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Russia's New Horizons
THE PIVOT EAST AND SIBERIA'S DEVELOPMENT AGENDA
Arena

JUNE 20, 2013
14:00–15:15, Pavilion 4, Conference Hall 4.1

St. Petersburg, Russia
2013

Moderator:

Yermolai Solzhenitsyn, Director, McKinsey & Company, Russia

Panellists:

Hu Bing, President, Co-Chief Executive Officer, Russia-China Investment Fund

Vladimir Dmitriev, Chairman, Bank for Development and Foreign Economic Affairs (Vnesheconombank) State Corporation

Tadashi Maeda, Managing Executive Officer, Japan Bank for International Cooperation

Artem Volynets, Chief Executive Officer, En+ Group

Front row participants:

Pavel Grachev, General Director, Far East and the Baikal Region Development Foundation

Vitaly Nesis, General Director, JSK Polymetal

Shigehisa Yoshihiro, Chairman Emeritus, JGC Corporation

Y. Solzhenitsyn:

Good afternoon. Could you please take your seats?

The subject of our roundtable is the development of the Russian East, the development of Eastern Siberia. The organizers proposed that our roundtable be entitled 'The Pivot East'. Here in St. Petersburg, in our 'window on the West', we shall discuss the issue of by whom, from where, and how our window on the East should be built.

The participants in our roundtable discussion are: Artem Volynets, Chief Executive Officer of the En+ Group; Hu Bing, President and Co-Chief Executive Officer of the Russia–China Investment Fund; Vladimir Dmitriev, Chairman of the Bank for Development and Foreign Economic Affairs (Vnesheconombank) State Corporation; and Tadashi Maeda, Managing Executive Officer for the Japan Bank for International Cooperation. Representatives of regional government authorities and industry are present in the audience, and we will also involve them in the debate.

Before addressing questions to our panel, I would like to cite a few figures which shed light on the current economic links between Russia and Asia. We all well understand that the centre of global economic activity is the Asia–Pacific region, and it is in this very region that the prospects for world economic development in the twenty-first century are focused. Yet if we were to take a look at the figures which show our engagement in this region, we would see that the indicators are astoundingly low. Today, only 25% of Russia's foreign trade is with Asia. This is probably a good indicator, reflecting the attitude of the general population, but it means that 75% of our foreign trade is not directed towards the global centre of economic activity.

There is an almost total lack of investment: less than 3% of all investments in Russia come from Asian countries. If we look at the opposite direction, we see the same picture: less than 3% of foreign investment from Russia is directed towards this region. China is a huge economy, and yet it makes up only 1% of both outgoing and incoming investment. Today we would like to discuss why this is the case.

Moving on to travel, Chinese citizens make up only 3% of arrivals in Russia, while Russian citizens make up 5% of arrivals in China.

The demographic situation in the Russian Far East, as we know, is rather complicated. Currently, 6.5 million people live in the region. Since 1992, its population has decreased by 20%. How can we develop this region? How can we create new growth areas? Can we do something about the demographic situation and reverse current trends in some way? I would like to take another 30 seconds of your time to communicate the two basic targets of the government's policies for the development of the Far East, which have recently been approved after long discussions. Then I would like to ask each of you – first of all, the Russian participants in this discussion – to answer the following question. What do you think about these targets, and what, in your view, should be done to achieve them by 2025, the year defined by the programme as a reference point?

The first target is, and I quote: “the establishment of conditions for the rapid development of the Russian Far East, and its transformation into a competitive region with a diversified economy where high-tech industries with high value-added will predominate. Shaping these conditions for the rapid development of the Far East helps to create further opportunities for the economic development of the Russian Federation.”

The second target is: “to radically improve the social and demographic situation in the Far East and the Baikal Region, and ensure a decrease in emigration from this region and an increase in immigration to this region of predominantly highly qualified specialists, in order to guarantee European living standards for the region's population.”

Many measures are envisaged, and investment by 2025 is likely to run to RUB 10 trillion. RUB 3 trillion will come from government funds, and the rest from other sources. One question is: what are these sources? So Vladimir, how do you address tasks of such magnitude in terms of the declared targets and the mechanisms employed to reach them?

V. Dmitriev:

Thank you, Yermolai.

I participated in many of the discussions prior to the endorsement of this decision, and I know how difficult it was to draw up this document. I believe that it is better to have it in place than to have endless debates on this subject. Of course, the targets set are extremely ambitious ones. It is a very significant challenge for us all.

You were correct in stating that only a small part of the RUB 10 trillion in investment will be coming from government sources, and the rest from non-governmental funding. This is a major challenge facing us: how and from where can we attract this non-governmental money? We, as a development corporation, alongside the entities for which we are responsible (the Russian Direct Investment Fund, the Export Insurance Agency of Russia (EXIAR), and the Far East and the Baikal Region Development Foundation, as well as the fund we have created in collaboration with the China Investment Corporation), aim to bring in funds and private investment. The scale of this task is huge.

We understand that reaching these two targets – firstly, enabling fast-track regional development and employing its competitive potential, and secondly, creating, as a result, a healthy social environment which will attract people rather than frightening them away from the region or causing them to leave – is extraordinarily difficult. But I will repeat once again that the existence of this programme and its defined targets, for which bureaucrats and quasi-state entities are answerable, is far better than having endless debates on this topic.

Thank you.

Y. Solzhenitsyn:

I have been looking up the figures: many of those involved with this programme know how these RUB 3 trillion will be distributed. Each year, about RUB 300 billion will be allocated. The lion's share – about RUB 1.6 trillion – will go towards the development of transport infrastructure which is probably no surprise. About RUB 500 billion will be spent on the development of energy infrastructure, and another RUB 500 billion on construction, to deliver programmes aimed at providing people with a comfortable living environment.

Artem, what is your attitude to this distribution of funds? What, from your point of view, are the main factors which will allow us to hit the declared targets?

