

**ST. PETERSBURG INTERNATIONAL ECONOMIC FORUM**  
**JUNE 21–23, 2012**

**Securing the Future**  
**THE ECONOMY OF THE ASIA-PACIFIC REGION: CHALLENGES AND**  
**OPPORTUNITIES**  
**Round Table**

**JUNE 23, 2012 — 10:00–11:15, Pavilion 4, Hall 4.1, Arena**

**St. Petersburg, Russia**  
**2012**

**Moderator:**

**Evelina Zakamskaya**, Anchor, Russia 24 TV channel

**Panelists:**

**Vladimir Androsik**, Chairman and Executive Director, NBC APEC

**Klaus Kleinfeld**, Chairman, Chief Executive Officer, Alcoa Inc.

**Andrei Kostin**, President and Chairman of the Management Board, VTB Bank JSC

**Alexei Kudrin**, Dean, Faculty of Liberal Arts and Sciences, St. Petersburg State University

**David Lipton**, First Deputy Managing Director, International Monetary Fund

**Ziyavudin Magomedov**, Chairman of the Board of Directors, Summa Group

**Jim O'Neill**, Chairman, Goldman Sachs Asset Management (GSAM)

**Bong-Jin Yang**, Chief Executive Officer, Hyundai Energy and Resources Ltd.

## **E. Zakamskaya**

Good morning, ladies and gentlemen, I would like to thank everyone who has taken the time to participate in this discussion today. I am especially grateful to our participants for coming here this morning, on the third day of intense work at the Forum. Judging by some of your faces, I can see that it was not easy, so special thanks to you for that.

The topic of today's discussion is The Economy of the Asia-Pacific Region: Challenges and Opportunities. We have focused on the topic of the development and integration of countries in the Asia-Pacific region because the role these economies play in the world, in world trade, is becoming substantially more important, and their political influence will increase accordingly.

In addition, this year Russia is chairing the Asia-Pacific Economic Cooperation organization. Russia aspires to play a significant role in this region. But in order for us to succeed, we need to understand the rules of the game. The rules are complicated and contradictory. This is what we will be discussing today. First, I propose that we watch a short video clip.

### **<Video Clip:>**

APEC is the largest regional association in the world. The 21 economies that are part of the Asia-Pacific Economic Cooperation account for 57% of global GDP and 48% of world trade. The fact is that this region is not only becoming the centre of global economic development, but also the centre of political cooperation on many issues. Our participation in APEC provides us with more opportunities to sell our goods and services to emerging markets. Modernizing trade and removing barriers are the key principles of APEC, and they must develop in order to create an Asia-Pacific free trade zone. In the 23 years of the organization's existence, the trade turnover between APEC economies has increased by almost 400%. The GDP of member economies is growing one and a half times faster than global GDP, and customs barriers within the organization have decreased to less than a third of what they were. Of course, the natural resources of Eastern Siberia and the Far East,

which include oil, gas, gold, and coal, are of great interest to our partners. The political round of negotiations about our country's accession to the WTO has come to an end. But Russia, like many other countries, is also paying more and more attention to regional free trade agreements. Let's hope that these regional groupings will not replace the global ones. It is important to understand that the APEC economies, including the US, can accelerate economic growth. This will reduce the impact of the European debt crisis now and in the future. However, development is not uniform throughout the member economies: the GDP per capita in the rich economies of the organization exceed that of the poor economies by more than 45 times, and the nominal GDP is almost a thousand times greater. A quarter of APEC's USD 1.5 trillion trade turnover is accounted for by only two members – the United States and China. The countries in the Asia-Pacific region need to even out the trade imbalances, as well as the social and economic inequalities between them. This is an important task for ensuring the stability and development of the region. Currency and trade wars in the Asia-Pacific region are becoming more severe. The US subjects 22 types of Chinese goods to additional charges. We are forming a special trade commission, which will be authorized to investigate cases of non-competitive and non-market behaviour in countries such as China. China is very concerned about some countries' attempts to interfere with the trade and economic policies of other countries. We will do our best to challenge such actions, including filing a complaint to the WTO. Ten countries in the region, including America, Japan, and Canada, are forming an alternative to APEC, which is the Trans-Pacific Partnership. Such major players as Russia or China have not yet been invited to this new club.

**<End of video clip>**

### **E. Zakamskaya**

So, it is clear that today we have something to talk about. I will introduce the participants in today's programme. This is Mr. Bong-Jin Yang, Chief Executive Officer of Hyundai Energy and Resources. Hello, Mr. Yang.

Klaus Kleinfeld, Chairman and Chief Executive Officer of Alcoa. Hello.

Alexei Kudrin, Dean of the Faculty of Liberal Arts and Sciences at St. Petersburg State University. Great to see you, Mr. Kudrin.

Ziyavudin Magomedov, Chairman of the Board of Directors of Summa Group and Chairman of the APEC Business Advisory Council. Hello, Mr. Magomedov.

Mr. Jim O'Neill, Chairman of Goldman Sachs Assets Management. Hello, Mr. O'Neill.

Andrei Kostin, President and Chairman of the Management Board of VTB Bank. Hello, Mr. Kostin.

And Vladimir Androsik, Chairman and Executive Director of the APEC National Business Centre. Hello, Mr. Androsik.

So, my first question is for Mr. Kudrin. Could you tell us, can the economy of the Asia-Pacific region really aspire to be the leading economy now and in the near future?

**A. Kudrin:**

Good afternoon, everyone.

I am sure that in the next 20 years, this region will become the most important one, largely due to China's increasing role and the higher rates of economic growth compared to other regions of the world. Therefore, it is now worth paying full attention to this region, and preparing new projects. We will be tightly linked with this region. But the link exists in reverse too: this region is now forming new relations with other regions. This is very significant for globalization. In the current crisis, we must take into account that this region has become more vulnerable to the impact of the crisis in Europe. Here is an example: the banks in this region have given loans to European banks. Almost 10% of all loans have been issued to European banks, or rather, European companies.

Therefore, a lot depends on the situation in this region. Many types of goods produced in this region are in direct competition with goods and services from other countries. On the other hand, we can say that this competition itself strengthens the

connections between countries which may be very different and very far apart geographically.

