

Deputy Prime Minister Aleksei Kudrin on creating a positive business climate in Russia

Interview by Stanislav V. Shekshnia

Executive Overview

Since 2000, Aleksei Leonidovich Kudrin has held two key positions in the Russian government simultaneously—Deputy Prime Minister and Minister of Finance. As deputy prime minister, Mr. Kudrin oversees forecasting of economic and social development, government economic policy and regulation, entrepreneurship and small and medium-sized businesses, antimonopoly activities, taxation, foreign trade, and relations with financial institutions in other countries and international organizations. The federal ministries reporting directly to him include the Ministry of Economic Development and Trade, the Ministry of Taxation, the Antimonopoly and Entrepreneurship Support Ministry, the State Statistics Committee, and the Federal Bankruptcy and Economic Sanation Service. As finance minister, Mr. Kudrin is in charge of formulating and executing the government's financial and fiscal policy, as well as preparing and implementing the budget.

From 1997 to 2000, Mr. Kudrin was first deputy minister of finance, and previously served as deputy head of the presidential administration and head of the internal control department. In 1995–96, he was first deputy mayor of St. Petersburg and chairman of the Committee for Economics and Finance. In 1994–95, he was deputy mayor in Anatoly Sobchak's administration, and was in charge of city finances and chairman of the financial committee. Mr. Kudrin began his political career in St. Petersburg in 1990 as deputy chairman of the Committee for Economic Reform, and later became deputy chairman of the Economic Development Committee and head of the Finance Department. Earlier, Mr. Kudrin worked as a research fellow at the Institute of Social and Economic Problems of the Soviet Academy of Science in Leningrad [now St. Petersburg]. Mr. Kudrin was born in Dobel, Latvia, in 1960. He graduated from Leningrad State University with a degree in economics in 1983, and earned a Ph.D. in economics from the Academy of Science's Institute of Economics in Moscow.

How do you characterize the business environment in Russia?

Russia has experienced political stability for the second year in a row, and I must note that this also pertains to economic stability. This is just a very short period, but the main task of the Russian government is to provide stability during the years to come. We must add assurance and predictability to the actions of our administration and our government, and continue to work on the development of our economy.

Based on its economic indicators, Russia is in-

deed an islet of stability. According to Russian experts' estimates, despite a recession, particularly in the developing countries, Russia preserves good prospects for stable growth in all economic indicators. International rating agencies raised Russia's credit ratings, recognizing its lowered credit risk. The Russian economy's dependence on outside factors has decreased, and we will meet our debt obligations even if oil prices drop.

Our efforts and results have been well received by our partners in the international community. There is good agreement with the economic forecast presented by the Russian government. They



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have expressed interest in our plans, such as instituting measures to curb inflation, setting up the 2003 debt-repayment schedule in advance, just as we did for 2001 and 2002, in addition to banking reform and our efforts to fight money laundering. I think that the next two years are going to be the test years for us to maintain a stable economy and continue the positive trends in our economy. This may be very difficult due to our high debt obligations and the necessity for continued debt repayments. But I think we can overcome these difficulties and maintain stability. I think this would be proof that it is possible to do business in Russia, and that investing there will yield solid returns.

We are lowering the risks, and that will allow our economy to develop at a normal pace and allow investors to realize continued positive trends into 2002 and 2003. Therefore, we expect that, by the end of 2002, the total government debt, including internal and external, will comprise no more than 50 percent of the GDP, which is within normal standards for the European community, and we hope to lower it to 40 percent by 2004. All these measures are part of our policy announced by President Putin to parliament. Our goal is to lower

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What plans do you have for Russia to become a full participant in the world economy?

