

# US-Russia Relations: Why Donald Trump is Right to Look East

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*US President-elect Donald J Trump has been widely criticised by his liberal critics in the media and by Democratic Party opponents for wanting to normalise his country's relations with Russia and to adopt a more balanced approach towards Moscow.*

The imposition of sanctions, combined with the stepping up military confrontation with Russia over Syria and Ukraine, have seriously endangered the common security of East and West; the reckless policy has also damaged the economic prosperity of the world, including the US and European Union's economies which have all been suffering a downturn.

The return of strident anti-Russian rhetoric and political grandstanding over recent years are reminiscent of the darkest days of the 1950s when McCarthyism and the Cold War dragged the world towards the brink of nuclear annihilation. While Trump has been derided mercilessly for expressing a willingness simply to talk to Putin and to cooperate on common challenges such as defeating ISIS and radical Islamist terrorism, the President-elect has also been attacked for naming the CEO of Exxon Mobil, Rex Tillerson, as his nominee for Secretary of State. Critics expressed alarm that Tillerson enjoyed too close ties with the Russian leadership and even had personal dealings with Putin. Trump apparently viewed these aspects of Tillerson's career in a more positive light; the Exxon executive was a "deal maker" like Trump himself.

Looking ahead, if Trump were to be successful in brokering a deal with Putin and embarking on a new era of détente, he would surely be doing the whole world a great favour.

The economic fortunes of America, Europe and Russia would all benefit enormously from closer economic cooperation.

The Russian economy has been ringed off limits and commercial links severed at the behest of short-sighted politicians. By adopting their anti-Russian stance, America and Europe have been inflicting wounds on themselves and weakening their own economies. Their people are losing out by refraining from trading and doing business with Russia which actually represents a vast market for US and European goods and offers immense potential for investment.

Trump is likely to be proved right by seeking to break with the West's current dominant foreign policy which strikes an obsessively antagonistic posture towards Russia. He should promptly reverse the economic sanctions that damage America's prosperity as well as Russia's.

It is to be hoped that a new generation of political and business leaders will soon be

emerging that will be open to engaging more closely with their Russian counterparts with a view to working together to achieve peace and prosperity.

It is now time to set aside prejudice and take a closer look with clear eyes at the potential for doing business in the Russian market which is a huge country and a developed economy with vast natural resources, diversified industries and exceptionally talented people.

Russia boasts a population of over 146.6 million (March 2016), a GDP of \$1.133 trillion (2016) and covers territory encompassing an area of 17.10 million km<sup>2</sup>, making it the largest country in the world by surface area and spanning eleven time zones.

Apart from the capital Moscow, which is one of the largest cities in the world, other major urban centres in the country include St Petersburg, Novosibirsk, Yekaterinburg, Nizhny Novgorod and Samara.

The economy contracted 3.7 percent in 2015 under the impact of sanctions and lower oil prices. But it is expected to recover in 2017. Inflation stood at nearly 13 percent last year, but is expected to slow down to 6 percent in 2016.

Investment opportunities in the market are becoming more attractive following the challenging economic conditions that Russia has faced in the recent period with a fall in oil prices and devaluation of its currency.

Russia is a member of the World Trade Organisation. The Russian Federation, as the country is officially known, has been a member of WTO since 22 August 2012.

#### Economic Forecasts

Economic forecasts are becoming more favourable. President Putin has said that the Russian economy is now on the road to recovery. The World Bank has upgraded its forecast for the country's economy. The Bank's prediction released on 9 November 2016 was better than expected, showing the economy shrinking by 0.6 percent in 2016, then rising by 1.5 percent in 2017 and by 1.7 percent in 2018.

According to the World Bank's report, economic decline has slowed considerably due to growth in such sectors as services, construction, transport and communications. The forecast also cited figures showing an increase in domestic demand for goods.<sup>1</sup>

#### A New Economy Minister Should Encourage Investors

Russia's newly appointed minister of economic development, Maxim Oreshkin, assumed office at the end of November. He is only 34 years old. He is popular with industry for his approachability and is fluent in English, the FT reported, 30 November 2016.

A graduate of Moscow's Higher School of Economics, Mr Oreshkin first drew public notice when he was appointed to run a central bank department while still at university, aged 20. He worked in banking at Crédit Agricole and Russia's VTB before moving to the finance ministry.

On assuming office, the new minister said that his main aim would be to help the country emerge from two years of recession.

