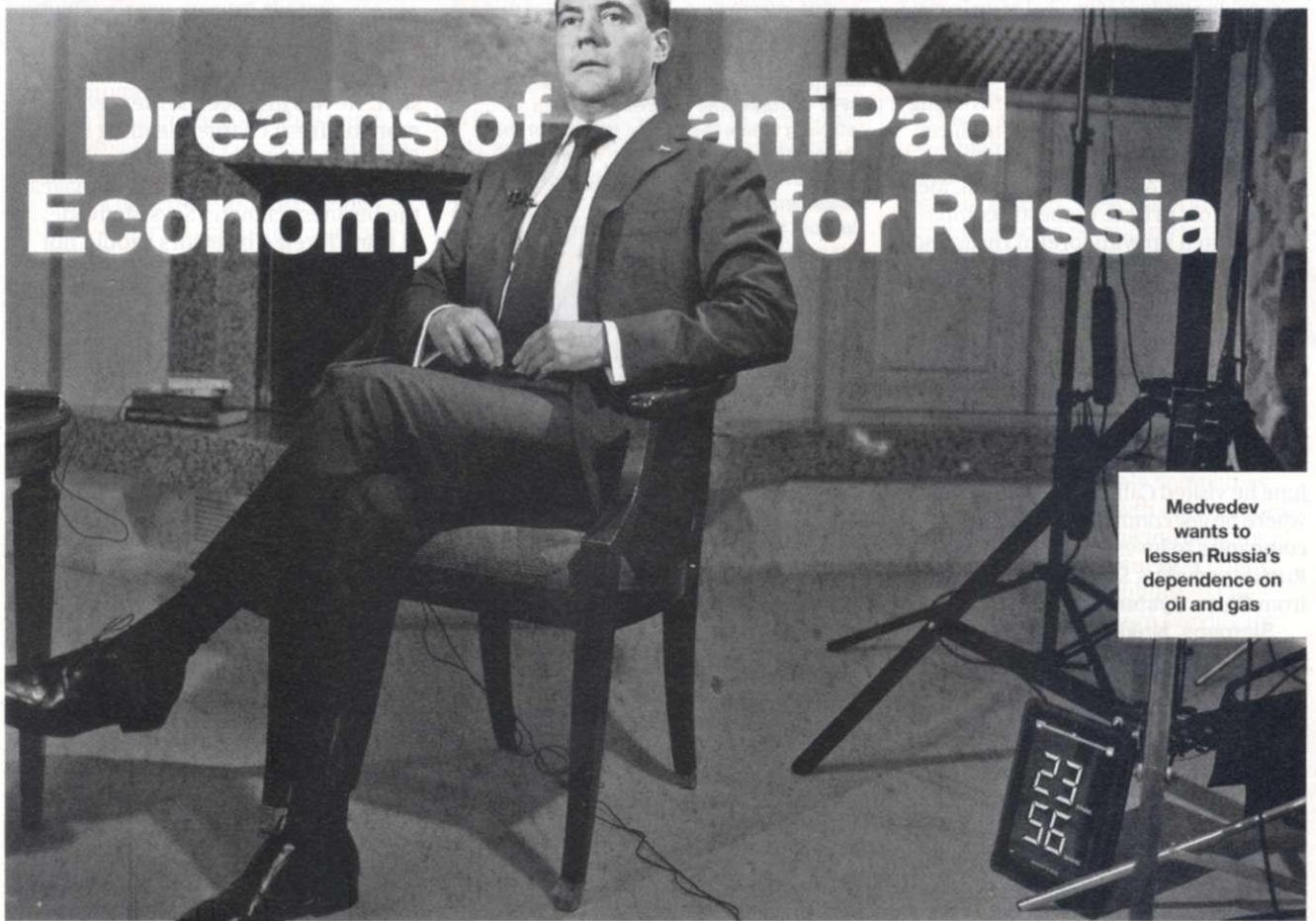


# Global Economics

Global Economics



Medvedev wants to lessen Russia's dependence on oil and gas

▶ Corruption, little innovation, and a slow-moving state sector challenge Russia's President

▶ "Before Russia can talk about electronics, it needs to improve the power system and the roads"

Transparency has not been a hallmark of Russian government. Exhibit A: No one has quite figured out the relationship between Russian President Dmitry Medvedev and his mentor, predecessor and Prime Minister Vladimir Putin. Yet in at least one regard, Medvedev is consistently forthcoming: Russia, he says, is steeped in corruption, and it will take a long time to rectify the problem.