A. Volynets:

Well, that is a hard question to begin with. Do you have any other questions up your sleeve?

Y. Solzhenitsyn:

Well, let us get started on this subject, and then you will have another question later.

A. Volynets:

Well, the question is certainly complex and many-sided, but I will try to keep the answer as simple as possible.

It is wonderful that the programme has been adopted: I am in full agreement with it. However, these targets (just like any other target) are impossible to reach through government efforts alone. In order to boost regional development, private initiatives on the part of both Russian and foreign players are indispensable. For this to happen in the region (as well as throughout Russia), a proper investment climate needs to be created. If we cannot lower interest rates and limit the growth in natural monopoly tariffs within the Russian Federation as a whole, then perhaps we should try to do this for the development of the Far East region, try to carry out this revolution within the boundaries of a single region. If this should prove impossible, then we need to create other stimuli to attract long-term investment. I use the phrase 'long-term' because such a huge territory cannot be developed on the basis of short-term investments alone.

We often speak of infrastructure investments, but infrastructure is always tied to specific projects. So Russian money will go there as long as there is a guarantee of a return, and for this to happen it is necessary to have already created favourable conditions. Foreign money will also be attracted if there is an atmosphere of trust. At the highest levels of government, we are doing everything possible to ensure good relations with our southern neighbours, and

they are coming to us with promises of large investments. We hope that this money can be invested in the Far East region: for this to happen it is necessary for our colleagues from South Asia to be allowed to hold assets in our country. There is nothing wrong with this; in fact, it is a positive thing.

The most important thing, as far as I am concerned, is this: it is not the infrastructure we have been discussing so far that we need to invest in. We need to invest in human capital! We need to create opportunities for people who live in this region, 40% of whom currently wish to leave. They need a European standard of living, not an Asian one, even though they live in Asia. They need to have interesting employment opportunities and the ability to earn money.

Y. Solzhenitsyn:

You talked about the need for favourable conditions. What exactly do you have in mind? What would these conditions be, on what scale do we need them?

A. Volynets:

Firstly, in order to launch any new project in this region, it is necessary, in one way or another, to cooperate with the natural monopolies. New enterprises need railways, Internet access, reasonable prices for gas, and so on. Could we perhaps create favourable conditions for these enterprises within this region even if these conditions cannot be created throughout the whole country?

Secondly, it is necessary, on condition of significant investment, to exempt enterprises from paying taxes on profits for a long period of time, even after they become profitable.

V. Dmitriev:

I would like to remind people that, in connection with the Far East and Baikal Region, the following decisions have already been taken: investors have been exempted from paying corporation taxes during the investment phases; local administrations have also enacted a series of property tax exemptions; and a whole range of other incentives are available to private investors working in the region.

Y. Solzhenitsyn:

So far, as we know, large-scale investors have not been forthcoming. Perhaps private investors are waiting for a signal from the government in the form of state investment. Mr. Hu, can you tell me how China looks at the issue of possible investments in the Russian Far East and Eastern Siberia? Why are Chinese investments in Russia and Russian investments in China still currently at such a low level? Is China interested at all in investing here? And if so, what is it interested in investing in? How do you see the reality of mutual investments?

H. Bing:

Thank you. I think that is a very good question, and let me just say a little bit about the Russia–China Investment Fund. We just recently launched, last March, but even before we officially launched we made one investment in the Far East, which is a timber company, in the forestry business. Ninety per cent of the company's products are exported to China. And over the last two months I have taken more than two trips to the Far East. Two of our pipeline projects are in the Far East. Why is that? We are talking about Vladivostok, we are talking about Eastern Siberia, and there, naturally, is a place that needs capital investment, it needs business know-how, it needs manufacturing industry coming in and providing high-end products to supply not only domestic markets but also neighbouring countries, such as China, Korea, and Japan. One of the very interesting sectors is agriculture. One of the companies we looked at is producing agricultural products in a very efficient way because they have the machinery just across the border on the China side. On the China side, there is a very well developed SOE which has a farm of more than a million acres. It is very modern, state of the art, cutting edge farming technology, so they can leverage that sort of resource and do the same thing on the Russian side. But on the Russian side, the border is a very remote area. Just think about it: flying from Moscow to Vladivostok takes about eight hours; from Beijing it is about two hours. So, I think with the establishment of the Russia–China Fund, we will see more and more investment from China in the Far East. To answer your question

of why now and not before: Number one is because previously lots of small companies going in did not have this kind of large-scale government support. The Russia–China Fund is supported by the Russian Government and the Chinese Government, so you are making an investment and you feel secure. For small entrepreneurial private companies to go to this remote area, they get scared and confused. Number two, I think in the last three years with Putin's government, there are lots of new initiatives in the Far East, and the local governments are starting to push out lots of good programmes. I visited several governors in charge of the area, and they have agencies that attract foreign investment. When we had the meetings, the governors specifically mentioned five or six projects to me. They act like businessmen, not like protocol diplomats. Then when we finished the meeting, I got a flash disk with all the files in it, which was very efficient. So I think that it is a dramatic change that has happened over the last couple of years. Going forward, I think what we need in the Far East is, firstly, transportation infrastructure. When we are talking about the RUB 3 trillion, the money you should spend on infrastructure, it has big multiplying factors. Second, I think, is about education because Russia has a very good education system, and lots of Chinese students like to come to Moscow and St. Petersburg to study. And in places like Vladivostok, you can build up a very high quality college, and people from China, Korea, and different Southeast Asian countries can come to study. Third, in the Far East we know that a lot of imported machines and automobiles come from the Port of Vladivostok. Over there we can set up a special economic zone and promote the localization of those manufacturing industries. One of the governors mentioned that he wanted to introduce Chinese automakers to actually produce there, and we actually helped facilitate that. So I think that, going forward, if the government is able to put money into the infrastructure of transportation and education, and also help to sponsor some big events, like APEC, in the Far East area, that would really help people. My experience is that if you come to the Far East, to cities like Vladivostok, you will really like it, and more people will come.

