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# Foreword



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Managing Director  
and Member of  
the Managing  
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This document is an updated and extended version of the report *Russia's Regions: Drivers of Growth*, presented at the World Economic Forum Annual Meeting 2014 in Davos-Klosters and first released on 22 January 2014. It has been prepared in close collaboration with the Forum's Global Agenda Council on Russia.

Building on the Forum's Scenarios for the Russian Federation initiative, the report highlights the potential of Russia's regions to become significant drivers of institutional reforms and, ultimately, to pave the way to fast and sustainable economic growth in all of the Russian Federation. Some regions are already showing markedly better performance than the country as a whole. In recent years, they have demonstrated remarkable dynamism and succeeded in substantially improving their business environment.

The "*Russia's Regions: Drivers of Growth*" report profiles the diversity of Russia's regions, identifies the obstacles to their growth, explores concrete reforms that can be undertaken at the regional level and highlights examples of best practices from leading regions. This extended version specifically focuses on the role of international businesses in the economically successful regions of Russia by presenting five case studies in which global companies have expanded in Russia by setting up operations in the regions. The case studies herein present the particularity of local practices, the effects of public-private cooperation and other factors, which have assured the success of those regions that have attracted foreign investment. The initiative and the report have been strongly endorsed by key decision-makers and thought leaders in Russia, including Alexei Kudrin, Chair of the Forum's Global Agenda Council on Russia and Alexei Ulyukaev, Minister of Economic Development of the Russian Federation.

The success stories in Russia's regions show that there is great potential for economic development in Russia as a whole. We hope that this report will contribute to a constructive dialogue among key stakeholders on steps that Russia could take in future to strengthen its economy through reforms inspired by its regional resources.

# Preface



Alexey Ulyukaev.  
Minister of  
Economic  
Development  
of the Russian  
Federation

The Russian government will pursue its key development priorities despite a challenging international economic and geopolitical context. We aim to expand investment cooperation with foreign partners and to develop domestic entrepreneurship.

To address these priorities, the Russian government is implementing measures seeking to improve the business environment, substantially reduce red tape, enforce legislation and develop a system of support for investment projects.

Both the business community and international experts confirm that Russia has made substantial progress over the past two years. In particular, according to “Doing Business” report rankings, Russia has jumped from 124 to 92 – and there is room for further improvement. Other indicators show that Russia ranks among the top twenty countries for its business environment. In addition, we have succeeded in significantly reducing the number, time and cost of administrative procedures in several areas crucial to entrepreneurs: connection to energy infrastructure, customs administration, registration of property and businesses, and more.

Clearly, these successful achievements can be attributed to the regional authorities. It is the regions that are implementing investment projects. Innovative policies introduced by regional authorities, their timely response to the problems confronting businesses and the marketing strategies they have put in place have yielded high investment rates.

Regional investment standards based on best practices are being introduced in all of Russia’s regions. The office of a business ombudsman is being established and the performance of senior officials in the regions of the Russian Federation is being assessed, all to create favourable conditions for business development.

The World Economic Forum’s report on the development of the business climate in Russia’s regions is of particular interest to us. It allows us to assess not only the effectiveness of measures that have already been implemented, but it also helps to identify and replicate best practices to further enhance the investment climate. Moreover, it ensures that the comments and suggestions of international experts are taken into consideration for further development measures to create a favourable business climate.



Alexey Kudrin,  
Professor and  
Dean, School of  
Liberal Arts and  
Sciences, Saint  
Petersburg State  
University

The latest report of the World Economic Forum's Global Agenda Council on the Russia Federation was presented at the Forum's Annual Meeting 2014 in Davos. Russia's Regions Drivers of Growth: 4x4 was compiled over the course of one year and discussed with representatives of Russia's regions, entrepreneurs and economists. The "4x4" reference in the report title highlights the four main conclusions about the role of regions and the reforms necessary for economic growth, as well as the four main areas in which reform is needed. We wish to strongly emphasize that success is possible only if comprehensive reform is implemented.

Some of the report's conclusions echo those underscored at a number of conferences. The distinguishing feature of this report is that it investigates the effect of specific sources of growth in certain regions.

Understanding how certain factors interrelate and what role they play in the success stories of certain regions can still prove challenging, even to me and despite valuable experience as Deputy Prime Minister and Minister of Finance. Such factors include the inherent conditions and situation in a region, the support afforded to the region by the federal government and the leadership qualities of the governors. This report elucidates all of these. It shows that the Ulyanovsk and Kaluga regions made significant progress in improving their business climate despite the fact that their initial starting point was similar to the average Russian context. The example of the Republic of Tatarstan is also interesting: it shows that although the region has enjoyed considerable support from the federal government, the major source of growth has been the reduction of administrative red tape. Significantly, the leadership qualities of their governors have been the key factors of success in all three of these regions. It is hoped that this report will allow other regional leaders to learn from the governors of successful regions, and in particular to define clear objectives for reforms in their respective regions.

At the Annual Meeting 2013 in Davos, the Global Agenda Council on the Russian Federation presented a first report, Scenarios for the Russian Federation, precursor of the work on Russia's regions. The scenarios were rather pessimistic yet depicted what could be considered an objective view given that more than 350 entrepreneurs contributed to the report. Unfortunately, that report's conclusions proved true in practice. The second report on Russia's regions is somewhat optimistic – it shows that even in conditions of an imperfect domestic institutional environment, more can be done to enable growth and investment in any region. This positive orientation allows us to expect that Russia's future economic growth will acquire a significant new dimension coming from regional-based growth.



# Executive Summary

Building on the main conclusions from the Forum's *Scenarios for the Russian Federation* process, this report provides a deeper analysis of the potential of Russia's regions to champion institutional reforms and thereby contribute to building a sustainable growth path for the country.

While much of the analysis has focused on the weaknesses of institutions and the business environment in Russia, the extreme diversity of Russia's regions in this regard is often overlooked. Indeed, some regions in Russia are performing significantly better than the country overall, having enacted significant institutional and business environment reforms over the past decade.

The first part of this report highlights four lessons from recent economic research in regard to Russia's institutional reform agenda, and then identifies four reform areas that are expected to have the greatest effect on growth.

The four lessons for Russia's future economic development are:

1. Improving institutions will be the main driver of growth in Russia.
2. Russia's regions can play an important role in improving institutions and laying the foundation of fast and sustainable growth.
3. Business environment reforms significantly increase growth in Russia's regions.
4. Comprehensive rather than selective reforms matter.

Building on these key lessons, the four reform areas with the greatest effect on growth in Russia's regions are:

1. Reducing corruption
2. Improving access to finance
3. Reducing red tape
4. Addressing the inadequate education of the workforce

In all these areas, different regions within Russia have accumulated significant best practices. Leading regions have started to address barriers in these areas, and analysing the best practices from within the country can be an important step in building a sustainable growth strategy for the country.

The second part of the report presents three case studies, covering three of the most advanced regions in terms of institutional and business environment reforms: Ulyanovsk, Kaluga and Tatarstan. The report presents the outcomes for each region of a best practices survey conducted by the Forum, as well as the success factors in the words of the governors of the three regions.

The four lessons and four reform areas (4x4), combined with the discussion of best practices, can provide a roadmap for Russia. Some regions may already have reached the goal that the country subscribed to in its various reform programmes; building on lessons from within the country can be a powerful mechanism for driving them forward.



# Regional Champions: The Diversity of Russia's Regions

**Russia has made little progress on most measures of economic productivity, the quality of institutions and the business environment.**

A favourable macroeconomic situation and limited structural reforms have contributed to small improvements in Russia's competitiveness and ease of doing business rankings over the past years. However, Russia's overall position in such rankings remains at the tail end of countries with similar levels of economic development. Despite rapid economic growth over the first decade of the 2000s, the quality of Russia's institutions has largely stagnated. The disparity between rapid GDP and real income growth and the lagging quality of the business and societal environment makes Russia one of the richest countries with such low levels of institutional quality.<sup>1</sup>

Two representative reports on the quality of the institutional and business environment highlight Russia's challenges.

The World Economic Forum's *Global Competitiveness Report* evaluates the institutions, policies and factors that determine a country's level of productivity. In 2013, Russia's overall competitiveness ranking improved from the 67th to the 64th place out of 148 countries assessed in the report. This relatively good overall position is against the backdrop of persistently poor assessments of the country's public institutions (118th), market competition (135th), protection of property rights (133th) and innovation capacity (78th). Even more worrisome is that Russia's competitiveness ranking has been on a gradual downward trend since its peak in 2008-2009, when it ranked 51st.

The World Bank's index in the *Doing Business* report measures 11 indicators that illustrate how easy it is to set up and run a small or medium-sized enterprise (SME). The

index evaluates a country's regulations and uses interviews and surveys to capture how regulations are perceived by business actors. Russia jumped from 120th place in 2012 to 111th in 2013, and to 92nd in the 2014 edition of the report. The most significant improvements were achieved in the categories of starting a business (from 100th to 88th place) and in registering property (from 46th to 17th place). The country also ranks high in enforcing contracts (10th) and paying taxes (56th). Yet, Russia suffers from substantial weaknesses in several important areas that complicate the creation and development of SMEs, such as getting electricity (117th), trading across borders (157th), dealing with construction permits (178th), protecting investors (115th) and getting credit (109th).