The nation is the world's most corrupt major economy, according to Transparency International's 2010 Corruption Perceptions Index. "Corruption has penetrated all echelons of Russian power," says Medvedev, "and it has spread far and wide after the emergence of a market economy."

The President also says he wants Russian entrepreneurs to develop and produce products as transformational, memorable, and profitable as Apple's

great icons, the iPad and iPhone.

"We need to think about developing the consumer market as a whole by creating good new products," he says. He does not want to return to Soviet practices, which focused on huge industrial projects at the expense of the consumer.

Medvedev, 45, one of Russia's first iPad owners, surfs the Net regularly and has an active Twitter account. His modernization plan envisions a shift from exporting mostly natural resources to excelling in high technology. Russia's exports of gas, oil, and other energy products made up more than 70 percent of total exports in the first 11 months of last year, according to Russian customs officials.

Medvedev wants technologies to make it to consumer shelves with "Made in Russia" written all over them. "This will be the kind of modernization we

seek," he says. "I would like us to create Russian iPads and Russian iPhones. True, I haven't seen anything that works yet, but it doesn't mean that we shouldn't invent. We should try and create our own models." In September, Russian industrialist Sergei Chemezov showed Medvedev a prototype of a Russian mobile phone. It will initially be assembled in Taiwan for sale later this year.

The President's push for diversification is getting some help from non-energy companies, as Russia's economy rebounds from a record contraction in 2009 and consumer demand revives. Shares of **X5 Retail Group**, the country's largest grocer, have climbed 546 percent in the past two years, while those of **Pharmstandard**, the largest drugmaker, have risen 326 percent.

Medvedev has identified five areas where Russia could and

should make breakthroughs: information technology, nuclear energy, pharmaceuticals, aerospace, and energy efficiency. The government is investing hundreds of billions of rubles in these programs, according to Medvedev's economy aide Arkady Dvorkovich. Medvedev wants private domestic companies to catch up with foreign rivals and has been on a charm offensive to lure multinationals to help.

The Russian President last May hosted a group of U.S. venture fund chiefs, including Drew J. Guff, a co-founder of **Signier Guff** in New York, and David Kronfeld, founder and chairman of **JK&B Capital** in Chicago. In June he visited California's Silicon Valley, where he got commitments from U.S. companies to invest in innovation in Russia, including \$1 billion over a decade from **Cisco Systems**.

**Siemens, Nokia, and Boeing** last year agreed to join in Medvedev's pet project of developing Russia's Silicon Valley, a tech hub in Skolkovo outside Moscow. Skolkovo will offer generous tax breaks and other incentives to companies nurturing innovation there.

At the same time, Medvedev has lambasted state-controlled companies, including airline Aeroflot and oil company Rosneft, for being slow to innovate. Economy Minister Elvira Nabiullina says that 22 of the top state-controlled companies last year registered only 1,000 patents combined, compared with 5,000 patents registered by IBM. "There is money to invest. But practically no innovation," Medvedev said at a government meeting on modernization on Jan. 31. Medvedev on the same day ordered the chief of Russia's United Aircraft to be replaced.

As big Russian companies trail in innovation, small companies find it hard even to survive. "When I say that it costs me \$35 to open a company here, no one in Russia believes me," Olga Potapova, a Silicon Valley entrepreneur, told Medvedev during his June visit to California. In Russia "small business does not have the capability of big business. Mr. Vekselberg can afford a group of lawyers. I can't."

Last March Medvedev appointed Viktor Vekselberg, an oil and metals tycoon who, according to *Forbes* magazine, is worth \$6.4 billion, to head the Skolkovo tech hub. Once it is up and running, sometime in 2014, Medvedev wants

### Quoted

"For the first time in three years, I'm starting to see the light at the end of the tunnel for our country."

—Francisco González, chairman of Banco Bilbao Vizcaya Argentaria, as leaders in Spain reaffirmed plans to get the deficit down to 6 percent of GDP this year



to replicate the model across Russia.

Peter N. Loukianoff, co-founder and managing partner of Almaz Capital Partners, a Cisco-supported fund with \$75 million invested in Russia-related projects, says that in general the U.S. venture capitalists who came last year to Moscow are looking more favorably on Russia. Of 20 venture capitalists who visited Moscow, at least three plan to set up biotech, clean tech, and nanotechnology funds in Russia. Andrew Somers, head of the American Chamber of Commerce in Moscow, which counts more than 700 members, says many foreign investors in Davos have reacted positively to Medvedev's modernization appeal. "I think that he is pretty successful in selling the determination of the government to stress innovation."

