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Euro crisis forces change on Russia

By [Kathy Lally](#), Published: July 22

MOSCOW — While the euro zone stands on the precipice of financial disaster, Russia looks on with a safely balanced budget, very little debt, a steady ruble — and a shudder of fear.

Russia's economy relies on oil — 60 percent of gross domestic product — and a deep recession in Europe would drastically slash demand and price, forcing major cuts in government spending and threatening to provoke widespread social protest. For several years, the leadership has been talking urgently about its intentions to diversify beyond natural resources, without actually doing anything.

Now, the [threat of a deeper crisis in Europe](#) is forcing Russia to get serious.

President Vladimir Putin, whose rhetoric often positions him as sternly anti-Western, is courting foreign investors with enticing promises as he seeks investment that can bring about economic development and insulate Russia from global tremors.

Investors have made a great deal of money in Russia, but doing business here has a bad reputation, reinforced by a World Bank-International Finance Corp. survey that puts Russia in 120th place out of 183 countries on ease of doing business.

“Russia is considered a risky place to invest,” said Roland Nash, chief investment strategist at Verno Capital here, “and people don't want to take much risk now.”

At a recent [economic forum](#) in St. Petersburg, Putin assured potential investors that Russia was changing. He vowed to fight corruption, a pledge heard so many times before with so little result that it was met with a cynical believe-it-when-we-see-it shrug. Putin attracted more attention when he guaranteed an improvement in the business climate, vowing to overtake Switzerland, France, China and others and move Russia to 20th place on the World Bank index by 2018.

Some investment advisers and economists are skeptical that can be achieved, but would consider any move in the right direction a success. Others contend that Russia doesn't deserve its tarnished reputation and called the index meaningless. They agree, however, that Russia needs more foreign direct investment — money put directly into business and industry rather than stocks or bonds.

“You don't have development and technological innovation without investment,” said Evsey Gurvich, head of the Economic Expert Group. “Improving the business climate means more freedom to operate your business, and this means more competition. More competition means more efficiency and better management.”

Putin says that only investment can create the new jobs Russia needs, and he wants to make investment 27 percent of GDP by 2018, from 20 percent today. **Gurvich called that ambitious but possible if the business climate is improved.**

“He didn't suggest any new measures to fight corruption, so we can't expect any progress there in the near future,” he said, adding that the business climate goal was different. “There's a concrete program with concrete objectives. I'm not saying it will work, but it's different than corruption.”

Foreign investment

Improving [Russia's rating](#) is a worthy goal, said Liam Halligan, chief economist at Prosperity Capital Management, because many investors give it credence. He doesn't.

"I don't think anyone who really understands business here thinks Russia is below Nicaragua [118], or Kosovo [117] or Ethiopia [111]," he said. "It's just ridiculous."

He finds good news in the underlying data. Russia is 13 on enforcing contracts, 45 on registering property and 60 on resolving insolvency.

But just try to build a warehouse and hook it up to electricity. That's where Russia gets clobbered. In Moscow, according to the World Bank, it takes 10 procedures and 281 days to get the lights on (every step an opportunity for a handout), and that puts Russia dead last in the world on electrical hookup, helping to drag down its overall rating.

Prosperity is the largest portfolio investor here, managing \$4.5 billion, and Halligan said it's attractive to business and getting better. It's a country that wants to be part of the world economy, that wants growth, that wants prosperity and so wants more investment, he said.

"The reality is that BP has invested \$7 billion and taken out \$18 billion," he said, "and still owns the assets. It's the only seriously smart thing they've done in the last few years."

Many Russians [voted for Putin](#) expecting more and more improvement in their living standards. As president from 2000 to 2008, he oversaw a boom fueled by high oil prices — wages increased 30 percent. They appear unworried now. A recent poll by the All Russia Public Opinion Research Center found that 85 percent were doing nothing to prepare for an economic crisis.

"If there was a Nobel Prize for talking about reform," said Nash, who has been doing business here for 20 years, "Russia would have won a long time ago."

Meaningful improvement will only come with deep institutional reforms of the economy, courts and government, said Yevgeny Gontmakher, deputy director of the Institute of Contemporary Development and International Relations.

Foreign businesses can thrive here — automakers are a clear example — but the rules are unclear. "It's possible to do business if Putin says 'I'll protect you,' " Gontmakher said. "Personal connections are a big influence."

Russia's business climate also reflects the toll taken by corruption, said Peter Westin, chief equity strategist for Aton, an investment firm. "The bureaucrats are not about to put themselves in jail. It's all part of the debate now, but nothing gets done."

Long-term, Westin is optimistic about the Russian economy, but not short term. "I think we'll have a huge blow up in Europe," he said.

Several factors drive foreign investment, including market size, human capital, political stability and business climate, which can be dramatically changed by determined leadership.

Political commitment

"Can Russia do better?" asked Augusto Lopez-Claros, director of Global Indicators and Analysis for the World Bank Group. "The answer has to be a resounding yes. It's already being done in some cities in the country."

He said other countries that have moved up have done so with strong political commitment at a high level. “Your effort needs to be sustained over a period of several years,” he said. “If you stand still, you fall behind.”

And when countries streamline requirements and make information about them easily available, other changes occur. “As countries make procedures more transparent,” he said, “the level of corruption comes down.” When you make information easily available, costs come down noticeably, he said.

Bernard Sucher, a banker and entrepreneur with years of experience here, agreed that starting a business from scratch can be difficult, even though the environment is good for big multinational companies selling products and services to the middle class.

“There are certain elements that are harder than in the U.S., but once you begin a business in Russia you tend to do well because of lack of efficiency in the domestic economy,” he said.

“The real issue is that the country has an economy where it digs things up from the ground, sends it overseas and uses much of that money to buy what it needs,” Sucher said. “That’s a weak model, and there’s no change there.”

Beyond that, the economy is becoming less and less competitive globally because of the perverse effects of the political system and bureaucracy, he said. Internally it’s neither competitive nor dynamic and favors incumbents over challengers, he said.

“Of course Mr. Putin wants foreign investment, but he wants it on his terms,” Sucher said. “The single most useful thing that he could do to encourage long-term investment is to preside over his own orderly departure from the Kremlin.”