

DIPLOMACY: India favours free movement of services and people, Russia awaits proposals

Setting stage for CECA boost

India and the Eurasian Customs Union of Russia, Belarus and Kazakhstan have agreed to start negotiations for Comprehensive Economic Cooperation Agreement

AJAY KAMALAKARAN
RIBR

With the India-Russia bilateral trade, which was a little over \$11 billion last year, remaining much below potential, the two sides are now looking to move beyond rhetoric. Against this backdrop, bureaucrats from both countries have been working behind the scenes to set the stage for a comprehensive trade and services agreement between India and the Customs Union of Russia, Belarus and Kazakhstan.

On April 2, 2013, Viktor Khristenko, Chairman of the Board of the Eurasian Economic Commission, visited New Delhi for talks with India's Commerce, Industry and Textiles Minister Anand Sharma. The two sides agreed to kick-start negotiations on a Comprehensive Economic Cooperation Agreement (CECA) between India and the Customs Union.

"This process of forming the Customs Union and a single market of the three countries has several positive aspects for India," Khristenko told RIBR in an interview after his meeting with Sharma. "A bigger territory is becoming more understandable to our Indian partners from the point of view of developing trade and investment operations," he added.

The Customs Union, formed in January 2010, capped years of negotiations between Russia, Belarus and Kazakhstan and is seen as the first step in developing a grouping of former Soviet republics in a format similar to the European Union. Russia's entry into the World Trade Organization last year has paved the way for India to work on a CECA with the Customs Union, although Belarus and Kazakhstan are not WTO members.

Ilya Rachenkov, an analyst with Investkaf, believes that India, a net importer, does not stand to gain much from a free trade agreement but is looking at reducing its rising



Viktor Khristenko, Chairman of the Board of the Eurasian Economic Commission.

energy bill. "India's interest is to avoid the possible imposition of export duties on oil and natural gas from Russia," Rachenkov says, adding that 35% of India's imports consist of energy products. He underscored a convergence of interests for the members of the union and India when it comes to heavy machinery, something that New Delhi does regularly import.

As has been in the case with India's negotiations on economic pacts with Asian countries, New Delhi is particular that bilateral trade agreements entail free movement of services, people and investments, as well as goods. Khristenko told RIBR that the Russia "understood fully well" that the new sources of development of economic activities "lie not only in trade in goods but also in services and investment."

Khristenko, who has interacted over the years with several senior Indian ministers as a former Russian minister of industry and energy, spelt out his vision for a potential CECA. "One of the possible formats is a free trade agreement," he said. "If a document like this does emerge, it should cover services, trade and investment too. Then it would be a truly comprehensive agreement that has a potential for development."

Striking a word of caution, Khristenko, however, said that it would be necessary to conduct research to assess whether a comprehensive agreement would meet the interests of India's development as well as the interests of all the Customs Union member states. Countries like Kazakhstan, which are keen to push through an agreement on goods, may like to negotiate harder

on the free movement of professionals. The Eurasian Economic Commission chairman said a joint working group would need to be set up to assess reservations that sections in the four countries had.

"We shall continue these discussions with the governments of the Customs Union member states in order to reach a common understanding soon," Khristenko said adding that there would be further discussions on a CECA on the sidelines of the St Petersburg International Economic Forum in June. "We are moving towards creating a platform for discussing a specific document, like a free trade agreement which could be conducive to the prospect of further developing relations between India and the Customs Union," he said.

A source close to Khristenko told RIBR that Russia is waiting for concrete proposals from India on sectors, which would be covered in a potential agreement. There is a need to protect certain sectors that would face competition in a market with more players, the source said. Ilya Rachenkov from Investkaf considers the steel sector an area of potential friction in both countries.

The Customs Union has also started talks with Vietnam on a FTA. "Setting any time-frames for talks would not be constructive. In practice, a discussion like that can last a long time, sometimes an endlessly long time," Khristenko said while drawing comparisons with India's 17 rounds of talks on a FTA with the European Union. "If everything goes well, then in a couple of years' time we may be able to complete work on an agreement with Vietnam. At least, we have scheduled rounds of talks for this and next year, with four rounds at the ministerial level."

When asked about potential cooperation between the Customs Union and BRICS, Khristenko said the union was ready to expand interaction with the grouping but ruled out an idea of any formal membership.

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NEWS IN BRIEF

BP deal: Rosneft world's biggest oil producer

Rosneft has announced completion of acquisition deals for 100% of TNK-BP. Rosneft paid \$16.65 billion and 12.84% of its own stock for the 50% stake in TNK-BP owned by BP, both companies said. Rosneft also announced it had paid \$27.73 billion for the stake held by AAR (Alfa Group - Access Industries - Renova). This brings the cash portion of both deals to \$44.38 billion. The united company will be producing around 4 million bpd (206 mta) of oil - the world's biggest output, and its reserves will amount to 28 billion bbl, says the state-owned company.