At the World Economic Forum at Davos, the varying views of Russia were evident. Indra K. Nooyi, chief executive officer of **PepsiCo**, which entered the Russian market decades ago, praised the country's efforts. PepsiCo in December agreed to buy a controlling stake in **Wimm-Bill-Dann Dairy and Juice**, a top Russian producer of juice and dairy products, for \$3.8 billion.

Also at Davos, high-tech entrepreneur and commentator Esther Dyson spoke up about Skolkovo. "What's missing is transparency around all the contracts that are being made with Russian and American companies" in the project, she said. "I would like to suggest that in Skolkovo you add transparency. If it's proper for people to make money it should be visible how they make money."

Investors are also divided over the implications of the Mikhail B.

Khodorkovsky case. In 2005 the nation's then-richest man was sentenced to eight years in prison for tax evasion. He has just been sentenced to six more on fresh charges, leading some foreign investors to view this as an episode of selective justice that damages the business climate. Says Medvedev, "I think foreign investors should not worry about just one case. When we talk about a prominent businessman, it's easier for him to inspire a wave of public reaction. He has the money." Medvedev also points out that 2,000 high-ranking state officials were sentenced on charges of corruption and bribery-proof of Russia's determination to stamp out white-collar crime.

Some big companies just find Russia hard to deal with. **Wal-Mart Stores**, the world's largest retailer, said in December it would close its Moscow office after it could not buy a local discount retailer. In 2009, **Ikea**, the home-furnishings retailer, suspended its investment plans in Russia after disputes with authorities over repeated problems in opening two new stores.

Above all, companies want a Russia that functions. As Christopher Weafer, chief strategist with Moscow-based bank UralSib Financial puts it, "Before Russia can talk about high-end electronics, it needs to improve the power supply and the roads. That's the reality that investors are more focused on."

—Lyubov Pronina, with Ryan Chilcote

*The bottom line* Medvedev is on a charm offensive, trying to persuade Western companies to invest in Russia despite its problems with corruption.

### Commodities

## All Fired Up Over Coal Exports to Asia

- Green groups are challenging plans for a West Coast export terminal
- "For these companies, it's a tremendous growth opportunity"

Even as the U.S. attempts to shift away from carbon-belching, coal-fired power plants, coal producers in the U.S. are gearing up to ship more of the fuel to China—which could boost their sales by hundreds of millions of dollars

annually. Green groups, though, say exports of the "dirty" fuel will worsen global warming and are mobilizing to block shipments. "How are we going to get to the climate goals that scientists have said are necessary?" asks Jan Hasselman, an attorney with Earthjustice. "These decisions are being made by others, such as the coal companies, by default."

Opposition from environmentalists has coalesced around a proposal from Australia's **Ambre Energy** to build an export terminal on the Columbia River in Longview, Wash., where more than 5 million tons of coal a year would be loaded onto ships. The Sierra Club and three other groups have challenged the project.

Washington State's Cowlitz County on Nov. 23 granted a shoreline development permit for Ambre to convert an out-of-commission aluminum smelter into an export terminal. The environmental groups have appealed the decision, citing the health hazards of coal dust and the increase in pollu-

tion that will result from burning the fuel abroad. In their petition for review they claim that the 5.7 million tons per year of coal exported by the facility will generate more than 11 million tons of carbon dioxide annually—roughly equivalent to the emissions of two million U.S. cars. A hearing on the matter is scheduled for Apr. 11.

Millennium Bulk Terminals, the Ambre Energy subsidiary spearheading the project, did not return calls. In a Jan. 13 statement, MBT Chief Executive Officer Joe Cannon said, "We will clean up and revitalize this property and ensure that it will have a very positive economic impact in the local area."

Insufficient port capacity has hampered efforts to boost shipments of low-sulfur coal from the Powder River Basin in Wyoming and Montana—an area that accounts for some 40 percent of all U.S. coal production—to Asian markets. Japan, China, South Korea, and India are the world's top importers of coal, according to data compiled by the World Coal Assn. Yet less than

7 percent of U.S. coal is shipped from Pacific ports, U.S. Energy Information Administration figures show.

