

# Russia's window on the world

By **SIR ANDREW WOOD GCMG**

SPECIAL ADVISER, RUSSIA, FIRST MAGAZINE



**SIR ANDREW WOOD** was a member of HM Diplomatic Service from 1961-2000, latterly as Ambassador in Moscow from 1995 to 2000. He also served in Washington, as Deputy Head of Mission and as Ambassador in Belgrade. Since retiring from diplomatic service, Andrew Wood has visited Russia regularly, where has been a senior adviser to Ernst & Young and has worked with BP, GlaxoSmithKline, Unilever, ITE Group plc and Guinness UDV. He is also a member of the Advisory Councils of British Expertise and Renaissance Capital. He is a Director of the Foreign and Colonial Investment Trust, the Russo-British Chamber of Commerce, the PBN Company, Mechel OAO, and Kopeyka.

This year's International Economic Forum in St Petersburg marks a further stage in the development of Russia's second capital, another year of Russia's growth, and an additional move in the country's repatriation of its ideas of itself. If the disintegration of the USSR was understandably followed by a search for new anchors of meaning in a changed world, Russia's recovery has now brought it to a new point: President Putin stressed on 26 April in his annual report to the Federal Assembly the need for a common set of guidelines, including respect towards the Russian language, the country's independent heritage, the memory of its ancestors, and "every page of our fatherland's history."

This sense of renewed pride in Russia is buttressed by the country's encouraging growth since the crisis of 1998. There were plenty then, in Russia itself as well as outsiders, who were close to despair. In fact, the recovery began surprisingly quickly, helped by stringent fiscal policies, domestic producers filling the vacuum created by suddenly expensive imports, and the elements of a market economy that had been established in the nineties – as well of course as by rising oil prices. The record during President Putin's two terms of office has been such as consistently to outperform the predictions of many of the most learned of economists, Russian or foreign. The growing importance of the St Petersburg Forum is itself recognition of the increased economic and of course also political weight of Russia in the world.

There are those in Russia who argue that foreigners look askance at Russia's return. What Russia chooses to do with its revived strength is of course a matter for outside concern or welcome as the case may be. But a prosperous and stable Russia is clearly in and of itself highly to be desired, a fact that ought not to need arguing. European Union, United States and other countries' companies have shown their eagerness to invest in Russia and to trade with her. Foreign representation at the Forum this year is strong proof of the basic proposition that Russia is seen outside the country as a necessary and welcome player in the development of the global economy.

That foreign commitment is also witness to faith in Russia's future, and to the hope of sharing in it. One question that will undoubtedly be raised is the scope

for further foreign investment, including how it may be affected by the evolving subsoil and strategic assets legislation, as well of course as issues familiar to participants in the Foreign Investment Advisory Council and to Chambers of Commerce including the Russo-British Chamber such as the role and intentions of the tax and customs authorities, the impact of regulatory provisions, whether federal, regional or municipal, and the status of the judiciary. These are of course areas where all investors, Russian as well as foreign, need to feel confident. Effective investment is a long term matter.

High oil and therefore gas prices, a benign global economic climate, and the existence of spare capacity in the Russian economy – open to exploitation thanks to the 1998 devaluation – have all been among the drivers of Russia's economic recovery and growth over the last nine years. The last set has lost its potential as spare capacity has been used up, labour shortages have begun to bite, and the ruble has strengthened. The energy sector and the diversification of the economy have accordingly become matters of particular focus for the future. That is not to imply that growth is at early risk, but only to draw attention to the fact that the Russian authorities have the issues clearly in their sights.

President Putin reported to the Assembly on 26 April that electricity supply had already become a constraint on further growth. It is reasonable to expect that the reform of the power sector which has started will help. The President called for extensive investment in new power stations, whether nuclear or more conventional. This will clearly be needed, but will also take time as well as money. As the inherited spare capacity in the economy has been exploited, so the increase in the energy demands of the Russian economy has risen from the 3 per cent of recent years to 5 per cent, which is a level more in keeping with the present overall growth rate of around 7 per cent. Gas plays a particularly important part in the provision of power, but the increase in supply from existing Gazprom assets is modest, and existing major fields are becoming less productive. Bringing the larger new ones on stream will be difficult and costly. The oil picture is not too different.

There are difficult issues here. How will

independent gas producers be brought into effective play? What will be the effects of that on the Gazprom pipeline monopoly? How will Central Asian supplies evolve over time? What is the best role for Western investors? Again, similar questions arise when one considers how Russian oil production will develop.

The growth of other sectors of the Russian economy, and their integration into the world market, are of critical importance. Russian export earnings are overwhelmingly dependent on resources rather than manufactures. If one compares the first quarter of 2007 with the same period last year, imports were over 35 per cent up, but exports rose only in single percentage digits. Q107 figures may have been untypical in range, but the general trend is an established one. The Ministry of Development and Trade has warned that unless things change, Russia's balance of trade figures will by 2010 be even, in place of the surpluses we have become accustomed to witness. At present, the domestic demand which is a key component of Russia's growth is still significantly the result of petrodollars.

It is encouraging in this context to note early signs of diversification in the economy. Minister Gref has recently pointed out that investment is increasingly becoming devoted to meeting consumer rather than energy sector needs. The Russian Government has again said that diversification will be a priority for them. The start to 2007 has been positive in this respect. It is not unrealistic to hope (no more as yet) that such trends will continue even if energy prices weaken, with a consequent lessening of Russia's dependence on oil and gas exports. And for that matter a corresponding increase in the possibilities of interaction between the Russian and other economies, not least those of the West.

Russian entry into the World Trade Organisation will be of critical importance in stimulating such an outcome. Nearly all the building blocks for that

are ready, but as I understand it the detailed work needed, not least from the Russian side, to give general understandings full legal force, is lagging. Once entry is achieved in whatever year that may be, everything will depend on WTO rules being implemented properly. This is a body which is devoted to mutual advantage, not winner takes all. The fruitful competition of freer trade can be painful.

Since the above has been written with President Putin's 26 April report very much in mind it seems right to end by noting the considerable attention he then paid to addressing his country's social and infrastructural needs. The programmes he described were ambitious, and directed at widely recognised demands. This year's Forum may throw further light on the way that these ambitions will be realised, whether primarily through a market system or by state direction. Only a purist would draw a rigid line between these alternatives, perhaps, but one of the features of the past few years has from outside Russia seemed to be an increasing accent on the state and state-related action rather than independent business and the market, including the development of 'national champions' in a widening range of activities. It will be important for Russia's friends, too, to have an accurate sense of what is in prospect – for all the fact that the elections due in early December and in March 2008 may make any answers now contingent on short term political developments.

The course of discussions in St Petersburg this month, whether formal or informal, will be illuminating. Such contacts are more than ever necessary at a time of change, and the rapid development of Russia and its economy. Healthy controversy is not just better than a series of misunderstood monologues conducted on differing understandings of what may be in partners' minds, but also essential to progress together. **F**

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Photograph by Alexander Petrovsky

The St Petersburg skyline: Russia's second city plays host to the country's flagship economic conference