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**INVESTMENT BEHAVIOUR OF CORPORATIONS IN A CHANGING GLOBAL
ENVIRONMENT: TO ADAPT, TO OVERCOME, OR...?
Building Russia's Creative Capital**

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The recent dramatic shifts in the global economy have led to the emergence of a range of new economic challenges, which in many instances can best be overcome through new approaches to public-private cooperation, especially with regards to investment decisions. At the same time, Russia's economic modernization requires innovative strategies for industrial development.

The participants of this roundtable will share their views on the potential investment models for major corporations and international banking institutions in the Russian market. There will be a particular focus on the potential impact of state incentives towards fostering investment.

Moderator:

Sergei Naryshkin, Chief of Staff of the Presidential Executive Office

Panelists:

Gabor Kapus, Vice President Finance, Schneider Electric

Shavkat Kary-Niyazov, President, Marine Façade Management Company

Glenn S. Kolleeny, Partner, Member of the Global Board, Salans

Igor Maksimtsev, Rector, St. Petersburg State University for Economics and Finance

Jean-Pierre Thomas, Special Representative of the President of France for Development of French-Russian Relations

Martin Wittig, Chief Executive Officer, Roland Berger Strategy Consultants

S. Naryshkin:

Good afternoon, esteemed colleagues and friends. I am very pleased to welcome all the participants of our roundtable. Today, we will attempt to speculate on the issue of what the optimal investment model of behaviour for a company is under today's conditions – under conditions of economic recovery from the crisis, under conditions of reestablishment of economic growth overall and the growth of our enterprises. I should say that one of the indicators of the success of the recovery of our companies is the degree of their investment activity. Of course, the global economic crisis has left a definite imprint on the psychology and philosophy of the market behaviour of companies. Companies have begun to take a wait-and-see attitude with respect to their own investment plans – in any case, a number of the companies have temporarily postponed their own investment projects. The results of the first months of this year are rather modest, and these results indicate that the growth of investments in fixed assets is still about two percent. Of course, these are not the numbers and indicators that we anticipated, and the government and business community face a number of problems. The first is to make investments more attractive for the companies themselves. There are a number of leading indicators: an increase in purchases of machinery, equipment, construction materials; an increase in the amount of construction contracts and imports – these are good signals for investors. In addition, a number of industries such as mining of resources, rolled metal products, and vehicle production have completely restored their indicators to a pre-crisis level. The recovery of world financial markets and the growth in profits of global corporations will result in an increase in the volume of foreign direct investments in emerging markets as well as an increase and growth of foreign direct investments in the Russian economy. Of course, we need to address a range of objectives and mandates for improvement of the investment climate that were proposed by President Medvedev during his speech at the plenary session of the St. Petersburg Economic Forum. Lastly, investments should become an effective tool for

modernization of the country, especially because competition in modern economic conditions is of a global nature and is not limited by national markets. Protectionism is a thing of the past: even within the scope of the Customs Union and the Common Economic Space, Russia along with its partners from Kazakhstan and Belarus are developing and adopting uniform tariff and non-tariff measures to protect their own markets. The future entry of Russia into the WTO will create additional barriers on the path to support of domestic manufacturers, but there will be benefits related to the opportunity to work under unified rules. So today we are trying to answer the question that is on the agenda for our roundtable – the task is not an easy one, considering the lack of time – but the discussion should nonetheless lead us to answers.

Taking part in our discussion are the heads of companies, experts, and scholars, and I would like to ask Mr Thomas to give the first words. Jean-Pierre Thomas is a Special Representative of the President of France on the development of economic relations and economic cooperation with the Russian Federation. Mr Thomas is a consistent supporter of the development of relations between Russia and the European Union, and he boldly offers his point of view and defends the thesis of the necessity of the development of cooperation between Russia and Europe. Let's ask him to answer the question posed to our roundtable. Mr Thomas, you have the floor.

J.-P. Thomas:

Thank you. I am studying Russian, but I don't speak it very well so I will speak in French.

I would like to thank you, Mr Naryshkin, for inviting me to participate in this Forum and in this roundtable. Listening to President Medvedev this morning, I thought about our conversation today. The point is that this topic became the central one in his speech, his strategy and the issues that Russia is facing today. In what context are investors and enterprises – Russian and foreign – making

investments in Russia today? Of course, the crisis of 2008-2009 changed the situation: the system came to a halt, the central banks were forced to intervene in the situation in order to avoid the worst – the freezing up of the entire system. A consequence of this was the emergence of institutional investors as well as the fact that enterprises began to behave more carefully. International accounting decisions should not be unilateral – they must correspond to the realities of each side, and not just the standards of our Anglo-Saxon friends. It is worth mentioning the rules of Basel III, which regulate the amount of capital resources. In Western Europe and other countries worldwide there are governments that have a large debt burden – this is not the case with Russia and this is your advantage. Today, Russia has the opportunity to create a model that can be quickly adapted to this new situation. As President Medvedev said this morning, and as is evident from his ambitious program, you have committed yourselves to increasing privatization of state enterprises and the government's withdrawal from the private sector. But even in the most liberal economies, the government plays a major role: for example, in the infrastructure sector. In the United States, the military complex also has a huge budget for R&D. You have little debt, you have financial means, you are still present in important sectors of the economy, and therefore you can combine these two models. You can also take advantage of the potential that international corporations investing in Russia have, and you can establish joint ventures.

