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International Business – Central European Business Realities



Trade and Investment Relations

between Czech Republic and Russian Federation

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Declaration:

I hereby declare that I am the sole author of the thesis entitled “Trade and investment relations between Czech Republic and Russian Federation”. I duly marked out all quotations. The used literature and sources are stated in the attached list of references.

In Prague on

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Introduction

Globalization today is a reality in which we live, and for a long time it has been a source of incessant debate in academic circles in terms of its effects. This process does not only affect just markets and states, but it also has its impact on the global economy such as investment, capital flows, trade, profits and welfare in total, demanding effort from national economies to adapt to these global changes. This Master Thesis is an attempt to understand how two European countries, Russia and the Czech Republic, with, comparatively to other European countries, a short history of market economy and common long-lasting experience of the communist past, cooperate with each other in the spheres of foreign trade and investment relations; and try to evaluate the effects of such cooperation on the domestic policies of both countries.

This Master Thesis has a long and complex genesis. Since 2009 I have had a research interest in relationships between my native country Russia and the European Union, in particular some of its individual member states, and mainly trade and investment aspects of their cooperation. Being a student of the University of Economics in Prague was my primary reason to concentrate on the Czech Republic for analysis, especially taking into account the fact that this country, while it was a part of Czechoslovakia, has a lot in historical past with Russia during the communist rule up to 1991, while the latter was a part of USSR.

In undertaking this work my concern has been primarily with issues raising the following questions: What the reasons are for the present trade and investment volumes in relations between Russia and the Czech Republic and what countries' governments do in order to increase them; how to improve the business environment in the countries and make national economies attractive for foreign capital; how to make foreign policy of the country successful in relation to each other (for example, how to expand the integration of Russia into the European community), what kind of facilitation and implementation issues should be done for the future successful trade and investment cooperation, etc. Answers to these questions can be found during the examination in the following chapters, and the search of these answers is the main goal of this work. The approach is partly analytical and conceptual, partly narrative and historical; and the discussion draws on information and data taken not only from the printed and electronic sources, but also based on the experience and knowledge learned from my study in the University of Economics in Prague.

Addressing the questions raised in the beginning of the previous paragraph requires in itself analysis of both countries. Therefore in the first chapter I provide a brief exposition of each state separately: its economic situation with an examination of GDP since 2000 up to today and a forecast for years 2011-2012, but also their integration into the international community in order to

have an idea of the present level of development of two countries and their place in the world. As for the membership in international organizations, all of these can be divided by specific character of their activities: political, military-political, economic, scientific, cultural, etc; in this paper I examine only the participation in these international economic organizations which are related to the topic of this work.

The second chapter is devoted to trade relations between Russia and the Czech Republic. This chapter contains an attempt to understand the reasons for cooperation between two countries: The beginning of the chapter provides a brief study of the history of trade relations. Nevertheless, the main period of the review chosen are the last few years (as in Chapter 3), as it gives us more thoughts for making a forecast of the development of relations in the next years to come. Further in the second chapter there is information given about organizations and last events which could affect the development of Russian-Czech bilateral trade relations and how it can influence their future position. The chapter concludes with analysis of regulatory and controlling governmental bodies and other organizations participating in the maintaining and improvement of trade relations between Russia and Czech Republic, particularly what regulation is provided in this sphere, some concrete legislative acts are given as examples.

The third chapter is concentrated on the analysis of investment relations between Russia and the Czech Republic. The structure of the chapter is based on almost the same principle as the previous one and starts with the brief history of investment relations during the similar period, including information about participants (governmental and independent) involved in the process of attracting and control of foreign investments within the country. During this chapter I try to analyze the reasons for the recent high interest in the Russian Federation: whether it is because of natural resources, the growing Russian market, low costs or the possibility to access market with huge opportunities for technological investments. At the end of the chapter I try to formulate the main conclusions that follow from the information provided in there, and to offer recommendations which are aimed to understand how to retain and attract foreign capital within the Russian Federation and make the country to take full advantage of its investment potential.

The most important chapter is the second one: not only because I am more interested in the topic of trade relations, but also because the relevant literature is far more extensive and offers in-depth look at the dynamics and trade problems in the world. The information presented is based on the data collected from the UN, OECD, World Bank, WTO, Central Bank of the Russian Federation, Czech National Bank, and other statistical sources.

The final chapter is short and attempts to draw my arguments together, this suggests some implications for the formation and implementation of the future foreign policy in the sphere of trade

and investment for both countries. In this chapter I try to combine and compare the findings of the decisions and ideas made by various analysts, either governmental officials and independent experts, with my own thoughts, and to analyze the whole information given throughout this Master Thesis, which could be a reason why it might have led to diverse and contradictory ideas about the future development of countries' foreign policies with respect to each other.

1 Characteristics of Russia and the Czech Republic

1.1. Russia: an overview

1.1.1. Economy: GDP and its structure

If we look at the dynamics of all economic indicators of GDP concerning the Russian economy from Table 1 below, during the period since 2000, all of them experienced steady upward trend with an annual average economic growth rate of GDP about 7.3%. However, the trend remained positive until 2009, when the consequences of the world financial crisis became obvious.