Boosting overseas shipments is a priority for the U.S. coal industry, which could soon face shrinking demand at home as a result of efforts to regulate carbon. West Coast shipments may increase by 50 million tons a year if more port facilities are built, according to Jeremy Sussman, an analyst at New York brokerage Brean Murray, Carret. At current prices of \$13.75 a ton, that would add \$688 million to the annual revenue of companies mining coal in Western states, such as **Arch Coal, Cloud Peak Energy, and Peabody Energy.** "For these companies it's a tremendous growth opportunity," says Kevin Book, managing director of ClearView Energy Partners, a policy analysis firm in Washington, D.C.

Environmentalists are seeking to turn the Ambre Energy development into a test case, in hopes of bringing a halt to other projects on the drawing board. Peabody, the No. 1

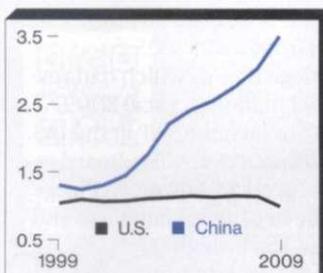
## Remapping the Coal Trade

A lack of port capacity on the West Coast has hampered U.S. coal exports to Asia, where demand is growing the fastest. Proposed terminals, such as one in Longview, Wash., are drawing opposition from environmental groups.

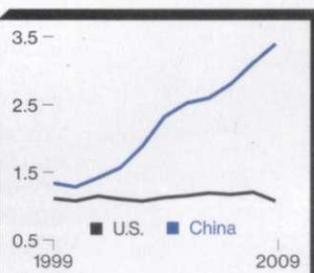
Tons of coal shipped by port (January–September 2010)



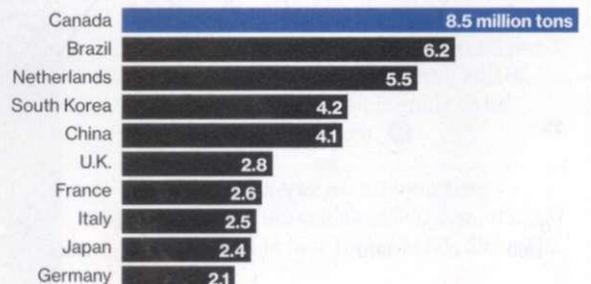
Coal Consumption (billions of tons)



Coal Production (billions of tons)



Top ten buyers of U.S. coal (January–September 2010)



## Global Economics

coal producer in the U.S., has said it will release plans for its own West Coast port by the end of this quarter. "What's missing is a coherent federal policy that looks at the bigger picture," says Hasselman of Earthjustice, which is representing the other environmental groups in the case. "There is a role for the Environmental Protection Agency to come in and help with some of the questions here." EPA spokeswoman Alicia Johnson said the agency is reviewing issues related to the Ambre Energy proposal.

Fredrick D. Palmer, senior vice-president for government relations at Peabody in St. Louis says a policy of restraining U.S. exports that contribute to global warming would affect a wide range of industries beyond coal. "Anything we make in the U.S. requires energy and creates carbon dioxide," says Palmer. "This is a deindustrialization philosophy applied to coal first, and it won't stand."

—Jim Efstathiou Jr.

**The bottom line** U.S. environmentalists seek to turn an Australian company's coal export terminal into a test case for slowing the global coal trade.

### Education

## The SAT Is to America As \_\_\_ Is to China

- A new push to offer U.S. college-entrance exams to Chinese pupils
- "There's this real sense of a huge, untapped market"

As a high school student in Beijing, Xi Zhao cleared a hurdle applying to U.S. colleges that Americans don't face. The SAT college-entrance exam isn't offered in mainland China, so Zhao flew to Hong Kong and South Korea to take it twice. She earned the maximum 800 in math and 2080 out of 2400 overall—a score that helped her get into the University of Southern California in Los Angeles. Not being able to take the SAT on the mainland "is a hassle," says the 20-year-old, now a junior with a 3.8 grade point average. "It's not fair that other students can just take the test at their high schools and we have to travel for hours."

The number of Chinese undergrad-

uates in the U.S. has quadrupled in four years. Now, the nonprofit College Board, which owns the SAT, PSAT, and Advanced Placement programs, is seeking the education ministry's permission to start offering the SAT on the mainland. "We've had serious discussions with Chinese officials," says Board President Gaston Caperton. "They recognize it's a big burden on parents."