I think that today the model for an enterprise is public-private partnership. How can the competence and know-how of Russian and foreign private enterprises and the development of services and infrastructure be combined? I welcome the creation of concessions, the satisfaction of the needs of Russian consumers and the development of services and infrastructure. I think we should reinvent this public-private partnership. We're not talking about our using the Russian market more, but about the establishment of a genuine partnership, about the creation of joint ventures in Russia, the development of infrastructure and the production of

joint products and services. Today, the representatives of French and other European companies are here and they are ready to follow this business model. Today, our population demands high-quality services, and private enterprises want to achieve a certain security, therefore the main thing for us is people who work and consume. Funds are also important. You have both. In addition, you have energy, oil, gas, and the capability for innovations. Space is required in order to achieve success. In Europe, the problem is that our friends are our competitors. You have already talked today about the fact that in global competition the model of development for an enterprise is to have a market large enough to be competitive and to participate in the economic battle. In the autumn, I will prepare a report for President Sarkozy on the fact that we should create a European-Russian economic area throughout the continent. We mutually complement one another. We have common assets, such as the nuclear industry, transportation, infrastructure or automobile manufacturing. In all the remaining areas we can also build not only a commercial partnership, but we can create joint ventures and produce joint products. I will give you a specific example of public-private partnership: your Northgas project. Russia and France are signing agreements on the creation of a joint venture on the basis of a PPP between Russian and French enterprises. Representing the Russian side is Northgas, and the French side – Caisse des dépôts. Together we will modernize and develop this enormous project, which will benefit the tourism sector, will be environmentally friendly and will create new jobs for the population. The Russian government, for its part, must guarantee the security of the project, which is impossible without the participation of private enterprise, as well as add new technologies to the existing ones that will allow Russia to go further. Today, President Medvedev said in his marvellous speech that the conditions will be created for the establishment of such a partnership that is relevant to the modern context, and the plan for modernization of the Russian economy will be accelerated.

We must also succeed in the area of innovations, and I am sure that Skolkovo and other projects, for example, carried out by St. Petersburg University, can facilitate this. Innovations are the foundation of research and the foundation of investments, and an element such as R&D is allotted an important place in your plan for modernization of the Russian economy.

In conclusion, I would like to say it is my belief that we should create a joint visa-free space. Visas are an anachronistic phenomenon that do not contribute anything positive and only slow down the already slow work of our administrations. Both Russia and France are coming to this; Russia and the European Union should abolish visas and entrepreneurs should have the opportunity to move freely in Moscow, Rome, Paris and Berlin and spend a few days there without visas. We must ensure the free movement of capital and create joint ventures. Ultimately, all these measures will further increase economic growth and the welfare of our people.

S. Naryshkin:

Thank you, Mr Thomas for your presentation. Indeed, in twenty minutes you will be participating in the signing of very important agreements between Russia and France, and we hope that nothing will prevent the signing of these documents. Nevertheless, since you are with us for another twenty minutes, may I suggest the following? Let's listen to another presentation after which the roundtable participants will have the opportunity to ask questions about the two presentations or comment on them.

I want to offer the floor to the Financial Director of the company Schneider Electric, Gabor Kapus. Schneider Electric is one of the world leaders in the field of manufacture of electrical equipment. The company, founded here in the Russian Federation, already works successfully on our domestic market and, if I'm not mistaken, is fifth in volume in its area. There is already sufficient work

experience in Russia, so Mr Kapus, I ask you to answer the question facing our roundtable.

G. Kapus:

Thank you. Good afternoon, everyone. So I have been working in Russia since 2006 and I come from a company as you know — when we have to present something we always use a PowerPoint presentation. This is something in our DNA. I am using this to support the presentation.

I would like to talk about how Schneider Electric sees investment opportunities in the new economies in general. And afterwards, I will talk about our presence and ambitions in Russia. Page two, please.

Schneider Electric is the global specialist in energy management. Our mission is to make energy safe, reliable, productive, efficient, and green. The company had in 2010, EUR 20 billion in sales, 110,000 employees worldwide, and we made 37% of our sales in new economies.

New economies presented a big opportunity for us even before the crisis, but they certainly gained more momentum after the crisis. In Schneider Electric, the growth in new economies is 10 percentage points above the sales growth in major countries.

When we look at new economies, it is not only important to develop trading activities but also these days, we talk a lot about rebalancing between major economies and new economies. It means that we are putting in place production facilities, sourcing themes, and also R&D facilities in countries with new economies.

A few years ago, they talked a lot about China. It was China, China, China. These days, China is still very important, and we have big ambitions there. But other countries are also gaining momentum and Russia is a clear beneficiary of this.

A few years ago, we had to really sell the idea to the boards. "Let's go and invest in Russia. We have to invite them to come to Russia to learn about the market." These days, the boards are already convinced to come. They are ready to invest in Russia. It's not only the board but also the middle management, and the experts are also coming to Russia to learn more about the market here.

So, there are plenty of opportunities and we are ready to develop them. Page three, please.

Let's talk about our presence and our ambitions in Russia. Schneider has, I would say, a traditional past in Russia. Fourteen years ago, they established trading operations. And progressively, we are also building up industrial presence through acquisitions for greenfield investments. In 2008, we acquired a company called Wessen together with its production facility in a city called Kozmodemiansk. And also we had two greenfield investments in two cities of Russia, St. Petersburg, and also Kazan.

This means that today, we have three production facilities, two big distribution centres and 3,000 employees in Russia. When I look at the big trends in a few years, one is to move from a trading company to a trading and manufacturing company. The second is that, we not only have manufacturing, but we also have an R&D centre for activities in Russia. We are going progressively from the traditional, central and northern part of Russia towards the East. And then we do this process. It involves organic development, but also acquisitions, partnerships, and greenfield investments.

The crisis didn't actually stop the investments. Some people said that the crisis is not only a danger but also an opportunity. So this is the time when some companies can invest, and Schneider Electric made the investments. One of the factories went live in 2009, the other in 2010. And also in 2010, we signed a joint venture agreement with a leading electrical manufacturing in Russia. We have a 50% holding in this company. They do not yet appear on the slide because this is just a 50% acquisition.

This means all together that today, the company has a significant presence and we are actually accelerating our move into Russia.

I would like to talk about a couple of points which are impacting our investment behaviour in Russia. One is what we call 'Made in Russia'. This is very important of course commercially. We have to be close to the market. We have to be able to give very good delivery time to our customers, and sometimes to participate in and attend their process. There is a prerequisite to produce a part of that in Russia. So the 'Made in Russia' policy is very, very important for us. And we would like to, in a few years from now, make over 50% of our sales in goods produced in Russia.

