

Showcasing the new Russia

INTERVIEW WITH HERMAN GREF

MINISTER OF ECONOMIC DEVELOPMENT AND TRADE, RUSSIAN FEDERATION



HERMAN GREF graduated in law from the University of Omsk State in 1990. From 1991-98 he was a member of the St Petersburg Municipal Property Management Committee, serving as Chairman from 1997-98. Between 1998 and 2000 he was First Deputy State Property Minister of the Russian Federation and was appointed Minister of Economic Development and Trade in 2000. Mr Gref also serves as Deputy Governor from the Russian Federation on the International Bank for Reconstruction and Development and the Multilateral Investment Guarantee Agency (MIGA).

You were closely involved in the organisation of this year's International Economic Forum in St Petersburg. How satisfied were you with the outcomes of the meeting and what innovations have you introduced to the format of the event?

We were extremely pleased with the results achieved. In the end, more than 5,000 delegates from 46 countries took part in the Forum, including President Putin and Finland's President, Tarja Halonen. We were also fortunate to have a great many senior executives from both Russian and international companies speaking on a wide range of subjects. Around ten contracts worth approximately US \$1 billion were also signed over the course of the three days.

As this year marks the tenth anniversary of the Forum, we introduced a brand new format in order to encourage discussion of the most vital issues facing the global economy. We also constructed a purpose-built venue to house the Forum, which allowed several exhibitions to be held concurrently with the main programme, on the themes of Achievements in Innovation, Advanced Technologies in Energy and Investment Projects.

Our aim is to make the Forum the principal platform for addressing the key economic issues affecting the world's emerging economies, in particular the so-called BRIC countries: Brazil, Russia, India and China. With that in mind, this year's programme focused on the economic prospects for these emerging economies in the age of globalisation, highlighting both their competitive advantages and structural weaknesses.

Senior representatives of the governments of the three other BRICs took part in the Forum and we devoted a special session on the second day to an in-depth analysis of the Russian economy in particular. This session featured roundtable discussions on different aspects of the economy, including knowledge-based industries, raw materials and commodities, the judicial system and related problems, corruption and issues related to efficient corporate governance.

In keeping with St Petersburg's status as the cultural capital of Russia, there was also an extensive recreational programme, including the White Nights Festival, a performance by the stars of the Mariinsky Theatre at the Peterhof and a concert by the Rolling Stones.

All in all, I think the Forum was the best marketing for the country that we could possibly have organised.

St Petersburg has historically been Russia's 'window on the world', and will be the focus of intense international attention during the G8 summit in July. How does the city intend to capitalise on this heightened level of international interest, and what competitive advantages can it offer would-be international investors?

St Petersburg has been riding a wave of vigorous development in recent years, particularly since its 300th Anniversary celebrations in 2003. Both visitor numbers and media interest in the city have grown, and it is actually becoming quite difficult to find hotel rooms at certain times of the year. At the same time, the city authorities are making full use of the available hotel facilities to encourage business events to come to St Petersburg.

They have also been very successful in attracting large-scale foreign investment in the city – Toyota, for example, has more than US\$1 billion invested in St Petersburg. Nissan also signed an agreement to build a manufacturing plant in the city during the Economic Forum, and General Motors has a significant presence, along with many others.

In terms of its competitive advantages I would say that its highly-skilled labour force, its strategic location and its long tradition as a cosmopolitan, outward-looking city have definitely helped attract foreign companies to invest. It has also seen the implementation of a number of interesting projects recently, in particular the redevelopment of New Holland Island, the former military zone in the central hub of the city. The project was put out to tender, attracting bids from such internationally renowned architectural practices as Germany's Engel & Zimmerman and the Dutch architect Erick van Egeraat, and was finally awarded to Britain's Norman Foster in February of this year.

Given its lack of significant oil and gas-based economic activity, do you see St Petersburg as a model for the diversification of the Russian economy as a whole? What is your view of the current state of this diversification process?

Economic diversification is a very lengthy process; it cannot happen overnight, in five or even ten years. At present, a quarter of the Russian economy is based on oil and gas, although diversification is very much a key priority for the government. All of the various economic instruments that were discussed at the St

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Is there room for a 'state within a state' – as some commentators have described Gazprom – in the modern Russia?

I would not say that Gazprom is in any way independent of the government, as the government has a controlling interest in the company. I myself sit on the board of directors of Gazprom.

Given the relatively small size of the Russian market at this point in time, Gazprom is undoubtedly the dominant company, accounting for around 30 per cent of the Russian stock market. Therefore, the dynamics of Gazprom largely set the pace for the dynamics of the market as a whole.

I believe we can safely say therefore that an efficient and effectual Gazprom is of paramount importance to the government, and that efficiency hinges largely on effective competition being put in place. On the other hand, Gazprom, like any mammoth structure, is driven to seek a monopoly position, so there is certainly a difference in the interests of the government and Gazprom in that respect.

Following the deregulation of the market in Gazprom shares however, and the adoption of a number of important structural reforms within the company itself, over the coming year Gazprom should see a delineation of its businesses, sub-dividing them into areas such as developments, transportation and so on, which is a major step towards making the whole company more transparent.

Gazprom's pricing dispute with Ukraine at the beginning of this year caused a certain amount of alarm in some European countries. How seriously has this episode affected Russia's economic and political relations with its European partners?

I have to say that I do not think the media coverage of this subject was either fair or accurate.

Gazprom is now embarking on a path of extracting gas from ever more fresh deposits, where the cost of production is considerably higher than it was in the past. In the case of these fresh deposits, Gazprom

Herman Gref in conversation with Alastair Harris, Executive Publisher of FIRST



produces gas at approximately US\$70 per 1000 cubic metres, whereas it was selling to Ukraine at US\$55, so naturally, the shareholders of the company were asking: what kind of business is that? Why should a commercial company be expected to sell gas at a price below the production cost of the deposits which it is currently developing?