**E. Zakamskaya:**

Mr. O'Neill, when you presented the BRIC acronym to the world, you pointed to other points of growth, not related to the Asia-Pacific region. Only two countries from the BRIC acronym are located in this region.

**J. O'Neill:**

If I understood you correctly, as Alexei just said, as is really the case for everything in the world, in many ways the key issue is China. As I have said at a couple of other events I have been at here, the scale of China's rise is unparalleled with anything I have observed in many decades, if not beyond, of history. Just to put it in context, just last year alone China's GDP changed by nearly USD 1.4 trillion. They nearly created a new India in one year, or more than Indonesia in one year, and to put it in the context of the European crisis, as many people hear me frequently saying these days, they create the equivalent of Greece every eleven and a half weeks. So, for anything to do with the world and certainly something as specific as trade and APEC, as Alexei says, what goes on with China is absolutely key. The other thing that I am sure will come up more, and as exciting as that is for everybody, within the Asia-Pacific region, partly because of the speed of their change, but also the history, there are many potential volatile things that could happen in the future. China's own thirst for commodities and its border with India is probably one of the few that does not get discussed as much as the other ones. The whole issue of whether Korea would reunify in the next 20 years; then there's Taiwan, Pakistan, and India. So, these are enormous issues, but of course with all of those are enormous opportunities too. But at the core of them is the 'C', China.

**E. Zakamskaya:**

I propose that we continue discussing this topic with specific examples. Mr. Yang, Hyundai is a multinational conglomerate, which is successfully represented across global markets in a variety of sectors, ranging from cars, which we all know, to shipbuilding and the construction of boreholes. Which markets do you currently consider the most promising?

**B-J. Yang:**

No question, I absolutely agree with Jim. China is a very important market, but China has its own facilities competing with us, so we have to find other markets. I agree with Jim that China is important, but China has its own problems. I have some doubts about whether China will be sustainable at the same growth rate because of the population problem. The population has been the source of growth in prosperity for 1.3 billion people. It has been the source of growth prosperity, but it has its own problems because of the One Child Policy that has affected it for 30 years. Young couples have to support four old people on the husband's side and the wife's side, and they have to support themselves too, and they have to support their little prince or princess. So, the young couple serve seven people at the same time. Also, ironically, China is already suffering from labour shortages. Shanghai, after the new anniversary, has suffered from shortages of labour. Guangdong Province alone has a labour shortage totalling about 2 million. The wages are increasing and therefore export products are losing their competitiveness, and they have to lower their expectations. Therefore, there is room for Russia to claim the leadership in the Far Eastern area if they properly introduce such projects as cross-border connection programmes like railways, electricity, and gas pipelines. APEC is a kind of conceptual regional party, but it has to serve the purpose of international peace and security as well. If you execute those cross-border infrastructure projects properly, encouraging North Korea to be a part of the world, I think Russia could be the clear new leader in the APEC framework. With full accession to the WTO Framework and the forthcoming APEC meeting in September, I think that would be the milestone for Russian leadership in APEC, period.

**E. Zakamskaya:**

That is good to hear, but it seems rather questionable. It is especially difficult to believe in China's demographic problems, and moreover, to compare its demographic situation with Japan. Thank you for the suggestion that Russia might become the leader. But do we have enough resources, not only demographic, but also economic? Mr. Magomedov, what do you think about this?

**Z. Magomedov:**

I believe that in Russia's case demographics, as you were saying, are certainly an important factor. In addition, it is key that our leaders understand the changes that we are all expecting. And for Russia's development, the most important factor is understanding the fact that trade between Europe and Asia accounts for about a trillion dollars, and Russia's role in this trillion is negligible at less than 1%. On the one hand, high-quality, intensive development is possible, if we take into account the resource base of the projects that are being implemented by Russia itself inside the country. On the other hand, we are all living in one transparent world, so we need to understand the processes taking place outside our borders, and correctly relate them to what is happening in our country. This correlation not only can, but should provide great motivation to develop. Our goal is to reach 3–4%. But this is still too little. We do not define ourselves as we should: we are a rapidly developing country, and we need to achieve 8–9%, like northern China.

**E. Zakamskaya:**

In what time frame do you think these goals should be achieved? Time is running out, and the situation is changing.

**Z. Magomedov:**

The most important factor here is the hierarchy of importance. We need to determine what is of primary importance and what is of secondary importance. It is

important to understand that within the next eight to ten years in India and China there will be another one to two billion people, who will be considered middle class. That is the first point. Secondly, the railway is the key to Russia's development. There are about 7000 kilometres of bottlenecks and single-track sections, and the deficit of dock side railway loading facilities amounts to 150 million tonnes. If these problems are solved, then we could say with certainty that we can play a more significant role. The lack of infrastructure is holding us back. Today Vladimir Putin rightfully criticized our desire to spend too much, too fast, and on too many things at once. The problem of low-quality and low-cost construction is largely a result of this. I am familiar with Hyundai's engineering and construction departments in China and Korea. They are guided by rational numbers and indicators, and we also have to get used to quality planning and prudent use of finances. Otherwise, we will end up with the exacerbation of structural inflation. We need to do it right, like in China. Another thing is that in China, for every city of a million people or more, they can build two airports, and they find money for the construction of perfect roads, on which no one travels except for local farmers transporting grain in order to dry it.

The main problem with economic growth in Russia is that in addition to its technological backwardness, there is also a lack of infrastructure. At APEC, we are discussing technology transfer, which is a very sensitive issue. We hope to convince our partners that the main goal of our cooperation is to even out technological inequalities.

**E. Zakamskaya:**

How is it possible today to work effectively within the APEC organization? I remind you that this union does not have very clearly defined rules and principles of existence compared to all the other economic unions, especially the European Union. Voluntary participation, compromise, and reciprocity are the main principles on which this organization is built. Mr. Kostin, in your opinion, can such cooperation be useful?