When we produce in Russia, they have to produce the very same quality as in any other countries, which means that we are not just transferring to Russia. I would say that all the product lines have been put in place using the latest technology. This is what I call bringing technology and competence and knowledge into Russia.

I will give you two examples for this. In our factory in St. Petersburg, we are putting in place the latest robot technology for welding. And also in our Kazan factory, when we go to the quality testing room, the equipment there is more updated than the equipment in the French factory. So, we really put in place the latest technology because that is very important.

The second point is that we then put in place production processes. We also transferred the knowledge and competencies, how to organize production management, how to ensure quality control. And this is also very important to make sure that the quality in Russia remains the same.

And the third point I would like to mention concerning our investment behaviour is social responsibility. You can put a lot of things behind that. But what I would like to tell you is that, when we acquired a company in Kozmodemiansk, in the Mari El Republic, we became the first employer in the town. It's a very small town of 20,000 people. And it is very important to keep employment safe.

What we did is put new production lines there. We have invested over EUR 10 million in that factory to make sure that there is growth, there are opportunities, and that we can provide work and employment to the people.

I give another example for what I call 'social responsibility'. During the crisis, unfortunately, we had to close down the factory in Magnitogorsk. And it is very sad news. But we did not just exit the city. We made sure that we could resell the factory to someone else, another entrepreneur who afterwards would re-employ the very same people we had to downsize. And they could easily be re-employed because the knowledge, what they learned when they were part of Schneider, was a marketable experience.

Quality control, production management, and then they could contribute to the sustainable employment level in that region. And also when we are making investment decisions, we look at health and safety, and environmental considerations, then make all these decisions.

So these are the three points that are important to mention when we look at the investment behaviour of Schneider Electric in Russia.

So, I'm coming to the end of the presentation. I think we can conclude that Russia presents for Schneider Electric and for lots of companies a very, very promising market. Creating joint ventures, creating partnerships, making greenfield investments is a work in progress. We are doing it and we continue to do it. However, this is not always a very easy process. There is certainly room for improvement when we talk about the investment climate.

I give you two examples of this. Setting up a production plant in Russia from our experience took us three years; whereas, in France, we can do it in one year. This is because the procedures are quite long, the paperwork is quite intensive. So, we have a ratio of one to three, and in terms of cost, one square meter production facility costs us twice as much in Russia than it would cost, for example, in Germany. And certainly one of the reasons for this is because the process is quite long. This doesn't help the investment climate.

The second thing I would like to say in relation to this point is that Schneider Electric is putting in place a production facility, and we would like to find lots of suppliers because our company is quite lean and we outsource plenty of the operations. For this what you will need is a network of small and medium size suppliers, reliable and creative companies producing good quality products. And it is very, very difficult to find those companies. That is of course concerning the process itself.

We are very happy to see that the Russian government takes this topic very seriously, and one of the key priorities is to improve the investment climate. And I think that is an excellent ticket for the future. Thank you very much for your attention.

S. Naryshkin:

Thank you, Mr Kapus. And now, esteemed colleagues, I invite you to ask questions or make short comments on the first two presentations.

M. Vybornov:

As a person who has worked on the practical implementation of large projects, I would like to respond to the thoughts of Mr Kapus on why investment projects are being drawn out and weighed down. On the level of a Federal Territory, a major investor agrees with the governor on certain parameters for work, after which he is sent to his workplace in the municipality. Here I should explain for my foreign colleagues that authorities on the local level are still rather inexperienced – and this is a new phenomenon for us – the arrival of an investor is sometimes perceived by these authorities as the opportunity to resolve their own problems. The project begins to struggle and is overwhelmed by intermediaries, advisors, etc. I have a proposal, Sergey. Surely there is a unified government foreign policy, and either the Ministry of Economic Development or some other department should develop some code of behaviour for working with investors.

Ultimately, everything depends on people. We certainly need trained personnel who are capable of understanding incoming investors and of adequately responding to their ideas on how they need to work here. Then maybe everything will proceed better and faster for us.

S. Naryshkin:

Please, we have more questions.

From the audience:

I would like to ask Mr Thomas a question. I represent the Association of Industrial Enterprises, which consists of 70 enterprises. Today, we listened with hope to your very clear, very optimistic and constructive presentation. When I was director of Russian Diesel and worked very closely with Saint-Nazaire, Chantiers de l'Atlantique, I bought Pielstick and assimilated it into Russian Diesel. How do you see the prospects for the creation of joint Russian-French enterprises for diesel engine manufacturing and other areas?

J.-P. Thomas:

I very clearly realize that we must proceed to a new stage. I recently discussed with Mr Gallois, President of EADS, how we may contribute to the development of the aircraft industry. Why don't we build a helicopter together, which we could sell both in Russia as well as in other countries worldwide? I think cooperation in the area of diesel engine manufacturing is very important. When we discuss this issue with French companies, they say: "Yes, we are ready to look for such a sector in the Russian economy where we might work together with Russian enterprises and manufacture some parts in Russia." I think that we should move more intensively in this direction and I am actually optimistic about this issue. This morning, with the president of EDF and a Russian company from Tomsk, we signed a very serious agreement concerning the interaction of the government

and the private sector. There are other areas. For example, the company Alstom is engaged in the production of locomotives and trains. I would like to encourage you to cooperate.

This morning, the Russian President noted that the new Russia is marking only its twentieth anniversary, and European countries have a centuries-old history. In my time I was Chairman of the Regional Council in France, and I worked with departments and municipalities. Of course, the system was more tried and tested than the system in Russia, but there is no need to think that everything is perfect here. Naturally, we also have bureaucratic barriers, which our industries face, therefore it is necessary to have patience, but I'm sure that through reforms you will be able to resolve these problems.