Y. Solzhenitsyn:

I have a question for you. According to government statistics – and statistics sometimes do not catch everything – China invested a total of about USD 200 million into Russia per year. Obviously, not all of this is going into the region. For you to increase this investment – you mentioned transportation, agriculture – are you welcomed to gain control of assets? Do you need majority control? Mr. Volynets mentioned we should not be afraid to let Chinese companies actually buy assets in Russia. Do you see any barriers, any hesitation to let Chinese companies or investment agencies actually acquire controlling stakes in Russian assets?

H. Bing:

Good questions, and first let me clarify that my friend, the leader of the RDIF and our Chairman of the Russia–China Investment Fund, Mr. Vladimir Dmitriev, may know the numbers better. The number you quoted is definitely not correct, because in the last two years, I have personally worked with VTB, with the Russian Direct Investment Fund, and we have invested more than USD 4 billion in Russia, not counting the USD 1 billion committed to the Russia–China Investment Fund. Just last year, 2012, we invested more than USD 3 billion in Russia, but you are right; not in the Far East. In the Far East, we have only invested something like USD 150 million together with the Russian Direct Investment Fund in the forestry deal. So I think, going forward, the RDIF is helping by attracting other investors, and there will be more investment in this region. You mentioned the issues and barriers. Let me comment on that. First, the CIC does not need a majority. Those USD four billion-plus we invested, none of them were a majority. I think most of them were 10%, or 5%, or 12%. But you are right, sometimes for small companies, if the company's market equity is only USD 100 million and you invest USD 50 million, which is 50%. So in Russia, you have this regulation that when you are a foreign investor and the investment is over a certain percentage, you have to file applications. It is the same for non-strategic assets. The CIC is a financial investor. The Russia–China Investment Fund is also a financial investor, so we have no strategic angle here, but sometimes when we go to 20% or 25% and we need to file applications, we want

the government procedure to be quicker. Sometimes it takes between six months or a year. If it is a public market-related transaction and the other party says you can finish the transaction and get approval in six months, they will say, "Sorry, forget it. We will not do it." So I think, in the future, if you can get government agencies to speed up the process, it would be better. The other barrier I will mention, for individual companies in the Far East, sometimes when you set up a business you want to clarify how much is the tax, what are the regulations, and also the labour quota. All of this needs to be really 100% transparent, and then when they apply for it you want to have fixed dates, like 20 business days for the business response time. That way the business knows what to expect where timing is a risk. Thank you.

Y. Solzhenitsyn:

One quick question for you, again. In Russia, since the 1960s and 1970s, there has been an almost mythological fear that because we have so much land and resources, and China has such a large population, there is a risk that, at some point, China will want to move over the border and take over the land. What is your answer to that comment?

H. Bing:

First of all, both countries are ruled by the law. China is now one of the fastest growing economies in the world. If China's economy is going very well then you should not worry about that, because these people just want to make money.

Y. Solzhenitsyn:

So we will watch China's economic growth closely for strategic and tactical reasons. Mr. Maeda, what is the view from Japan on these issues?

T. Maeda:

We have a long history of investing into the Russian Far East from the Soviet era, for many decades, but now, we are shifting the investment focus from oil, gas, and coal to new kinds of industries that can be deployed in the Russian Far

East. For example, at the Japan Bank for International Cooperation, we launched a joint investment platform with the RDIF in December, but this is not funded like the Russia–China Fund. The key feature of this joint investment platform is to deploy cutting edge technologies, for example, the Smart Communities, or the balanced medical treatment system, which is an integrated system that is ready to operate in the Russian Far East. Besides investment in fossil fuels, we already have some investments in the manufacturing sector in the Far East. For example, our leading automobile company, Toyota, has already made a substantial investment in Vladivostok. However, all of the automobile products will be delivered from the Russian Far East to European Russia via the Trans-Siberian railway. So it means that still the Russian Far East is a manufacturing centre, that there is no actual market yet recognized by the Japanese. So we need to make the Russian Far East a centre of excellence of new technology. This is one example that we will underscore: a new approach from the Japanese side to the Russian Far East, because the Russian Far East is our neighbour, and the gravity of the world economy has shifted from Europe to the Asia–Pacific, and China has a border with Russia. We do not actually have an onshore border, but obviously Russia is our neighbour. So we are going to create a regional economic zone, as North East Asia, which is more prosperous, by means of cooperation amongst neighbours – Chinese, Japanese, Koreans, whatever. So the ultimate goal is to make the Russian Far East a part of this centre of excellence. There is a long way to go, but we just started this totally different approach towards the Russian Far East.

Y. Solzhenitsyn:

What can Russia contribute to such a technological centre? Why would investors want to invest in technological activity in the Russian Far East when Japan, Korea, and China are all nearby? Is the Far East attractive for investments predominantly for the raw materials?

T. Maeda:

Yes, that is true, but, as you said, now the Russian Far East population has declined for many consecutive years. It has already lost 20% of its population over the last twenty years. So you need some economic zone, by utilizing the vast piece of land, and you will also have some potential technology to deploy from European Russia to the Russian Far East. This is a matter of allocation of resources by the Russian Federation Government, but obviously we need a strong and stable commitment from the Russian Government. During our negotiations with the RDIF on making this joint investment platform, we agreed to several sectors as priority sectors. The RDIF put the top priority on the development of the Russian Far East, not just the typical development of oil and gas. With or without this joint investment platform, Japan continues to invest, but the question is separate from the oil and gas sector. Therefore, we need to intentionally drive things in this direction by means of a strong commitment from the Russian Government. That is what I am saying.