## **A. Kostin:**

Of course, Russia has only recently joined this organization. I cannot ignore this opportunity to remind you that on September 7–8, in conjunction with its chairmanship of APEC, Russia is holding a summit in the Far East, on Russky Island near the city of Vladivostok. I hope many of you here today will be able to participate in this event. As chair of the summit, I can say that this is a very important event for Russia, and for all the participants. All the countries in the region have been invited. Construction in Vladivostok is in full swing, and will, I hope, be completed on time. There are reasons to believe that this summit will be a new milestone in the integration process. Of course, all of the APEC countries are very different, and they have different types of problems. There are a number of areas in which APEC is having some success. One of them is the development of principles of free trade and principles of free movement of capital. This meeting is the most important one of all. I think that these processes will keep on developing and that integration will continue.

Now, looking at Europe's experience, many people are sceptical about integration. But I think that APEC will involve a different kind of integration. It will not be so deep, but will certainly be quite extensive.

If possible, I would like to raise another issue for discussion. It seems to me that for Russia, participation in APEC is not that important for gaining an advantage in economic negotiations. Rather, I think it is important for Russia's vast expanse called the Far East, which Russia has been trying to master for centuries, but has not yet entirely succeeded. Those who have been to Vladivostok think of it as a place where men drive Japanese cars, and women wear Chinese fur coats. Even to host the APEC forum, we had to build almost all of the infrastructure from scratch: the hotels, roads and bridges, hostels, and everything else that will allow us to host leaders and business people from APEC member economies. Russia faces a number of difficult challenges to develop this region. We have Japan on one side, which is a country with which we still do not have a peace agreement, and it seems we have not come any closer to making one since the war, because no one is

looking for a solution to the problem of the islands. On the other side we have China, which we all love but are also afraid of. Not because of their military might and their powerful economy, but because there are so many people. Chinese men drink less, work harder, and earn more. The 'Chinesation' of a large part of Russia is quite a clear trend, and this is becoming a particular problem for Russia.

In my opinion, the goal for this region's development should be for Japanese and Chinese businessmen, to fly to Vladivostok or Khabarovsk, instead of Moscow, so that business can develop and Russia can reinforce its position there, as part of the Russian state and the Russian economy. This is even more important than being a leader of the APEC organization.

**E. Zakamskaya:**

Do you think that it is only Russia that is interested in this or do our neighbours, the APEC economies, need this too?

Mr. O'Neill, the US is also wary of China, is it not? We have seen Barack Obama's speech, stating that he no longer wants to provide competitive advantages to Chinese companies. So, there is some rivalry. What if Russia starts developing rapidly? Why would the United States need Russia to be powerful in the East?

**J. O'Neill:**

Strangely, as the discussion develops, I find myself thinking, what actually is APEC? You made an interesting comparison with the EU, which has a really clearly defined purpose, and APEC is sort of, I think, a loose collection of countries that just want to do more stuff with each other, and seemingly from what Andrei said, including the fact that China needs to drink more. But in many ways, what Russia needs to do, or what any of the APEC countries need to do to help APEC is the same as what they need to do anyhow, which is just that enlightened self-interest to do things that make you a stronger economy and more competitive. By definition this will be good for everybody. Competition between two parties is usually regarded as something that people worry about, but that is what makes everybody in the world stronger.

Korea actually is a country that I have increasingly found myself in the past few years thinking of it in many ways as a bit of a role model. We have linked to the research that came with all the BRIC nations – we have indices of competitiveness that look at 180 countries, and South Korea is actually the fourth highest in the world. It would be the highest scoring one on this index of any APEC country. And with it, in my lifetime, South Korea has seen its wealth go from an African country to now one of the G7 countries. And so in terms of what others have to do, I think personally many have to look at what has helped Korea do that, including Russia. Infrastructure would perhaps be a tiny part of it, but there are many other things to do with productivity and spreading the use of the technology, as well as obviously being open to trade, I think, which is at the core of it. But I do not think that there should be a fear of competition. I think it is a good thing.

**E. Zakamskaya:**

What do you think about this, Mr. Kleinfeld? There is no need to be afraid of competition, but some are still wary of it, and expend efforts on trying to hold their neighbours back.

**K. Kleinfeld:**

Well, I think that Russia has shown over the last 20 years that it is not afraid of competition, and I think what has been achieved is remarkable, and I think this is going to continue. At the same time, when you design a strategy, I think you have to understand where you are, what your strengths are, what your weaknesses are, and it is foolish if you do not build on that. So, what do we see here? I mean, we have Russia that historically has relied very strongly on commodities. At the same time, when you look at the numbers here, Europe – the West – is basically the biggest trading partner. For Russia, the EU is the number one trading partner. In reverse, Russia is the EU's number three trading partner, so that is really critical. Gazprom, in terms of its importance for Russia, is 25% of the state budget, basically. So, those are the numbers. At the same time this relationship is not free of challenges. I do

not think I am telling anybody here any news that Europe is going through a drastic crisis. So, that puts questions there. At the same time, you know better than I that there are some challenges internally: shrinking natural resources, more difficulties to get to these, they are more expensive, the changing energy landscape, the shale gas finds, LNG availability – all of this is there. So, that is the situation. The other situation that you see, and also nobody here, I guess, will doubt that the East is attractive, and the East is China, period. Then the rest we can add onto it, but really it does not matter. Jim, I totally agree with you. And I think that basically also answers the question on APEC. APEC without China is a hollow structure. With China it can be something meaningful, but you have to start right there. But I think that that is very well understood, and particularly here in Russia. The interesting thing is when you look at the statistics, China's demand for natural gas is going to increase by 13% every year, projected on to 2020 or 2017, or something like that. That is massive. In terms of oil production and oil consumption in China, according to the statistics last year, the three largest suppliers of oil to China have been Saudi Arabia, Angola, and Iran respectively. Russia comes much later on that list, although Russia is one of the largest oil producers. So, that also shows that there is an imbalance there. But, when you look at the strategic initiatives and also the recent ones, they show that this is well understood by the leadership. Russia is clearly taking action, and action starts with targets. The target is there, basically saying China–Russia bilateral trade should be increasing by 2015 to USD 100 billion, and then by 2020 to USD 200 billion. That is a big, big number. Seventeen bilateral agreements have been signed, which is great stuff. Now this has to be basically filled with content. Well, filled with content is a problem. Andrei, you had it in your side sentences, and I think you said it very well. The real problem is infrastructure. I mean, let us think about it. I mean, this is all weight. If we are going to go to the East and build the East, how are we physically going to get this stuff that you talk about there? You are talking about Vladivostok. It is without question that the APEC summit is of high importance for Russia to show their capabilities. At the same time, we know what the struggles are there, and I think we cannot close