What these rankings fail to represent, however, is the extreme diversity within Russia. The results of the *Doing Business* report are based on the performance of "the largest commercial city of the country", Moscow, which ranked last among Russia's regions in the sub-national edition of the *Doing Business* report. The methodology of *The Global Competitiveness Report* also primarily focuses on the performance at the country level and does not distinguish results at the sub-national level.

**But some regions are doing significantly better than others.**

In a country as vast and diverse as Russia, regional disparities are significant. Some of Russia's 83 federal subjects perform considerably better than the national average, or indeed as the capital, which is the basis of much of the existing analysis. The most comprehensive ranking of the business environment in Russia's regions is the World Bank's *Doing Business in Russia* sub-national report published in 2012. This report compares regulations that enhance or constrain business activity in 30 Russian cities.

The top-performing cities in the ranking include Ulyanovsk, Saransk and Vladikavkaz, while Russia's main cities, including Moscow, St Petersburg and Novosibirsk, find themselves at the bottom end of the ranking.

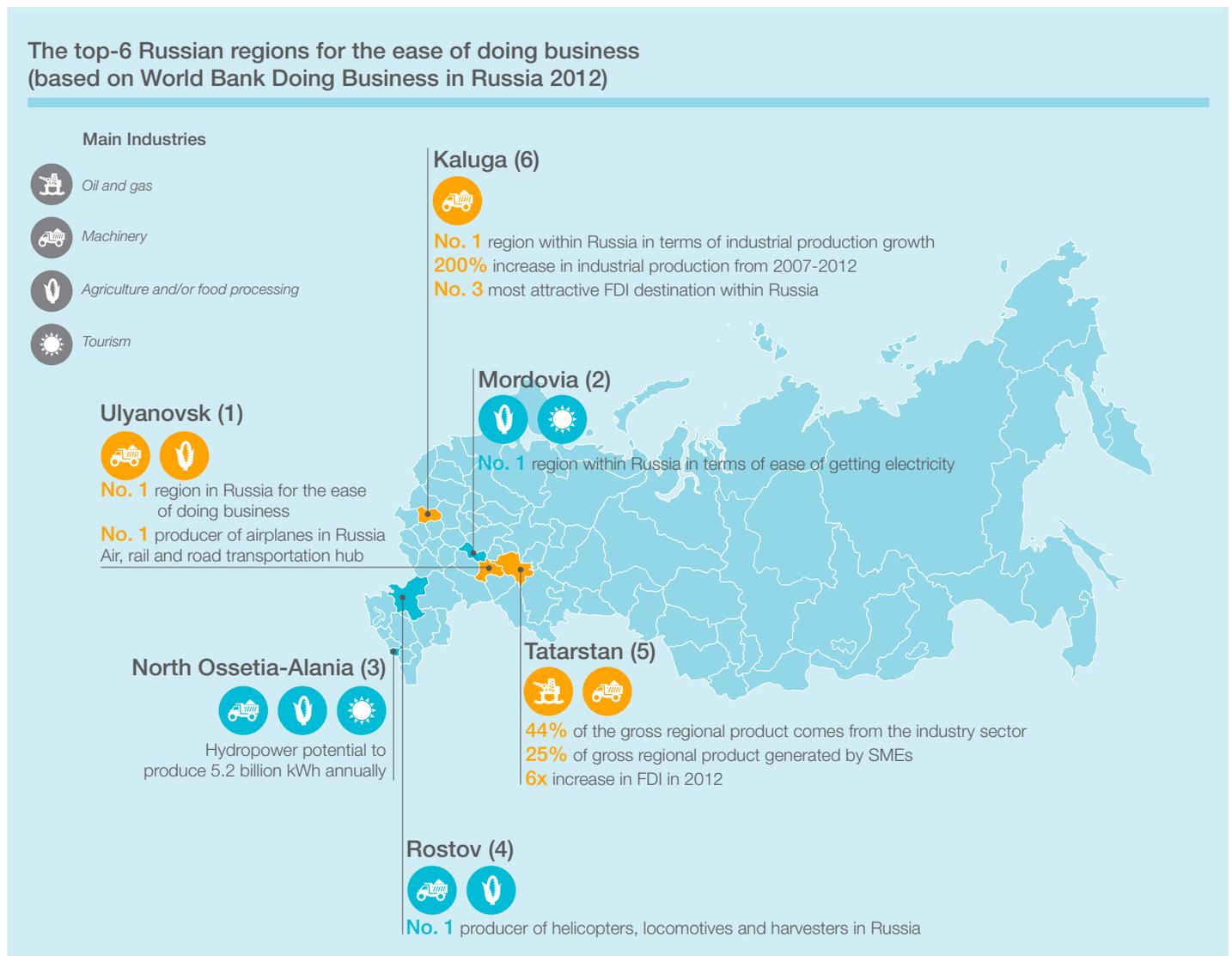
The extent of these differences within Russia become evident when comparing its top-performing regions with countries in the global *Doing Business* ranking: in the "cost to deal with construction permits" sub-indicator, Kazan in the Republic of Tatarstan would rank 46th globally while

Russia ranks 113th; in the “dealing with construction permits” sub-indicator, Surgut would rank 78th while Russia ranks 173rd. <sup>2</sup>

Nevertheless, caution is necessary when interpreting these rankings, which can mask strengths and weaknesses of a given region. A region may score high in the overall classification because it excels in a given sub-indicator, while performing poorly in other sub-indicators. For example, the *Doing Business in Russia* sub-national report comprises four indicators (ease of starting a business, dealing with construction permits, getting electricity, and registering property). The Republic of Mordovia and the Republic of North Ossetia-Alania achieve the second and third positions, respectively, in the overall ranking. Yet, this is primarily due to these regions being the two best performers in terms of getting electricity, without achieving very high scores in other sub-indicators such as “ease of starting a business”, where neither region is in the top 20.

While the discussion here focuses only on three highlighted reports, there are of course many other surveys ranking Russian regions and cities – from attractiveness for FDI to quality of life. These reports, however, are typically less representative and, while informative, are less suitable for comparing performance, the quality of institutions and the business environment across regions.

Nevertheless, an unequivocal message that emerges from practically all available reports is that the diversity of Russia’s regions is immense and there are top regional performers with significantly more favourable conditions for doing business than in Russia as a whole. In short, the diversity of the regions presents tremendous opportunities, and there are important lessons to be learned from Russia’s top-performing regions.



# Institutions and Growth: Four Lessons from Economic Research

This section uses the insights from recent economic research on institutions and growth to derive four key lessons that stimulate a deeper analysis of the regional disparities. They also form the basis for identifying the most promising reform areas in the third part of this report.

## **Lesson 1: Improving institutions will be the main driver of growth in Russia.**

At its current stage of economic development and due to an unlikely sustained increase in oil and commodity prices, the main driver of growth in Russia is improving institutions.

The Forum's 2013 *Scenarios for the Russian Federation* argues that, at the current stage of Russia's economic development, the main driver of growth is improving institutions. The advantages of catch-up growth and simple macroeconomic reforms are already realized. It is also highly uncertain whether oil and commodity prices will continue to grow as fast as during the first decade of the 2000s.<sup>4</sup>

A large body of academic literature supports the conclusions of the *Scenarios for the Russian Federation* report. For example, Daron Acemoglu, Simon Johnson and James Robinson (2001) convincingly argue for the causal importance of institutions as a driver of growth.<sup>5</sup>

Daron Acemoglu's, Philipp Aghion's and Fabrizio Zilibotti's (2006) "Distance to Frontier, Selection, and Economic Growth" is of particular relevance to Russia. This study analyses two stages of economic growth: catch-up growth and growth at the frontier.

Under catch-up growth, a relatively poor country can grow through either improving institutions or top-down measures. For example, importing frontier technologies or business practices developed elsewhere may be sufficient to sustain the catch-up type of growth. This can be done through a top-down model of growth where a government decides to implement a national development programme. Alternatively, catch-up growth can follow a bottom-up logic, with the government facilitating development by improving institutions.

According to Acemoglu et al., however, a richer country can only grow at the frontier by improving institutions. A top-down development strategy is less likely to succeed. Fast growth in this context can only be achieved through improving the rule of law, strengthening property rights and reducing barriers to doing business. Only then can competition among existing firms and the entry of new firms foster the business and technological innovation that drives growth at the frontier.

As a high-income country with high levels of human capital and development, Russia clearly falls into this second type: growth at the frontier.

Nonetheless, a common misconception is that oil prices are the only driver of growth in Russia. Without doubt, natural resource prices are an important factor. For example, Guriev and Tsyvinski (2010) argue that an increase in the price of oil by US\$ 10 per barrel leads to an increase in annual GDP growth of about 1% in Russia. However, at the current stage of economic development, commodity prices are not the only factor of growth.

The same paper highlights that, during Russia's period of fast growth from 2000 to 2008, only about half the level of growth was driven by increasing oil prices. The remaining part of growth was due to the advantage of the low starting point of underused production capacity and low level of GDP, prudent macroeconomic and fiscal policy, and delayed effects of the reforms of the 1990s that established the basic market institutions and economic reforms of the first term of Vladimir Putin's presidency.

Hence, improving institutions remains the main driver of fast and sustainable growth for the country.