“The worst is already behind us, but growth rates are, of course, still not good enough.” He added that he would “prepare key measures that would allow us to remove structural barriers for the growth of the Russian economy and help it move forward.”

Mr Oreshkin’s appointment was greeted with optimism by the markets.

“An unexpectedly good option. Every cloud has a silver lining,” said one senior Russian banker on Mr Oreshkin’s promotion.

Ivan Tchakarov, chief Russia economist at Citibank, said Mr Oreshkin was “the best economist on the government side that I have communicated with during my years in Russia”. Among Mr Oreshkin’s strengths, he said, were his “unqualified knowledge about the Russian economy, recognised ability to analyse the strengths and weaknesses of Russia from a macroeconomic perspective and demonstrated ability to confer with foreign investors”.

Oleg Kouzmin, a former central banker now at Renaissance Capital, an investment bank, said that Mr Oreshkin’s appointment would help smooth relations between the economy ministry and the finance ministry, which has recently taken a greater role in economic policy. His appointment should give encouragement to investors.

#### Diverse Potential for Cooperation

According to the Ministry of Economic Development, there are 103,000 small companies in Russia which have an element of foreign participation: 13,800 have a share of foreign capital below 49 percent, 15,500 have a share between 49 and 75 percent, while in 73,900 the share is above 75 percent. This means the new bill will concern about 90,000 companies from the last two categories.

The main beneficiaries of the assistance are expected to be companies in the agricultural sector.

Small companies with foreign capital from the Far East may be able to take advantage of state support. There are opportunities for cooperation with foreign investors in numerous sectors.

Russia is cooperating with Japan, for example, on projects in agriculture, health, land and infrastructure. Japan’s Trade Minister described cooperation with Russia as a “win-win situation”. 2

#### Support for Business

State assistance is to be made available to 90,000 foreign companies in Russia.

Small and medium businesses will be able to benefit from support from the Russian government as part of a new initiative aimed at boosting investment and developing networks in the country.

Soon SMEs in which foreigners own more than 49 percent of the shares will be able to apply for Russian state aid, according to the Kommersant business daily, which reports that the initiative forms part of a bill from the Ministry of Economic Development.

The initiative is expected to attract additional investment and help to “form new technological networks” in the country. The benefits will primarily involve the purchase of premises, fiscal preferences, advantageous credits and exemption from scheduled inspections.

#### Russian Definition of SMEs

According to the ministry, in Russia a medium business consists of between 101 and 200 staff, while a company employing up to 100 people is considered a small enterprise.

The maximum revenue of a medium enterprise is considered to be two billion roubles (\$31.4 million), with that of a small company being set at up to 800 million roubles (\$12.5 million).

Foreign ownership is not such a problem.

“For us the problem is not with the company’s foreign ownership, but with distinguishing real small and medium businesses from the so-called ‘Gazprom subsidiaries’ [subsidiaries owned by large companies],” Deputy Minister of Economic Development Oleg Fomichev said during a BRICS and SCO Small Business Forum, held in the Central Russian city of Ufa (720 miles east of Moscow) on 1-2 December.<sup>3</sup>

#### Opportunities in the Energy Sector

The Russian oil sector is undervalued by \$1 trillion, but the value of Russian oil companies dropped more significantly than that of their foreign competitors during the collapse in oil prices in 2013-2016, according to data from Dutch-Swiss multinational trading company Trafigura Eurasia.

Despite economic sanctions imposed by the EU and the U.S, foreign companies have continued to work with Russian oil firms in the country. Oil major BP recently stated that it has no plans to quit the Russian market. BP CEO Robert Dudley told RBTH 7 September that, “BP is a very big investor in Russia, has been for 25 years. We’re very comfortable here; it’s an important place for investments today.”

“In Russia, Italian Eni, US ExxonMobil and Norwegian Statoil work with Rosneft, while France’s Total and China’s CNPC work with the largest private producer of gas, Novatek,” according to Georgy Vashchenko, head of Russian stock market operations at investment company Freedom Finance.

According to Alexey Kalachev, analyst at Moscow investment company Finam Management, the sanctions impinge on the oil and gas sector in two ways. First is the ban on providing debt financing for three energy companies — state-owned firms Rosneft, Transneft and Gazpromneft. US and EU companies are prohibited from trading in bonds of these companies with a maturity of over 30 days as well as any involvement in arranging such securities.