Funds cleared, MTA to enter global market



The Multirole Transport Aircraft (MTA) project is moving to the next stage with a legal order and financing cleared for the Russian-Indian JV. "Russia and India have invested \$300 million each, making a total of \$600 million," Viktor Komardin, deputy general director of JSC Rosoboronexport and head of the joint delegation of Rostech and JSC Rosoboronexport, told reporters. He said that on the Russian side the aircraft would be developed by Ilyushin Aviation Complex. As soon as Ilyushin creates, tests, and presents a working prototype, the JV will commence production. RIA Novosti

Andhra Pradesh dam project takes off

An Indo-Russian consortium led by the Indian associate of Russia's Transstroy has begun work on the Polavaram or Indian Sagar, a mega-dam project in the Anguluru Hills in Andhra Pradesh, reported the New Indian Express. Recently, officials of the Transstroy consortium and the Indira Sagar project organised a launch for the \$3 billion Polavaram project. The Polavaram multi-purpose irrigation project envisages the construction of a dam across the Godavari River, will link the Krishna and Godavari rivers, and cover 15 out of 23 districts in Andhra Pradesh. RIBR

Cadila Pharma to build plant in Astrakhan



Eyeing a presence in the lucrative and growing Russian market, Ahmedabad-based Cadila Pharmaceuticals is looking at investing upto \$150 million to build a pharmaceutical manufacturing plant in the Astrakhan Region. Cadila Managing Director Rajiv Modi visited the Russian region and signed a protocol with Astrakhan representative Konstantin Markelov. Modi was part of a delegation from the Indian state of Gujarat, which has a cooperation agreement with Astrakhan. The volume of Cadila's investments may reach \$150 million. RIBR

Trials of new engine for rocket Soyuz 2.1 over

The NPO Energomash company has completed trials of a new engine for proposed Russian lightweight carrier rocket Soyuz 2.1 and is currently preparing it for serial production, the company's CEO said. "We have completed tests of the new RD-193 engine, designed for Soyuz 2.1 lightweight [rockets]. We are now preparing documents of how to integrate it with the rocket," CEO Vladimir Solntsev said. The first launch of Russia's new lightweight carrier rocket is likely to be delayed until the second half of 2013. RIA Novosti

FINANCE: The first female Central Bank chief

Elvira's brief: How to revive the economy

Nabiullina to take charge in June and grapple with twin challenges of flagging growth and high inflation

TIM WALL
RIBR

Russian President Vladimir Putin's nomination of Elvira Nabiullina, former economics minister as Central Bank chief has been hailed as a sign of continuity, but is also an indicator of concern about flagging growth. She is likely to align the regulator's fiscal policy closer to the Kremlin's.

Economists have welcomed the choice of Nabiullina, who will be the first female Central Bank chief in the G8, and pointed to her track record on liberal reforms and closeness to the president. Outgoing Central Bank chairman Sergei Ignatiev is expected to be asked to stay on as an adviser to Nabiullina. "I believe this is a good candidacy, and I am sure she will be able to do the job," Alexei Kudrin, a former finance minister, said at the Russian Business Week forum in London.

Nabiullina will take charge at a time when the administration is grappling with the twin challenges of boosting declining growth while trying to curb inflation. Russia's growth at 3.2% in 2012 is the weakest since 2009 and year-on-year inflation in February, at 7.3%, is the highest in 18 months. Leading officials, and the president himself, have hinted that a cut in interest rates could be on the cards to boost credit flows and

growth, if inflation can be controlled. Anna Bogdyukevich, an analyst for Aton Capital, says the Russian economy is "operating close to its long-term potential" and that "policies aimed at stimulating aggregate demand would result in higher inflation while not affecting the real sector much." The appointment of a politician, however, raises questions about whether the Central Bank will be able to maintain the independence displayed under Ignatiev, who had resisted calls for looser fiscal policy and higher spending. Investment analysts from Sberbank say the market "will likely expect monetary policy to become more dovish based on Nabiullina's experience as economics minister, in which she advocated increased government spending to spur economic growth. The fight against inflation remains a key priority for the government's economic team."

Much will depend on the state of the economy when Nabiullina takes charge in June. Sluggish growth will increase pressure for a cut in interest rates, but inflationary pressures and a further global downturn may restrict her room for manoeuvre. All eyes will be on how Nabiullina performs and the possibility of her supervising the government's planned creation of a new "mega-regulator", combining the functions of the Central Bank and financial markets watchdog.



The former economics minister, Nabiullina joins the Bank at a challenging time. The market is 'likely to expect the Central Bank's monetary policy to become more dovish'.

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DIPLOMACY: Getting Development Bank right, managing solidarity key challenges

The post-Durban roadmap

The Durban summit has mapped out an ambitious agenda for cementing intra-BRICS architecture

MANISH CHAND
SPECIALLY FOR RIBR

The 5th BRICS summit in Durban hogged headlines and created quite a buzz in the incestuous strategic and think tank community around the world. It's not surprising to hear sceptical sniggers about the BRICS-led Development Bank – the showpiece outcome of the Durban summit that is projected to rival the West-dominated Bretton Woods twins. True, a lot of hard work remains to be done to get the Bank in place, but the fact that the leaders of the five BRICS countries, with their distinctive trajectories of economic growth and national priorities, could join hands and declare the "viability" of a BRICS-led Bank in times of the continuing slowdown is in itself a signature achievement. The delay in announcing the details of the Bank underlined the BRICS' maturity to move beyond showmanship to establish a real and solid bank that will provide the developing world a viable alternative to the World Bank and the IMF.