S. Naryshkin:

Thank you. Now I will ask one of the heads of the company Caterpillar, which has been operating successfully both in Russia and worldwide, including in the production of diesel engines, to make a few comments.

G. Vittecoq:

Yes. Obviously, when we are speaking about diesel engines, Caterpillar is part of the discussion, and we are currently in a lot of discussions with various entities in the Russian government. Maybe the challenge that we have is that diesel engines are used in a lot of applications: construction equipment, trucks on the highway, oil and gas rail, ships. So the challenge is to find a common voice to be able to promote development together.

But from our experience there is a strong wish, a strong desire to cooperate and to improve the level of technology and efficiency of diesel engines in Russia, and also, we always mention diesel but gas is very important for Russia too.

There is a lot of available gas. The world is slowly moving from oil to gas and there are a lot of possibilities in Russia due to its gas.

S. Naryshkin:

Thank you, Mr Vittecoq. I hand the floor over to our next speaker. Mr Martin Wittig, General Director of Roland Berger Strategy Consultants, a group that has worked throughout the world for 50 years and is engaged in strategic consulting, as is clear from its name. Please, Mr Wittig.

M. Wittig:

Thank you Mr Chairman. From my side, four observations on the reality of corporate investment as it is today, two recommendations for corporations and one statement on how the state should facilitate corporate investment.

If you look into corporate investment we can say for starters, we can say that corporate investment is definitely back nearly to the pre-crisis level. You see already in 2010 that the top 3000 companies are investing at a level of 90% of the pre-crisis level. We are very close to what they spent pre-crisis and if you look into the development of the first half of the year, we are quite convinced that in 2011, we will even over-achieve in comparison to the pre-crisis year 2007.

If you have a little bit of a closer look into foreign direct investment, we see more of a mixed picture. We see definitely on the bright side if you look into the BRIC countries. China is experiencing continued growth in foreign direct investment.

Europe is rather flat and the US, and this might be surprising, the US is attracting the most significant foreign direct investment in 2010 and with the continued trend for that in 2011. Brazil and especially India are rather flat, and Russia is on what we would call a stable path.

If we ask companies where they will spend their money, then what we see is, I would say a rather aggressive behaviour, so there is tremendous appetite for investment among the top 3000 companies and investors, but most likely

appetite for spending the money in relatively safe things like acquisitions or expanding operating activities, and less appetite for destabilizing measures like returning cash to shareholders, which could be an alternative.

So there is still a lot of insecurity on the investors' part. If you have a closer look into Russia, we see that Russia is heading, can I have the next slide, please. That Russia is definitely in terms of investment into M&A ahead of the peer groups, and Russia is significantly leading the deal flow at the moment compared to peers or to all other regions in the BRIC region. If I would give two recommendations in these very uncertain times to corporations on how to deal with corporate investment, then the first one is to look rather at macro trends than into short term forecast.

Maybe if you learned one thing from the recent past, from the crisis, then it's that all short term forecasts are rough. Often very rough. There are, if you look into the quality of long term predictions, macro trends like even the predictions out of the 60s. How many people will there be on earth? How many people will live in cities? Will there be water shortage for example? Which will be the developing areas in the world?

All these trends are surprisingly accurate. So, if your corporation relies rather on long term trends, you can only rely with your investments on long term trends if your equity is there, if your balance sheet is stable.

If you want to do that, if you want to sustain long term investment, you need stability and equity, a significantly equity-based balance sheet. We just discussed it over lunch with Mr Ulrich from Volkswagen, who is sitting over there, about 41 investments over the last two decades that he observed in the company during that period.

Volkswagen always started with its investment into Russia. They had investments into the retail networks in the beginning, and then later on investments into the greenfield plan. And I think they were extremely right. Why could they do this? Because they have an extremely safe and secure balance

sheet with lots of cash. Several times investors tried to force them to distribute that cash amongst investors, they refused to do so.

They always stuck to their stable balance sheet and they stuck to their investments longer term, basing their investments on longer term trends and macro trends and I think they are completely right with that strategy.

The second recommendation for corporations, if you base your investments on what I call non-arbitrage, on the short term advantage of lower labour regulations, lower environmental practices or regulations and law, you're completely wrong. You will lose. I think that in a macro environment with a new media society where the next day the people will read about your poor supplier in China where the people are jumping from the roof, you are hurt as a global company.

So, if you base your investments on short term non-arbitrage, you will lose. We will see global corporate standouts in this world very soon. Not introduced by government. Not introduced by the IMF. Introduced by NGOs, by communities which operate mostly through very new channels to stimulate their people.

The last thing is a statement on investment facilitation by the state. I might not be very popular in this, and especially not with my French colleague here, but I'm not a strong believer in state stimulus for corporate investments.

Yes, I think the state has to take rescue actions in a very severe situation as we saw it in the crisis 2008. If the state hadn't rescued, and I think this was the first sign of global cooperation of governments in the fiscal system as weak as it might be, it was right that in a kind of global operation banks got rescued with all the unrest that it provoked within our civilizations and I know that.

Yes, in some areas also the very short term stimulus packages were right. But the main role of the state, in my strong opinion, and I think we learned it the hard way from the reconstruction of eastern Germany 20 years ago, is not to invest into corporations or to substitute corporate investment.

It's to facilitate corporate investment by safe rules and regulations by stable systems. By making it possible to invest in a region by supporting the infrastructure. Yes, invest as a state in infrastructure, this is the correct thing.

I had expected a lot more investment into infrastructure from the US government especially after the crisis, instead of investment into foreign policy and military.

But invest mostly into stable systems, facilitate trade with trade insurance, with credits available especially to small companies. Don't forget it's a lot of small companies, not always the big corporations, which drive the prosperity of a country, so help these small companies to invest globally to do foreign direct investment which we can only do if the state secures some of the credits they get from foreign direct investment.

