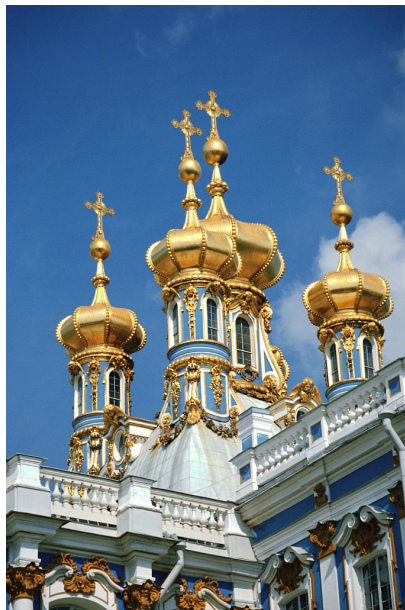


Business in Emerging Markets



Russia Attractiveness

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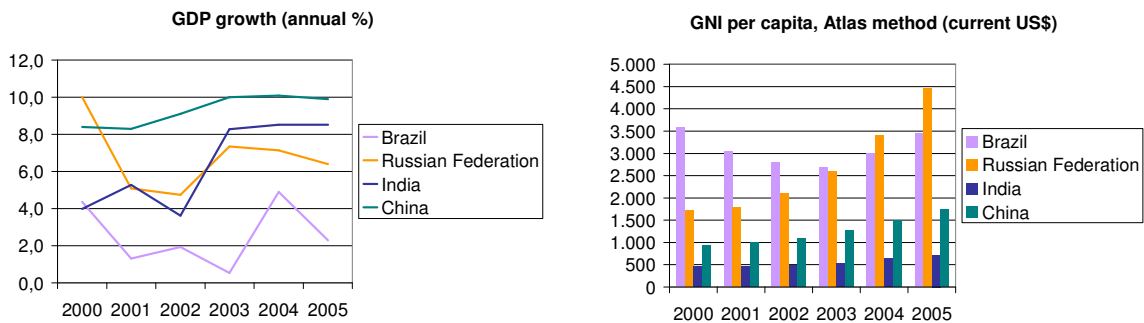
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1. Assessing Russia's attractiveness

1.1. Russia's economic development

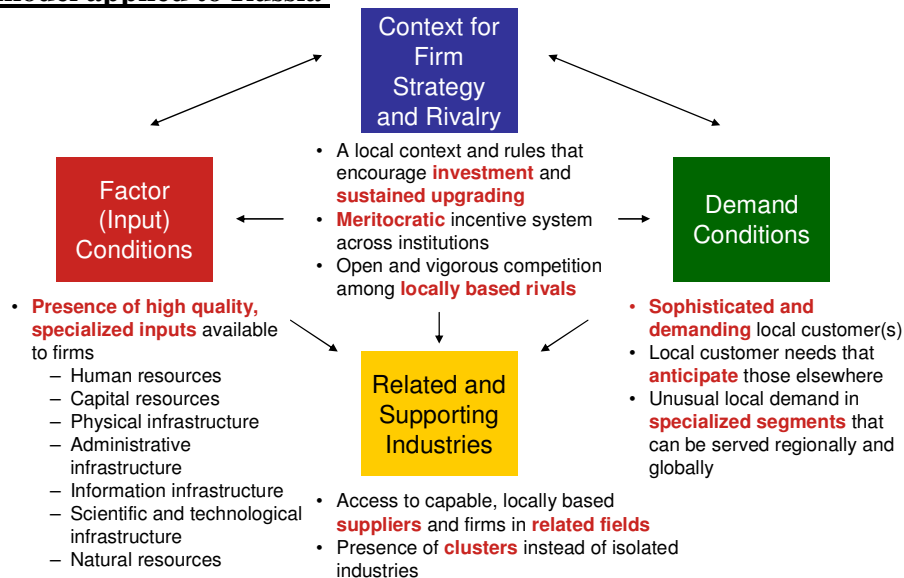
Russia's economic development in the first five years of the 21st century has revived hopes that the country will regain its leading position in the world, which it lost during its transition from a centralised and planned governance system to market-economy methods of regulation. From 2000 to 2005, Russia's Gross Domestic Product increased 50 percent¹, while the government's rigid financial policy eliminated the need for foreign loans. This has given Russia the opportunity to beef up its budgetary and hard currency reserves against possible financial crises.



1.2. Russia Competitiveness

Competitiveness is determined by the productivity with which a nation uses its human capital and natural resources. Productivity sets a nation's standard of living (wages, returns to capital, returns to natural resource endowments). Nations compete in offering the most productive environment for business. Porter-4 model helps to understand the competitive position of countries.