H. Bing:

Can I comment on that question? I think there are several factors in answering that question. First, it is not that the case that previously international investors were not interested in this kind of investment. It is only because ten years ago, Russia was not ready for two reasons. It was not ready in the two important aspects: the legal and business environments were not ready for international investors to come. They worried that if investment happened there, the businesses may have to be taken over by someone else. But now, I think, after 10 years of work, people are not only able to do business in Moscow and St. Petersburg but they feel safe to do business in the Far East. Second, in the last ten years the Russian middle class has grown into a very significant consumer force, and the production of consumer products in Russia can be very profitable. And the third thing I want to say is that in Russia you always have the opportunity for import substitution. The majority of consumer goods come from outside. So if you are a smart international businessman, you always want your factories set up here to produce here and sell to the local market.

Y. Solzhenitsyn:

Most people set up factories near St Petersburg, not so much near the Far East, as we said: six million people, small market.

A. Volynets:

But you can serve the Asian market from the Far East very easily, provided that you can manufacture goods in the Far East and in Siberia that can be exported to Asia.

Y. Solzhenitsyn:

Name some examples of some goods that can be manufactured in the Far East and competitively be exported to Asia.

H. Bing:

Okay, I will give you one example. You can basically transport gas to the Far East, and then you have petrochemical products exported to Asia. Second, Russia's pharmaceutical industry is very advanced, and you can produce either in the Far East or even in neighbouring towns of China and sell to China. When I went to Vladivostok, one of the Chinese entrepreneurs told me that he has a joint venture with a Russian partner producing pharmaceuticals in Russia and in China's Far East and selling to the Chinese market.

Y. Solzhenitsyn:

This is a great example. Let us hope we have more of this.

I would like to ask three questions of Vladimir Miklushevsky, Governor of Primorsk Territory. My first question is: what, from your point of view, does this government programme offer the Territory? What more do you want from the federal centre? And what, in general, do you need from it? My second question is: how do you perceive your integration with the Asian region? How far are Vladivostok and Primorsk Territory already integrated into this region, and how far can the region be integrated? Where are the boundaries of this integration,

and what issues does it cover? My third question concerns the demographics: are people leaving the Territory? If so, who is leaving, and are people coming to Vladivostok from other parts of the region where the population is in decline? I would like you to talk about these subjects and, perhaps, others too: it would be interesting to know how all these issues are seen from the eastern part of the country.

V. Miklushevsky:

Thank you very much.

I will start with your first question. In our debate, a point of view has been voiced about the government programme which I am ready to agree with. One cannot separate this government programme from our plan to attract private investment and invest seriously in human capital. I am ready to dwell on the last point in a little more detail since it is linked very much to your third question. First of all, I would like to say that those pessimistic feelings that many experts have are not confirmed by the statistics, at least in Primorsk Territory. Last year we once again observed a negative demographic and migration balance, but this negative figure corresponds to only 0.15% of the population of the Territory. In other words, the figures are close to the levels of statistical error, and are not of a critical nature.

Of course, we aim to ensure that this balance becomes positive. A major problem is that the best people are leaving, and here I am ready to agree with many critics that, more often than not, it is impossible to find equivalent replacements among those who are arriving. This compels me, as the Governor, to consider investment in human capital and the creation of acceptable living standards in Primorsk Territory. Here, people have been talking of the European standard of living as being higher than Asian living standards, but I would say that nowadays the reverse is true: the Asian model of consumption has many advantages over the European one, and the social conditions in Asia are often better. With open borders, people travel a lot and have the chance to make comparisons, and we need to face this challenge. If we do not, then we will have those problems that we are talking about today.

In this regard, I can say that many efforts are underway to confront these problems, from the implementation of the Executive Order of May 7, 2012 'On Measures to Implement State Social Policy', to various local initiatives. Recently I initiated a bill which has already been discussed at the Legislative Assembly for the free provision of land to build low-rise residences for families with two children and young families where the couple are under the age of 35. This was possible thanks to the transfer of a large amount of land from the Ministry of Defence. I believe that this is a political task, because these measures are not only able to check the outflow of the population, they can also stimulate a subsequent inflow. By acquiring land and acquiring one's own housing on the land, a person starts to take root in this land.

As far as your second question is concerned, I would like to underline the special role that Primorsk Territory plays. We have just had a debate about relative export potential. I am one of those who believe that it is necessary to focus our efforts on exports: not many people live in the Far East, and the market is not very large. Of course, we should also pay attention to this market; we should not neglect it, but we must remember that 400 million people live within an hour's flight of Vladivostok. No single Russian region can compare with these territories in terms of population, and we should take advantage of these circumstances.

Incidentally, in Vladivostok and in Primorsk Territory as a whole, export-oriented production already exists: for example, in the timber industry. Many Japanese investments have already been made, and they produce not round timber but added-value wood processing products. Hydrocarbons have already been mentioned here. There is an oil loading terminal in Primorsk Territory, and there are plans to liquefy gas in the region, but at the same time, petrochemical and gas chemical production is also being developed. In conjunction with South Korean and Japanese car companies, the company Sollers has realized a project, which as yet is not export-oriented. In cooperation with Hyundai Heavy Industries, a factory for the production of electrical equipment has been built; its products will go not only to the domestic market but also to export. The Territory also has enormous tourist potential, so for us the creation of a resort in the

gaming zone around Artyom is of great importance. We believe that this has the potential to attract many tourists to Primorsk Territory from nearby regions.

In conclusion, I would like to say that there are two international transport corridors – Primorye-1 and Primorye-2 – in Primorsk Territory, linking the Chinese border to the Eastern and Trinity ports respectively. Northeastern China, as is known, has no outlet to the sea, and the existence of such a transport corridor, if well-organized, will allow us to receive significant amounts of income from transportation, as well as allowing our Chinese partners to develop their Northeastern provinces.

Thank you.