And last and most important here is a very, very stable system. I'm German but I have been living in Switzerland for 15 years. Switzerland has, within the European environment, the highest density of global corporate and European headquarters in the world. It's a very dense area between Zurich and Zug.

And we did a survey amongst these companies and surprisingly it's not what everybody expects, that the low taxes are why all these corporations are there.

And if you look into reality it's not true you can gain due to taxes. Your tax is basically the same in Munich as when you are taxed as a corporate global holding in Zug in Switzerland.

But what all the corporations said is that it's the stability of the legal system and especially of the tax system, so if this country wants to make progress in foreign direct investment, the foremost thing is, besides infrastructure and securing infrastructure, is securing stability for investment in the legal system. Thank you.

S. Naryshkin:

Thank you very much, Mr Vittecoq, for a very focused and substantive attempt to answer the question of our roundtable. With your presentation, you again proved that it is no coincidence that the advice of strategic consultants is so expensive.

You were able to give a great deal of valuable advice in your short presentation both to representatives of the government, such as I, and colleagues present here. I am pleased to welcome here the first Vice-Premier of Azerbaijan, Yaqub Eyyubov. A really interesting presentation, interesting both for representatives of the government as well as representatives of business, scholars, and experts. Thank you very much.

The next speaker is Glenn Kolleeny, Senior Partner and Member of the Board of Directors of Salans. Since 2000, Glenn has been working in St. Petersburg, where he is the head of the St. Petersburg office of Salans. He openly criticizes the mistakes of the Russian leadership's economic policy, but openly speaks also about the positive aspects, which he observes in our country from the point of view of development, investment legislation and a new regulatory environment, which serves to attract investments and develop business in our country.

G. Kolleeny:

Thank you, Mr Naryshkin. It is a pleasure to be here today. I would like to thank the organizers of this incredible event, which, each year, seems to become even more incredible than the last year. If we could only turn this amazing energy that we have here at the Forum into innovations, let us say, we would certainly be far ahead.

I think that the last speaker, Martin Wittig, really gave a tremendous introduction for the things that I want to speak about today. I, indeed, agree with Martin very strongly that a government needs to step back from the corporate world. And, indeed, the Russian Federation has made steps just recently in this direction.

But, equally, I agree with Martin that in the area of infrastructure development, this cannot be pursued without the interest of all the people and all the people are, of course, represented by the government. Also, the projects are sufficiently large that they cannot be done without finding a mechanism for governments and

investors to work together and to balance the interest of society, of the corporate world, with the interest of the tax payers and the interest of creating jobs and stimulating the economy, in general.

I guess recently, again, you could say, because this is already the second wave, there has been a tremendous amount of interest in PPP projects. On the one hand, if you look at the history of PPP projects in Russia, there have been very few projects, first of all; really only two projects that have gone through what is called Financial Closing. But, nonetheless, there is a lot of interest and a lot of prospects for this type of balancing of interest between the public sector and the government.

If you look at the big, at the macro picture, it has been estimated that over the next 10 years, Russia needs to invest USD 5 trillion in infrastructure. Five trillion dollars, break that down, say, in 10 years, that means 500 billion per year. So, this year, maybe we have invested, let us say, maybe 10 billion USD in infrastructure so far. Maybe we will double that by the end of the year.

So, as you can see, we are coming up way short. We are coming up short by a factor of 20. Infrastructure is the backbone of the economy. Without the infrastructure, nothing can function. People cannot get to work. People cannot study.

If you look at this slide, you could see that St. Petersburg is way out in front in organizing large infrastructure projects. But, you can also see that the infrastructure projects, thus far, have focused on a very narrow section of the overall infrastructure problem.

Infrastructure is not just roads or toll roads. Infrastructure is also the backbone of innovation. For instance, we have the communication infrastructure; the need for an increase in the broadband network to cover the entire territory of the Russian Federation.

This type of innovation infrastructure of rebuilding, I would say, is relevant to the educational system in Russia. These are no less important than, indeed, I would

argue more important, than building toll roads. Indeed, because of the fact that the needs for infrastructure investment are so enormous, the government, ultimately, has to make choices. And what I would urge on all levels, both on the federal level and on the regional levels, is that one focus, in particular, that government funds and taxpayer funds be used, primarily, for projects that cannot be financed by the private sector. Toll roads, by and large, can be financed by the private sector. Things like universities, hospitals, low-income housing, heat, clean water—these sorts of things are the things which will require government support.

Some of the issues that we have in the PPP area: we have a Federal Law and several regions have also adapted PPP Laws. The first and most developed one is in St. Petersburg. But, now, there are about 18 subjects of the Federation that have legislation.

There is still a lot of work to be done to get rid of the conflicts between budget legislation, in particular, and legislation on state procurements and PPP legislation. There is a very high transaction cost for PPP projects. In many ways, you might argue that if the government could afford it, it should not engage in PPP projects because it takes too long and the transaction costs are too high in many respects. For instance, if you compare Moscow and St. Petersburg, Moscow has pursued the route of direct investment or state procurement, where St. Petersburg has pursued more of the PPP approach.

I would argue that even when it is possible for government to finance a project outright without involving an investor, it is always better to involve an investor when the project is an infrastructure project. Why is that? The reason is quite simple. An infrastructure project is a project that is designed to last for several generations. So, it, of course, makes sense to put the cost of the project not on one generation but to spread it over a number of generations.

Moreover, as we have seen, if you look in the last 10, 15 years and even the last 2 or 3 years, with the increase in growth of the middle class in Russia, future

generations of tax payers will be better able to support the burden of infrastructure projects than the current generation of tax payers.

I have pretty much already gone through this slide and I think several of the others because it also mentioned the need for a cadre with sophisticated financial expertise. I must say that, in this respect, I am proud to be from St. Petersburg, which really has put a tremendous emphasis on developing the specialized expertise necessary to engage in large scale infrastructure projects.