our eyes. Coming to this panel, I looked up some statistics, and I was stunned to see that only one third of Russia's roads in the Far East meet the World Bank's quality standard. That gives you a good idea of how easy or difficult it is. The majority of the port infrastructure in the Russian Far East was built 50 plus years ago – that is another one of those factoids. And then, one thing that we have not talked about is that you have a population that is really not growing in Russia. On the other side, you do have a population that is big and that is looking for more land, and that country is not really that fitting, last time I looked. And it is not just the drinking habits, Andrei, which you were referring to. So, I think there are challenges. I think there are challenges and then it is about how to manage those challenges. In the end I believe good strategies are built around doing both. It is not now about giving up the relationships to the West, which have been built over centuries – many hundreds of years. That is what St. Petersburg symbolizes so well. It is a question of how can one combine both of these things. In my view it has to be a two-pronged strategy. On the one hand, diversifying the economy, going more strongly into high tech industries, going into automotive, IT, those things that were also talked about a lot here. At the same time expanding and building a good strategy around how to expand into Asia – and Asia starts with China.

#### **E. Zakamskaya:**

This is a great wish, and we think about it day and night.

Mr. Kleinfeld's speech raised an important point: it is necessary to diversify the economy. At the same time, when our partners say that we should not say 'no' to the West, that we should cooperate with the West and the East, as a rule, they are talking about where Russia should supply energy: only to the West, or to the East too?

In fact, a lot is being said about diversifying the Russian economy. We say that it would be good for the whole world, but increasingly we are coming to the conclusion, especially in the expert community, that we are not capable of playing a

role beyond that of the petrol station of the world. And no one needs us to play a different role. What do you think, Mr. Androsik?

**V. Androsik:**

It is true. Russia is seen by many as a kind of battery of the world, or at least, they want to see it that way. Since APEC is an organization that seeks compromise, today we can see our partners' interest in developing the following areas. Firstly, the region wants to strengthen its trade with Europe. Obviously, the route across Russia is the cheapest. Accordingly, our partners believe that the development of infrastructure, above all transport, will help to solve common problems in the region: this will be a win-win strategy for all of the countries involved. Secondly, as we have already said, APEC is an organization that seeks compromise, so it also deals with various humanitarian issues such as food safety. According to our partners' assessment, Russia has additional potential to supply agricultural products, above all grain, and about 20 million tonnes of it. And this potential can be realized within three to four years.

**E. Zakamskaya:**

Supplying the East?

**V. Androsik:**

Yes, the East. This, too, is a winning strategy for everyone. We have already talked about energy. We are not just talking about oil and gas. Our partners have asked us to provide a reliable electricity supply. These are the three issues that are constantly being discussed at APEC.

**E. Zakamskaya:**

So there is good reason for us to be wrestling with this topic today.

And what would you say about the supply of grain, Mr. Magomedov? Our traditional partners are still located in Europe, Turkey, and Egypt. What opportunities do we have to open up this market?

**Z. Magomedov:**

Today, the main buyers of our grain are not European countries. They are North African countries.

Last year Russia exported 23 million tonnes of grain. Unfortunately, we still have the same old problem. Potentially, over the next five years, the Altai Zernosoyuz alone could increase its production of grain from 5 to 15 million tonnes. The problem has to do with the costs of transporting it by rail. The current rates are too high; for the delivery of grain to be economically feasible, it is necessary to apply certain mechanisms, including those regulated by the World Trade Organization. I mean the so-called 'yellow basket'. This will help reduce transportation costs, and then we will be able to transport about 10–12 million tonnes of grain to the Southeast Asian markets. In total, there are about 925 million people around the world who do not have access to a stable supply of food. Around 850 million do not have access to enough fresh water, and 875 million have no access to electricity. These problems are most acute on the African continent.

**E. Zakamskaya:**

China also does not have enough food; it also needs to be fed.

**Z. Magomedov:**

In America, a huge amount of grain is used to produce ethanol, which also causes some concern among some of our colleagues. On the other hand, I think they are moving in the right direction: the production of clean biofuels, which is also very important.

Russia is home to 20% of the world's fresh water supply. This is a truly inexhaustible amount. Consequently, we have great potential for increasing grain

production. As for consumer markets, Europe is, of course, the traditional market for Russian goods, but the trend over the past seven to ten years has been the growing Asian market. So, obviously, we have been paying more attention to that region over recent years.

**E. Zakamskaya:**

So, Russia is in first place in terms of the volume of explored gas reserves, and in second place in terms of fresh water reserves. We can continue to itemize our potential, but we need to focus on real possibilities. What do we need to do today in order to improve our infrastructure? Will we manage to build and develop it on our own? Or do we now need help from investors?

**Z. Magomedov:**

The famous rule that John Maynard Keynes made in 1932 is still relevant. According to his postulation, the focal point of Russia's growth is the construction of infrastructure. I will immediately address a possible question about inflation. We just need to limit our spending and reduce the costs of infrastructure projects. In this respect, it appears that the role of PPPs (public-private partnerships) will be quite significant. Private businesses will closely monitor their spending on every kilometre of railway, on the construction of each bridge, and so on. I believe that with this kind of partnership, we can make a giant leap forward by building a second Trans-Siberian or Baikal-Amur Highway or a completely new high-speed road that will connect China and India to Europe. Participation of the private sector is simply vital; otherwise costs will be off the charts, or it will take too long, and let us be honest with ourselves, it will not be very efficient.

**E. Zakamskaya:**

I also cannot ignore the issue of road construction costs per kilometre. When we compare the cost of road construction in China and in Russia, the authorities and

officials generally say that our terrain is completely different. But China is closer to the Far East! So, by now the costs should have been compared and synchronized.