Y. Solzhenitsyn:

Mr. Miklushevsky, one more question. In the programme, if I am not mistaken, there is a subtarget aimed at ensuring that economic growth in the region exceeds average growth in Russia by 1.5%. Russia is seeing economic growth of 2–3% a year; these are the figures we hear. In China, the figures are many times greater, even now after some corrections. Would it be right to expect economic growth in Primorsk Territory to reach Chinese growth figures? Should we be aiming for this?

V. Miklushevsky:

We do not tend to talk about ourselves in a positive light, but we should. Last year's economic growth figures for Primorsk Territory were about 5.1%: twice as high as average Russian growth, higher than South Korea's figures, but lower than China's. Already, many of our economic indicators significantly surpass the average Russian indicators and, in general, are comparable to those of our neighbours.

Y. Solzhenitsyn:

A final question: does the population of Primorsk Territory fear integration or opening up to the Chinese in the first place? Does it fear any kind of economic,

or maybe even psychological, occupation? Does this problem exist? And how do you address it?

V. Miklushevsky:

I do not think that the problem exists.

Y. Solzhenitsyn:

Fine; I just wanted to clarify that point. Thank you very much.

I would like to ask two questions of Pavel Grachev, who is General Director of the Far East and the Baikal Region Development Foundation. Firstly, I will ask the question that I have asked of each participant: what has to happen for investments to be allocated where they need to be allocated, and what are the prospects of this happening?

The second question is: looking from the sidelines, it seems that we have a large number of federal entities and development agencies addressing the problems of the Far East. There is the Ministry of Economic Development, the Ministry of Regional Development, and the Ministry for the Development of the Russian Far East. There is the Russian Direct Investment Fund, which works with the Russia–China Investment Fund, and there is the Far East Development Foundation. To whom should those investors looking to invest their money address themselves? We have a multitude of protagonists, but is there some kind of first port of call where these investors can go? How would you comment on this?

P. Grachev:

Thank you. With regard to the problems that we need to resolve to attract investment to the Far East, I will tell you about the issues we have encountered. In spite of conventional wisdom, there are an enormous number of infrastructural and industrial projects in the Far East and the Baikal Region. Indeed, there are also funds (both private and government) which investors are prepared to invest in such projects. But the investment does not take place because of the inadequacies of the system for regulating this type of investment, above all

because of legislative shortcomings. There is no opportunity to build these projects with allocated investments on a repayable basis, and the use of state support where necessary. What do I mean by that? Firstly, I mean that we need to introduce individual, long-term tariffs on electricity and rail transportation as soon as possible. This would instantly unblock the investment market for electricity and rail infrastructure, and allow us to structure these investments on a repayable basis: that is, to compensate investors for the money they have invested through returns on the projects.

Further, a private investment initiative (PII) is needed to initiate these kinds of infrastructure projects. Frequently these projects exist, everyone knows about them, and no one doubts the need for them, but in order for them to reach the investment stage, they need to go beyond preparatory phases, and certain costs (however small) are necessary to set them up. The private sector and the state observe each other, neither willing to take the initiative in order to move beyond this pre-investment phase and bring this project to tender where it would be proposed to a wide circle of investors. Furthermore, the state often has no funds. All of these issues need to be addressed at the level of concession legislation too, and legislation on state procurement and associated acts needs to be drawn up.

Finally – and this question has been debated for years – a global mechanism needs to be adopted, enabling future budgetary income to be used to address the subsidizing of concrete investment projects: so-called tax increment financing (TIF), which permits (once again on an individual basis) the targeting of future tax revenues for infrastructure investment financing.

Once again, these three things are present on the surface, and, as I have already said, have been discussed for many years at government level. Yet because of the understandable fears of the Ministry of Finance and other entities, these mechanisms have not yet been introduced at a federal level. I agree with Artem's thesis that it would be right, considering the situation of pent-up demand, to try to introduce them as part of pilot projects in the Far East. I do not think that there would be any negative consequences. It would then also allow these schemes, later on, to be gradually introduced at a federal level.

Now, regarding the multitude of state and quasi-state entities which deal with the Far East, on the one hand, this is an indicator of the interest which the government has in this region, and this is a good sign. On the other hand, there is a certain duplication of functions, especially in the eyes of an outside observer who does not always grasp the internal rules, local contexts, and so on. Nevertheless, there is a sufficiently clear distinction of functional responsibility between political entities, including the Ministry for the Development of the Russian Far East and economic or business-oriented institutes, above all Vnesheconombank, the Direct Investment Fund, and our organization, which uses state or quasi-state funds to promote these or other investment projects.

I will now say a few words on the Far East Development Foundation. Our mission is, above all, about structuring and preparing greenfield projects so that they can be proposed to potential investors. We undertake, for example, the structuring of business projects for the construction of bridges, and this morning we signed an agreement with some Chinese colleagues in charge of the Harbin Railway (Province of Heilongjiang) for the construction of a bridge along the Amur River near the Chinese town of Tongjiang and our Nizhneleninsk. We are also involved in Russian airport investment projects. In half an hour's time, we will be signing an agreement with the Singapore company Changi Airports to develop the airport in Vladivostok. Vladimir Miklushevsky is also involved in this project. We are actively discussing road building infrastructure projects in these regions, including working as a consortium with other organizations and investors. But generally speaking, the focus is on long-term investment projects which are implemented from scratch.

Y. Solzhenitsyn:

And so, to sum up what you are saying, the main barrier today is a legislative one. You believe that the economy, in principle, is in good shape, the funds are there, the projects exist and moreover are of an appropriate quality, but that the legislative foundations are lacking. Have I understood you correctly?

P. Grachev:

I would say that the legislative foundations are lacking in the very widest sense of this term. I am talking here not only about federal legislation but also about how it is applied in practice, and about the rules that are developed at the local level. Existing, as well as future, legislation is construed according to the interpretations set down by law enforcement agencies.