I want to conclude with two new ideas that are just starting to be used in Russia. The first idea is the idea of municipal bonds. When I was a young a lawyer working at Cleary Gottlieb in New York, I was tortured by having to go through bond indentures, three hundred-page contracts that support municipal bond offerings. When I came to Russia, I always dreamed that we would be able to use this mechanism; a mechanism that has been used for hundreds of years, especially in England, to help cure this problem of infrastructure development and the problem of how to finance the enormous needs.

So far, infrastructure bonds have started in Russia, or municipal bonds, as I would prefer to call them but, unfortunately, thus far, they have started only in one area: that is in the toll road area. In addition to that, largely, the bonds have been supported by state guarantees. In my mind, if we have smaller, well-structured projects, structured as project-financed projects, we will be able to use municipal bonds in the future to finance projects like sewage, education, health care, etc. Again, St. Petersburg has been in the forefront in this area, in developing, for instance, legislation and models for medical infrastructure projects.

Still in all, if you look at the West, you will see that roughly 20% to 22% of infrastructure projects are financed through municipal bonds. Municipal bonds will be the key in Russia to unleashing the pension funds and bringing pension fund money into the area of infrastructure development.

The key to making this successful will be to provide tax stimulants. That is to say to make the revenues on the bonds not subject to local and federal taxation to one extent or another.

Finally, even though I do not want to steal from another round table, and certainly there has been a lot of discussion of the Russian Direct Investment Fund, but this, too, is an interesting idea which may have a significant role in infrastructure finance over the next decade. The idea, in a nutshell, is to share risk. In other words, the fund, which will be a subsidiary of Vnesheconombank, will not engage in any investments on its own. It will engage in co-investment. So it will take a project and, in effect, mitigate the risk by co-investing with another investor, whether it would be a foreign investor or Russian investor.

Some of the sectors identified for particular concern are power, gas, pharmaceuticals, and space exploration. And, again, one of the major priorities for the Russian Direct Investment Fund is the development of infrastructure. Infrastructure, again, means not just roads, not just transportation but communication, universities, methods for people to exchange information and ideas.

So, with that, I will conclude. Thank you very much.

S. Naryshkin:

Thank you very much. Just like Jean-Pierre, you spoke about the public-private partnership mechanism as a possible model for investment behaviour. The Marine Facade Company has had great experience using this mechanism. I will ask Shavkat Kary-Niyazov to tell us about this great experience.

S. Kary-Niyazov:

Thank you very much. I want to say a few words about this. Next slide, please. It so happens that we got involved in public-private partnership projects before Russia had a legal basis for such partnerships. So we practically had to manually

create regulatory documents needed to implement these projects. I will say a few words about our projects, and then I will try to answer the questions we are here to discuss.

The first project is the Marine Facade Passenger Port in St. Petersburg. We can already announce that the project has been completed. It began in 2004-2005 when the first ideas, the first presentations appeared. And now, it is ready. This was a public-private partnership. It was a complicated project. You can see its description on the slide. The project was to create a new passenger port on the raised banks of Vasilievsky Island consisting of seven docks, the water area, an access channel, and dredging works. Investments from both private and federal sources topped RUB 17 billion. Construction began in 2006. Literally a month ago (even less—on the city's birthday), the port was transferred into the hands of St. Petersburg's administration. The project has been completed, and the city owns 100% of the object.

Next slide, please. These are a few milestones, the key turning points of this project. We think the project was completed fairly quickly. In 2006 the city adopted a targeted program for the construction of a new passenger terminal on Vasilievsky Island. In 2008 we completed construction of the first section of the port and received the first ship. In 2009 we operated (and had our first navigation) and simultaneously continued building. Later that year, we completed the port's second section. In 2010, we completed the ferry terminal as well, and the two sections were completed and began operating. And in 2011 the entire facility became fully operational. We have seven docks, four terminals, a full-service customs station, all of which is legally operating on the territory of St. Petersburg. Today, more than 90% of cruise passengers pass through the gates of the Marine Facade.

Next slide, please. Private investments. What was the project all about? Private investments were used to pay for constructing the foundations, erecting the harbour wall, buildings, stations, constructions, port administration centres,

roads, and engineering infrastructure. This money came from private investors. The federal investor provided dredging works, built the access channel, and provided navigation equipment and state border customs station equipment. Next slide, please.

The port development project is intrinsically linked with another big project currently in the works. It has not been completed yet, but is currently at the stage of development. I am talking about the creation and development of the western bank of Vasilievsky Island. As you can see on the map, we plan to create the foundation for a fairly large area, more than 400 hectares. The central port is one of the main real estate projects in this area. At this time, we have already cleared approximately 170 hectares—176, to be precise. The port occupies 32 hectares out of these 170. This project, also developed with the city's participation, involves risks shared between the government and private investors. Private investors pay for creating the foundation. They also take care of engineering training, while the city carries the responsibility of developing the roads and social infrastructure. The result is a new, fully equipped, carefully planned area which boosts the city's development. Next slide, please.

The new project, which we began quite recently (we have only been working on it for a year and a half, but we have already reached certain milestones) is construction of a tunnel. The project is actually very old. Research shows it has been discussed in the city since before the revolution. And after the revolution, the overall development plan for the city included certain decisions in this regard. Still, the tender for which we applied was not issued until last year. We actually signed the concession agreement with the city of St. Petersburg at the last Economic Forum. What does this very complex engineering project entail? We plan to connect the left and right banks of the Neva by a permanent crossing—a tunnel. As you know, during the river navigation season, bridges across the Neva are raised at night. This creates certain problems for the city's inhabitants, especially in the city centre. The problem might have gotten less dire with the

unveiling of the cable bridge, and the St. Petersburg Ring Road in general. Still, the city has never had a central round-the-clock crossing. Construction of the Orlovski Tunnel will allow us to connect the left and right banks of the Neva. It will be located in the city centre. You can see here. This is the centre—across from Smolny Cathedral, in a historical spot. This is largely why the project is so complicated. In the middle of the city, traffic is quite heavy. That is why the city set a goal to have three lanes in each direction. On the other hand, the location did not allow us to build two tunnels in opposite directions.