Second, the sanctions ban the export of technology in deep-water drilling, exploration in the polar region and production of oil from shale deposits.

Therefore despite sanctions, Russia is still able to attract foreign investment into its oil sector. To this end, Russia issued a tender in 2016 for the Nazymysky and Ai-Yaunsky oilfield production sites in the Khanty-Mansyisk Autonomous Region offering a rare opportunity for

foreign companies to work in an undeveloped Russian oilfield. The sites, located more than 1,600 miles northeast of Moscow in Siberia, have proven reserves of almost 100 million tons of oil.

The tender, which was open for bidding until the end of October, was designed to attract investment to make up for income lost due to the low oil price. It was also intended to attract foreign companies with the technology for processing thick crude. Russian oil firms are looking for a foreign partner with the appropriate know-how.

For the first time since 2011, Gazprom has been named one of the world's top three biggest energy companies, according to the rating from S&P Global Platts released in 2016. In terms of revenues, Gazprom ranked ninth in the world and in terms of net profit, it came second, behind only ExxonMobil. Publicly owned Rosneft and privately-owned Lukoil and Surgutneftegaz oil companies are the three other Russian firms among the top ten. 4

### Opportunities in Agriculture

The country's agricultural exports are expected to exceed \$16 billion this year, (AP, 1 December 2016), President Putin announced in his state-of-the-nation address. To stimulate growth, support for farmers and incentives for small businesses are in preparation.

### Wheat Exports

Having experienced a good harvest for wheat production this year, Russia is hoping to export more to meet the demands of markets in the MENA region.

In mid-August 2016, the US Department of Agriculture (USDA), whose analytical service is considered to be one of the world's most respected, announced a sensation: In the 2016/17 agricultural year, "Russia is forecast to be the world's largest exporter for the first time ever."

According to the USDA forecast, Russia will be able to sell 30 million tons of wheat on the world market, ahead of all the 28 EU countries combined. This year's crop failure in France and Italy (the former of which is the EU's largest exporter) opens up new markets for Russia.

"Russia has freight and logistical advantages to growth markets in North Africa, Sub-Saharan Africa and the Middle East and can easily grow its market share in these regions to replace a portion of the curtailed EU exports," the report said.

According to USDA data, Russia will collect a total of 72 million tons of wheat this year. Russia's Agriculture Ministry predicts 73 million tons of wheat, taking into account the crop harvested in the Crimea region.

According to Russia's Agriculture Ministry, Russia exported a record 34 million tons of grain in the last agricultural year, including 25 million tons of wheat. 5

### Boosting Food Exports

A cheaper rouble has made it profitable for Russian food manufacturers to export their products to Asian countries.

Consumers from across Asia are increasingly buying Russian food products thanks to a

recent growth in exports.

Brands of Russian chocolate, popular among tourists, are now being exported to Asian markets such as China.

But manufacturers are now looking beyond China, and are increasingly seeking to obtain Halal certification to sell in Muslim countries.

The Russian confectionary industry is also developing new products specifically for the Asian market to cater to local tastes.

The organic food market is growing worldwide and Russia now seeks to seize the potential.

Health food brands are being developed and Russian food producers have been achieving success in the baby food niche market. 6

### Fish Farming

Fish farming is not particularly successful in Russia. However, there are some notable exceptions. Thanks to local entrepreneurs, in a republic in Russia's north the production of one of the country's favourite fish, the trout, is developing at incredible speed. The Republic of Karelia produces three quarters of all the red fish in Russia, and the Karelian trout is known for its excellent quality.

Fish farming is a growing industry. Today there are about 50 trout farms in the republic, employing more than 1,000 people. In 2013 the farms produced 23,000 tons of fish.

The industry is achieving international recognition

Nikolai Fyodorenko, a modest entrepreneur from Karelia, recently scored a remarkable triumph at the SIAL 2016 Food Exhibition in Paris. His trout received three gold medals simultaneously and the event's guests and participants were vocal in their appreciation for its quality and fine taste.

### Development of salmon farming

There are around 60,000 lakes in the region, but only five percent are deemed suitable for farming trout. In response, Karelian trout farmers are considering the possibility of studying Norwegian techniques in order to farm Atlantic salmon. 7

### Investing in Russian gold

A consortium made up of the Chinese state-owned mining firm China National Gold Corporation, India's SUN Mining Group and the Russian Far East Development Fund, as well as funds from South Africa and Brazil joined forces to invest up to \$500 million in the development of the Klyuchevskoye gold field in the Transbaikal region. It marked the first mining deal in the history of BRICS that involved all five member states.

