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THE QUEEN'S AWARDS
FOR ENTERPRISE
2010

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Realising the potential of the Russian economy



The visit of Prime Minister David Cameron to Russia, accompanied by other ministers and a high level trade delegation, comes at a crucial time. The two countries have long worked closely together, as permanent members of the UN Security Council, the Middle East Quartet, and within the G8 and G20 forums. Moreover, Britain is one of the largest foreign investors in Russia, witness major recent investments by pharma companies like GSK and AstraZeneca, while Russia-based international companies now account for a large part of the overall market capitalisation of the London Stock Exchange. Bilateral trade has been growing by more than 50 per cent year-on-year, and Britain is keen to see Moscow develop as a successful and well-regulated

financial centre, a conduit for international investment into a country rich in both natural resources and intellectual capital.

The Russian economy recovered well from the downturn of two years ago, when it contracted more than any of the other large emerging markets. However, this was largely due to the revival of global demand for Russian oil, gas and metals – and therefore much higher prices – rather than any underlying improvement in its structure and capabilities. Much needed investment in infrastructure and innovation has been slow in coming, and in the view of many commentators – both domestic and foreign – Russia remains over-reliant on the export of its natural resources and has not yet put forward a clear plan as to how it will diversify its economy.

In the current situation, with the threat of a double-dip recession undermining international commodities prices, the need to move towards a more balanced economy is all the more pressing. Equally, the need to raise new capital to secure Russia's future growth. For, although Russia today remains the world's most important producer of hydrocarbons, massive new investments – both in terms of capital and the introduction of the latest technology – are needed to move production beyond the so-called 'low hanging fruits' towards unlocking the potential of new fields in Eastern Siberia and the Arctic shelf.

Similarly, more could be done to develop areas of expertise in which Russia has traditionally excelled: its strong science base, particularly in engineering; nuclear energy and space flight; international co-operation in the defense industry. There are plans to realise this potential across many industries, from automotive to pharmaceuticals and healthcare, so that Russia can move on from being a primary resource-exporter that imports too great a proportion of finished products it consumes, towards establishing a more competitive, broad-based economy.

The opportunities are immense, but to realise that potential will require enormous investments. And whereas many international investors express a desire to involve themselves more closely in Russia, concerns about validity of contracts, rent-seeking and rule of law have all too often proved a deterrent to action.

Modernisation, it is generally agreed, is urgently needed. But, as yet, a comprehensive explanation of what such 'modernisation' entails, or how it might be implemented, has yet to emerge. Individual initiatives, such as President Medvedev's opening of Skolkovo – a hi-tech innovation hub near Moscow which it is hoped will become Russia's answer to Silicon Valley – or Prime Minister Putin's launching the Agency for Strategic Initiatives (ASI) – a networking channel for medium-sized business across Russia intended to promote innovative projects by bringing together individual research and targeted programmes – are to be welcomed in that, provided they complement each other, they should provide a focus for Russians' acknowledged engineering and technical expertise. But will that be enough to kick-start a broader shift of the economy away from natural resources extraction towards more innovative, value-added, 'post-industrial' activities? Indeed, can a 'top-down' system of political and business governance really foster innovation and entrepreneurial risk-taking, especially if open competition and a level playing field are far from being assured?

The conundrum that Russia faces today is that, in order to attract new investments and encourage innovation, other changes must take place as well. To push through those changes – often against the entrenched opposition of vested interests – will require exceptional political courage and leadership. Whether that commitment is really there may soon become apparent during the forthcoming elections to the Duma and the presidential campaign. If it does, then investment into Russia and its closer integration into the world economy will surely follow.