## **Lesson 2: Russia's regions can play an important role in improving institutions and laying the foundation of fast and sustainable growth.**

Russia's regions have implemented different institutional and economic reforms. Unlike in the 1990s (when the legacy of the Soviet economy and resource endowments defined their economic

destiny), the growth prospects of Russia's regions are now determined to a significant degree by the quality of governance and by the scope of economic reforms they enact.

There are relatively few detailed studies that analyse the economic performance of Russia's regions. Perhaps the most convincing study on this issue is "Understanding Russian Regions' Economic Performance during Periods of Decline and Growth – An Extreme Bound Analysis" by OECD economist Rudiger Ahrend (2012). This study uses data from 77 Russian regions for the period 1995-2006. The dataset includes almost all *oblasts* (districts), *krais* (territories) and republics, and two cities (Moscow and St Petersburg).

The author breaks the dataset into two periods: pre-1998 and post-1998. The crisis of 1998 is a natural dividing point between the period of general economic decline and transitions following the breakup of the Soviet Union and a later period of strong growth. <sup>6</sup>

According to the study, differences in Russian regional growth during the period up to 1998 were to a large extent driven by three factors:

- 1) *Natural resource production*: Production of oil largely explains economic performance pre-crisis; gas production is significant in 90% of the regressions.
  - 2) *Industrial structures*: The initial share of exports is robustly and positively related to growth in the pre-crisis period. Regions with larger shares in chemical or fuel production, and with smaller shares in power production, performed better pre-crisis.
  - 3) *Secondary education*: The levels of secondary education score is another important factor in this period.
- In sum, the initial conditions – resource production, industrial structure and the level of human capital – which are all inherited from Soviet times, largely determined the pre-crisis economic performance of Russia's regions. Furthermore, for the 1995-1998 period, there is no strong relation between measures of regional economic reforms and economic performance.

The drivers of regional growth for the post-1998 period are dramatically different.

First, initial conditions are significantly less important for growth. Among the factors described above, only the share of fuel production in the regional industrial structure remains significant.

Second, the "quality" of governors is robustly related to post-1998 growth. Ahrend defines the quality of governors based on a variable that uses two independent ratings, ranking governors on their perceived capacity to implement reforms and improve the region's economic performance.

Third, the degree of implementation of economic reforms, including the extent of small-scale privatization and development of small businesses, is strongly related to economic growth. This is in contrast with the 1995-1998 period, where such a relationship was not found. <sup>7</sup>

### Lesson 3: Business environment reforms significantly increase growth in Russia's regions.

Indicators measuring the ease of doing business provide a benchmark for what types of reform areas have the greatest effects on growth performance.

One of the most influential studies on the interplay between the quality of the business and institutional environments and growth is "Regulation and Growth" by Simeon Djankov, Caralee McLiesh and Rita Marie Ramalho (2006). The study uses an aggregate index of the World Bank's *Doing Business* indicators to analyse its correlations with the growth performance of 135 countries from 1993 to 2002.

The analysis finds a significant impact of reducing the burden of regulation. Moving from the worst to the best quartile in the ranking implies a 2.3 percentage point increase in average annual growth. This is in stark contrast to other potential areas of growth policy, such as increasing enrolment in primary education, improvement of secondary education, inflation or government consumption, all of which have significantly lower effects.

A variety of other studies demonstrate a large effect of reducing the burden of business regulations. For example, Benjamin P. Eifert (2009) studied reforms in business regulations using the *Doing Business* database for the period 2003-2007. Comparing countries that reform in at least one area with those that do not, the study found that reformers grew 0.2-0.4 percentage points faster and witnessed an increase in investment by 0.15-0.27 percentage points.

In another study, Miriam Bruhn (2008) used data of the Mexican National Employment Survey that is conducted quarterly and covered 150,000 households for the period 2000-2004. She found that simplifying entry regulations increased the number of registered businesses (5% increase after the reform) and employment (2.8% increase). As a result, consumers benefited from decreased prices by 0.6%.

In sum, the existing economic literature clearly establishes an association between improved business environments and growth across a variety of countries and circumstances.

#### **Lesson 4: Comprehensive rather than selective reforms matter.**

Overall levels of institutional quality determine to what extent business environment reforms can have a positive effect on growth. To succeed, reforms aimed at addressing barriers to doing business need to be accompanied by overall improvements in governance.

The hallmark of economic studies on the implementation of reforms in Russia's regions is Evgeny Yakovlev and Ekaterina Zhuravskaya's (2013) paper, "The Unequal Enforcement of Liberalization: Evidence from Russia's Reform of Business Regulation".<sup>8</sup> This study analyses administrative reforms that reduced the regulatory burden on existing and new businesses. The authors focus on reforms aimed at increasing the entry and growth of small businesses by limiting the number of inspections (e.g. sanitary), abolishing licensing requirements, and allowing registration of new firms to be notification-based.

The main finding of the paper is that reforms aimed at reducing the burden of regulations succeeded in regions that already had better overall levels of institutions. In contrast, in regions with weaker institutions, there was no effect of the reforms undertaken and, in some cases, even a negative effect.

Specifically, reforms were more effectively enforced in regions with more transparent governments, more informed societies, a higher presence of industry (and thus a more effective monitoring by businesses) and stronger fiscal autonomy. The more local governance institutions improved, the more the level of enforcement of national liberalization laws increased, and thus the positive effect on outcomes such as firm performance and small business employment.

The authors provide an example that clearly illustrates the econometric results by comparing a typical "good" region with a typical "bad" region. According to this analysis, in a region with good institutions, reducing inspections leads to a 12% increase in sales for average small firms, compared to only 1.6% in a region with bad institutions.

Similarly, simplification of company registration leads to an increase in the share of small business employment by 1% when institutions are good, but to a 0.3% fall in employment if institutions are bad. This is largely due to the expectation that, in a poor institutional environment, the moves may not translate into a significant change in the actual regulatory level or because the measures may remain poorly enforced and thus create an unequal playing field for companies.

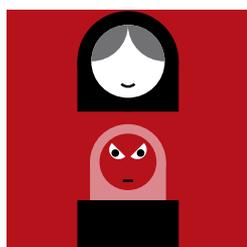
# Policies and Best Practice: Reforms that Most Affect Economic Performance

Different studies have started to quantify the impact of business environment reforms on economic growth across countries and with a focus on the obstacles businesses face in Russia's regions. Combining these insights allows for the identification of the most promising reforms Russia's regions can undertake to increase growth and develop a sustainable economy.

The assessment of the most promising reform areas is based on three criteria:

1. The potential to significantly improve growth based on a cross-country economic analysis
2. The potential to remove a significant obstacle to doing business, i.e. top concerns in a survey by the European Bank for Reconstruction and Development (EBRD) on the barriers to doing business discussed below
3. The potential to remove significant negative cost effects on firms' activities

## Reducing Corruption



The first most promising reform area is **reducing corruption**. Studies highlight corruption as the most widely-cited problem for business operations in Russia and as the costliest problem of all the barriers that companies face.<sup>11</sup>

The insights from economic research show that the measures that broadly define the rule of law are among the sub-indicators of Doing Business that have the highest impact on growth. This is consistent with the broad conclusion in the economic literature that reducing corruption has a sizeable impact on growth.<sup>12</sup>

## Improving Access to Finance



The second most promising reform area is **improving access to finance**. The financial constraints that companies face are among the top problems named in different business environment surveys in Russia. The insights from economic research identify access to credit as

the indicator of *Doing Business* with the highest impact on growth, and the index of legal rights as the most important sub-component of this indicator.

As such, improving the rule of law and improving access to credit will have complementary and reinforcing effects. The conclusion is consistent with recent findings in the economic literature on the significance of financial constraints in misallocating resources, reducing productivity and having a significant impact on growth.<sup>13</sup>

## Reducing Red Tape

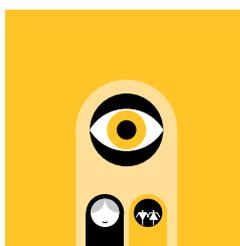


The third most promising reform area is **reducing the costs and burden of licensing and permits**. The costs of business permits and licensing are among the most frequently stated in the surveys and constitute a significant barrier to doing business in Russia. The insights from economic

research show that costs associated with permits are among the highest growth-impact factors across a broad range of indicators.

Reduction of such barriers will likely also reduce the potential for corruption and have complementary beneficial effects. The high-growth potential of reducing the regulatory burden is consistent with findings in economic research that the process of creation and destruction of firms is a major driver of growth in the modern economy, and may account for as much as one-half of the growth in modern economies.<sup>14</sup>

## Addressing the Inadequate Education of the Workforce



The fourth most promising reform area is **addressing the inadequate education of the workforce**. This area represents an indirect cost to businesses in terms of reduced innovation capacities and lower growth potential when an adequately educated workforce is not available.

But the costs may also be direct, such as the cost of a longer search for candidates to fill the vacancies, the increased cost for their adaptation and training, or the cost of producing defective goods and products.

## Insights from the Economic Literature

A variety of studies support the above conclusions, both across countries and specifically for Russia's regions. Comparing the performance of different countries at the global level, Marek Hanusch's (2011) paper, "The Doing Business Indicators, Economic Growth and Regulatory Reform", analyses which business environment reforms have the largest effect on growth.<sup>15</sup>

The study finds that the most important *Doing Business* indicator for economic performance is "getting credit". This indicator measures the prevalence and severity of financial constraints companies face. The second most important indicator is "enforcing contracts". This indicator is important as it measures the rule of law as a key determinant of economic growth. Another related and significant indicator is "protecting investors"; however, it is not as high in magnitude as the other two factors.