The SAT's absence on the mainland is a relic of an era when China was less open to the West, Caperton says. As a former British colony, Hong Kong has long let students take the exam. China permits other U.S. tests such as Advanced Placement exams, which let high-schoolers earn college credits.

Chinese officials "have a very mixed feeling" about the SAT policy, says Tom Melcher, chairman of Zinch China, an online social network that matches Chinese students with U.S. colleges and scholarships. Officials "don't want the SAT blasted on all the walls of all the high schools," Melcher said. "It would feel politically invasive."

In the last academic year, 39,921 Chinese undergrads studied at U.S. colleges, passing South Korea as the No. 1 source of international undergraduates, according to the Institute of International Education, a nonprofit group in New York. "All of us in higher education are hopeful that the day will come when the SAT will be available in mainland China," says Kelly Walter, executive director of admissions at Boston University. The Education Ministry in Beijing and the embassy in Washington, D.C., did not respond to messages.

U.S. college recruiters are mining China's best schools for well-qualified, full-paying applicants. Increasing affluence and China's one-child policy mean middle-class Chinese can afford tuitions that far exceed the price of school at home. "There's this real sense of a huge, untapped market," says Timothy Brunold, dean of admissions at USC, which admitted 162 students from China in 2010, up from six in 2005.

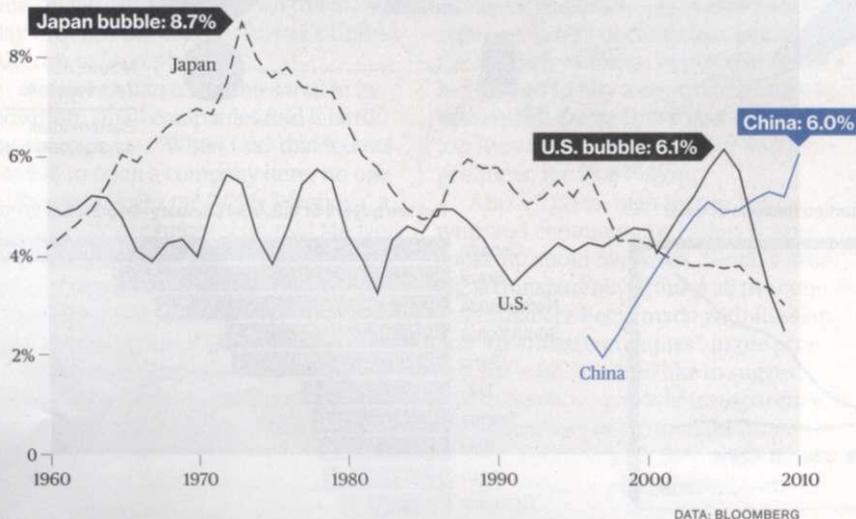
The College Board, which had revenue of \$623 million in fiscal 2009, charges \$47 to take the SAT in the U.S. and \$75 internationally. The Board in 2006 introduced an Advanced Placement course in Chinese language and culture, and has brought more than 450 instructors

### Housing Market

## First the Boom, Then ...

China's property market may be poised for a steep downturn as the economy's reliance on real estate reaches a level close to the housing peaks witnessed in the U.S. and Japan, according to research by Citigroup.

Residential housing investment as a share of GDP



Foto

February 7 — February 13, 2011  
Bloomberg Businessweek

## Tom Keene's EconoChat

Tom talks with **Tom Porcelli**, U.S. market economist at RBC Capital Markets, about Egypt, inflation, and the rebound in U.S. consumer spending

### **Do you care about Egypt?**

We should all care about Egypt. We went back and looked at the last time an event like this happened in the Middle East. We determined that Iran back in 2009 had some similar events, and what we saw then among investors was a massive flight to quality. Over that time, 10-year [Treasury] yields rallied about 40 basis points, so I think something like that is certainly something we should be braced for.

### **Tell us about retail sales booming as jobs struggle.**

We are looking at around 3 percent growth in consumer spending over the course of a year. That might sound O.K., but the truth is, we should be significantly higher than this given the recession that we just came out of. We are growing at half the pace relative to other severe, post-recession recoveries.

### **Why is that?**

If you look at the distribution of jobs, growth has really been concentrated in just three categories. Together they account for 75 percent of all job gains. It's professional, medical, and shockingly-manufacturing.