The post-Durban roadmap for the BRICS, therefore, will entail intense negotiations and some give and take among major players inside the grouping. The finance ministers have been tasked with getting the details right: the Devil and God lie in details, after all. One can expect some power-play as there are lingering differences on the structural features of the Bank,



United we stand: Leaders of Brazil, Russia, India, China and South Africa join hands to assert their solidarity at the 5th BRICS summit in Durban.

including the initial corpus capital; the governing board; and headquarters of the Bank. While Indian officials say the Bank could get going with \$50 billion, the Chinese side is insisting on \$100 billion seed capital, a move which could give unfair advantage to China, the largest BRICS economy with \$3.2 trillion foreign exchange reserves. Indian officials believe that equity should underpin the bank as any deviation from this cardinal principle could lead to a replication of asymmetries of the Bretton Woods institutions.

The Durban summit has already created a \$100 billion strategic re-

serve of foreign exchange that could be an option of last resort to a BRICS country caught up in a balance of payments crisis. The launch of the BRICS Business Council in Durban and how the council brings together investors and entrepreneurs of the five countries will remain a work in progress. Another big takeaway from the Durban summit was the focus on a resurgent Africa. In the eThekweni Declaration, the BRICS leaders robustly backed calls for greater infrastructure investment in Africa, supported development agencies and endorsed regional integration plans. The challenge will be to sustain the

African agenda with joint initiatives.

The road from Durban to the next summit in Brasilia promises an exciting journey for the "Big Five" of the emerging world, as Russian President Vladimir Putin described it, but it's a road that is also going to be strewn with pitfalls. This would entail delivering on promises of the Durban and New Delhi summits – getting the Bank in place by the 2014 summit. No deadline has been set, but India's Finance Minister P. Chidambaram is confident that the edifice of the Bank will be ready by the time Brazil hosts the summit in 2014. Another important challenge will be to deftly manage conflicting perceptions on key international issues. Be it Syria or Iran in the Middle East or festering crises in Mali and Central African Republic, the BRICS should try to forge joint positions.

Above all, the leaders of BRICS countries should avoid one-upmanship and seize every opportunity to reassert the BRICS solidarity. Equity, therefore, should be the guiding principle in both letter and spirit. If the BRICS countries seek to fructify their overarching goal of reconfiguring the existing world order, they sail or sink together. There is really no half-way house here.

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Full version of the article at www.indrus.in

BIG PICTURE

Creating a neutral Afghanistan

M. K. BHADRAKUMAR
Foreign policy analyst

Geopolitics has throughout been a template of the three-decade old war in Afghanistan. There were times of high tide and low tide. If the so-called 'Afghan jihad' of the 1980s was a high noon when Afghanistan became an epicenter of the Cold War, the geopolitical content ebbed during the mujahideen era that followed, but only to pick up a decade later with the US' intervention in Afghanistan in 2001. All the same, the US had a free hand through the past decade to conduct the war as it pleased. Regional powers such as Russia, China and Iran were, arguably, net beneficiaries of the North Atlantic Treaty Organisation's war for keeping the terrorist forces at bay. Despite their robust counter-moves against the US' 'containment strategy' towards them, they side-stepped Afghanistan as a theatre of contestation although the US and NATO's military presence in such a highly strategic country would have profound implications for the geopolitics of the region.

Unsurprisingly, geopolitics took a back seat during the past decade. However, as a critical turning point approaches with the projected withdrawal of the troops belonging to the North Atlantic Treaty Organisation [NATO] and the United States from Afghanistan by end-2014, we see a dramatic surge of geopolitics. Suffice to say, there is a growing likelihood that the big-power rivalries being played out on global scale could become a destabilising factor in the overall Afghan situation, which is delicately poised at present.

The core of the problem lies in the US' intention to establish long-term military bases in Afghanistan. This agenda was unfolding steadily over time, which is evident from the fact that the US has been spending hundreds of millions of dollars to renovate and refurbish select military bases to bring them on a par with the standards and amenities provided for American troops stationed abroad. The US, of course, never acknowledged that such a project was unfolding, which added to the strategic ambiguity regarding its future intentions.

Therefore, what we have at the end of the day is a manifest keenness to end the US' "combat role" but an agenda to occupy Afghanistan on a long-term basis. The US has taken a surreptitious course by pretending that the

government in Kabul represents a sovereign state and the conclusion of a status of forces agreement is a purely bilateral matter between the two governments. This is a total fallacy, since Afghanistan is a highly fragmented country and no Afghan group – including the government in Kabul – can today claim to genuinely reflect the will of the Afghan people today. Ironically, Washington has been the most vociferous player to allege that the government headed by Hamid Karzai rests on a highly disputable mandate secured through a rigged election in 2009 (which was "won" solely through the last-minute acquiescence by the US government on the understanding that Karzai will relinquish power in 2014).