**Z. Magomedov:**

We can speak endlessly about topography, terrain, and so on, but the problem for us lies in the fact that the scale of our railway construction is incomparable with China's: each year China builds thousands of kilometres of new railways.

**E. Zakamskaya:**

Yes, we know that. We watch and envy them.

**Z. Magomedov:**

It is the law of dialectics: the transition from quantity to quality. They have learned how to build well over the years. I believe that we need to define the hierarchy of our projects and to decide what we need. Because sometimes we build what we do not need. We do not have much money, as everyone knows. But a lot of it is being spent. A lot of money is being invested in the US and European markets, etc. If you put the money to work for domestic investment projects, there will be enough of it.

**E. Zakamskaya:**

What have we already built that is superfluous?

Mr. Kudrin would like to speak.

**A. Kudrin:**

Let us talk about infrastructure. The fact is that I have repeatedly said that we need, at the very least, to quadruple the annual construction of infrastructure across the country. We have fallen seriously behind in the construction of infrastructure. The problem is the populist policies of the authorities. Today, I must confess that in my time I could not overcome it. If we cannot solve the pension problem in light of our difficult demographic situation, then all our resources will be consumed in a very

short period of time. Today we spend 2% of our GDP on the pension fund deficit. In five years we will be spending 3%. My suggestions that we should increase the retirement age and seek other solutions to free up resources for infrastructure development are not currently being heard.

Here is a second example. Compared with any other country with a similar economic structure, we are currently spending a large amount on subsidizing business. A huge amount, equal to 2–3% of GDP. We can curb these expenditures and allocate the resulting funds to infrastructure development. Together that is 5% of the total GDP, which could be reallocated from the state budget and spent on the construction of infrastructure. The reluctance to do so, the continuing paternalistic system of support provided to certain industries, and the populist social policies all make it impossible for us to build any meaningful infrastructure. In this sense, I would respond to Ziyavudin by saying that we do not need to increase spending through the even greater use of funds generated by oil, but through the redistribution of the resources that we already have today.

I take responsibility for my words when I say that in the next 2 to 3 years we will see that the level of spending set out today will not be sufficient to pay for social programmes, nor to cover costs as a whole. Today the state budget is being spent based on the price of a barrel of oil at USD 115. Our budget is balanced only when the price of oil is USD 115 per barrel. Therefore, we cannot increase the expenditure of resources within the country, and of course, we need to reallocate investment to infrastructure development.

Secondly, I think that it is the attitude of the authorities that is unfortunately limiting economic activity in the Far Eastern region. We are limiting the inflow of foreign investment in the region. I am not talking about any insurmountable legal restrictions, although they also exist. We need to be more ambitious in the creation of joint ventures, more ambitious in seeking to develop deposits and processing facilities in this region. I am talking about the exploration and processing of any natural resources, both renewable and non-renewable. Of course, we will depend on the peak inflow of labour from other regions. But we should not be afraid of this.

We need to create clear rules for the region, as they would give an instant boost to the economy there.

And the last point I would like to make regarding infrastructure: I believe that some infrastructure should be allowed to be built privately. Of course, this is acceptable only under one important condition: the infrastructure facilities must meet the criterion of universal access. The private nature of their ownership will mean that the income they generate will go to the owner. I repeat: it is of great importance that the accessibility of the infrastructure for all users must be spelled out in law. We can significantly increase the pace of construction of infrastructure through private investment. For example, private funds could greatly accelerate the process of paving the roads to oil fields.

**A. Kostin:**

An example from VTB: in St. Petersburg, two infrastructure projects are being implemented, Pulkovo and the Western Rapid Diameter. Yesterday, we signed the documents, and more than USD 10 billion is being invested. Maybe for the Far East this is not very significant, but for us it is a considerable sum of money. There is no government money involved, but there are built-in state mechanisms, which give certain guarantees to the investor, and a thirty-year licence to operate.

**E. Zakamskaya:**

Mr. Kostin, in this case what will be the sources of income for the private investor?

**A. Kostin:**

The thirty-year licence to operate, with the possibility to extend for a further 30 years is absolutely realistic, especially in the case of airports. In such cases, there is a clearly defined rate of return, which is tied to the exchange rate. Quite simply the state should pay more attention to this. PPPs are still perceived as unusual in Russia. We intended to develop this programme, but then the crisis hit us, and we began using government funds for construction. But in the current climate, money is

not easy to obtain, even for PPPs, because investors have become more cautious. Long-term money is not easy to find. But I think that this should be the primary way in which we build infrastructure. Why are we spending more money on construction than the Chinese? To paraphrase Rosenbaum, it turns out that here we 'love so we love, walk so we walk, steal so we steal'. So that is why everything is more expensive. The Chinese have a little of everything, whilst here the scale of things is different. I would like a Far East Ministry to be established, and this, I believe, is the key.

**E. Zakamskaya:**

You said that you are financing road projects in St. Petersburg and Moscow, but not yet in the Far East.

**A. Kostin:**

Not yet in the Far East, because state support is needed in the form of institutional agreements. In addition, the state has certain obligations.

**E. Zakamskaya:**

In that case, I would like to ask our foreign guests a question. Mr. Yang, what can you say about the investment climate in the Far East? What is hampering business and investment in the Far East?

**B-J. Yang:**

Yes, we have investment in the Far East. Hyundai alone is now building a GIS plant in Primorsky Krai, putting in USD 40 million. GIS is gas insulators which give off electricity. We have the Hyundai Hotel in Vladivostok, we have two farms in Primorsky Krai which are running now, and we are facing a lot of bureaucracy. I quoted one episode in an earlier session where in Korea, when you move house, you go to sleep in the same bed as you woke up in that morning. So, it is that fast. Our process is very fast, and the package delivery and moving services there