Y. Solzhenitsyn:

This is a general Russian subject, as I understand it, and not a unique feature of the region. Vitaly Nesis, your company, Polymetal, has created many ore-mining and smelting enterprises practically from scratch. In this sense, you are a fine example of an investor in the Far East region. What are conditions (economic, infrastructure, regulatory) like there for an investor? In your view, what do all interested parties need to work on to make life easier for investors, especially in the raw materials industry, which will play such a significant role in the future?

V. Nesis:

I am fully in agreement with Artem Volynets and Pavel Grachev regarding the fact that the state should create the most favourable conditions for investment in the Far East. I wanted to remark that, of course, infrastructure is very important, but it is also important to note that the deposits opened during the Soviet period are gradually being depleted. Today the issue of primary importance is the discovery of mineral- and raw-material-based sites that can ensure long-term economic growth. I believe that the creation of new jobs is of especial importance. This is a task which is within the capabilities of a powerful regional geological prospecting industry. From my point of view, the Far East is ready for a much more adventurous government policy in the field of subsoil use, particularly in relation to solid mineral deposits. What I have in mind is a certain weakening of federal control over the licensing process, giving the private licence holder the opportunity to choose which areas can be used for geological prospecting according to his own initiative. It might also be a good idea to delegate some of the federal centre's power to approve development projects for new deposits to the regional level.

This would permit the creation of a large number of new jobs, not through the implementation of a limited quantity of large schemes, but as part of many smaller and fairly labour-intensive schemes. People will be offered interesting work. This would also allow the Far East regions to compete amongst themselves to create the most favourable conditions for the fairly mobile geological survey capital which, in the primary stages of investment, is necessary in small quantities. Similar operations do not require fiscal concessions on the part of the state or government investments, but rather some well-targeted alterations to the legal framework and greater trust shown towards private initiatives in the field of geological prospecting, as well as the exploration of mineral resources (at least solid ones).

Y. Solzhenitsyn:

You alluded to comments made about infrastructure and concession policies. In the electricity and transport industries, do you think that costs and, correspondingly, concessions are decisive in any way, or does the problem here also lie in overall capacity? What should we do to improve the infrastructure of the Far East: increase the quality of the product, or expand the existing power supply and build additional structures?

V. Nesis:

It is difficult for me to speak for others. I represent a rather specific segment of the ore-mining and smelting industry: the gold and silver production industry, which is comparatively independent of transport infrastructure and not very energy-intensive. I would say that for the extraction of solid commercial minerals in the Far East, the main problem is that of the energy grid. As a whole, regarding long-term structural limitations on regional economic growth, I would not prioritize road or energy infrastructure, but rather human capital and the need to attract highly qualified specialists to the region. Of course this is a very complicated question, but in making long-term state investments in the region, we need to take into account the quality of life, and this includes, in part, transport connections between regions and the central parts of the country. It is

clear that anyone going to the Far East will be from European Russia, and will be leaving behind friends and relatives. At the present time, one of the main limitations is the high prices for flights from the Far East to the central part of Russia.

A. Volynets:

I will reply to your question: we need to do both of these things. Prices are not just high in the natural monopolies. Rail transport tariffs have risen by more than 75% since 1999, and gas tariffs are now higher in Siberia than in Minnesota. Correspondingly, Russia is quickly losing one of the competitive advantages that it held until recently: comparatively low prices. A few words about capacity: the carrying capacity of Russia's railways to the Far Eastern ports is 60 million tonnes, and the capacity of Russia's Far Eastern ports for exports is 70 million tonnes, whereas the capacity of a single Shanghai port is 600 million tonnes. Consequently, within a fairly short period of time, we need to carry out massive investments to widen those bottlenecks. Pavel is absolutely correct in talking about the need to specifically pinpoint subsidies for new enterprises simply so that they can survive. Today in Russia, electricity tariffs, railway tariffs, and tariffs on basic infrastructure items already exceed those in developed countries such as, for example, the United States.

Y. Solzhenitsyn:

How can that be? Look, Artem, the fact is that we have already reached the limits of our competitiveness because of tariff rises, and yet we still need to think about what these tariffs will be in ten years' time. Besides, you are saying that it is necessary to invest a lot of money in infrastructure. These investments will somehow or other be reflected in these very tariffs. Then the cost price of export goods will rise. Can the state inject some funds, or is it a question of developing competition and implementing institutional reforms?

A. Volynets:

For a start, it would not be a bad thing to compare our refinancing rates with the rates at which one can obtain loans for these wonderful schemes in other countries. In developed countries, the average refinancing rate is about 1.2%; in developing countries, it is around 5%, and in Russia it is higher than 8%. We need the chance to invest in the development of rail and port infrastructure and so on in order to increase the quantity of products. The more products, the lower the price. We need to have long-term funds. I am hoping that some funds will be provided by our Chinese friends. And some should be provided by our government agencies, though not at the current rates.

Y. Solzhenitsyn:

Rates?

V. Dmitriev:

I mean the refinancing rates: this debate revolves around refinancing rates. Yesterday, the President met with representatives of the Russian business community, and a very informal and open discussion was held. Among other things, the question of lending rates was touched upon. Indeed, this subject is related not so much to refinancing rates as to the net interest margins which banks establish, including banks partially owned by the state. Official statistics show that occasionally the net interest margin – that is, the amount which the bank earns from the customer – in state and commercial banks runs from 5–7%. These are insane margins, insane earnings. And these net interest margins are not always borne out by the risks incurred by the bank with respect to the borrower.