S. Naryshkin:

Shavkat, I apologize for interrupting you, but as Chairman, I have to keep an eye on the clock. Of course physical characteristics of projects are very interesting, but I do need to ask you, as a person who already has experience using the public-private partnership mechanisms, to give a brief answer to the question. In your opinion, how useful is it in Russia and especially in Russia's post-crisis development period?

S. Kary-Niyazov:

Sure, of course. Then I will definitely move on to the theme we all gathered here to discuss.

First, of course the public-private partnership mechanism is suitable, and is appropriate in our present conditions. What can it be used for? First of all, for complex technological projects. The public-private partnership is probably a tool that can attract Russian and foreign partners in order to create very complex infrastructure projects, like the Passenger Port or the Orlovski Tunnel, which I mentioned before.

What problems arise, in our experience, in the area of public-private partnerships? Unfortunately, the legal basis is in its embryonic stage. Let me put it this way—we are constantly facing the fact that it is not entirely well-designed,

not clear, and I would say, overly complicated. At the project implementation stage, all investors realize that in order to forecast the risks—and that is the most important part of any investment project—we have to answer a great number of complex questions. I am not talking about the kind of questions, that say, Glenn spoke about in his speech. These are land issues and taxation questions. But you know that when we talk about investments for terms of 25-30 years, this question carries consequences. Therefore, I believe the government must, first of all, develop simple, clear public-private partnership models with easy-to-understand risk distribution—what will be the government's liability, and what will be the liability of the private partner. But to understand how these risks are distributed, we must decide—what do we want to get out of this? I think the government wants to find a partner who will, first of all, bring technological and financial resources to the table. The government, on its part, must provide a certain standard foundation, a certain standard guarantee of land ownership terms, and taxation terms, to ensure some level of stability. Examples of public-private partnership tenders that were already completed and are now operating in St. Petersburg and in Russia as a whole, show that the initial conditions under which they are formed are constantly changing, constantly getting rescheduled. I will not name any specific names. But even in the case of Orlovski Tunnel, the project was rescheduled several times, and conditions kept changing.

What does this mean? It means there is no clarity. In these conditions, investors have a very hard time making a decision. For example, I will remind you that the Orlovski Tunnel tender received only one application—ours. I guess the secret, or the recipe, is that the government must develop simple, clear, and stable rules of the game. Before making financing decisions, investors and financial institutions have to trust that these rules of the game will not change next week, next month, or next year.

S. Naryshkin:

Shavkat, you should not criticize the government of St. Petersburg so openly. You still have to work in this city.

S. Kary-Niyazov:

Our work is going well.

S. Naryshkin:

Thank you. Our next speaker is the Rector of St. Petersburg State University of Economics and Finance, Igor Maksimtsev.

I. Maksimtsev:

Dear colleagues. We see how quickly the global economy is changing, what processes it is undergoing, and we realize that investors must make decisions much quicker than they would have 5-10 years ago, because the conditions (slide, please)—the conditions we are living in today demand very important decisions on the part of consultants. My colleagues spoke about this today. Look—investors' decisions are calculated, as Shavkat told us moments ago, over 10, 20, and 30 years. So in order to forecast what will happen 20-30 years from now, we naturally need very solid sources of information. We realize how quickly education is developing in the Russian Federation. We are getting used to the market conditions in which universities and high schools are operating. We understand that based on our forecasts we must be training specialists who will be working on the Russian market 5, 10, 15 years from now. We must be conscious of the factors that will influence these specialists in the future, and take them into account. We must give them competitive information and education to make sure they graduate with merit and business fortitude. We have had such an experience when we observed Russia's business development. In recent years we have been closely cooperating with foreign companies. We have conducted round tables in Russian universities, including ours. We recognize our current

need at this stage of our country's development—the need for involvement of university research centres. Along with professional consulting, which is always present, our institutions of higher education can serve as a kind of intermediary between the government and companies during development of large investment programs. Because of these factors, the studies we have already amassed over the years give us the agility to move away from consumer investment projects and to global investment projects necessary for Russia's modernization. Thank you.

S. Naryshkin:

Thank you. Dear friends, though we have already gone over the allotted time, I want nevertheless to use the opportunity and do a bit more work. I want to ask you to stick with two short questions or short comments, and stay within the topic of our present discussion. Anatoly, Governor of the Kaluga Region go ahead. This region is going through active, energetic development primarily, maybe, due to the regional government's highly effective and calculated investment policies.

A. Artamonov:

Thank you very much, Sergey. I want to take literally one minute because we are all tired, and we have run out of time. I would just like to touch upon one question—this public-private partnership, since so much has been said about it today. And when I came here, the agenda was to discuss companies' behaviour in our present conditions. As I understand it that is exactly what we need to discuss more. But in reality—which is probably only natural—our discussion ended up focusing on this question anyway. This is probably one of the key success criteria of an investment project, and I completely agree with that. Why? Because when investors enter a certain territory they want to be sure of several things—primarily, how the government will share their risks. Investors can, of course, sign a contract that they share these risks and accept certain liability, but

then change these conditions later. Or the head of the territory might change, and investors might be left alone with their problems. But when the government, represented by the local authorities, invests in the project together with private investors, then, as a matter of fact, there is no need for signatures. You get a sense of shared responsibility. We began operating this way in the Kaluga Region many years ago, and we are still operating this way. We chose the route of creating industrial parks within our region, and took all the infrastructure issues, the creation of infrastructure in all these areas, upon ourselves. You will agree that is no small thing. When we provide a fully ready platform, supplied with all the necessary energy resources, investors who join the project say, "Yes, the government invested in it too". Then they also have to put in some work to demonstrate the project's success.