The Taliban and many other sections of Afghan opinion oppose the establishment of the US military bases. The prevailing mood in the country is also "anti-American" and the Afghan people always resisted foreign occupation. On the other hand, the prospect of the establishment of the US military bases in Afghanistan rings alarm bells in many regional capitals. Besides, the

The core of the problem lies in the US' intention to establish long-term military bases in Afghanistan.

US' clandestine efforts to have direct dealings with the Taliban to strike a secret "deal" also raises misgivings in the region, given Washington's abysmal record of using the forces of political Islam as instruments of its regional strategies – be it in Libya, Egypt or Syria. The prerequisite of a durable solution to the Afghan problem is two-fold. First the international community should agree that Afghanistan is best restored as a "neutral" state free of foreign military presence. Second, a truly intra-Afghan peace process needs to be initiated under the auspices of the United Nations. In sum, the accent should be on the restoration of Afghanistan's sovereignty and independence with the international community playing a future role by assisting that country to get on to its feet after the debilitating civil war, which, by the way, really began in 1974 with the overthrow of King Zahir Shah.

Read the author's blog at www.indrus.in

ENERGY: Split it into Western and Eastern units to benefit Far East: Deripaska

Calls for a shake-up of top brass at Gazprom, get louder

Russian gas giant has come under fire for its focus on West at the cost of the growing Asia market

ANATOLY MEDETSKY
The Moscow Times

Russia's natural gas giant Gazprom is in a churn, with the country's business elite and investment community rooting for radical changes that range from a reshuffle of top executives to a split of the company into two businesses in order to focus on European and Asian markets.

Gazprom's veteran CEO, Alexei Miller has a contract to lead the company until June 2016. But the company is now facing a strong challenge to its position in the Russian gas market from the country's oil champion Rosneft, and private gas producer Novatek. Besides,

European exports sank 7% to 139 billion cubic meters last year. "A company like Gazprom, where management has been incumbent for a long time, could probably benefit from a shake-up," says Mattias Westman, founding partner at Prosperity Capital Management. "There are other Russian state-controlled companies that are better run than Gazprom."

Westman was referring to Rosneft, managed by former Kremlin and Cabinet heavyweight Igor Sechin, and Russia's biggest lender, Sberbank, led by former Economic Development Minister German Gref. Also wading into the Gazprom debate has been billionaire Oleg Deripaska, CEO of

Russian Aluminum, who has called for Gazprom to be broken up.

In an interview with a business newspaper last month, Deripaska said that Gazprom was too "preoccupied with its business in the West" at the expense of opportunities in Asia. "For the benefit of the Far East and eastern Siberia, Gazprom should be split into Western and Eastern units," advocates Deripaska. Gazprom has come under a barrage of criticism for its multibillion-dollar projects to build new pipelines to Europe – Nord Stream and South Stream – at a time when its exports to the continent have dwindled.

A reshuffle in Gazprom could send an encouraging message to the investment community, says Gennady Sukhanov, who helps manage the Russian oil fund at TKB BNP Paribas Investment Partners. "A change of the



RusAI CEO Oleg Deripaska

chief executive could signal a different policy," he says. Gazprom's stock could then as much as double in value, he predicts. A reshuffle would appeal to investors only if it comes with a plan for Gazprom to spin off several companies, thus making it easier for investors to understand the business, says Pascal Menges, energy fund manager at Swiss investment firm Lombard Odier.

India and Russia: A perfect marriage for space voyages

As Russia celebrates Cosmonaut's Day, India, which is being courted by leading powers, must pick the right partner for its space renaissance

RAKESH KRISHNAN SIMHA
Specially for RIBR

In times of global slowdown and scarce funding, the once leading space-faring nations are scrambling for partners. India is one of the players being courted by NASA, Russia's Roscosmos and the European Space Agency (ESA).

While the big three have plenty of experience and grand plans for the future, they lack something that India has – a large pool of scientific talent. The aerospace industry operates on such a vast scale that it requires prodigious numbers of scientific and technical personnel to complete various projects. India's highly subsidised university system and the importance given to science and mathematics by Indian families ensure a steady supply of technical graduates. In the West, the recession is driving youngsters away from science degrees simply because there are not enough skilled jobs. The decline in the youth population in Europe and Russia will also impact scientific institutions in the decades ahead. Partnering with India, therefore, seems like the perfect get-out-of-

jail free card.

Now, there's nothing wrong in alliances, but there's one thing the Indian Space Research Organisation (ISRO) must not do – choose the wrong partner. Space is an area of strategic importance, and a mistake in strategy cannot be undone in the same war.

The single biggest reason to go with Russia is that India can be the inheritor to Russia's legacy in space. Russia's space industry is vast but its population base is too small to support it. The average Russian space scientist is in his 50s – not a positive trend for the future. For Russia, the ISRO can be a lifeline as many of the projects it can't handle can be farmed out to India. Also, Indian scientists can be sent to work in Russia's cutting-edge research labs that are off-limits to non-Russians.