### **What about inflation?**

I think we are probably going to have slightly more inflation than the market now presently thinks. The consensus outlook is around 1 percent to 1.5 percent for core inflation by the end of the year. We think it is going to be closer to 2.2 percent. ©



Keene hosts Bloomberg Surveillance 7-10 a.m., 1130AM in New York, XM 129, Sirius 130.

## Global Economics

# Seven Days

Events  
of note in  
the week  
ahead

by Ira Boudway

from China to teach it in the U.S.

Next year, Chinese schools will offer the PSAT, which identifies academic strengths and weaknesses in younger students. Says Xiang Wang, who in 2009 became the College Board's first vice-president of international relations for Asia, Chinese officials are "very tantalized but very cautious" about introducing international educational programs. "This is not an easy decision."

—Daniel Golden

**The bottom line** The College Board wants permission to offer the SAT in China, opening up a huge market for the \$600 million business.



IPO for the Aveon Group on the NYSE



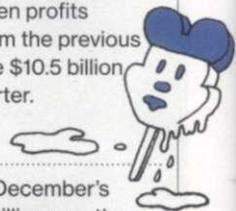
▶ **U.S. consumer credit:** Auto and student loans drove increased lending in October and November, even as credit-card debt continued to shrink. Surveyed economists expect lending to expand by \$2.4 billion in December.



Bank of Italy lending and bad-debt data

Canada's housing starts

▶ **Walt Disney earnings:** The media company fell short of expectations in the fourth quarter when profits dropped 6.7 percent from the previous year. Analysts anticipate \$10.5 billion in sales for the first quarter.



### Energy Security

## The Oil Market Keeps a Close Watch on Suez

- Security is increased on the still-vital transit route for tankers
- The parallel pipeline is even more important than the canal itself

Egyptian troops have reinforced the guards protecting the Suez Canal and the Suez-Mediterranean oil pipeline running alongside it, according to an official with knowledge of the buildup. Energy consultancy IHS CERA figures that more than 17 millions barrels of crude pass through the canal and the "SuMed" each day. The SuMed takes oil from large tankers that cannot navigate the canal when fully loaded and delivers it to empty tankers waiting off Egypt.

An act of sabotage or a decision by a new regime to close the canal and the pipeline to punish supporters of Egyptian President Hosni Mubarak could send oil prices sharply upward. From 1967 until 1975, Egypt kept the canal closed in response to Israel's seizure of Arab territory, forcing tankers to travel around the Cape of Good Hope. Today disruption of the SuMed would have a bigger impact on the oil and shipping markets than a shutdown of the canal itself, Eri Nikolai Stavseth, an analyst at Arctic Securities in Oslo said in a report on Jan. 31.

—AbdelLatifWahba

**The bottom line** Investors worry that the flow of oil through the Suez Canal will be disrupted by the Egyptian uprising. So far the canal has stayed open.



Japan's Consumer Confidence index

Earnings from Allstate, MetLife, and Whole Foods



▶ **China's trade balance:** December's export surplus of \$13.1 billion was the smallest since April.

▶ **Coca-Cola earnings:** Analysts expect fourth-quarter revenue of \$10.2 billion at the world's largest soft-drink maker.



New York Fall Fashion Week begins

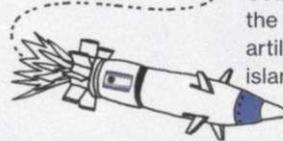
Earnings from Chipotle, Kraft, PepsiCo, and Philip Morris International



▶ **CPAC 2011:** Speakers at the annual conservative gathering include Mitt Romney, Ron Paul, and Michele Bachmann.



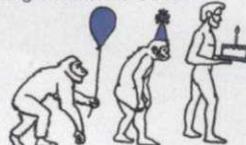
NBA: Los Angeles Lakers vs. New York Knicks



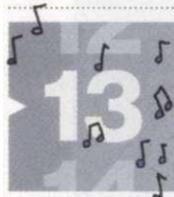
▶ **Korean military talks:** Representatives from the North and South are scheduled to meet for the first time since the North fired artillery shells onto a South Korean island in November.



Darwin Day: Universities and museums mark the English naturalist's birth



▶ **Manchester Derby:** English soccer's Manchester United and Manchester City, both contenders for the Premier League title, meet at Old Trafford stadium.



The Grammy Awards in Los Angeles



▶ **Japan's fourth-quarter GDP:** Surveyed economists anticipate that the world's third-biggest economy contracted slightly in the last three months of 2010.



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