We talked yesterday about how inflation may play a less than essential role, because banks make money from the turnover of funds directed towards the financing of projects. Here, too, an interesting situation has arisen. It is said that our economy has overheated, that the growth in credit for the real sector is higher than in other developing countries such as China, India, and so on. Official statistics indicate that – and I am digressing here from the Far Eastern subject to illustrate our general situation – in 2012, RUB 1.5 trillion was

channelled to the financing of mergers and acquisitions. This figure is twice as high as the amount allotted by Russian banks to upgrade fixed assets belonging to companies. We report to the Central Bank on the fact that we are lending to boost the economy, but in reality we are lending in order to transfer funds from the pocket of one oligarch to the pocket of another. Undoubtedly, the state should approach loans in a selective manner to aid the real economy. At the same time, colossal reserves are concealed in order to finance, in conjunction with the government, projects that are key to the country's economy or carried out in the most important regions. There are three such regions: the Northern Caucasus, Kaliningrad, and the Far East.

I hope the Governor of Primorsk Territory will forgive me, but the Far East has been neglected and we need to send all kinds of resources there. A lot of what we have been talking about today is linked not to a radical change in legislation but to the desire (or lack thereof) to manage things correctly. Pavel has talked about the so-called TIFs; the problem is how to correctly distribute the taxes arising as a consequence of the creation of extra production, new jobs, and so on.

I will mention a few figures from our practice. Vnesheconombank currently finances around 20% of projects in the region, with a total budget of a little less than RUB 500 billion. From the implementation of these projects, the state receives RUB 350 billion; this is despite the fact that the projects are carried out by private business which uses its own funds as well as borrowed funds. What if the state were to direct the resources of the National Wealth Fund towards implementing supplementary infrastructure schemes being carried out in the interests of integrated regional development? Now, as far as I remember, the funds of the National Wealth Fund have an annual average yield of 1.5% to the state budget. It would be a realistic step, taking into account future tax revenues, to designate a part of these funds for infrastructure development, giving a push to the development of new production facilities. Happily, decisions to move in that direction have already been taken.

Y. Solzhenitsyn:

Vladimir, could I ask you a rather provocative question? You know the overall picture of development priorities in our country. There is an opinion that we have a lot of areas which are not sufficiently funded: education, health, and so on. Among these can be included infrastructure in European Russia, where the population density is rather high and the benefits from many of the projects would be more palpable. How would you reply to this kind of question: do we not have more significant problems to deal with? Should the funds of the state not be directed first of all to these other issues? The Far East is, of course, a fine aim, but these are immense and almost unpopulated spaces. This huge amount of money does not bring significant advantages to the remaining 130 million Russians. This, of course, is a provocative question. How would you respond to it?

V. Dmitriev:

Yermolai, the answer to this question has already been given: we need to develop the Far East. This is Russia; these are Russian citizens; there are opportunities still to be realized. In European Russia, there are no deposits which have not yet been prospected; there is already too high a density of productive enterprises located there. If people agree that the Far East has very strong export potential, then for me, the answer to this question is clear: we need to go there, to develop its economy, to look for ways in which the state and private investors in this region (including foreign investors) can work together.

Y. Solzhenitsyn:

Thank you.

Among the participants in our debate is Mr. Shigehisa Yoshihiro, the Chairman Emeritus of the JGC Corporation.

Mr. Yoshihiro, you have listened to this discussion from the Russian side, from some of the foreign participants in the economy there. What would be your advice to the Russian government, to Russian business people, and also to foreign investors as we consider how to develop the potential of this region?

S. Yoshihiro:

Let me say that here in this conference, President Putin gave a 15 minute speech saying, "Let us go to the East, not to the European side." That was the essence of what he said, and it was quite impressive. Almost 80% of the Russian people are on the European side, but I sincerely hope that European people will come to the East. If there are no people from Russia in the East, maybe we cannot develop anything. I hope you can understand me. I am an energy contractor, the world's biggest energy contractor. When I talk energy, I say, "Okay, give me the job." At the moment, we are undertaking an energy project in Oman together with French companies. But there are two phases of the work: one is doing the work, the engineering and construction; plus, we are private investors making investments in many countries, even in China, where we are creating a smart city. And we love the people of China, so we will try our very best. In India we are building an industrial city on the Chennai side. Why not in Vladivostok? We can easily do it, so give us a chance. We will invest in developing and making up a smart compact city in Vladivostok or any other part of East Siberia. What kinds of investments can we make? Somebody said pharmaceuticals – yes. We are making investments in Cambodia, which is in East Asia. And what about farmers? We are sure we can take our technology and make the most convenient and efficient pharmaceutical or agricultural type of business development. I am prepared to make the investment. There are many things we can do. Please give us a chance to work for the Russian people.

Y. Solzhenitsyn:

I will say my piece about your comment regarding the need to move, that people should go east. The population of the Far East is 6.5 million. Let us say that two million people move there: that would be movement on a mass scale. Perhaps some programmes should be developed, for example, to allocate resettlement grants? Before our meeting I familiarized myself with the programme for Alaska: each inhabitant of Alaska is paid between USD 1,000 and USD 2,000. I do not know how these facts are linked, but for the past 30 years the population of

Alaska has been growing at an annual rate of 2.5%, whereas the population of the USA as a whole has been growing by 1.5%.

Once again, Vladimir, my next question is for you. Another way of guaranteeing demographic growth is to encourage immigration from other countries. If we take California and other western states of the US, probably half of the inhabitants are immigrants from Latin America or at least second-generation immigrants. What percentage of the population of the Far East, of Primorsk Territory, is made up of immigrants from other countries, and what do you think about the prospects awaiting us in the next 10–20 years? What percentage of the population might be immigrants from Asian countries?

V. Miklushevsky:

If I may, I will begin with another issue arising from a question that you asked Vladimir Dmitriev regarding whether it is necessary to develop the Russian Far East. It has already been said that there are Russian citizens who live there and deserve the very best conditions. Russia is simultaneously a European and an Asian country. As is well known, Europe is in crisis and world economic growth has moved to the Asia–Pacific region. Therefore, it would be foolish not to develop the Russian Far East, not to use those advantages that we have. It seems to me that everyone should understand the significance of this.