Trust is a key factor here. The Russians wouldn't trust the NASA or the ESA anywhere around their research facilities. There is a lot of red hot technology locked away in deep vaults in once secret Russian cities. The ISRO alone can be trusted to inspect and develop these technologies. This is because India is unlikely to become Russia's geopolitical or economic rival,

so any technology that is exchanged between the two nations is in safe hands.

According to Space Daily, "one of the major reasons for the delay in India's second moon mission (Chandrayaan-II) is the absence of a reliable GSLV (Geo-Stationary Launch Vehicle)". "Further, the absence of a GSLV is also affecting India's strategic preparedness because India cannot launch satellites required for strategic purposes from a foreign launch pad or atop a foreign rocket."

That sounds pretty close to the truth. How's this for comparison – India's most reliable rocket, the PSLV, which launched its first lunar mission, can lift 2000 kg, whereas Europe's Ariane 5 is able to launch 10,000 kg into space.

India's biggest strengths are in high-tech instrumentation and satellites. India not only has the largest constellation of remote sensing satellites orbiting the earth; it also has plans to create a satellite navigation system that will rival the American GPS.

Besides super heavy-lift rockets like Energiya, the Russians were the first to develop landers and rovers that traversed the lunar surface before the



The Indo-Russian space cooperation is poised for an upgrade.

Americans got anywhere close to the moon. Lately, Russia's soaring ambitions – epitomised by the Phobos Grunt mission to Mars – have come to terms with gravity, but that's precisely because Russian instrumentation has fallen on hard times. In such a scenario, the two countries are perfectly placed for space cooperation.

Sure, the implementation of the US-style project management and quality

assurance techniques can work wonders. It has led to impressive successes like the moon shots and the Voyager spacecraft, one of which recently became the first manmade object to exit the Solar System. But it's hard to see the NASA treating the ISRO like an equal partner. Indeed, shortly after the successful launch of Chandrayaan-I in October 2008, the ISRO told the media that many space-faring nations have

The Cryogenic Chronicles

In December 1982, the ISRO set up a Cryogenic Study Team to develop cryogenic engines needed for a large spacecraft. Only four countries, the US, Japan, France and the Soviet Union, had this technology. The first three backed out but in January 1991, ISRO signed a deal with Russia to buy two cryogenic engines and the technology to develop them in India. Delivery was quick. However, under the US pressure, Moscow backed out. The ISRO then decided to do it alone – armed with Russian blueprints and seven engines earlier supplied by Moscow.

become wary of India's rapid advances in space technology. According to ISRO, its scientists and engineers work in a "hostile environment" with other countries sharing little information and expertise. That won't change – not if you choose the wrong partner.

Read the author's blog at www.indrus.in

TECHNOLOGY: Focus on projects in medical sciences, space, chemistry, games

Technoparks spawn a new breed of hi-tech winners

The Idea technopark in Kazan, located 450 miles east of Moscow, has become a pioneering incubator for hi-tech start-ups and symbol of Russia's success in commercialising science.

ARTEM ZAGORODNOV
RIBR

If one investor typifies foreign involvement in Russia's burgeoning technoparks, it would be Kendrick White, CEO of Marchmont Capital Partners, who has spent the last two decades promoting horizontal integration and start-up financing to generate demand for hi-tech solutions in the country's regions.

The opportunities in today's Nizhny Novgorod were unthinkable even a generation ago, when the city (then named Gorky) was closed to foreigners and a virtual open prison for famous scientists such as Andrei Sakharov, a Nobel Prize winner and Soviet dissident. The scene changed dramatically in the past five years when many Special Economic Zones (SEZs) and technoparks sprang up to cash in on Russia's vast scientific potential and wean the country's economy off its raw materials dependency.

The sprawling Idea technopark in

Kazan (450 miles east of Moscow on the Volga River) was set up on the grounds of an abandoned defence plant in 2004 with the aim of creating hi-tech businesses. By providing two key services – cheap rent and sound business advice – the technopark graduated enough firms within three

Technoparks are a viable model of economic development and are attracting top companies like Honda and Danone

years to become self-sustaining; by 2007, its companies were funneling enough taxes into the local budget to repay the start-up capital. "Our experience proves technoparks are a viable model for economic development," says general director Sergei Yushko. Most of the companies at Idea provide

engineering services, software or web design. Smarthead has scored top-notch clients as diverse as Honda, Danone and L'Oreal. After three years, graduates of Idea have the option to leave the technopark, usually securing bank loans independently to acquire office space, or moving into its business park, where rent is no longer subsidised. There, neighbours include the local R&D branches of international behemoths such as GE, Honeywell and Siemens.

White believes that the government's investment of billions of dollars into special economic zones and technoparks is now paying off. "They're starting to get to the root of the issue – how to get the flow of new companies into them and successfully commercialise science," he says. "Games and programming outsourcing have been the first signs of Russia's emerging hi-tech sector, but I'm a lot more excited about projects in microelectronics, medical sciences, nanotechnology,

chemistry, space and quantum mechanics that will gain global recognition in the coming years," says White. He singles out Kuzbasstechnopark in the coal-mining Siberian region of Kemerovo for developing coal-based sorbents to absorb oil spills, and the pharmaceutical cluster in Obninsk ("home of the peaceful atom") offering cutting-edge solutions to medical problems.