We view participation in the World Trade Organization (WTO) as a major goal for Russia. It will require synchronizing our legislation and many institutional reforms to bring them into conformity with international law. Recently, the government approved a special legislative action plan so that, in the next 18 months, the draft legislation will be introduced in the Duma [parliament] for approval. I am hopeful that they will see this through, which will enable us to successfully complete the negotiation process and see Russia become a member of the WTO. What we expect from this process is not only the opening up of the Russian market, but also the export of Russian goods and services to markets abroad. Having participated in a number of international forums devoted to free trade, I've noticed time and again that newly accepted members of the WTO very often enjoy the status of a younger brother.

All the agreements that we are now in the process of achieving with the United States were reconfirmed at the European Union level. So, this is the degree of support we are enjoying now, which is a serious precondition for Russia to join the WTO within the next two years. Our proposal has also been accepted, in that, starting this fall and then into next year, a working group will prepare a report on Russia joining the WTO. These are the protocols of acceptance that would spell out all the conditions and measures for Russia's entry into the WTO in tariffs, agriculture, and services. I believe that the necessary agreements are likely to be reached during the next two years.

I also believe that more equitable trade relations are very much on the agenda in countries throughout the world, not only for Russia alone, but also for other countries that are serious about the liberalization of their economies. We are prepared to engage in such work, and expect that reciprocal measures would be forthcoming to achieve equitable trade relations.

What reforms are occurring within the banking sector?

Reforming the banking sector is among our very important near-term goals, and such reform will stimulate investment. Last month, the Russian government adopted a joint strategy with the Central Bank for development of the banking sector. I would like to name some of the most important components of this strategy. In July of this year, parliament passed a law that will obligate banks to be responsible to shareholders, and they will also be responsible for showing that their capital is sufficient. We have not had this in Russia before. We realize that banks need to improve very seriously, and by January 1, 2004, we plan to adopt international accounting standards within our banking system.

According to the Central Bank's assessment, nearly half of Russian banks will need to be restructured by the beginning of 2004 so that they can work with these higher standards. Moreover, we have introduced a five-million-euros minimum capital requirement for new banks to obtain a license. We are also taking measures to gradually privatize state banks, and to stop the practice of the Central Bank's holding the capital of other banks. We will also be monitoring the activities of savings banks more seriously. We are preparing a major inspection of them, which will make the banking-services market more competitive. We will achieve this by using specific measures that are described in our strategy.

Do you also foresee changes in accounting systems and practices?

Yes, this is another major area of reform. This would cover many areas of the economy, and includes a switch to GAAP [Generally Accepted Accounting Principles] accounting in 2004. Such standards are being introduced in a gradual manner. We have taken this evolutionary route because it will take time for accounting and financial people to learn and get accustomed to the new systems.

What is the role of big business in the Russian economy?

We have to remember that the current structure of the Russian economy was created under the central planning system. Therefore, large companies dominate it and create, by far, the largest part of the gross national product. That's a fact of life and will remain so for many years to come. Knowing this, nobody should be surprised to learn that the

Russian government is concerned with what is going on in large corporations. This sector is important for macroeconomic stability of the whole economy and also for the interests of the government as a shareholder in some of these large organizations, such as Gazprom.

However, it does not mean that the government is trying to tell managers of these organizations how to run their enterprises. We believe that dialog between business and government is important, and we have seen positive outcomes of such dialog in Russia, working with the Entrepreneurship Council, under the Prime Minister of the Russian Federation, and the Russian Council of Industrialists and Entrepreneurs. A number of important legislative initiatives came out of this process and are being implemented in the country. At the same time, everybody should be doing their job—government should create favorable economic conditions for large and small businesses to flourish, and managers should run their companies to the satisfaction of all their shareholders, big or small.

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How does the Russian government view entrepreneurship and small business?