Porter-4 model applied to Russia²



¹ Figures of GDP growth and GNI per Capita downloaded from www.worldbank.org

² "Russian competitiveness", http://www.isc.hbs.edu/pdf/CAON_Russia_2003_Harvard_Symposium_11-13-03_CK.pdf

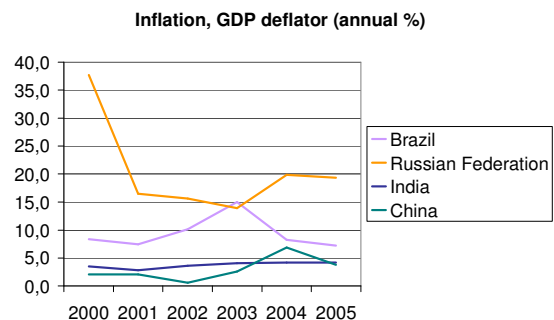
Based on the World Economic Forum report on countries competitiveness³, Russia has fallen from its 53rd rank in 2005 to 62nd in 2006. The private sector in Russia has serious misgivings about the independence of the judiciary system. Legal redress in Russia is not expeditious, transparent, or inexpensive, as it is in the world's most competitive economies. A ranking of only 110 among 125 countries in 2006 suggests that it is time consuming, unpredictable, and a burden on the cost structure of enterprises. Partly because of this, the environment for the protection of property rights is extremely poor and worsening. Russia's ranking in this indicator during the last two years has suffered a precipitous decline, from 88 in 2004 to 114 in 2006, among the worst in the world.

Country/Economy	GCI 2006-07 rank
Switzerland	1
Finland	2
Sweden	3
Denmark	4
Singapore	5
United States	6
Japan	7
Germany	8
Netherlands	9
United Kingdom	10
India	43
China	54
Russian Federation	62
Brazil	66

1.3. Inflation in Russia

Before 2004, Russia's economic development was driven by the export-oriented resource sector, which ensured high growth rates, the rapid growth of budget revenues, and the accumulation of hard currency reserves for the Bank of Russia. This growth largely came from the extensive development of relatively new oil fields. At the same time, in 2003-2004, new sources of economic growth were found in less risky investment projects in the non-resource sectors. The fifth year of the new century came as a period of striking contrasts for the Russian economy. The most important were the sharp changes in the structure of economic growth, the failure to fulfil official plans for reducing inflation⁴ (despite the inclusion of huge amounts of liquid assets in the Stabilisation Fund), and the slowdown in the growth of industries oriented to the domestic market amidst an increase in domestic demand, supported by consumer crediting.

Many of the financial crises of the past decade in some of the largest emerging markets have often involved weaknesses in the financial sector, including deficiencies in the regulatory regime, a limited supervisory capacity on the part of the central bank, and delays in the modernisation of the legal framework for bankruptcy procedures and creditor rights. A sound financial sector is increasingly perceived as a key ingredient of the institutional infrastructure underlying a growing economy.



1.4. WTO Accession of Russia

Accession to the WTO is critical to Russia and its political leadership. President Vladimir Putin has made it a top priority. He views accession as an important step in integrating the Russian economy with the rest of the world and in fostering economic growth and development by attracting foreign investment and by lowering trade barriers. For the United States, the European Union and other trading partners, Russia's accession to the WTO could increase stability and predictability in Russia's foreign trade and investment regime.

³ "GCI index report", http://www.weforum.org/pdf/Global_Competitiveness_Reports/Reports/gcr_2006/gcr2006_rankings.pdf

⁴ Figures of inflation downloaded from www.worldbank.org

The Russian accession process is moving forward, but differences over some critical issues remain, making the time for Russian accession to the WTO uncertain. The European Union and the United States have raised concerns about Russian energy pricing policies which allow natural gas, oil, and electricity to be sold domestically far below world prices providing, they argue, a subsidy to domestic producers of fertilisers, steel, and other energy-intensive goods. Russia counters that the subsidies are not illegal under the WTO. Concerns regarding Russian trade barriers in the services sector, high tariffs for civil aircraft and autos, and intellectual property rights have slowed down the process and made the original target of completion in 2003 unattainable.

Studies of the World Bank have shown that Russian WTO accession in the medium run will result in gains averaged over all Russian households equal to 7.3 percent of Russian consumption with virtually all households gaining.

1.5. Opportunities vs. Risks

Russia with its rapidly growing economy, vast natural resources and highly educated workforce presents an attractive and lucrative market which is difficult to ignore. Nevertheless, like any other emerging economy, in Russia much remains to be done. In other words, market opportunities in Russia are high, but the associated risks are high as well.