And now I will say a few words about demographics and the growth of the population. You were talking about two million people. I believe that that is a completely realistic prospect; there are no problems. We should focus on Russian citizens, those who live in the European part of the country and the Urals: they could come and help to develop projects in the Far East. However, I do not think that quantity is so important. Today we have already touched upon the issue of labour productivity and schemes in which this should be very high. By making investments, our neighbours can improve the situation in this respect in the Far East and Primorsk Territory. When I was preparing for the concluding meeting with colleagues at the Ministry of Regional Development, my staff passed me information about average labour productivity in Primorsk Territory and at Sollers. I was simply astounded, and I want to relay these figures to you.

At Sollers, labour productivity is 14 times higher than the average for Primorsk Territory.

Another example which I have already given is the lumber enterprise created with Japanese investors. The log factory is run by a brigade of seven people: five mechanics and two operators, each of whom handles two joysticks. I am saying this to suggest that an explosion in population growth is perhaps not so necessary: we need, above all, a situation where labour productivity is very high. If we are talking about an inflow of population from Asian countries to Primorsk Territory, that will happen in any case, but it will not attain critical dimensions. Citizens of the People's Republic of China who work in Primorsk Territory make up about 1–2% of the population. I believe that the use of a foreign workforce, the labour of migrants, is necessary in any case, but we should not place this fact at the forefront of our policy decisions.

Y. Solzhenitsyn:

Thank you. I suggest that migrants might have various roles to play. For example, many engineers have gone to work in Asia in recent years.

I would not be surprised if, in a year's time at this or some other forum, a similar debate is dedicated to the Far East, and its participants spend their time discussing what to do next. I wish to ask the following question: can you name events or actions, changes in certain indicators, or laws approved this year which allow you to say with some confidence that we are going to be able to see a positive development trend in this priority region? What has to take place this year so that you will be strengthened in your conviction that we are moving in the right direction?

Vladimir, I will start with you, and then we can go around the circle and conclude our discussion.

V. Dmitriev:

On the one hand, it is a little easier for me. On the other hand, what I am about to say may seem a little fantastical and excessively ambitious. Vnesheconombank and its structures are a development agency: in this case, I am also talking about

the Foundation which Pavel Grachev heads and about the Russian Direct Investment Fund, which is headed by someone with the same surname as mine. I would like these development agencies to have become, firstly, that very one-stop shop which can receive bids and work with investors, and on the other hand can be an integrator of programmes, including government schemes and integrated federal programmes carried out by various ministries and government agencies. Practice shows that, unfortunately, one hand does not always know what the other is doing, and schemes which need to be implemented using both hands are often not realized in full, or even sometimes not realized at all. And here are the extremely important functions of a development agency: yet again, processes need to be correctly managed. I would like for us to be able to state with confidence a year from now that investors are coming to us, and government ministries and agencies are now working more closely with us.

T. Maeda:

Yes, my advice to the Russian Far East is to ride on the bandwagon of their neighbours and take the opportunities of the general advantages possessed by the Russian Far East, such as the fact that the price of land is cheaper than in neighbouring countries, and to use this advantage to make, for example, a smart city in the region. It could be a centre of excellence in the region and could really demonstrate the technology level of the Russian Federation together with the Japanese, for example. Secondly, you have a very strong nuclear industry. And there is some spin-off technology like radiation, which can be applied in medical treatment. Why not integrate the hospital system by using the spin-off technology from radiation? That can be done. You can demonstrate some sort of showcase, utilizing the advantages of the region. That is my advice.

A. Volynets:

In the next year, I would like to see three concrete projects, with transaction documents signed by private Russian companies and Asian companies, one in Irkutsk Region, another in Primorsk Territory, and the third in Khabarovsk Territory. Then we will know that we have moved away from this stalemate.

H. Bing:

Yes. I am just hearing the translation. I agree with Mr. Volynets on that. So the first item on the agenda I think should be making some kind of special arrangement between the Russian Far East and neighbouring countries. Not exactly the same as Canada with the United States, like NAFTA, but something similar to make border trade easier. For me to go to Vladivostok to Qiqihar I have to transfer from Beijing, otherwise I have to go to Moscow and come back. But the problem is if I cross the border it takes me four hours. So, the government has to do something to make the activities of labour movement and transportation easier. The second thing I want to mention is that the federal government has to spend lots of money on transportation infrastructure. That way business people will come. Without infrastructure you cannot do all of the other stuff. You have to have industrial parks, special economic zones, highways, railways, and good airports, otherwise you really cannot do business investments. For example, I flew to Vladivostok just two weeks ago and there is no five-star hotel there. Why? They say because there are no people. But this is a chicken and egg issue. If you have the hotel, people come, but somebody must make the first move. You mentioned you cannot force people from Moscow and St. Petersburg to go back to Vladivostok, but if you have good jobs there, a good environment and good salaries, then people will come. I use the example of the city of Kazan in Tatarstan. It is not the Far East, but it is not Moscow or St. Petersburg. I visited there twice as they have an IT park and are trying to build lots of companies to attract IT people from Russia. Right now you will see the progress they are making. The last thing I want to mention is that I hope within a year a lot of old legislation that cause obstacles for the local business environment will be really cleaned up. For example, just a year ago, my colleagues tell me that if you went to Vladivostok as a foreigner, any police could stop you to check your passport. Why? The federal legislation asks them to do so because it is a bordering province, so it is for defence reasons. But that law got removed last year, so now people can move freely. Although these are only small things, they give people a different feeling. You want people to come to the

Far East and feel that this is a very civilized country. Like when you go to Europe or other different countries, you do not have people harass you. It is not really harassment; it is just old laws, because previously the federal government thought of the Far East as a place not for development but as the frontier, a place to defend from the enemies. Now, there is global peace, so we should treat each other in a different way.

Y. Solzhenitsyn:

Now it is an economic frontier.

Unfortunately, our time is up. I would like to thank all the participants in this discussion.