The resulting media coverage was not of a particularly high standard and unfortunately it sent ripples across a number of European countries, despite the fact that Gazprom has been a reliable supplier to Europe for many decades, without any reproach in fulfilling its obligations.


The fact is that Europe has one main supplier, which is Gazprom, and Gazprom has one main buyer, which is Europe. There is a mutual co-dependence, which I believe is the best basis for any partnership. Gazprom could not turn off the supply to Europe tomorrow, because the Russian economy would collapse. So I think these anxieties on the part of our European partners are totally without foundation.

To what extent has investor sentiment recovered from the setback caused by the Yukos affair, and how do you see the investment climate in Russia developing, particularly in the so-called strategic industries?

Foreign investment in Russia is increasing, but it is still not at sufficiently high levels to meet our needs. Russia needs foreign investment in order to develop and diversify its economy, and to enable that, we have to work hard to improve the investment climate in the country. A great deal has been accomplished over the past year but there is obviously quite a lot still to be done. It is a gradual process, but I believe that the most important thing is for investors to see at first-hand the positive dynamics which I believe we have in the Russian economy today.

The government has been saying for some time that it is going to clarify the guidelines concerning which industries are to be closed to foreign investment. Can you comment on the current progress on that front?

The relevant draft law is currently being worked upon. There will be a shortlist of industries – still to be determined – where certain procedures will need to be followed and authorisations sought prior to the acquisition of a controlling interest in the enterprise in question.

At this point in time it appears that there will be as many as 39 such industries, principally those concerned with armament equipment production, nuclear materials and space technologies. All together, these sectors account for no more than 5 per cent of GDP, so I do not think it will affect the overall investment climate in a negative way. On the contrary, investors will have more clarity as regards the rules. 

Petersburg Economic Forum are dedicated to this specific strategic objective. These include the creation of special economic zones, designated territories with facilitated administrative, fiscal and customs regimes.

Other mechanisms have also been put in place to facilitate Public-Private Partnerships and there are a number of ongoing projects to encourage venture capital and investment funds. We are also introducing a series of other instruments geared towards sending the right messages to the economy, in order to encourage investment in non-energy related sectors.

As regards St Petersburg, it has always been a highly diversified city. Since it has no oil or gas, it has been able to successfully develop its expertise in such areas as manufacturing, tourism, culture and scientific research. These form the backbone of the economy of the city.

In terms of the wider economy – excluding the energy sector – what do you see as the main drivers of future economic growth?

I would say primarily space and aerospace technology, industrial machine manufacturing – particularly car making – petrochemicals, and high-tech sectors such as information technology, biotechnology and nanotechnology. In the case of the latter, we are currently seeing some very encouraging development collaborations, particularly in the area of new materials. Some 35 per cent of the hulls of the new generation of Boeing aircraft, for example, are built from composite materials that are made in Russia.

What steps is the government taking to promote uniformity of development across the regions?

This is, of course, a very serious problem. The level of development in the provinces varies hugely from one region to another. Some regions, such as Moscow or the petroleum producing regions, have budgetary efficiency levels on a par with many European countries, while at the same time we have a great many regions where income levels are extremely low. What we are trying to do is to try to achieve equilibrium through the use of budgetary instruments, although it is an impossible task to level it off completely.

Have you had any notable successes to date?

Well, no, because those instruments are currently in the initial stages and frankly speaking, we cannot boast of any results at this point in time. We are now in the second year of implementation of this programme and what we are seeing is an ongoing process of evolution, but it stands to reason that it will certainly yield results in the not-too-distant future. We expect to see the first outcomes by 2008, but it is certainly too early to talk about any kind of breakthrough.

What is your view of the current state of the economic reform process in Russia? What further reforms do you see on the horizon?

The process of economic reform is presently at a halt. At the top of the government's agenda right now is a whole series of key reforms: first and foremost, as stated in President Putin's State of the Union address, from the 1st of June this year we should see a completely deregulated currency market, including a fully-convertible ruble. At a recent government session, we approved a package of measures associated with reform of the corporate sector, and in many ways that also touches upon the next set of reforms, which are all about financial markets.

The Russian stock market is currently in a phase of vigorous development. Last year it rose by 83 per cent, and in the first quarter of this year it rose by more than 50 per cent. Clearly, this type of growth presents its own set of problems, and I need to make sure that we are up to speed with developments in the market so that we will be in a position to act promptly and appropriately in order to ensure the protection of investors' rights and entitlements.

We are also addressing judicial reform as well as our ongoing tax reform programme. We have consistently been following the path of reduction of the tax burden, at the rate of 1 percentage point of GDP per year.

Also currently ongoing is a large-scale reform of the housing market to set the stage for the introduction of mortgages in Russia, in order to make the system accessible and affordable. This has been designated as a national priority, as much as healthcare and education.

You have expressed concern in the past about the growing role of the state in the economy, particularly in the energy sector. Do you think that a 'high water mark' has been reached in this regard, or is the process still ongoing?

I do not foresee any forthcoming nationalisations at this point, but the subject is obviously quite a topical one. Personally, I belong to a group of liberal-minded economists who trust private enterprise more than officialdom, particularly as the officialdom is still evolving in both the State and economic system.

Certainly Gazprom is in a position to buy up new assets, should it choose to do so. But it appears that the company is currently committed to the implementation of a number of big-ticket projects, including the development of the Shtokman project in the Barents Sea, the Yuzhno-Russkoye gas field project and the construction of new gas pipelines. I think it is appropriate at this time for Gazprom to concentrate its resources on these areas.

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