According to plans for the site, Klyuchevskoye will become operational three years after investment becomes available and will yield some 6.5 tons of gold per year.

Acquisitions of Russian gold-mining assets by Chinese companies are expected to increase in the future while gold production in China falling — it was down 0.4 percent in 2015 — and

consumption is rising — up + 3.7 percent in 2015. 8

## Pharmaceuticals Sector

In recent years, the Russian pharmaceutical market has become popular among investors.

“Indeed, since 2010 investors have invested more than \$2 billion in the Russian pharmaceutical industry and, perhaps this figure will double by the end of the next decade,” said Vasily Ignatiev, the CEO of the R-Pharm group of companies.

According to the Federal State Statistics Service, Rosstat, the volume of production of medicines increased by nearly 27 percent in 2015 compared to 2014, totalling 231 billion roubles (\$3.6 billion).

Pharma 2020, a large-scale Russian government programme, is offering subsidies to local manufacturers that produce medicines from the health sector’s essential drugs list (EDL).

The initiative aims to increase the share of Russian drugs to 50 percent of the domestic market by 2020. During the first year that Pharma 2020 was introduced, the share of locally produced drugs in the domestic market doubled in value terms from 13 percent to 26 percent.

In July 2016, US pharmaceutical giant Pfizer became the first foreign company in its sector to localise its business in Russia with a Russian partner. Pfizer and the Russian-American company, NovaMedica, whose shareholders include the Russian state-owned company Rusnano, decided to jointly invest in the construction of a plant in the Kaluga Region, 125 miles southwest of Moscow.

By constructing this production facility in the country, Pfizer is eligible to take advantage of Pharma 2020. 9

## Medical Tourism Potential

*“Russia becoming more attractive as medical tourism destination”*, according to a recent report in the business press.

Four times as many non-Russians came to the country for medical help in 2015 than in 2014, the country’s health ministry has said.

The number of foreigners coming to the country as medical tourists is on the rise, bringing in billions of roubles in extra revenue, according to Igor Lanskoï, advisor to the Russian health minister.

These travellers generated 7 to 10 billion roubles (\$108-154 million) for the state budget.

Demand for Russian medicine is growing because of the fall in the value of the currency. Treatment and accompanying services in the country are now four times as cheap as they are in the West, estimated Yakov Margolin, general director of the Clinical Hospital in Yauza.

There is certainly great potential in this sector for expansion because to date the attraction of medical tourists remains an untapped market. In a recent ranking of the most attractive countries for medical tourism conducted by Visa, Russia was 34th of the 41 countries listed.

Russia's specialist health sector and resorts should be able to attract more visitors from abroad in search of competitively priced treatment in the country's hospitals and sanatoriums in future. 10

#### Education Sector- An Increasingly Attractive Option for Foreign Students

Higher education has become more affordable for foreign students with the fall in the rouble and universities in Russia are beginning to see attracting students from overseas as an important source of revenue.

The appeal of education at a Russian university for foreigners has risen in recent years and the government is introducing new measures in order to capitalise on the trend.

According to the Russian Ministry of Education and Science, more than 1 million people from 160 countries have graduated from Russian universities.

Numbers of overseas students are rising.

According to fresh data from a study conducted 2016 by the Russian Presidential Academy of National Economy and Public Administration (RANEPA), the number of foreign students in the country's universities has tripled in the last decade: from 100,900 in the 2004-2005 academic year to 282,900 in the 2014-2015 academic year.

The revenue universities earned from foreign students increased as a result— from \$356 million in 2005 to \$1.46 billion in 2015.

During the 2014-2015 academic year alone, the number of full-time foreign students grew by 17.2 percent in comparison with the previous year, while the number of students taking classes remotely increased by 6.1 percent.

Traditionally, the universities with the highest number of foreign students are Peoples' Friendship University, St. Petersburg State University, St. Petersburg Polytechnic University, the Crimean Federal University and Moscow State University.

More than half the number of foreign students studying in Russia (53 percent) originate from former Soviet republics, but Russian universities have begun to attract students from further afield. 11

#### Engineering Sector

Russia has ambitions to supply electric engines to European and other overseas markets. On 18 November, a company called Genborg launched at a factory near Lipetsk the production of electric motors for use in the mining, metallurgical, chemical and food industries.