But infrastructure is not the only thing in which the government should invest. Who will be working in these companies? The question of personnel is also crucial. When we began building the automotive manufacturing cluster, we simultaneously invested about EUR 20 million into the construction of an education centre designed to train personnel for this cluster. Currently, we are building a pharmaceutical cluster, and simultaneously creating an education centre to train personnel for it. I am not just talking about building education centres. I am also talking about development of institutions of higher education. For example, if we have a technical university, it seems that it is the duty of the federal government to support it. This year, we are beginning the construction of a new 10,000-square-metre wing of the university. This will become Bauman University, and will train specialists for the companies we are building. Earlier today, Mr Kapus was saying that Schneider Electric ran into problems and had to spend a great deal of time on implementing their projects. I see the Volkswagen representative is with us today. He can confirm that since we signed the agreement and got started, within 11 months we were already producing cars.

The rule of thumb is that any project, no matter how complex, must be completed within a year. So come visit, let's talk.

But here is the problem. To answer your question, if we rely solely on the qualifications of municipal government, municipal authorities, we will get nowhere. Today, our objective is to require regional governments and heads of regions to take care of everything concerning investment policies, while simultaneously training and educating personnel and distributing them among various levels, including municipal, and see how well they have mastered their field. Until they can manage on their own, the government must support these processes. To this end, we have created two effective structures which operate under the auspices of the regional government. One is the Regional Development Agency, which provides consulting for each and every investor, and for free it should be noted. The other is the Kaluga Region Development Corporation, which takes care of development projects aimed at providing the necessary facilities for investment platforms. Without this, everything would be as it always is—investors would be forced to spend years trying to coordinate some trifling problems.

As far as consistency of rules, this, Sergey, is the first thing everyone talks about in regard to Russia's investment climate. Yes, there are terrible rules. But it is possible to get used to them and manage. These rules are necessary. And if they exist, they must only grow better. But it is crucial that conditions for investors are not allowed to get worse. The general rule should be to prevent conditions for investors from getting worse. This should be our commandment. Thank you very much.

S. Naryshkin:

Thank you, Anatoly. It is always a pleasure to work with Anatoly—he asks a heap of questions and he knows how to answer them. We have our own history with Volkswagen. I also work in the Leningrad Region. I spent half a year trying to

convince Volkswagen to build a factory in Leningrad. Anatoly beat us and won the project, but I do not hold a grudge.

Colleagues, any more questions? One more question or comment. No? Then let us bring...You have a question? Go ahead.

From the audience:

RUDO Company, Moscow. We have three enterprises working in Ryazan and Vladimir Regions. Allow me to throw a fly into your ointment. My words are meant primarily for the Chairman. Unfortunately when we talk about...

S. Naryshkin:

Please note—you have the last word, so do not darken the mood. You have quite a responsibility. Can you feel it?

From the audience:

I will try. I simply want to say that in addition to the fact that we need to drive some of the aspects of our projects forwards – and yet something still seems to be holding us back; and that what the Schneider representative was saying earlier is true; of course it is hard for us in Russia to hear that we solve problems three times slower than they do in France. Worse, some problems cannot be solved at all. In other words, there are certain aspects of the investment process that are completely unregulated. For example, I have a project in Ryazan—the construction of a building. And this building shares a courtyard with a municipal building. In a case like this, there are no procedures for solutions, beyond our architects' opinion. In other words, I cannot take this problem to any court. The process has already eaten up four years. It gets passed from one committee to another, and we still have no solution. Personal preferences come into play—some are for, some are against. But until you give them money, nobody wants to make a decision either way.

In 2006 I renovated my factory in Ryazan and increased productivity three-fold. I went to Vodokanal and said, “We’ve done this and that, we have new equipment, here is what I have done, give me new water limits”. They told me, “We cannot”. I said, “What do you mean, you cannot? I am already using the water!” “No, we cannot”. This went on for about a year. And what did I get in the end? I did not get new limits, and under local legislation, they charged me five times the fee for my excessive use! And before that, they got 20 million off me. “Give us the money, and then we will leave you alone”. I spent two years going from court to court, lost every case, and had to shell out 15 or 16 million. The only thing I gained was that I dragged it out, but there is no legislative solution yet.

In this regard, this is what I would like to propose—if these kinds of collisions arise between federal and regional laws, between common sense and technology or some other things, the country must have some kind of state expert committee which will not be swayed by your opinion as a government official or by my opinion as a business owner. In other words, we need an independent body that could decide these cases. This would be, I think, a win-win situation, because as a rule, these are simple, basic issues.

And my last comment is even worse than the one I just made. I want to mention alcohol. I make money with beer, but since 2009, certain people have been ‘bringing order’ to this sector.

S. Naryshkin:

I have to ask you to wrap up.

From the audience:

Yes, yes, yes. I can tell by the faces in the audience that you like women, and as per tradition, it follows that you like vodka. But you cannot imagine what goes on at the plants that make vodka. There is no mechanism at all for getting a license, if you have been turned down. But of course, you will not be left without vodka,

instead you might just find that you are left with, say, two brands—Stolichnaya and Moskovskaya. And that will be the end of that... So I also think we need some kind of mechanisms that do not depend on preferences. If we are wrong, then take us to court. If we are right, then just let us work. Thank you.

S. Naryshkin:

Thank you very much. Let us summarize. I want to thank everyone who took part in this round table session—our speakers, our audience, and those of you who had questions. We had here representatives of completely different categories—business owners, managers, consultants, experts, scientists, representatives of business communities. Sergey Katyrin, President of Russia's Chamber of Commerce and Industry is present. Even some of my relatives are here. So pretty much everyone is here.

It is true that the global crisis and the post-crisis development stage set a great deal of challenges for companies. And I think we all understand that we might be facing more and more of these challenges as time goes by, and they will only get harder. Russia's modernization policies and innovation development must prepare companies to meet these challenges. So I believe our collective opinion—I will try to offer a brief answer to the question we discussed at our round table—is that companies' investment behaviour must aim not only, and maybe not so much towards adapting to existing conditions, as looking for and implementing daring breakthrough decisions. Thank you all.