The paper then studies the most important sub-indicators of the *Doing Business index*. The cost component of "starting a business" (i.e. how expensive it is to set up a company) has the highest impact on growth overall. The cost indicator in general has the highest effect on economic growth. It stands out as the most important factor for five separate indicators: "starting a business"; "dealing with licenses"; "registering property"; "enforcing contracts"; and "closing a business". For "getting credit", the Legal Rights index and Credit Information index are the most important sub-components.

Focusing on the constraints to doing business in Russia's regions, the best qualitative and quantitative evidence comes from the European Bank for Reconstruction and Development and the World Bank's *Business Environment and Enterprise Performance Survey*.<sup>16</sup> This survey finds that the top five obstacles to doing business are tax rates, inadequate access to finance, corruption, unfair practices of competitors and an inadequately educated workforce.

*Qualitatively*, the study summarizes the answers provided by companies about the obstacles to doing business. Enterprises in all regions view the rate of taxation as a significant obstacle to business operations. In some regions, such as the Moscow region, Samara region, Primorsky territory and Stavropol territory, more than 70% of companies identify tax rates as a major or very severe obstacle.

Inadequate access to finance is cited among the top three most severe obstacles to business in 26 regions, with 14% of firms across the country ranking it as the biggest obstacle to business.

Corruption is cited among the top three obstacles in 11 regions, or a total of 8% of firms across the country. However, in some regions, this share is much higher. In Moscow city and the Leningrad region, for example, some 25% of enterprises view corruption as a very severe obstacle.

An inadequately educated workforce is assessed more diversely in different regions. In the Rostov and Samara regions, for example, more than 50% of respondents view an inadequate education of the workforce as a major or very severe obstacle to the operation of their business. In other regions, however, such as Smolensk, Stavropol and Belgorod, it is not seen as a major impediment.

The same study provides a *quantitative estimate* of the costs associated with these barriers for businesses.<sup>17</sup>

Corruption is by far the costliest problem for businesses. Eliminating this obstacle would decrease firms' costs by about 8%. This is a very significant number and represents what economists call a "corruption tax". Overall, 27% of firms reported that corruption is a severe or very severe obstacle for current operations. On average, firms pay 0.6% of their annual sales as informal payments or gifts; 15% of firms do it frequently, while 3% of firms always use informal payments to get things done.

Firms reporting that corruption is a minor obstacle experience on average 7% higher growth in employment compared to firms for which this obstacle is moderate.

Improving access to finance by one degree of severity (e.g. from a moderate to a minor obstacle) is associated with a 17% higher chance of innovative activities, a 4% higher employment growth and a 3.5% increase in exports.

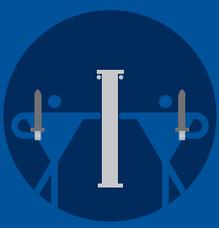
Removing the negative effects of business licensing and permits could decrease firms' costs by more than 6% overall; 14% of firms responded that business licensing and permits are severe or very severe obstacles for current operations. The survey reported that 24% of firms submitted an application to obtain an operating licence during the past year. On average, it took 54 days to obtain a licence and 9% of firms reported having to make informal payments to obtain a licence. The survey found that 11% of firms submitted an application to obtain a construction-related permit. On average, it took 164 days to obtain this type of permit, and 24% of firms reported having to make informal payments to obtain a licence. In other words, business licensing and permits are compounded and are correlated with corruption.

The cost of labour regulations and tax administration are also above 5%. Firms that reported that licensing is a minor obstacle experienced on average 6% higher growth in employment compared to firms for which this obstacle is moderate, and 12% higher growth compared to firms for which this obstacle is major. An increase by one degree of severity of the business licensing decreases innovation by 2%.

Regarding the effects of improving the quality of the labour force, an inadequately educated workforce significantly reduced the likelihood of introducing innovations by 13% and was associated with close to 4% slower growth of exports for firms in regions where this obstacle is moderate compared to regions where it is minor.

# Lessons from the Regions: Regions that Lead





### Ulyanovsk leads the overall ranking of the sub-national Doing Business index as the region with the most favourable business environment within Russia. It ranks 3rd in the ease of starting a business, 4th in dealing with construction permits, 5th in the ease of getting electricity, and 8th in the ease of registering properties.

In terms of the reform areas that this report identified as most promising for spurring growth, Ulyanovsk leads the way in one important area: corruption. According to the EBRD's Business Environment and Enterprise Performance Survey (BEEPS), less than 5% of the surveyed firms in Ulyanovsk cite corruption as the main obstacle of doing business – way ahead of the national average. Access to finance and an inadequately educated workforce, however, still pose significant challenges for companies in the region, with slightly less than 20% and slightly more than 10% of firms respectively identifying these issues as the main obstacle for doing business. Red tape also remains a challenge in the region at a similar level to what companies face elsewhere in Russia.

The regional best practices survey conducted by the Global Agenda Council sheds light on Ulyanovsk's key success factors from the point of view of the regional administration, and may indicate some of the reasons for the strong performance in fighting corruption in the region. The key factor cited by the administration is the personal involvement and dedication of Governor Morozov as well as the engagement of all relevant stakeholders, allowing the region to significantly enhance its business climate. This view is consistent with the insights from economic research presented in this report, highlighting the quality of governance in the regions as one of the key determinants of their growth performance.

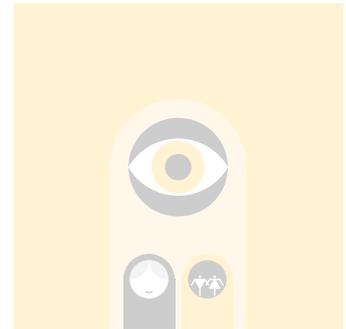
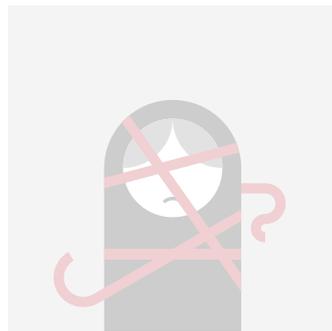
A further explanation for the quality of governance in the region, according to the administration, is the active involvement of all relevant stakeholders in the decision-making process: the Ulyanovsk regional administration, the administration of municipalities, experts and the associations of entrepreneurs. They highlight three examples of multistakeholder engagement:

1. A regional week of entrepreneurial initiatives during which the entrepreneurial community of the region can submit

proposals on how to improve municipal, regional and federal legislation

2. A governmental commission for the development of SMEs, headed by the governor and including more than 30% of representatives from associations of entrepreneurs
3. A commission on the reduction of administrative barriers, addressing individual matters regarding the interaction between entrepreneurs and the authorities

#### Areas of Particular Progress





## Sergey Morozov

Governor

Ulyanovsk Regional Administration

### The Formula for Success in the Words of Governor Morozov: The 10 “I”s <sup>18</sup>

In the beginning, there was only one “I” – **“investment”** that the government of the region was aiming for. To diversify the economy of the region, the government identified one main instrument: attraction of foreign investment. However, we understood very fast that it is impossible to attract investment with the help of only nice words and promises. Concrete measures had to be taken to create favourable conditions for investors.

Therefore, the second **“I” appeared, which stands for “infrastructure”**. We formed competitive territorial-industrial clusters and complexes such as the aviation, automotive cluster or the cluster for nuclear innovation. We are forming more clusters: the creative industries cluster and the cluster of information technology. Additionally, industrial zones, centres for nanotechnology, centres for nuclear innovation, industrial parks and business incubators are being set up. However, these efforts were also not enough.

The third **“I” stands for “innovation”**, which is the readiness and willingness to develop and introduce advanced technology. Our goal is to become a region that uses the most advanced knowledge available today.

But innovation is closely linked to the development of human capital – **intellect – the fourth “I”**. The region started to develop human capital and to form a creative environment. But this also did not seem to be enough.

The fifth **“I” stands for “internationalization”**. Nowadays in a global economy, it is impossible to become one of the economically successful regions in Russia without enhancing cooperation on an international level and without taking part in the international division of labour. We have to open our region to foreign partners.

And this demands the sixth **“I”, standing for “Integration”**. This is the need and willingness of the region to be included in all positive international processes, not only in the economic sphere, but also in the cultural and social sphere.

Another important factor for the success of the region is the support of the population of Ulyanovsk. This can only be reached through the transparency of the work of the government of the Ulyanovsk region. The government is also keen on closely cooperating with the population and on involving the population in decision-making processes. The government of the Ulyanovsk region wants the citizens to have the possibility to control its actions. This is the reason why the seventh **“I” stands for “interactive”**.

In 2013, the eighth **“I” was introduced, which stands for “intensification”**. The achievements that the Ulyanovsk region has reached in the enhancement of the business climate can only be preserved if the region can keep up the high pace of developing and implementing the above-mentioned “I” s.

The ninth **“I” stands for “identity”**. This means that the population of Ulyanovsk identifies with the fate, the history and traditions of the region as well as with the decisions that are currently being taken. Identity also means that the population feels responsible for the future of the region.