The company claims that this is the only factory in Russia whose products meet premium EU standards for energy efficiency. At full capacity, the factory is expected to supply 10% of the products sold in Western Europe, 30% in the CIS market, and 60% of products on the Russian market. Deliveries to countries near and far are expected to start in 2017.

#### Foreign Investors in the Car industry

In autumn 2016, the Russian government decided to undertake initiatives to support the



automobile industry for the first time in recent history, highlighting export subsidies in the amount of \$50 million. Subsidies also apply to vehicles of foreign brands which are manufactured in Russia.

Daimler, parent company of Mercedes-Benz, plans to sign an investment contract to construct an auto manufacturing plant in Moscow region which is expected to cost more than 300 million euros.

2016 witnessed a growth in demand for foreign cars assembled in Russia from CIS countries and the Middle East.

Nissan has plans to deliver its model Datsun, which is assembled in Russia, to the Middle East, and Hyundai plans to export cars produced in its St Petersburg plant to Georgia and Tunisia.

Meanwhile, Renault has indicated its plans to export its Dacia Logan and Sandero Stepway models, both assembled in Moscow, to Vietnam.

Experts say Russia has the capacity to produce 3 million cars, which would be in large part for export. Domestic demand stands at around 1.5 million.

The export potential of the industry is stronger than the domestic one. Russia's domestic auto market is not currently attractive to international manufacturers because of declining sales since early 2015. 12

#### Opportunities in the Russian Far East

Opportunities exist in the development of the vast country's remoter regions and in this regard the Far East offers significant potential.

Industrial activity in the Russian Far East is currently growing. The region saw industrial growth of over 5 percent in 2015, whereas in the rest of the country the figure was just 0.3 percent.

In 2015, more than 300 investment projects were launched in the region, which attracted over 1 trillion roubles (\$15.35 billion) in investment.

Russia intends to set up an international science and education centre in Vladivostok and is seeking the help of Asian expertise.

Favourable conditions have been introduced to attract foreign investors to the region, including the launch of the free port regime for Vladivostok and the Territories of Accelerated Development (TAD), which offer a simplified tax regime and favourable credit conditions for investors. In the near future, the Russian government plans to ease visa requirements for foreign nationals and is to start issuing electronic visas, President Putin has stated.

The government has offered land free in the Far East to Russian citizens prepared to develop it. The unused land is given away to applicants as part of an initiative by the Ministry of the Development of the Far East.

The region has the potential to become a supplier of organic food produce for customers in

the Asia-Pacific.

Under the law passed in the summer of 2015, Russians are able to obtain one hectare (2.47 acres) of land as personal property on condition that they develop it within five years. From February 2017 the land offer will be accessible to all Russian residents.

The development of the Far East, located some 4,000 miles from Moscow, has become a priority to Russia as it seeks to develop closer economic relations with Asian neighbours. For this policy to succeed Russia needs to create a dynamic economy in the Far East. 13

#### A New Hub for IT and Software Development

The Russian technology sector can now compete with traditional tech offshore hubs like India and China. It just needs to attract more investment.

The fall in the rouble has made Russian software engineers and IT specialists much cheaper for foreign customers to hire and do business with.

According to TAdviser, an analytics company, software and IT services exports from Russia have been steadily growing since 2010 and hit \$7 billion in 2015.

There is great potential in the regions of the country where costs are lower than the capital.

Voronezh, a former industrial town has started to turn into a thriving provincial tech hub, as startups and online contract work have become a source of good jobs and income. Six hours by road from Moscow, Voronezh is more cost effective than setting up in the capital. Office rent and salaries are significantly lower.

The tech sector is crying out for investment. One key problem facing startups in Voronezh and elsewhere is a lack of investment to grow. Many locals with promising ideas are compelled eventually to leave for Moscow or foreign countries. The right investors could help create a thriving local industry. 14

#### Access to a Wider Regional Market

Trading with Russia gives potential access to a wider market via the Eurasian Economic Union (EEU). Russia launched the EEU in 2014 in cooperation with Belarus and Kazakhstan. It is a free market of 181 million people. Armenia and Kyrgyzstan have since joined the trade bloc and Vietnam became the EEU's most recent member in October 2016. The EEU is designed to ensure the free movement of goods, services, capital and workforce between its member countries. 15

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