World Economic Forum Moscow Meeting

View from the ground

29 October 2013

Summary

Russia's economic growth has been heavily reliant on the energy sector and is, therefore, vulnerable to price and technology changes in the global energy landscape. As the US and Europe are moving increasingly towards natural gas, domestic production of shale gas and alternative energy sources, diversification has become a slogan in some quarters of Russia.

The reality, however, is that Russia continues both to suffer and benefit from its Soviet economic legacy – the USSR was an autarchy with a fully diversified economy aimed at providing self-sufficiency. Modernising Russia to deliver on its competitive advantage and reach a fuller capacity of its various sectors requires it to:

- improve its institutional framework,
- enable development of its regions, and
- continue actively to work on attracting both domestic and foreign investors.

It is the Russian regions that are driving reform. In particular, those without oil and gas resources are building stronger institutions and decreasing red tape, as well as arguing for more consistent long-term policies and fighting local corruption. These improvements are local but due to the competitive nature of the regional markets, if the right balance of power is struck between the local and federal levels, the regions may prove to be the pivotal drivers of the national economy.

Introduction

The World Economic Forum (WEF) Moscow Meeting took place on Sunday 20 October 2013 under the title *Russia's Regions: Drivers of Growth*. The Forum gathered to discuss and develop the findings of *Scenarios for the Russian Federation*, a Forum publication produced in cooperation with 350 business, policy and academic leaders and launched in January this year at WEF's Annual Meeting in Davos.

The publication explored possible future scenarios for the Russian economy, outlining three main uncertainties: ongoing developments in the global energy market, the quality of Russia's domestic institutional environment and the dynamics of social cohesion.

The report highlighted the potential for Russia's regions to drive institutional and economic reform, as one of the most sustainable and positive scenarios for the country's development.

Main outcome of WEF Moscow Meeting

Attracting investment

Corruption in Russia is more prevalent than in other countries with a comparable GDP level and has remained consistently high even after a decade of sustained growth. However, corruption took third place after 'red tape' and inconsistent long-term government policies as the most significant problem voiced at the Forum by the foreign investors already operating in Russia.

Bureaucracy and a weak rule of law increase the administrative burden and prevent companies of all sizes from realising their full potential. Capital flight from Russia has been exacerbated by the country's uncertain regulatory and institutional environment, where too often capital from natural resource revenues is not retained or put to use within the country.

While historic windfalls from high energy prices are not expected to continue forever, there appears to be a realisation at the top of the country that a more resilient economy is needed. In order to attract both domestic and foreign investment, the Russian government is already introducing a number of measures including establishing the Russian Direct Investment Fund, which partners with foreign sovereign funds to make investments in Russia, or establishing local incubators for small businesses like the IT-Park in Kazan.

The Forum overwhelmingly agreed that the greatest potential for attracting investments and securing further growth will come from improving the current institutional environment and boosting the development of the regions.

Institutional Environment

Russia's accession to the WTO in 2012 has brought with it the expectation of a number of regulatory changes and opportunities for foreign investments in a wider range of sectors. OECD accession will also motivate the government to commit to more institutional reform. Russia has taken steps towards greater regional integration, as evidenced by the Customs Union between Russia, Belarus and Kazakhstan, and is attempting to increase the scope of its economic influence in Central Asia in the coming years. In addition to this Russia is discussing joint infrastructure investments with China in the Arctic region.

The government also needs to create an attractive environment for both local and international workers to attract and retain professional talent and prevent the brain drain currently occurring. Russia's falling birth rate and ageing population is expected to increase considerably in the next decade and will present serious challenges to its economic ambitions.

Regional Rebalancing

Centralisation of administrative power by the federal government limits the development of the economy. Inter-regional disparities produced an investment environment in which local governments are actually more encouraging of business ventures and subsequently more competitive in attracting investors and have better institutions in place than the federal government.

Long-suffering regions, which have often historically taken the brunt of Moscow's weak federal institutions, are already setting themselves apart from the centre and are working on fostering a reliable and safe environment with a radically improved infrastructure for foreign investors as well as up the workforce through investment in education.

The gathering was joined by eight regional governors as well as senior members of the federal government. The governors shared some of their best practices in attracting investors and developing progressive institutional environments to ease doing business in their regions. In a heated dialogue with Igor Shuvalov, First Deputy Prime Minister, they often directly criticised actions by the federal government and advised on concrete measures for further regional rebalancing.

According to Alexey Kudrin, Russia's former Finance Minister, one of the key outcomes of the meeting was the potential for the regions to play an important role delivering long-term, sustainable growth and building an ecosystem that is able to mobilise all of Russia's resources. To achieve this he emphasised the need for urgent improvement of institutions.

In many of the regions economic growth is heavily supported by the federal government's investments in the defence industry. While Shuvalov seemed to agree with the urgency required to empower the regions he was generally more cautious when it comes to wholesale reforms.

Conclusion

A sustained fall in energy prices could be a catalyst for the implementation of institutional reforms (provided that the government does not become paralysed by an economic crisis). However, long-term planning is vital and could help Russia avert any potential disasters and become more protected from global pricing fluctuations.

Regional resurgence is happening in the context of steadily declining oil and gas prices and a corresponding reduction of budget allocation. However, the world needs more natural resources beyond oil and gas, and Russia has some of the largest freshwater reserves in the world, vast amounts of arable land and huge potential for agricultural development. Thus, even if the world turns to natural or shale gas, Russia will still command large reserves of rapidly dwindling resources and can capitalise on this wealth as long as it finds the right balance between the regions and the centre.

Navigating the difficult regulatory environment in Russia will remain a burden for foreign and domestic investors for some time to come, but the Russian regions may prove to be even more attractive than before given the determination of the local governors to deliver regional development.

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