"In addition to building up the technoparks' infrastructure, you need to link them with scientists in nearby universities and provide management training. You need a proof-of-concept centre to test the commercial viability. Then, you need an accelerator programme that can contribute real money to developing a prototype," says White.

"Soviet tradition has most scientists and entrepreneurs looking to budget-holders in Moscow for money; what needs to happen is local horizontal integration between all these forces."



The 'Idea' was set up on the grounds of an abandoned defence plant in 2004.

OPINION

Climbing up innovation index, opening new vistas



CONOR LENIHAN
Vice President at the Skolkovo Foundation

Russia has rapidly climbed up the rankings over the past five years. France's Insead Business School recently placed Russia in 51st place in their innovation index, while a new Bloomberg ranking put the country at 14th worldwide.

The collapse of the Soviet Union led to human capital flight, through the emigration of talented Russian scientists, engineers and technologists. The Organization for Economic Cooperation and Development has stressed the need to create alternative champions to Gazprom and

Rosneft in the non-resource sectors. Of course these companies are vital for Russia's revenues, but nimble, more innovative small companies need to emerge from Russia's research landscape. In response, the Russian government has launched a series of initiatives around innovation, including technology platforms, tax benefit-driven territorial clusters, Special Economic Zones and new development institutions such as Skolkovo, Rusnano, the Russian Venture Corporation and the Russian Direct Investment Fund.

Polishing the image: Fast-tracking SEZs

YEVGENY BASMANOV
RIBR

At the World Economic Forum in Davos, the Russian Direct Investment Fund launched a brand new image campaign entitled "Invest in Russia", which will enlist the world's top investment banks. The first consultant is already known to be Goldman Sachs, which has been tasked with bolstering Russia's international image over the next three years. This fits in with the larger national strategic goal. A presidential decree issued last May states that Russia must be in the top 20 in the 'Doing Business' ranking by 2020, up from its current 112th position.

Given the dynamics of the last couple of years (up from 124th), it looks doable. A major priority will be to accelerate the somewhat tardy, but already tried-and-tested government initiative to set up Special Economic Zones (SEZ). Having appeared in their present form only in 2005, Russia's SEZs now count

57 foreign companies from 21 countries among their residents. In 2012, six US companies came on board. General Motors invested \$180 million, 3M (industrial and household consumer goods) \$30 million, and Armstrong

Russia's SEZs now count 57 foreign companies from 21 countries among their residents. GM and 3M are among top US investors.

(building materials) \$75.4 million. "Our company faced a tricky choice: where to locate our production facilities, in Russia or some other Eastern European country? In the end, we got residency status in the Alabuga SEZ in Tatarstan region," 3M's head of legal Alexei Zavalev told RIBR. "Besides the benefits on offer, a not inconsiderable

factor in our choice was the impression we gained from speaking with the SEZ managers, who represent a new breed of Russian officials with excellent English and business acumen."

The tax incentives alone would have swayed the decision-makers: 3M will pay the Russian government 2% for the first five years of profit-making operations, instead of the standard 20%. And that is not the only privilege on offer: given a minimum investment of \$3 million to operate in the zone, the company will be granted a zero rate of VAT and import duties on equipment, which, Denmark's Rockwool, for example, has already used to save \$12.6 million. Besides there is free power, which in Moscow would cost \$1 million per megawatt of capacity.

Besides Alabuga, the management company JSC SEZ controls, with state participation, 16 zones. In seven years, the SEZ has managed to raise foreign investments worth \$3.6 billion. The zones

are divided into four types: industrial, tourism and recreation, ports and shipping, and technical innovation.

The process for obtaining residency status is the same for everyone. "First of all, a set of documents is drawn up by company staff and examined by the Supervisory Board of the SEZ, after which the business project is either approved or sent back for revision. The next step is the Expert Council of the SEZ, which operates under the Ministry of Economic Development (MoED). Here, the final decision is taken to adopt the project and admit the investor into the SEZ. After that, the investor concludes a tripartite agreement with the MoED and JSC SEZ on the conduct of its business inside the SEZ," explains Oleg Kostin, former head of JSC SEZ. The procedure will be simplified in due course.

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Special Economic Zones: Scripting a new economic renaissance in Russia



Legislation benefits for SEZ residents
Zero tax on property, land and transport for ten years from the moment of the emergence of the tax base

Profit tax: 2% in the first 5 years, 7% in the second 5 years, 15.5% until 2055

Insurance premium: 14% in 2011-2017, 21% in 2018, 28% in 2019

Customs benefits (import without duties and VAT): raw materials; machines, equipment, components.

Types of SEZ:
Tourist - Located in scenically attractive Russian regions, popular with tourists, these SEZs provide ideal conditions for tourism, sports, recreational and other types of business.

Industrial zones - Located in major industrial regions, they are known for proximity to the production resource base, access to infrastructure and the main transport arteries.