That is a very important question. On the one hand, entrepreneurship and small business are a cornerstone of any market economy. None of the big companies were born big, except in a planned economy. They all started out small at some point. In developed economies, small business creates the lion's share of jobs and GDP. In this country, its contribution to GDP is very moderate, at just over 12 percent. In this respect, there is no more important priority for the government than support and development of small business. This year we have a special government program worth 140 million rubles dedicated to supporting small business. This money is being used to facilitate introduction of new technology, including information technology, into the small companies, as well as training and retraining of entrepreneurs. Some of this money was also used to provide loans, usually interest-free, to small businesses. However, I do not believe that the government should directly

finance construction of new gas stations or small shops. Extending credit lines to small businesses is not a function of the government's budget; rather, it's a function of commercial banks.

I see the role of the government at a much higher level. It should be, and is, creating business conditions which allow individual entrepreneurs and small business owners to prosper. The Russian government has taken a number of steps to foster entrepreneurship. We have simplified the registration process for people who want to become individual entrepreneurs, so it's very easy to start commercial activities in Russia this days. We have a number of tax advantages designed for individual entrepreneurs and small business owners, including lower income tax, VAT and social-security tax exemptions, and lower taxes on profits, among other measures. We call it the velvet tax revolution in Russia—we are trying to lower taxes gradually, while maintaining all government social programs. People have responded positively, and today there are 3.7 million registered individual entrepreneurs in Russia.

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What other policies are necessary to help entrepreneurs and small business owners?

We see a need for further improvements in government policy toward small business. We are not taking a path of providing any special privileges, which, from past experience, led to various kinds of abuses. In our opinion, adopting a new set of laws on deregulation of the economy and debureaucratization will be much more effective. The government has prepared a document on state policy on small entrepreneurship, which will be presented to the State Council in December. This document reflects 10 years of small business development in this country and calls for a number of tightly interrelated new laws, amendments to existing laws, and presidential decrees to improve the situation for small business in Russia. This package will further simplify registration procedures for startups and filing requirements with fiscal authorities. We intend to dramatically reduce the list of business activities that require

licensing and to abolish other outdated regulations in the small-business sector. New laws will also limit the ability of so-called power ministries and their departments (the Ministry of the Interior, the Federal Security Service, and the General Prosecutor's Office) to interfere with the business activities of small companies at their will. We need to create a stable, predictable business environment, and entrepreneurs will do the rest. Direct government intervention only creates additional opportunities for embezzlement and corruption.

How does the Russian government view social conditions in the country?

We are trying not to cause any serious social risks in our country. The standard of living is growing, and this is one of our major goals. As I said earlier, we are trying to maintain government social programs while simultaneously reducing taxes. We have had some success, and the real income of the population has grown by more than five percent so far this year, and we expect that by the end of the year it will reach almost six percent.

How do you view Russia's business relationship with the United States?

At the U.S.-Russian summit held during the G8 meetings in Genoa in July of this year, President Putin and President Bush issued a joint statement creating the Russian-American Business Dialog. The objective is to utilize private-sector organizations in both countries to supplement government channels in developing private-sector business ties between the two countries. The specific objective is to facilitate increased trade and investment activity. This agreement on business cooperation lays the foundation for cooperation between business leaders of our two countries. As the presidents outlined, they hope that the dialog will encourage participation by large, medium, and especially small enterprises from many sectors, especially technology businesses.

Other matters that remain to be resolved include some long-standing issues with the United States around antidumping restrictions and limitations, but progress is being made here. Some Russian companies have filed a petition with the U.S. Department of Commerce to recognize Russia as a market economy. This petition was accepted for consideration, and we will continue to work with the Department of Commerce and hopefully achieve an objective consideration of this petition. This will open up new prospects for business rela-

tions with the United States. At this point, we are facing serious restrictions, with 80 percent of Russia's exports to the United States being subject to various limitations that have been enforced for a long time.

I expect a lot from the Russian-American Business Dialog initiative. The events of September 11 forced both sides to take a hard look at the relationship between our countries. Old approaches no longer fit. The time has come to understand that we have practically no ideological differences. Nevertheless, the question of mutual cooperation must be approached pragmatically, and I would not go as far as saying that investments should be made only in Russia. The dialog should help explain to investors that Russia is a country just like any other, and that one can do normal, successful business there. Today, we are no longer asking people to invest in us, but we are creating all the necessary conditions.