symbolizes how fast the system is. But, when I moved from Vladivostok to Ussuriysk, from our office to one of the farms, it took us two and a half months. So it is impossible to compete with others while doing business at that speed. I think speed is a very important key area for Russia to take leadership in. From Korea's perspective, China is important, but China alone may not be good for the purpose of world global leadership. I am representing Korea, and China is the sole big brother of North Korea. But, in our perspective we want to have two or three big brothers. I mean, Russia used to be a bigger brother than China. Now you have the opportunity to reclaim that status if you properly manage the area. I want to elaborate on the three projects that I mentioned earlier – firstly, the gas pipeline. We import about 35 million tonnes of LNG from outside, and if you construct a pipeline through North Korea, you have leverage on North Korea, and you have revenue. LNG is more expensive than pipeline gas, so that is an incentive for us to import directly from Russia. If you connect the Trans-Siberian railway and the South Korean railways, then you will have very well defined ports in South Korea without the worry of them freezing in winter. So, you can outsource infrastructure that has already been established in South Korea by connecting the Trans-Siberian and South Korean railways. You do not have to build a new infrastructure there. In terms of electricity, we have about a 76 million kilowatt capacity, and if you have a shortage of electricity, you can connect and use the excess power generation by just connecting Russia and South Korea through North Korea. So, to put this matter on the agenda of APEC in September would be a milestone for the Russian transition process of economic development. I think APEC will be a very important key event for Russia to move into the leadership of the APEC economies.

**E. Zakamskaya:**

This will be discussed, but you probably already know about these proposals.

**Z. Magomedov:**

The improvement of the transport infrastructure is one of the paramount tasks facing Russia. There is clear mutual interest. In addition, we are promoting some other initiatives, considering, for example, the fact that nearly half of the world's population, or about 49%, live in urban areas. This is a very interesting process. We once again drew attention to the well-known concept of living cities. We know about the Clinton C40 initiative. We know that there are global environmental standards such as LEED and BREEAM. We have initiated the development and implementation of a Russian national environmental standard, which would bring together all the best practical experience. Work to guarantee food security has been converted by us into a global food partnership. The main aspects are technology and information transparency along the lines of AMIS and the G20 initiative.

One of the problems that is hindering the successful implementation of this programme is the lack of reliable information. The volatility of the market is also causing a lot of difficulties. There is a clear gap between the volume of actual physical production and derivatives issued with a coefficient of 10–15. This is also a problematic point for all the commodity markets including oil, gas and others. Our goal is to identify Russia's role in this transit. I think that this could well be the starting point for a joint project.

As for the thesis put forward by Mr. Kudrin, I absolutely agree with him. Creating a SPV with Western or Eastern companies is an important part of our business initiatives, which can qualitatively change the landscape of our market. In my view, the state must maintain a presence in infrastructure projects to which equal access must be guaranteed. The infrastructure potential needs to reach sufficient capacity. The rest will be done by private business. Believe me, private business can do this far better than state-owned companies.

#### **E. Zakamskaya:**

I propose that we continue to elicit the opinions of our foreign visitors about the prospects for joint ventures, and the conditions which have been created in Russia to facilitate these.

Alcoa, represented in Russia and 31 countries, is one of the world's largest metal companies. Mr. Yang said that it takes a lot of time to open an office here: two and a half months. I do not know how long this would take in China, but maybe you can compare and determine where the better working conditions have been created, and to what degree Russian conditions meet these standards.

**K. Kleinfeld:**

We can compare them. As you correctly said, we are operating in many countries, and we have invested in total about USD 1 billion here in Russia. Here we have two large plants and more than 5,000 people. Frankly, one can see the effort that it took us to get this production up to the world-class level where it is today. I would not be being honest if I did not say that it was not free of many hiccups. However, I think that the most critical one, even though administrative barriers can always be eliminated and can always be improved, I could not agree more. Recently, I think as of two years ago, the Foreign Direct Investment Committee formed an advisory council. The President basically suggested setting up a hotline, which was then called the Ombudsman, and Igor Shuvalov was named to take the role on that. That was a very, very good idea. We had two occasions on which we called on him. One, by the way, at a Far Eastern port, where we have some issues, and they were resolved. That was a good thing. So yes, there are administrative barriers, probably more in Russia than in other places, but I see that as a transition process, and I think the process is going well. I have complained to Alexei Kudrin for many years about the tax burdens, the amount of formalities that are there, and the numbers of papers, and I tell you, we had years where we had to file more than 80,000 physical paper copies to the tax authorities, and our operations are not that complex that they require 80,000 copies. But the good news is we are now one of the pilot plants that has changed over to the electronic system. Already this year it is down by 50%, and next year it will be down by 90%.

The biggest thing, however, that I want to mention with regard to the hurdles that we faced here was the cultural change. We have a very strong safety culture and I just

use that as an example. In the plants that we had, traditionally there were a lot of accidents and obviously nothing of that sort happened intentionally. Today I must say that they are on the level of our worldwide safety standard, which basically means that whoever works in an Alcoa plant is typically about 40 times safer than in any industrial workplace in the United States. And that also holds true for Russia. That took a long, long time, but it is doable, and I do not think we are the only example, there are many others. In terms of openness to public-private partnerships, I totally agree with what has been said here. This is of great potential. The models for that are well established all around the world. Many others have worked with that. As Andrei correctly said, it requires a consistent flowback to make a business case. I would say that lots of businesses are willing to invest in Russia.

**E. Zakamskaya:**

Mr. O'Neill, what do you think about this? Have you seen an improvement?

**J. O'Neill:**

I mentioned before in the context of South Korea about this index of competitiveness. We have got a Growth Environment Score, and it consists of 18 different variables that I believe are relevant for sustainable growth and productivity. Importantly, infrastructure is not one of those 18 variables. The things that probably drive good infrastructure that are commercially owned and broadly useful for an economy depend on these 18 variables. When I look at where Russia stands on it, it is an index from 0 to 10, so I will just tell you a few numbers. South Korea is 7.7, where 10 is the Manchester United of growth environment scores, it is the best. China and Brazil are the two highest of the four BRICs, at 5.4. India is the weakest, not Russia. For all those people around here that occasionally send me emails about why the 'R' is in BRIC, Russia is not actually the weakest of the four, it is India. And I do not know how long it will take to open an office in India – I suspect quite a bit longer than these other places. So Russia is OK, but if it wants to help itself, as well as do a lot more trade with all these exciting places in Asia, it needs to

do things to boost something like a Growth Environment Score. And so I am not sure if focusing just on the infrastructure, it is like an output. It is the other things to do with commitment to many forms of technology, supporting research and development, all the macro variables. By the way, education is probably the single most important of them all, which actually Russia does score relatively well on, certainly for its people, compared to the others. India is very much the lowest in that. And the other important thing that Alexei is so passionate about, oil prices or oil or commodity production, are not one of those 18 variables either. I often find myself thinking that I am very much supportive of what he tried to do in his wonderful life as a Finance Minister. Russia should probably condition itself to want oil prices to go down, because there is something called the Dutch disease. Here we have South Korea with 7.7 on this Growth Environment Score, and it does not have a lot of commodities. Having oil and just assuming oil prices are just going to go up forever is dangerous. I think it should be the kind of thing where you could have some special provision where only if oil prices go to USD 20 can you use any public money to build infrastructure. Concentrate on these other things and the infrastructure will follow – that would be my possibly naïve presumption.