This sense of identity can only be created through the cooperation between the citizens, their associations and the authorities that should focus on the prosperity of the region.



# Kaluga

Attracting FDI and Providing Incentives to Investors  
Regardless of Size

**Kaluga ranks 6th among Russia's regions in the sub-national *Doing Business* index, and the region is ranked 1st in the category of the ease of registering property. It is one of the leaders within Russia in terms of attracting foreign direct investment, particularly from foreign car manufacturers, rivalling much larger regions and cities such as St Petersburg.**

In terms of the reform areas that this report identified as most promising for spurring growth, Kaluga has made significant progress in three out of the four areas. According to the EBRD's BEEPS, access to finance seems to be almost completely removed as a barrier for businesses in this region, with less than 5% of firms ranking it as the main problem for businesses (compared to close to 20% on average across Russia). The same is true for the level of education of the workforce as well as red tape, both of which are seen by less than 5% of firms as a key problem in Kaluga.

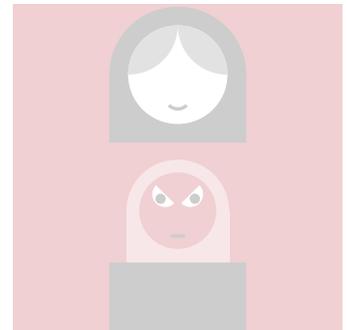
The regional best practices survey by the Global Agenda Council highlights several important measures which could explain Kaluga's strong performance in these business environment rankings. In 2010, Kaluga adopted a strategy for the socio-economic development of the region until 2030. A key feature of this strategy was the development of special-purpose industrial parks. Within the industrial parks, and as a matter of general policy, policy-makers put specific emphasis on reducing administrative barriers. As the analysis of the most promising reform areas indicates, this is one of the most important measures in terms of impact on growth.

While the region attracted a number of high-profile investors, it also specifically created programmes to support small and medium-sized companies. Entrepreneurs in the region receive a comprehensive package of services aimed at enhancing innovation and export capacity, as well as to improve access to finance and staff development programmes – both among the key reform areas identified in this report. Regarding access to finance, the National Entrepreneurship Support Fund of the Kaluga region provides guarantees for bank loans for companies with insufficient collateral as well as loans at preferential interest

rates. In terms of education, the region established several specific training programmes, such as the Kaluga region training centre for the automotive industry, as well as others aimed more specifically at SMEs and their management capacities.

Furthermore, the regional administration put in place a system of tax incentives for investors of any size. Focusing on investors regardless of their size is particularly important. Typically, policy-makers in Russia's regions focus on large investors that can generate headline news and bring immediate benefits. Small and medium-sized investors, however, are often more affected by deficiencies in the business environment. Large investors generally face less corruption or can deal with it more effectively, face fewer administrative barriers and have better access to finance.

## Areas of Particular Progress





**Anatoly Artamonov**  
Governor  
Kaluga Regional Administration

## The Way Forward in the Words of Governor Artamonov: Seven Factors for a Real Competitive Advantage <sup>12</sup>

Our country and the region have a very real competitive advantage. However, to improve the business environment, additional steps are required.

**First**, there is a need for accelerated modernization of transport infrastructure, especially roads and railways, as well as the development of inter-regional aviation links. We started creating the special economic zone (SEZ) “Ljudinovo”, which is a big step in reducing disparities in the development of the northern and southern parts of the region. Over the next 10 years, this zone will attract investments of more than 30 billion roubles and create about 4 thousand new jobs. However, a significant limitation for the development of this SEZ is the state of the federal highway M3 “Ukraine”, which has seen an increase in accidents, fatalities and injuries [due to its bad road conditions].

**Second**, many of the issues would be resolved faster if regional authorities had the necessary authority and competence to adopt legislation on issues that directly affect the well-being of the regions. Is it possible, for example, for one federal law on the turnover of agricultural lands to take into account all features of land use from the Yamal-Nenets Autonomous District to the Belgorod region, in areas of permafrost and the centre of Russia? Regulation of these issues by regional legislation would avoid a situation where thousands of hectares of land are overgrown with forest and cannot be returned to agricultural use. Taking into account local peculiarities, regions could well establish requirements for the architectural appearance of buildings, construction of social institutions, for the violation of traffic rules, safety issues for roads and other problematic issues.

**Thirdly**, as far as agricultural land is concerned, the absence of proper regulation of the turnover of agricultural land currently limits investments into the agricultural sector. Land tax for those who do not cultivate the land must be increased by at least 10 times.

**Fourth**, special attention should be paid to property management and land resources owned by the Russian Federation. The state should keep as much property as it

needs to fulfil all its responsibilities. Everything else should be transferred to the regions.

**Fifth**, it must be noted that the current system of vocational education does not meet the requirements of the new economy. That is why we were forced to create a special training centre for the automotive industry and to invest about 1 billion roubles in the project. Special government programmes are needed that would ensure the availability of professional staff for investment projects that are carried out in the different regions.

**Sixth**, investors coming into the regions rely heavily on the guarantees of stable conditions that protect their activities. Yet, in our region we can only improve the conditions that depend on the municipal or regional authorities [...].

**Seventh**, the system of financial and tax relations between the Federation and its subjects should be aimed at enhancing budgetary self-reliance. Implementing large investment projects in the Kaluga region will significantly increase tax revenues, primarily in the federal budget. Last year, the activities of industrial park residents alone raised some 20.5 billion roubles in tax revenues. Of these, almost 14 billion roubles were transferred to the federal budget.

The solution of the above-mentioned problems will open up additional opportunities to improve the business climate in the Russian regions.



# Tatarstan

Focus on SMEs and Transparency

**Tatarstan ranks 5th in the overall ranking of the sub-national *Doing Business* index in Russia. It ranks 4th in the ease of starting a business, 14th in dealing with construction permits, 17th in the ease of getting electricity, and 4th in the ease of registering property.**

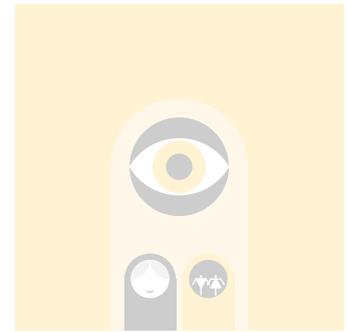
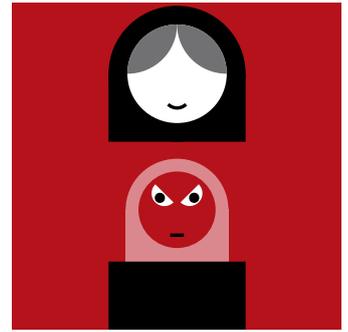
In terms of the most promising reform areas highlighted in this report, Tatarstan leads the way among Russia's regions in three out of the four areas. Aside from the inadequate education of the workforce, companies see all other areas (corruption, access to finance and red tape) as significantly less of a problem to doing business than in other parts of Russia. According to the EBRD's BEEPS, less than 10% of firms cite corruption as the main obstacle to doing business. Only slightly more than 5% of the firms view the costs of licensing and permits as the main obstacle.

The key success factors identified by the regional administration in the best practices survey conducted by the Global Agenda Council can be grouped in three clusters. The first is the provision of specific support services for small and medium-sized enterprises. This includes financing and infrastructure dedicated to start-up and small enterprises, but also specific subsidies for educational expenditures to develop and train staff. The latter programme was specifically designed in response to surveys highlighting an inadequately educated workforce as a key business constraint.

The second factor highlighted by the administration relates to effective cooperation with associations of entrepreneurs in the policy-making process. As of 2008, Tatarstan created a coordination council which consists of entrepreneurs, business associations and umbrella organizations such as the all-Russian association of entrepreneurs, "Business Russia". The council is regularly consulted on existing policies and the environment for doing business in the region. Furthermore, the Ministry of the Economy created an expert council to advise the Ministry on the support for SMEs in the region.

The third factor highlighted by the administration is transparency. Recognizing the importance of transparent access to information for investors, the ministries created a map for investors that contains all relevant information concerning energy, transport and social infrastructure in the region.

## Areas of Particular Progress





**Rustam Minnikhanov**  
President  
Republic of Tatarstan

## The Main Success Factors in the Words of Governor Minnikhanov: Three Key Priorities

### Special Economic Zones and Public-Private Partnerships

Special economic zones play an important part in the development strategy of the Republic of Tatarstan. They include: Alabuga, an industrial economic zone; Innopolis, a special economic zone on technical innovation; four industrial parks; nine technology parks and eight business incubators. Alabuga produces more than 70% of the total volume of goods of all Russian special economic zones. To date, there are 39 registered companies in Alabuga. The total volume of investments declared by residents of the special economic zone is 95 billion roubles, and it is projected to create more than 10 000 jobs. The region is also developing an innovative city known as “Innopolis” that will accommodate 60 000 high-tech and IT-professionals. Another important area of infrastructure development is the project “Smart City Kazan”, aimed at creating an infrastructure of international standards to attract main Russian and foreign companies.

### Facilitate Investments

The Republic of Tatarstan has taken a broad range of measures to facilitate investments in the region. In 2012, it was selected as a pilot region for testing the Regional Investment Standards developed by the Agency for Strategic Initiatives, a federal initiative to promote best practices and learning among Russia’s regions. Tatarstan was also one of the first federal subjects in Russia that successfully implemented all 15 sections of the Standards. The next step was the development and testing of the Standards by the municipal authorities to ensure a favourable investment climate in the municipalities of the Republic of Tatarstan.