Technical innovation zones - located in major science and educational centres with a rich scientific tradition and recognised research schools. Residents of these zones have taken out 350 patents for inventions. Among the consumers of their products are Boeing and Apple. **Port SEZs** -- Located in close proximity of the main transport routes, logistical SEZs may provide sites for ship-building and ship-repair activities.

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RESOURCES: Russia has firmed up Arctic Development Strategy. Sweden, Finland Iceland follow suit. Canada, US join the game

Geopolitics of energy: The debate over the melting ice of Arctic region heats up

Facing prospect of dip in oil production after 2020, Moscow proposes reserve fund of hydrocarbon resources in North Pole

ALEXEY DOLINSKIY
RIBR

The increased melting of the ice in the energy-rich Arctic has unleashed new opportunities for economic activity in the region, and the change has not gone unnoticed by regional players. In the first decade of the 21st century, the five countries that directly border the Arctic Ocean — Canada, Denmark, Norway, Russia and the US — started adopting national Arctic development documents. In February, Russian President Vladimir Putin signed the Arctic Development Strategy, which proposed that the oil and gas reserves of the Arctic shelf be considered a part of Russia's reserve fund of hydrocarbon resources, which will help offset the expected drop in production after 2020. The other three countries that have parts of their territories beyond the Arctic Circle — Sweden, Finland, and Iceland — soon followed suit.

"Vast energy resources are probably the most important reason for the Arctic economic development," says Andrei Zagorsky, head of the Arctic Project at the Russian International Affairs Council. "High energy prices and technological advancement made shelf oil and gas drilling there potentially profitable." According to some estimates, 58% of the hydrocarbons located under the world's oceans are located in the Arctic. Major players in the oil and gas industry, including Shell, Statoil, Total, Gazprom, Rosneft and BP, have ambitious plans for the Arctic.

The new accessibility of Arctic resources has stirred the previously frozen issue of who owns the Arctic. The 1958 Convention on the Continental Shelf and the 1982 United Nations Convention on the Law of the Sea state

that nations have the right to a territorial waters zone of 12 nautical miles and an exclusive economic zone of 200 nautical miles. In an Exclusive Economic Zone (EEZ), a country has sovereign rights for the purpose of exploring natural resources. Nations can also claim their exclusive right for seabed resources exploration in a stretch of the seabed adjacent to their shores in a zone up to 350 nautical miles, if they prove that it is a continuation of the continent. Russia and Norway have already claimed their extended continental shelf in the Arctic region while Canada and Denmark are preparing to do so. Although most of the natural resources are located in undisputed EEZs and continental shelves, some may still be located in the open sea and available for exploration by other countries. Another issue that has a potential for disputes is jurisdiction over shipping routes. Both Russia and Canada claim their northern sea passages are historic routes that need to remain under national rather than international control. National control would not prevent vessels from other countries from using the passages, but they would have to inform national authorities in advance to get permission.

The lack of clarity over territorial and economic rights in the Arctic is a potential mine of conflict. In 2007, Russian submarines put a national flag on the seabed beneath the North Pole; Canada, Norway and Russia have announced the modernisation of their military forces in the Arctic; and Denmark is also creating its own Arctic Command. However, Zagorsky says there is hardly any space for security competition in the region. "All countries would get more from cooperation, and the challenging Arctic conditions are very conducive to it."



The Russian Arktika-class nuclear-powered icebreaker "50 Years of Victory" sails through the Arctic Ocean.

India eyes a share of icy pie, pitches for observer status at Council

The Arctic is of interest not only to potential investors, but also their governments. Many countries are seeking observer status in the 8-member Arctic Council. There are currently six observers, but the list of candidates is twice as long. Among the latter are India, China, Italy, Japan, South Korea and Singapore. A decision regarding their status is to be taken in May at the next ministerial meeting of the Council when Canada will be set to take

over the chair at this meeting. India had applied to join the Arctic Council as an observer on permanent basis in November 2012, and with Canada assuming chairmanship of the Council, its chances are brighter. "Arctic is something which is of extreme importance to us knowing in the due course of time, it's going to be an important hub for possible sources of energy, could be a passage which shortens transit times for shipping and for that matter, many scientific areas in which

we'll be quite interested," said Admiral (Retd) Nirmal Verma, high commissioner to Canada, recently. India is already taking steps to bolster its claim to the mineral-rich region. In January, the Indian Navy took charge of its diesel-driven submarine, Sindhurakshak, after its overhaul at the Zvezdochka shipyard in Northern Russia. It has become the first Indian vessel to sail home through the Arctic, thus developing naval experience in harsh conditions.

Key to global energy security

OPINION

ROBERT BLAAUW
Senior adviser
of Shell's Global
Arctic Theme

The global demand for energy will double between 2000 and 2050, according to Shell's forecast. Renewable sources of energy, even if used on a larger scale, will only meet around 30 per cent of demand, meaning that the world will still depend on the extraction of mineral energy resources.