#### **E. Zakamskaya:**

Please do not scare us like that: USD 20 is taking it too far. In Russia they are always talking about how it is important not to consider oil and gas revenues, and not to rely on them, but on other sources of income. So far, unfortunately, this is not happening.

We have very little time left. And I would still like to get an answer to a question from our Russian participants. Why, Mr. Androsik, do we need APEC? We mentioned at the beginning of the session that it is a structure that exists on voluntary and optional conditions. I would like to remind you that the goal of APEC was to create a free trade zone. This goal was declared back in 1994. The zone should have been established by 2010. This did not happen, and in place of APEC, smaller local unions were created which are solving their own problems, including political ones. I

am referring to the Trans-Pacific Partnership, and the free trade zone which is now being considered by the countries of South-East Asia. Maybe we can focus on these relationships, and look at APEC as a sort of special interest club?

**V. Androsik:**

Yes, the Bogor Goals were indeed adopted, which stated that by 2010, developed countries should establish a free trade zone. According to the goals, developing countries were supposed to join in by 2020. This goal has not yet been achieved, but there is still time. In fact, we have seen some good progress. First of all the Bogor Goals were declared, and then the process of reducing the average customs tariff was initiated. To date, this key figure has fallen from 20% to 5%. As we can see, progress is being made and we are getting closer to achieving the goals.

Moreover, APEC is not an organization, but a forum, where various issues are discussed and compromises found. Some of the issues are contradictory. If a group of countries comes to a compromise, they can create a different kind organization which takes binding decisions. Therefore, the Trans-Pacific Partnership, ASEAN Plus Three, and ASEAN Plus Six are perceived by all participants as an intermediate step to achieving the goals of the APEC. There is no contradiction in this.

**E. Zakamskaya:**

And yet what objectives will Russia pursue?

**A. Kudrin:**

We have established the Customs Union with Belarus and Kazakhstan. Together we can now hold negotiations, and sign free trade agreements with individual members of APEC. I think there is no contradiction in this: Russia is creating a customs union in the Asia-Pacific region for good reason: the future development of the country is tied to Asia. And I think that on the basis of what we have already achieved, we can and should establish a national economic diplomacy and hold

talks about free trade zones with all the APEC economies, both individually and as part of this forum.

**E. Zakamskaya:**

It probably will not be possible to do this with all of them, and surely there will be priority economies?

**A. Kudrin:**

I think that it will be possible. Of course, it will be done in stages, starting with the smaller countries such as New Zealand. This process has just begun, and if it goes well, we will have a chance to sign similar agreements with the biggest economies in APEC.

**E. Zakamskaya:**

Mr. Kleinfeld, how do you assess the chances? I mean the chances of organizing a free trade zone and bringing more countries into the Customs Union which currently contains countries from the former Soviet Union. As I understand it, New Zealand is to ally itself with this union.

**K. Kleinfeld:**

Well, I think if I look at the priorities of Russia from afar, my impression is that this is not one of the highest priorities, that in reality the right things are pursued. I mentioned at the state visit that just happened recently, targets have been set, I think they are ambitious targets, but doable given that China is growing substantially. So, orienting towards China and Asia – I think you are right – geopolitically it makes all the sense in the world to reach out to some others, and absolutely South Korea has to be on the top of the list for a whole host of reasons. One reason being that South Korea is very strong on technology and has companies like yours that can also help on the diversification front. You would be foolish to leave them out. Also in terms of the cultural shift it would be much, much

better, because I consider Korea to be very westernized, to be honest. So, the chances are good for doing all of this in my view. I mean to reach out to New Zealand as a new future strategic alliance partner; I would think that that would be a little far-fetched to be honest.

**E. Zakamskaya:**

Yes, it is kind of exotic. We only have 10 minutes left. If anyone in the audience has any questions, I suggest we get going with them. I think we have time to answer a few questions.

**H. Teplitskaia:**

Helen Teplitskaia, President of the American-Russian Chamber of Commerce. A few brief remarks.

Yesterday we held the VEB panel, in which state support for infrastructure was discussed. In this regard, I unfortunately have not heard anything yet about how important is it for Russia to develop its domestic market. This is exactly what is needed to deal with the consequences of the crisis and prevent it from heavily impacting the on-going sustainable development of the economy.

I also have not heard anything about the importance of supporting small and medium-sized business. Everyone is tired of this support: they do not want to give anything, microloans are a big headache, but without this there will not be a middle class in Russia that is big enough to ensure the on-going development of Russia's economy and social and political stability.

Furthermore, I have not heard anything about how important it is to develop public-private partnerships, using the successful models of the BRICS countries, which are already being applied in practice. This not only means licences to operate, but, as for example in China, Infrastructure for Resources, IFR, Build-Operate-Transfer, BOT, which have already proven to be successful. BRICS countries have allocated targeted intensive funding for one of the regions. Siberia and the Far East represent a huge chunk of Russia, which is comparable in size to an entire continent. At a

summit in Delhi, the decision was taken to form a BRICS bank for precisely this purpose. The new group of countries which is yet to be formalized, the BRICS Plus South Korea, may well be able to provide substantial assistance in this process.

**E. Zakamskaya:**

Support for small and medium business. Mr. Kostin, would you like to say something?