Several other measures complement these steps: the creation of an Investment Board, adoption of an investment declaration, establishment of a procedure for impact assessment of existing and adopted legislation, and the creation of a Geoportal of the Republic of Tatarstan, which provides investors with the necessary information on the

energy, transport, engineering and social infrastructure in the region ([investkarta.tatar.ru](http://investkarta.tatar.ru)). Finally, the establishment of the Investment Development Agency and the Development Corporation of the Republic of Tatarstan is aimed at supporting investors by adopting the principle of the “single window”, with businesses being able to get answers in one single agency and significantly reducing paperwork.

Tatarstan is also implementing the roadmap developed by the Agency for Strategic Initiatives to reduce the burden of licensing procedures. The responsible ministries and agencies are actively working in this direction, which has already led to a reduction of processing times for approvals of construction works and questions concerning architecture to 30 days. The processing time for the examination and approval of capital construction objects that have to comply with requirements of technical regulations as well as for other regulations and project documentation has been reduced to 10 working days.

### Focus on SMEs

From 2011 to 2013, Tatarstan invested more than 5 billion roubles in the development of small and medium-sized enterprises. It amounts to the second largest SME support programme among all the federal subjects of the Russian Federation in terms of overall resources committed, just after Moscow. Regarding investments per small enterprise, Tatarstan is the leader among all regions. The support structures for SMEs in the region also include creating regional centres of engineering to provide a supportive infrastructure for these firms.

# Conclusion: The Way Forward

The title of this report, *Russia's Regions: Drivers of Growth 4x4*, brings together two key insights. First, the report highlights four lessons from research and the four most promising reform areas that can lead to sustainable growth across Russia's regions. Second, the report highlights and emphasizes the best practices from leading regions. Using the conceptual machinery of the 4x4 insights and following the example of the regions already in "pole position", Russia's regions can indeed become the drivers of fast and sustainable growth for the country.

The analysis presented in this report clearly underscores the important role of Russia's regions in building the foundation for the next phase of Russia's economic development. Despite the extreme diversity of the country, Russia is often portrayed as a uniform country with little regard to the activities and developments taking place in its regional centres. Yet, as this report argues, there is much to learn from shifting the perspective from the national to the sub-national level and from analysing best practices from the Russian regions that are already the key drivers of growth for the country.

While there is no leader who excels in all areas, Russia's regions boast a reservoir of good practices and experience with institutional reforms which can and should become a guide to improving the conditions for doing business in the country. Some of the regions portrayed in this report are already ploughing the way for what a more modern and diversified Russian economy could look like. They also demonstrate what potential could be unlocked by a more wide-ranging implementation of some of the measures that are already in place in the leading regions. Combining the different strengths and best practices in a comprehensive manner would clearly represent a quantum leap for the Russian economy. Learning from the initiatives taking place at the regional level is thus a worthwhile effort. The quality of governance clearly stands out as a key

factor. Both the academic research and the results of the best practices survey among representatives of the different regional administrations underscore the importance of different measures of the quality of governance in determining the success of a region. This indicator also seems to be closely linked with the role played by key individuals in the policy-making environment. Regions that lead in transforming their business and investment environments did so on the basis of the determined and forward-looking leadership of their governors as well as a public service apparatus able to implement and monitor progress in achieving the established goals.

Cooperation and transparency of decision-making also stand out as key attributes in the different success stories. Regions that lead have all pointed to the importance of participatory governance and the integration of various stakeholders in the decision-making process. Building highly service-oriented public institutions seems to be based on effective cooperation with those stakeholders that are being served and that should benefit from the established policies. It is also a recipe for building requisite levels of trust that can help unlock investments and the entrepreneurship potential.

Finally, the different examples point out that a more sustainable economy requires greater competition, also between the different regional entities. This entails all actors benefiting from clear rules whereby the most innovative and leading regions will be able to fully unlock their potential while supporting others in building cohesion across the country. Sharing and transferring best practices between the regions may be one of the most effective ways of achieving this.

Building on its longstanding work in the region, the World Economic Forum seeks to further support this focused and forward-looking policy discussion by bringing together key stakeholders of the Russian economy.





# Five Case Studies

## Case Study: Wienerberger – Kurkachi Plant in Tatarstan

### Investor

Wienerberger AG is a global building materials group with a key focus on ceramic-based building materials. It was founded in 1819 in Vienna, Austria, and is currently present in 27 countries with 245 plants in Europe and North America and 13,787 employees worldwide.

### Investment in Russia

From 2006 to 2009, Wienerberger constructed a €30 million bricks production plant on the basis of an existing facility in the town of Kurkachi, 40 kilometres from Tatarstan's capital Kazan. Negotiations with the Government of Tatarstan first took place in 2005 and resulted in a letter of intent and an investment memorandum signed with the government in 2006.

Wienerberger benefited from strong support from the government with regard to land access, natural resources, infrastructure, gas, electricity and railway, and, as a result, the Kurkachi plant was put into operation in 2009. Today, the plant employs 100 staff and has the capacity to produce 150 million brick units, with the key focus on ceramic blocks, including porotherm.

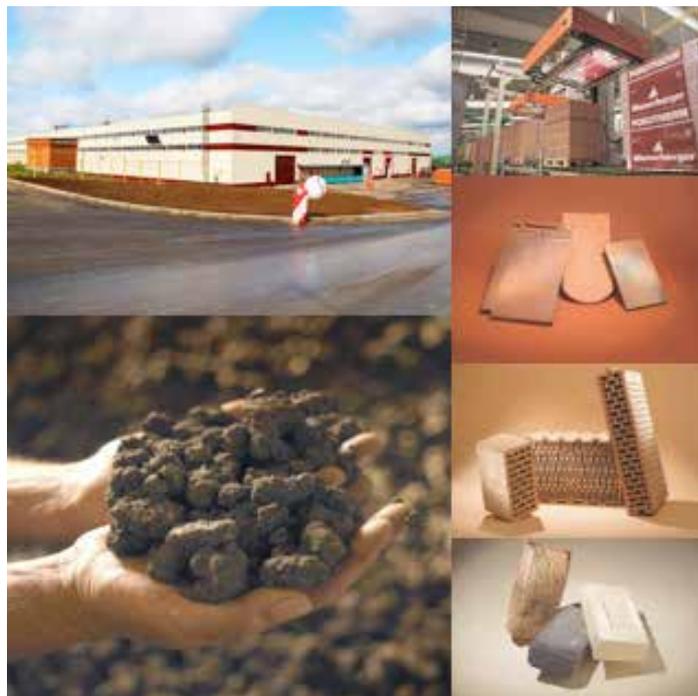
Porotherm is a special product that is fast, virtually dry, safe and simple to use. It is very strong, efficient for stock-holding and storage, and environmentally friendly. This product type brings cost and time-saving benefits throughout the build while its thermal and acoustic efficiencies bring further advantages for decades to come.

Wienerberger's first investment in Russia was a greenfield plant 120 kilometres north-east of Moscow in 2006. The Kurkachi plant is Wienerberger's second investment in Russia and has become one of the largest brick factories in Russia, demonstrating a high level of automation, which includes the newest generation of kiln, dryer and machinery. The Kurkachi plant was awarded "Best Brick Plant in Russia" in 2010.

Wienerberger was supported by the European Bank for Reconstruction of Development (EBRD), which invested €4.1 million equity into the investor's Russian subsidiary, Wienerberger Kirpitsch, and provided Wienerberger AG with a multi-project facility of €50 million for projects in several of the countries where the EBRD invests, including Russia.

### Comment by Peter Hennig, General Director of Wienerberger Kirpitsch, Russia:

"Tatarstan, being one of the top regions in housing construction in Russia, was chosen as an investment opportunity. We experienced excellent local government support, a highly motivated and educated local workforce and a fast-growing business environment, which made us feel comfortable from the very beginning."



## Case Study: Continental Tyres – Greenfield Plant in Kaluga Region

### Investor

Continental AG is a global automotive supplier of electronic systems and components, tyres and non-tyre rubber products. It operates in 49 countries and employs around 178,000 employees.

### Investment in Russia

In November 2011, Continental laid the first stone in the foundation of its first tyre plant in Russia, a greenfield investment in the Kaluga region. Two years later, the new plant – totalling 86,000 m<sup>2</sup> – was ready to mass produce its first products. Since the end of 2013, Continental AG in Russia has been producing tyres for passenger and light truck vehicles under the labels Continental, Gislaved and Matador, and today employs 700 workers. The plant's capacity allows production of up to 4 million tyres at the first stage, with the possibility for extension of production capacity up to 16 million tyres and up to 2 million truck tyres.

The project was implemented in several stages. At the end of 2011, the piling works were completed; in 2012, the plant's foundation was laid and main buildings were topped out. In January 2013, equipment tests started and, in July, the first tyre was produced using components fully manufactured at the Kaluga plant.

Such high-speed implementation was possible largely due to the comprehensive support of the regional government. Within just five months of the decision to build the plant, local authorities prepared the construction site, built a new road and provided the engineering communication lines. More than 500 trucks brought in and installed equipment, and the required infrastructure and logistics were created according to schedule and in compliance with the highest quality standards.

