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Economic Glasnost

By [Chris Weafer]

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Twenty years after Soviet leader Mikhail Gorbachev's policy of glasnost brought about the end of the Soviet Union, the government of President Dmitry Medvedev and Prime Minister Vladimir Putin is again embarked on a strategy of openness. Only this time they are banking on economic glasnost to attract the investment flows that Russia needs to both create greater diversity in the country's oil-dependent economy and to rebuild its aging infrastructure.

They are also hoping that the open door will swing both ways as Russia's industries also need to create strategic links with established companies, especially in Europe. That is what is behind the government's greater determination to improve how foreign investors, legislators and major corporations view Russia. It also explains why the country is so keen on attracting major sporting events such as the World Cup and a Grand Prix, and why, after 17 years of hesitancy, there is now greater urgency to be admitted into the World Trade Organization in 2011. Russia needs the investment capital and the expertise of Western companies if it is to break the stranglehold of oil. That is why the modern-day economic glasnost is real and will be sustained.

The $1.5 trillion earned from exporting oil and gas since 2000 certainly has taken Russia out of the chaotic 1990s and has created a strong domestic consumer-driven economy. Russians spend almost $50 billion each month on consumer goods, and that figure is again growing by more than 5 percent annually. In addition the country is on course to sell almost 2 million automobiles by the end of this year. But according to Finance Ministry projections, the federal budget now needs oil to average more than $90 per barrel to balance. Most of the budget's spending commitment is for programs in social sectors — mainly health care and education — and to pay for pensions and state employee salaries. No government anywhere can reduce this type of social spending without risking an increase in instability.

But at the current price of oil, there is no money left to fund many economic expansion programs or rebuild its infrastructure. The total cost of infrastructure spending over the next five years is conservatively estimated to be $500 billion. The proceeds of planned privatization sales will only contribute less than 10 percent of that. The rest will have to come from an expansion of public-private partnership programs, from a very significant increase in foreign direct investment flows and from the debt market. All three categories are at a very low level today with, for example, foreign direct investment expected to reach not much more than 1 percent of gross domestic product this year. At the same time, however, Russia has plenty of scope to tap debt markets with a current debt-to-GDP ratio of less than 11 percent.

European legislators and investors who are not involved in Russia's natural resource industries are skeptical of Russia, which is hardly surprising after the numerous events that generated negative headlines through much of the past decade. These are exactly the groups that now need to be convinced that Russia is changing and is becoming more open and welcoming for strategic investment, especially in the sectors that now need to be developed. As the recent huge

PepsiCo and Thomas Cook deals demonstrate, there are no barriers to entry, either legal or administrative, to deals in the consumer areas. That is not often the case in the country's so-called strategic sectors, of which there are 42, or in infrastructure projects.

Equally, the government continues to be frustrated by what it sees as barriers to investment in Europe by Russian companies. Medvedev highlighted the issue in his speech at the recent Group of 20 summit. Creating strategic relationships is key to speedier improvements in the country's industry — for example, the Renault-Nissan project with Russia's largest carmaker, AvtoVAZ, is a good case in point. Russia wants to create more of these long-term strategic relationships via equity cross-holdings.

The government does have a tough battle to change the lingering negative perception of the country and to clear the legal and administrative obstacles that still make it difficult for direct investors. A softer foreign policy, WTO membership, hosting high-profile sports events and a better public relations campaign will surely help, but to achieve a significant, long-term change in how investors view Russia and its high risk factor there will also have to be very visible success in lowering corruption, cutting business red tape and improving the reliability of the legal system to give greater investor protection.

Thankfully, the government has started making this process — mainly because it has no other choice if it wants to survive. Since the oil advantage has been all but used up, Russia now needs investment flows. If the country fails to attract that capital and if it remains overly reliant on the price of oil and gas, that would lead to average annual growth in the range of only 2.5 percent to 3 percent. Russia needs to achieve average annual growth of at least 5 percent. That will only be achieved by attracting a large increase in investment spending.

Just as was the case 20 years ago, glasnost is not an option. It is a necessity.

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The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.