**A. Kostin:**

I think that the issue of small and medium-sized business is certainly important. This is undeniable. With regard to different forms of PPPs, then, of course, it is logical that every form is suitable for a particular industry.

With regard to the various banks, experience will show whether it is worth establishing a bank to deal with every problem that arises. I do not know yet. Maybe we should consolidate the existing structures. We have Vnesheconombank, and it is right that we did not create a Far East corporation. If you select a project from the Far East as part of the Development Bank, I think that it will be a good solution. It is better to give state support to an existing organization than to create a new structure, where you will have to first look for an office building, computers, secretaries, and only then get down to work.

**A. Kudrin:**

I would like to try to answer the previous question. Every Russian knows that the US, and New York in particular, are very far away; 10 hours by plane. It is easy to forget that we are neighbours with the United States, and that we have a common border. And APEC is in the region where we have two neighbours, China and the United States, the biggest economies in the world. If you add Japan and Korea, then in this one region the potential for trade is immense. And we have the land and the natural resources. Our mutual interests are so intertwined that I can say that the potential of APEC is far from being realized, especially for Russia. Today, Russia is

interested in realizing this potential perhaps more than any other country in the region.

Once again, the most significant limitation is our own Russian policies with regard to how, under what conditions, how fast, and whom we allow into Russia.

In Sochi we have brought in migrants to construct a major urban and resort complex. This region could be a centre for development, and then there would be a lot of opportunities for small business. There is enough work for everybody, migrants included.

We have a common problem with our largest eastern neighbour, and that is that we have a state economy, and we are continuing to support big corporations. For some reason, it is a given in Russia that without large corporations nothing can be solved. In this respect, I think we need to allow significant competition. And we need to enforce the rules more strongly for all of the players. Corporations and large companies are setting their own informal rules. We need to make these informal rules more transparent, then small business will be able to operate.

#### **E. Zakamskaya:**

We have time to ask two more questions. Please continue.

#### **I. Hill:**

As the Ambassador for the small, exotic country of New Zealand, I felt I should defend the honour of my country. We are a small country, but one that I hope enjoys considerable credibility in trade policy terms internationally. And we are a neighbour of Russia; the fact that we have 10,000 kilometres of ocean between us is beside the point. I just want to pick up Mr. Kleinfeld's reference to 'strategic', because perhaps calling it a strategic alliance is a little fanciful. We do not use that term. But it is, I think, the initiative of our leaders to conclude a free trade agreement. It is a strategic move for Russia as much as it is for New Zealand. I think for Russia it is a first step. It has been called a trial step, a pilot study for Russia to move into the Asia-Pacific region, which has already been mentioned as an area of huge

dynamism, where trade is growing exponentially. New Zealand is part of that process. We were the first country to sign a free trade agreement with China; we have negotiated also with Korea, and with India. We have a free trade agreement with ASEAN, we are part of the Trans-Pacific Partnership. So, we are integrally involved with this. And for Russia, which has not been part of this process, it is a first step, a strategic move by Russia, and we welcome that. We are looking forward to signing this in Vladivostok in September, God willing, and I think it is a very encouraging move. Thank you for the floor.

**E. Zakamskaya:**

Thank you for your comments, and we hope that other people will support you.

Another question? Yes, please.

**N. Murashkin:**

Nikolai Murashkin, a postgraduate student at Cambridge University. I have a question for Alexei Kudrin about Russia and its cooperation with the Asian Development Bank. In the mid-2000s, Russia had the opportunity to join the bank, as a donor. But an agreement could not be reached with the United States and Japan. What is the situation now, and what are the prospects? Is it worth it now?

**A. Kudrin:**

Back then, and now, I am for us joining the Asian Development Bank. This imposes certain obligations on us, including donorship, but I think that the overall effect would be very positive. I am not going to list the obstacles that stood in front of us. The Deputy Minister of Economic Development Mr. Likhachev is here today, and he probably knows more about the current status of the application, but in any case I support it.

**E. Zakamskaya:**

And the last question we have time for. Please, go ahead.

**I. Nesterov:**

Siberian Branch of the Russian Academy of Sciences, Rosneftegaz, Tyumen Region. Ivan Nesterov.

I have a question. The state strives to support large companies. Maybe this is necessary, but they need to be controlled, and controlled tightly. At the same time we need to strengthen the role of small and medium-sized business. I will give you one example: the attitude of the major companies to oil. I think that the attitude to oil is negative, although I am sure that there is an alternative to oil. The question is how to tightly control large companies. Otherwise, and I will give an example, we will in the near future lose about USD 6 trillion due to the fact that 15 billion tonnes of recoverable reserves will be turned into non recoverable reserves. In this regard we need to establish control over large companies.

**K. Kleinfeld:**

I think this is at the core of many of the things that have been discussed here at the Forum. I mean, it is well understood, as far as I can see, by many here in Russia, and that is why it is also understood that the economy has to diversify. This diversification it is obviously not just about different industries, industries that, like aerospace, have once been a foundation. Russia has become the second largest automotive market in Europe, right after Germany. There is no automotive company on this planet that is not interested in investing here. But, it also includes strong entrepreneurship and the build out of small and medium-size companies. And for that, it is not just the financing that is needed; it is also that we have to make sure that the education comes in here for commercialization skills, because frankly, you cannot build successful small and medium-sized companies if you do not also give them the capabilities to scale up. And scaling up means in today's globalized world that they have to understand how the world market is structured, otherwise they will be wiped out by global competition coming in. We have great examples here. I mean Yandex and Mail.ru are great examples of companies that have done that. I

am more optimistic, particularly given the strong educational background that this country has and the strong inventiveness. In a way, the Soviet times have shown that the inventiveness of the nation is probably much larger than most people here think it is, because they have had to cope with so much adversity.

**E. Zakamskaya:**

This is a fair point. I would like to thank you for your comments.

In conclusion, I would like to say that the word 'potential' and the concept of 'potential that has yet to be realized' has come up many times at this round table. I hope that every year when we come together at the St. Petersburg International Economic Forum and other venues, we will be able to say that this potential is steadily becoming more in demand and is being realized through actual projects.

I am very pleased that our foreign participants were committed to open dialogue and cooperation. I thank you all for coming.