The advanced level of cooperation between investor and regional authorities proves that Kaluga is a modern and comfortable destination for business, with an excellent professional workforce and an outstanding business environment.

Factors such as the favourable investment climate; a beneficial geographical location in close proximity to Moscow – which is the key after-market for tyre sales; easy accessibility to the major European Continental plants; the region's powerful cluster of major European car producers such as Volkswagen, PSMA, Volvo Trucks and Continental; and Kaluga's team of highly professional counterparts in the regional administration contributed to the successful implementation of the project.

The investment for the construction of this greenfield plant amounted to €240 million. The European Bank for Reconstruction and Development supported the investment with an eight-year term loan of €90 million.

### Comment by Georgy Rotov, General Manager of Continental Kaluga:

“With the opening of the Continental plant in Kaluga, the automotive cluster in the region has grown to three dozen companies. Here is a very high added value, because this product will be produced in Kaluga, and our engineers will be able not only to apply their knowledge, but also to improve our products as a result of international scientific and technical cooperation. I am glad that, with the successful cooperation of specialists of the Kaluga region and Continental's experts, such a significant project was accomplished successfully in a short time.”



## Case Study: Lafarge – Greenfield Cement Plant in Russia’s Kaluga Region

### Investor

Lafarge is the world leader in the cement, aggregates and concrete industry, operating in 64 countries and employing over 65,000 people. The group is a leader in innovation, with a portfolio of 1,000 patents and a position as the cement industry’s standard-setter in the use of alternative fuels. Lafarge is listed on the Paris Stock Exchange and has a market capitalization of €15 billion.

### Investment in Russia

As part of its long-term strategy to expand in Russia, Lafarge was the successful bidder of a limestone deposit in the Kaluga region in western Russia. In 2011, Lafarge started construction of a new state-of-the-art, two-million-tonne greenfield cement plant in Ferzikovo, with the aim of supplying high-quality cement to markets in the region and Moscow. Construction was completed in the first quarter of 2014, setting a benchmark as similar projects have been completed within an average of four to five years in Russia.

As at the end of the first quarter of 2014, the total amount of capital expenditure undertaken in connection with the project had reached €400 million, and an estimated 11.2 million man-hours were spent on the project, marked by an outstanding safety record.

The greenfield construction entailed a number of challenges. For example, to procure the continuous and secure supply of limestone from the quarry located on the other side of the Oka River, a 5.1 kilometre-long conveyer belt was built across the river to connect the plant and the quarry.

Critical to the implementation of the project was the approval of numerous permits, licences and authorizations, such as the conversion of federal land into the industrial category and the plant’s design approval from Glavgosexpertiza Russia, the federal agency authorized to conduct public examinations of project documentation. In addition, large investments were made in infrastructure, including the construction of a high-voltage connection line to the plant, a gas pipeline, roads, water connection and preparation works for a rail connection.

The success of this project is predicated on the expertise of the Lafarge Group and a local team, the technical and managerial assistance of the Lafarge Engineering and Technical Centre, careful selection of sub-contractors and the comprehensive support of the Kaluga government. The involvement of the Kaluga administration and support from the European Bank for Reconstruction and Development (EBRD) was critical for the timely commissioning of the plant, and included assistance at the federal level.

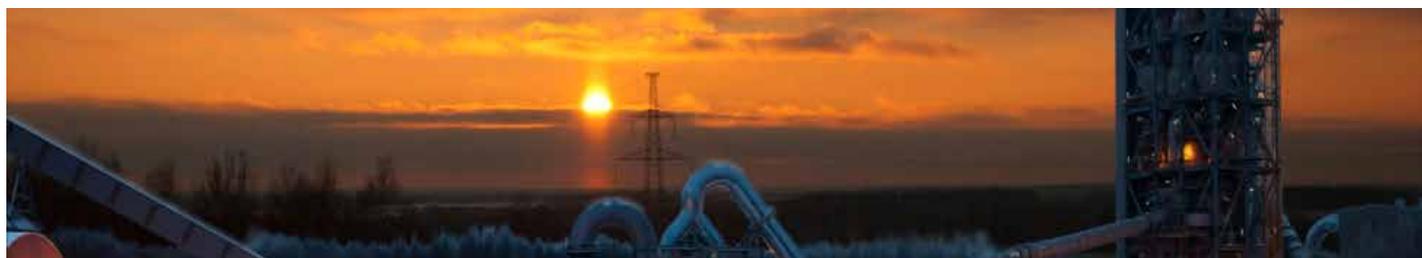
The location is one of the key competitive advantages of the Ferzikovo plant, as logistics is a major element of the cost structure in the cement industry, defining regional markets and setting natural barriers at the country level. The Ferzikovo plant is located close – 130 kilometres – to Moscow, the largest cement market in Russia, and is in the midst of the growing regional markets of Kaluga, Tula and Serpukhov.

The cement plant will create employment for more than 300 people and conform to the strictest European environmental standards. It will offer much-improved fuel efficiency (estimated ~3,346 MJ per clinker tonne) and a higher labour productivity as a result of the installation of a modern process control system and devices. The plant will also have the capacity to substitute up to 40% of gas consumption with alternative fuels.

The project is financed via a joint venture between EBRD, where the bank holds a 25% equity stake. The EBRD has committed €190 million to invest in the equity to support the financing of this project and further expansion of Lafarge in Russia.

### Comment by Andre Martin, Chief Executive Officer, Lafarge Russia:

“The Lafarge Ferzikovo plant is currently the largest investment of the Lafarge Group. This new plant will produce high-quality differentiated cement products, complementing our Voskresensk plant and aggregates business, and will solidify our market position in the central region. The Kaluga region benefits from proximity to the Moscow markets and stands out for its investment-friendly climate and developed legislative and institutional framework. Kaluga’s governor and regional administration are always highly receptive to Lafarge’s needs and provided the necessary administrative support in the course of the project’s realisation.”



## Case Study: RusVinyl, Nizhniy Novgorod region

### Investor

RusVinyl LLC is a joint venture created for the construction and operation of a polyvinyl chloride (PVC) integrated plant near Kstovo in the Nizhniy Novgorod region. The founders of the joint venture company are SIBUR, a first-rate petrochemical holding company in Russia, and the Belgian company SolVin, a leading PVC manufacturer in Europe. SolVin is itself a joint venture of Solvay, an international group of chemical companies, and the German concern BASF.

### Russian investment

RusVinyl is building the state-of-the-art PVC plant in Russia for a total investment cost of almost €2 billion, making it the largest in Russia and the largest EU-Russia cross-border industrial green-field joint venture outside the oil & gas sector. The RusVinyl agreement was signed in June 2007 and the construction began in July 2010. The work is now nearly completed and production is scheduled to begin in 2014. Once operational, the investment will create about 500 jobs.

The plant will produce up to 300,000 tons a year of S-PVC, up to 30,000 tons a year of E-PVC and up to 225,000 tons a year of caustic soda. Russia's current PVC production is not enough to cover internal demand, but even such a large facility will not have the capacity to replace all Russia's PVC imports.

Many construction and equipment installation tasks were unique and challenging. For example, the oxychlorination reactor – weight 170 tons, length 21.1m, diameter 5.5m – was delivered by water to Mikhalchikovo Kstovo port, then transported to the construction site in Kstovo with special machinery. Despite the reactor's huge dimensions, the installation was executed in minimum time. It took only 3 hours 20 minutes to install the equipment on the foundations. Two cranes of 500 and 250 tons of cargo-lifting capacity were used to lift the oxychlorination facility.

The production complex also includes a recently completed logistic and railway infrastructure (total length 8.96km), including a platform that occupies 7.76 hectares, an administrative building, a weighing bridge, and a warehouse for over 7,000 pallet positions and the block of 21 silos for PVC packing and storage.

The European Bank for Reconstruction and Development (EBRD) supported the investment, granting RusVinyl LLC, in parallel with Sberbank, a €150 million long-term loan, significantly contributing to the overall debt financing of €750 million. The EBRD also gave SolVin an equity investment into SolVin.

### Comment by Guenther Nadolny, RusVinyl CEO:

"The location in the centre of the European part of Russia determines easier logistic schemes and ensures proximity to potential clients. Historically strong chemical and petrochemical industrial sectors in the region have helped to solve the task of attracting high-skilled staff.

"It's also important for RusVinyl that attractive conditions for investors in Nizhny Novgorod were created by the regional government. RusVinyl was granted priority project status and received support in relation to infrastructure. Cooperation tools such as an investment committee and a 'one window' system prove the intention of the government to form effective direct cooperation between the authority and the business. RusVinyl appreciates the established business relations with the regional government and is grateful for efficient decisions and support."



## Case Study: Takata – Greenfield Plant in the Ulyanovsk Region

### Investor

The Japanese Takata Corporation is one of the world's leading producers of automotive safety systems, such as seatbelts, air bags, steering wheels and other products that help to keep people safe.

### Investment in Russia

The Takata Corporation decided to construct a greenfield plant to localize the production of safety devices to be supplied to domestic and international carmakers in Russia.

After a comprehensive review, the company's management team decided that the Ulyanovsk region, located some 900 kilometres east of Moscow, was ideally placed for the establishment of its first production facility in Russia.

The three key factors that determined the decision were: active support by the regional authorities; good logistical infrastructure ensuring access to Takata's main customers; and availability of qualified local staff.