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How does this tie in to broader relations between Russia and the United States?

Russia and the United States have tremendous potential for joint work. Investments in Russia from the U.S. still enjoy the leading positions in the total value of accumulated investments. At the same time, in the past year, other countries have begun to catch up, but I believe this is only temporary. The United States, with its tremendous potential, will be able to maintain its lead in Russian investment. There are many U.S. companies that have operated successfully in Russia for many years. I see a lot of familiar faces, a lot of friends with whom I have worked in the past 10 years. I am sure that we are talking the same language. The policy pursued by the Russian government is quite transparent and understandable. The purpose here is to improve its transparency and its democratic institutions. This leads me to believe that, at the political level, we will see a greater understanding of our goal to build one world.

How does the Russian government plan to attract foreign direct investment into Russia?

We welcome foreign direct investment (FDI) into our economy and regard it as an important contributor to economic and social growth in Russia. I wouldn't say that it's unimpressive, even though there is a lot of room for improvement in this area. The level of investment is growing, and in the first nine months of this year, investment grew by 7.5 percent, and in the first eight months, foreign investment reached \$6.7 billion. For example, as many people know, Exxon just announced its \$4 billion commitment to the development of oil field Sakhalin 1 in the Russian Far East. It's the largest single project in Russia with foreign-company participation. We are also very pleased to see many smaller investment projects that materialized over the last few months.

As for government strategy, we believe a number of factors will facilitate development of FDI in Russia. We see Russia's entry into the WTO as an extremely important step. The government has developed a focused action plan to carry through some important legislative and administrative reforms required to bring our internal systems in line with WTO requirements. I am confident that the government will have support of the Duma in approving these initiatives. We also look forward to working with our partners in the West to accelerate Russia's entry into WTO organizations, and I think we have made some significant progress recently.

I also regard attracting foreign investment as an important part of the government's strategy and the legislative work we are doing to improve the legal framework for doing business in this country. We have significantly simplified personal and corporate taxation, lowered social-security contributions, streamlined banking regulations, and significantly reduced customs tariffs for many goods. All these actions make doing business in Russia much more transparent for foreign investors, and therefore more attractive.

How do you see fiscal policy affecting foreign investment?

As Minister of Finance, I see continuous improvement in the government's budgetary process as being an important factor in making Russia a more attractive place to invest. President Putin made it very clear that our expenses should not in any case exceed our revenues, and a balanced budget has been an important achievement of the current government. In the first eight months of 2001, the budgetary surplus reached three percent, and we hope

that it is not going to drop significantly by the end of this year. In fact, we expect to have a budgetary surplus of about two percent. For next year, the Russian government has already submitted a reduced budget that will have a surplus of no less than 1.6 percent. In September, the Duma approved the main parameters of that budget, and their actions indicate that we have a consensus between parliament and the administration on the main parameters of budgetary policy and its influence on the main macroeconomic situation.

We have also created a financial reserve that will contain approximately \$3.5 billion by the end of 2001. This is intended to be strong protection from worsening external economic factors, and we will be less dependent on reduced oil prices. We based our calculations on the assumption that oil prices will be approximately \$23.50 a barrel next year, but the protective mechanisms we've created within the budget, especially the financial reserve, will allow us to withstand oil prices falling to \$18.50 a barrel. This creates a sufficient foundation to implement the budget.

Our gold reserves have grown significantly in recent years, and today consist of more than \$37 billion. This year the gold reserves of the Central Bank have grown by \$9.7 billion, and this is also a strong foundation for providing stability in 2002 and 2003. The stable exchange rate of the Russian ruble is another factor increasing the confidence of foreign investors. And so is the economic growth that we saw last year and this year. By 2002, we

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