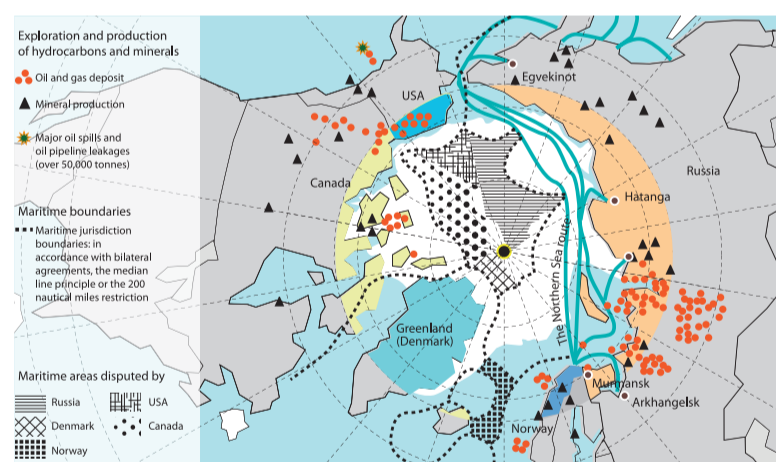
The US Geological Survey announced in 2008 that the Arctic contains around 22 per cent of the world's undiscovered oil and gas reserves. A reasonable development of those could provide energy security for the world's growing population. On one hand, the Arctic is a very cost-intensive environment, but on the other, it has enormous potential. Drilling in the Arctic isn't something new. There's a wealth of accumulated experience, and the industry is well aware of the risks involved. We are continuously improving technology to prevent oil spills, reduce the environmental footprint of our facilities, and increase work safety.

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Investing in Arctic

Within the framework of the new Arctic strategy, Russia's Energy Ministry outlined a new tax policy designed to attract \$500 billion in investment in offshore Arctic energy projects over the next 30 years. The Arctic projects are due to be divided into four levels of complexity. Each will have its own preferential rate of mineral extraction tax: from 30% of the cost of raw materials for basic projects, to 5% for Arctic projects. Project operators may be exempt from export duties on oil, as well as import duties and VAT on hi-tech equipment. It is proposed that the tax regime be invariable for 5-15 years.

Arctic resources and maritime boundary line



Northern Sea Route: Turning point for maritime trade

OLGA SENINA
RIBR

The opening of a new sea lane, called the Northern Sea Route (NSR), to regular commercial transit promises to be a game-changer in the world's maritime transport system. The NSR, which stretches for 3,500 miles, takes ships through the Kara Strait off Russia's northeastern coast to Canada's Providence Bay. The route remained closed to foreigners during the Soviet era and stays ice-bound for a part of the year. An ice lane for super-heavy vessels was opened only in 2010. This route is a third shorter than the traditional route from Asia to

Europe via the Suez Canal and reduces the transit time on the benchmark Rotterdam-Yokohama route from between 35-38 days to between 20-23.

"The Atlantic is full of storms, and the Gulf of Aden, pirates. If you're afraid of pirates, you face a 45-day trip around Africa. The N.S.R. saves time and money. Icebreakers are par for the course, but the cost is comparable with the Suez Canal passage, while the expensive insurance required for carriage of goods through icy waters is offset by the risks of a confrontation with pirates on the southern route," says Vladimir Mikhailichenko, director of the Non-Profit Partnership for Coordination of the Use of the Northern Sea Route.

Until 2010, proponents of the N.S.R. faced an additional problem. Whereas the Suez Canal administration has kept its freight tariff at \$5 per tonne for many years, in Russia, the fee averaged between \$20-\$30. Two years ago, however, the Russian government imposed a ceiling with the intention to reduce the rate for vessels under contract. The average tariff is now a steady \$4-5 per tonne, and traffic in 2011 rose by a factor of 5.5 times, partially as a result of these changes. Recently, Mikhailichenko's organisation measured the speed of passage through the N.S.R. of 15 super-heavy vessels: they

took between 7-22 days, depending on the weather conditions and the exact route. Daily maintenance outlays per tanker come to between \$40,000-50,000; choosing the N.S.R., therefore, over other options could result in substantial savings.

The popularity of the Northern Sea Route is steadily surging: 46 vessels used its waterways last year, compared to 34 in 2011 and just four in 2010. According to the Russian Federal Agency for Maritime and River Transport, about 4 million tonnes of freight was transported along the Northern Sea Route in 2012. This figure included 1.2 million tonnes of transit freight, which is 53% up on the 820,800 tonnes transported in 2011. The share of transit freight is set to grow by another 5-6% this year.

Russia is beefing up its icebreaker fleet to support active shipping operations along the Northern Sea Route. The vessels currently providing ice escort services along the Arctic route are the twin-reactor nuclear-powered icebreakers - Rossiya, Sovetskiy Soyuz, Yamal and 50 Let Pobedy; the single-reactor nuclear-powered shallow-draft icebreakers Taimyr and Vaigach, the nuclear-powered icebreaking LASH carrier Sevmorput, and five maintenance and repair vessels.

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4 million tonnes of freight was transported along the N.S.R. in 2012

70 million tonnes of freight per year is the expected volume by 2020, says Russia's Ministry of Transport