In September 2010, the investment agreement between Takata and the Government of the Ulyanovsk was signed at the IX International Investment Forum in Sochi. In May 2011, the ground-breaking ceremony was held in the presence of Sergey Morozov, the Governor of Ulyanovsk.

Just one and a half years later, in April 2012, operations were launched at the newly built plant. The current product portfolio includes steering wheels, airbags and seatbelts.

The new plant makes a significant contribution to the development of the Russian automotive industry by supplying high-tech products to the major Russian and international OEMs located in the country. Steering wheels, airbags and seatbelts produced at the Takata Ulyanovsk facility help to improve road safety and reduce fatalities resulting from traffic accidents.

As one of the first foreign investors in Ulyanovsk, Takata plays an important role in the development of the regional economy by adding new jobs – Takata now employs 300 staff in Russia – and creating a positive image of the Ulyanovsk region on the global investment map, hopefully leading to new investors.

The European Bank for Reconstruction and Development (EBRD) supported the construction by providing a financing package consisting of two long-term facilities with a total amount of €7.4 million.

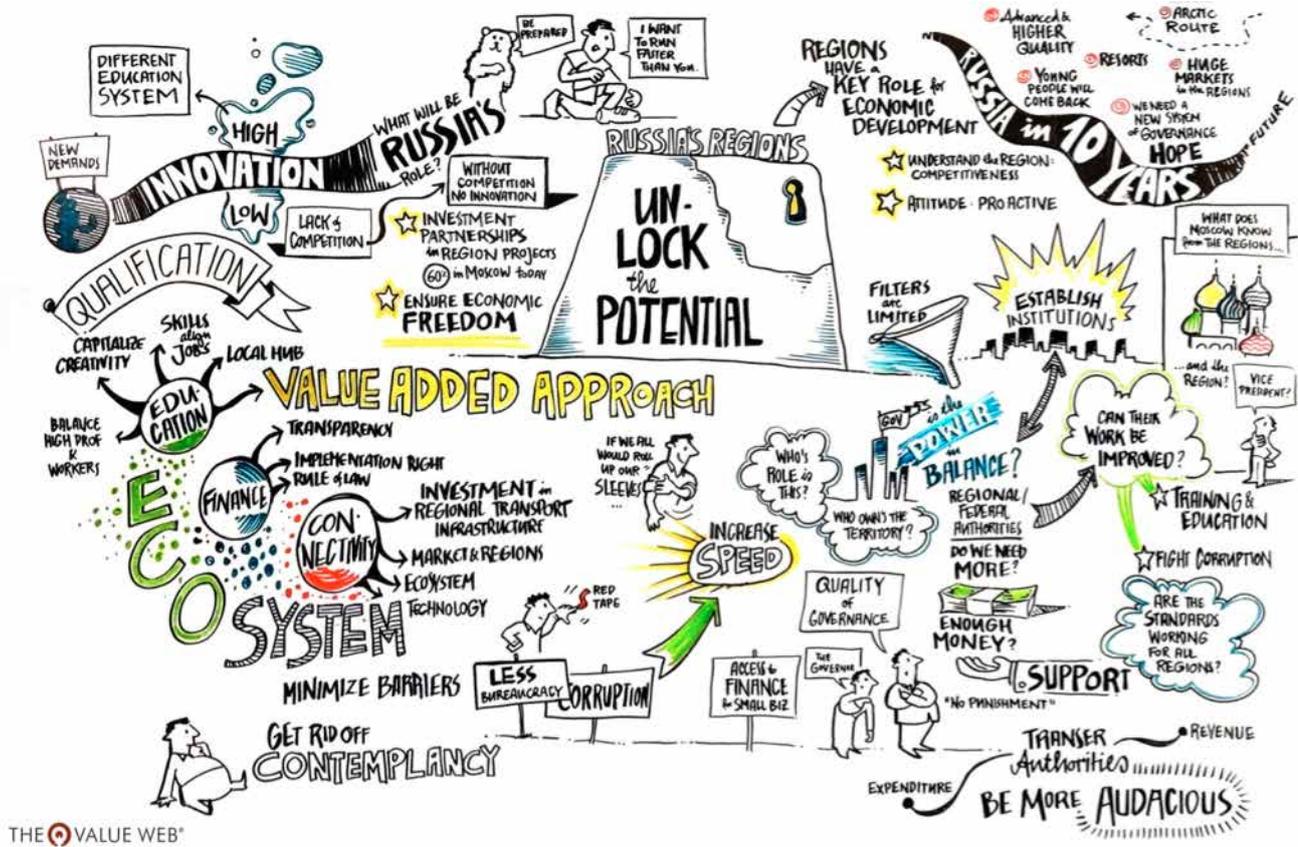
### Comment by Andrey Slepushkin, General Director of Takata Rusisa:

“The site for the new Takata plant was chosen due to its advantageous location in the mid-Volga region. It is close enough to the main car manufacturers in Russia, which is important in terms of logistics. There are some good technical colleges in the area, providing the plant with qualified specialists. Moreover, the local authorities support the plant, which has an official status of an especially significant investment project.”





# Key Process Milestones



THE VALUE WEB®

St Petersburg International Economic Forum

St Petersburg, 21 June 2013

Roundtable discussions with regional administrations

July-September 2013

Best practices survey among regional administrations

September-November 2013

World Economic Forum Moscow Meeting

Moscow, 20 October 2013

World Economic Forum Summit on the Global Agenda

Abu Dhabi  
18-20 November 2013

World Economic Forum Annual Meeting 2014

Davos-Klosters  
22-25 January 2014

# Endnotes

<sup>1</sup> See, for example, the EBRD *Transition Report 2013*.

<sup>2</sup> Here, for comparison purposes, the country's rankings are based on the 2012 edition of the *Doing Business* report.

<sup>3</sup> The website that accompanies the *Russia's Regions: Drivers of Growth* report provides a link to several such rankings.

<sup>4</sup> See the Global Energy Landscape section of the *Scenarios for the Russian Federation* report.

<sup>5</sup> For a more popular description of this research, see Acemoglu and Robinson (2012), *Why Nations Fail: The Origins of Power, Prosperity and Poverty*.

<sup>6</sup> The methodology of the study is based on close to 1 million regressions using combinations of 40 variables that are potentially related to growth. The analysis of these regressions determines which variables have a statistically significant association with regional economic performance.

<sup>7</sup> A surprising finding is that measures of the quality of infrastructure are not statistically significant in either the pre- or post-crisis period. This finding is consistent with recent studies on the limited importance of infrastructure investment for regional growth. Perhaps the best recent work on this topic that reaches similar conclusions is by Abhijit Banerjee, Esther Duflo and Nancy Qian (2012). At the same time, it should be emphasized that this study is not about casual relationships between these factors and economic growth; rather, it is about highlighting a correlation. However, the scope and the methodology of the study allow the drawing of useful conclusions on what key factors drive growth.

<sup>8</sup> These results for Russia are consistent with an influential study on the differential effects of de-licensing reforms by local institutions in India by Philippe Aghion, Robin Burgess, Stephen Redding and Fabrizio Zilibotti (2008).

<sup>9</sup> The methodology is based on the analysis of a dataset created by the Center for Economic and Financial Research (CEFIR) in Moscow under a project of Monitoring of Administrative Barriers to Small Business (MABS). The project consisted of six waves (2002-2006) of surveys on the level of regulatory burden of the top managers in 2,000 small firms in 20 regions of Russia.

<sup>10</sup> As an example of a "good" region, the authors take the Samara region (Samarskaya Oblast). It has one of the highest levels of government transparency, own revenues and industrial concentration; out of 20 regions, it is the fourth from the top in terms of government transparency, the second in terms of fiscal incentives (i.e. the size of own revenue share) and the first in industrial concentration. It is also among the top third of regions in terms of Internet penetration. As an example of a "bad" region, the authors chose the Amur region (Amurskaya Oblast). It is 17th out of 20 regions in terms of government transparency and has the second-lowest levels of fiscal incentives and Internet penetration, while it is sixth from the top in industrial concentration.

<sup>11</sup> This point is consistent with the top barriers for businesses highlighted in the World Economic Forum's *Global Competitiveness Report*.

<sup>12</sup> See e.g. Mauro (1995) or Fisman and Svensson (2000).

<sup>13</sup> See e.g. Buera and Shin (2013).

<sup>14</sup> See e.g. a review by Caballero and Engel (1991).

<sup>15</sup> The study mostly follows the analysis of Djankov et al. (2006) but updates the data for a more recent time period (2003-2009) and focuses on the impact of individual sub-indices on growth performance.

<sup>16</sup> The fifth edition of this survey was conducted from August 2011 to September 2012 and covers 4,220 companies in 37 Russian regions. The survey was carried out through face-to-face interviews with firm managers and owners regarding the productivity of their firms and the business climate. The questions concerned the degree of severity of a variety of problems that these businesses face.

<sup>17</sup> The quantitative results that conclude this section have to be taken as indicative rather than definitive, as the standard errors are often quite large and some of the coefficients, while large, may not be statistically significant.

<sup>18</sup> Based on Governor Morozov's remarks at the World Economic Forum Moscow Meeting 2013

<sup>19</sup> Based on Governor Artamonov's remarks at the World Economic Forum Moscow Meeting 2013

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