration and the Parliament to work out necessary issues, including amendments to the Constitution of the Russian Federation. The new institution might move to Saint Petersburg, and the Prime Minister, Dmitry Medvedev, is expected to be appointed as its head. This announcement came as a surprise, not only to many attending the Forum, but also to the State Duma deputies and the Russian legal community that we have spoken to. There is speculation that this decision was made without any official discussion.

Zastoy: Russia's new standstill

Many of the deals and decisions that were unveiled in Saint Petersburg this year are outwardly positive; however, they were received by many stakeholders as unlikely to provide the panacea to Russia's current economic slowdown.

The country's investment climate suffers from long-term structural issues. Among those which dominated the discussions in the hallways of the Forum's venue were high inflation, oil dependency and weak investor confidence. Some fear a return of the economic zastoy (standstill) of the Brezhnev era, when economic stagnation resulted in severe shortages of many (including basic) goods.

Inflation: According to the Federal Statistics Service in Moscow, Russian inflation is now growing at its fastest pace in 21 months: consumer prices rose 7.4% year-on-year in May, after increasing 7.2% in April and 7.0% in March. Higher

food costs are adding to price pressures. Inflation remains an entire percentage point above the top end of the 5% to 6% target set by the Central Bank (the Russian government has allegedly been applying pressure on food companies operating in the country to keep their prices down).

Oil dependency: High oil prices buoyed Russian growth in 2011-12 and helped Russia reduce the budget deficit inherited from 2008-09. However, according to Fitch Ratings, Russia is the most oil-dependent of the world's ten largest economies, with oil and gas accounting for 50% of federal government revenues and up to 20% of gross domestic product. Weak demand, particularly from China, and the US fracking revolution have weighed heavily on oil prices this year. Many analysts believe, however, that Russian economic growth is more inhibited by untapped domestic reserves and weak productivity rather than the continued decline in global oil prices. Whether the source of the problem is the declining price of oil or unrealised domestic production, it has long been agreed that Russia needs to reduce its dependence on oil revenues and diversify its economy.

Investor confidence: Russia's legal framework has not been fully modernised since the Soviet era. Many investors we spoke to feel that the rule of law is not observed uniformly

across the country, and the judiciary is subject to political pressures. Protection of private property rights is weak, and contracts are not always enforced. Meanwhile, many in the legal community argue that Putin's proposal to unite the Supreme Court (which one source described as a 19th century institution) and the Supreme Arbitration Court (a 21st century institution and considered to be more progressive and effective), will result in a colossal 'supercourt' further lacking in efficiency and enforcement capacity, especially in Russia's regions. Contacts in the legal community say that this decision might have an adverse effect on the investment climate.

Conclusion: mixed messages

The reality is that the Russian economy is stagnating. Both Russian and foreign businessmen working in-country and present at the Forum were visibly worried. Behind the scenes discussions went as far as likening today's Russia to Brezhnev's standstill, the period of sharp economic slowdown of the 1960-1980s. The comparison with zastoy, however, is hardly justified – the range of basic and gourmet foods available in the country's supermarkets is perhaps the most telling evidence for that – and the country's relatively poor economic performance is largely due to decreasing investment. The negative take on the Russian economy is very relative: there is zero growth in most European countries, serious slowdown in China, slower growth in India, Brazil and South Africa and continuing issues in the US.

One of the most discussed issues at SPIEF this year was Russia's oil dependency at the time when the country suffers low productivity and lack of capacity in other sectors. We believe that diversifying the economy requires increasing productivity as well as improving competition, by investing in technology and human capital, and making market regulations less restrictive. This should be coupled with a series of governance reforms of state-owned enterprises which would ensure fair market competition. While 'innovation,' 'modernisation' and 'technology' were the buzz words at the Forum this year, in Russia they are associated with the presidency of Dmitry Medvedev and lack credibility as a consequence.

This year, Russian leaders took a number of steps to send positive signals to foreign investors and to demonstrate their commitment to improving the business climate in the country. However, given the problems that Russia faces today – some of which we described here – we are yet to see whether these efforts are sufficient. Doing business in Russia is difficult because of the heavy administrative burden, widespread corruption and low investor confidence. However, returns remain very high for those who navigate Russia's risks successfully.

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