Table 1. Economic indicators of Russia (RUS) and the Czech Republic (CZ) in 2000-2010

Indicators	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1) GDP, current prices, US dollars (in billion)											
RUS	260	307	345	431	592	764	989	1 294	1 660	1 229	1 508
CZ	57	62	75	91	110	125	143	174	216	195	199
2) GDP per capita, current prices, US dollars (in thousand)											
RUS	1.8	2.1	2.4	3	4.1	5.3	6.9	9.1	11.7	8.7	10.7
CZ	5.5	6.1	7.4	9	10.7	12.2	13.9	16.9	20.7	18.6	19.1
3) GDP based on PPP valuation of country GDP, current international dollar (in billion)											
RUS	1 123	1 207	1 285	1 408	1 549	1 698	1 888	2 098	2 264	2 110	2 209
CZ	154	161	167	177	191	207	229	250	261	253	259
4) GDP based on PPP per capita GDP, current international dollar (in thousand)											
RUS	7.8	8.3	8.8	9.7	10.7	11.8	13.2	14.8	15.9	14.9	15.7
CZ	15	15.8	16.4	17.3	18.7	20.3	22.3	24.2	25.1	24.1	24.8

Source: International Monetary Fund¹

Already from the forth quarter of 2008 there was a rapid slowdown due to:

- reduction in demand for basic Russian exports and a significant deterioration in the terms of trade. For example, in May 2009 in comparison with May of 2008: exports fell by 45% to 23.4 billion US dollars; imports fell by 44.6% to 13.6 billion dollars; the trade balance decreased by 1.8 times;
- deceleration of economic activity, such as a fall in industrial production in first 5 months of

¹ Report for selected countries and subjects, World Economic Outlook Database, International Monetary Fund, September 2011, accessible from http://www.imf.org/external/pubs/ft/weo/2010/01/weodata/weorept.aspx?pr.x=32&pr.y=11&sy=2000&ey=2010&scsm=1&ssd=1&sort=country&ds=.&br=1&c=922%2C935&s=NGDP_R%2CNGDP_RPCH%2CNGDP%2CNGDPD%2CNGDP_D%2CNGDPRPC%2CNGDPPC%2CNGDPDPC%2CPPPGBP%2CPPPPC%2CPPPSP%2CPPPPEX%2CPCPI%2CPCPIPCH%2CPCPIE%2CPCPIEPCH%2CLUR%2CLE%2CLP%2CGGXCNL%2CGGXCNL_NGDP%2CNGDP_FY%2CBCA%2CBCA_NGDPD&grp=0&a=

2009 was 15.4% compared with the same period in 2008;²

- reduction in investments inflows, for example, in January 2009 increase of investments made up -15.5% compared with the same period in 2008;
- slowdown in domestic demand at the end of 2008 and the recession in 2009. For example, the domestic demand decreased from 7.2% in the fourth quarter of 2007 to 1.9% in the fourth quarter of 2008, which was due to higher unemployment and lower incomes of the population, etc.³

Despite having suffered very badly from the crisis with GDP declining nearly 9% and a massive outflow of capital from the country in 2009, Russia experienced a growth in GDP of 4.5% in 2010.⁴ As it's seen from the Table 1 above, in 2010 all indicators almost returned their pre-crisis position. According to the declaration of the World Bank, the losses of the Russian economy occurred less than expected at the beginning of the crisis, partly due to a massive package of anti-crisis measures taken by the Government (enormous resources on bailing out the banking system and large state companies).⁵ Another reason for the relatively rapid recovery can be named: favorable oil prices together with the overall stabilization of the global economy.^{6 7}

Estimating the position of Russia in 2010 among all 184 countries, Russia ranks the 10th with 1.5 trillion US dollars according to the nominal GDP (1st indicator). But taking into account the huge population of the country, it stands only 53rd in accordance with the 2nd indicator – GDP per capita. Russia's GDP based on PPP (3rd indicator) in 2010 was 2.2 trillion US dollars, which puts the Russian economy higher in the list – the sixth country among all 183.

Analyzing the figures of the 1st and the 3rd indicators with the world's total, Russia's share in the world economy in 2010 constituted 2.4% and 3% respectively.⁸

To evaluate the effectiveness and prospects of any country's economy, it's important to consider not only the value of GDP, but also its structure. According to the data of Central

2 Экономика России в мае обвалилась на 11%, ООО “Лента.Ру”, издание Rambler Media Group, June 23, 2009, accessible from <http://lenta.ru/news/2009/06/23/gdp/>

3 Доклад об экономике России, No 18, The World Bank Russia Country Service, The world Bank Group, March, 2009, accessible from <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/RUSSIANFEDERATIONEXTN/0,,contentMDK:20888538~menuPK:2445695~pagePK:1497618~piPK:217854~theSitePK:305600,00.html>

4 Russia to have key role in building fairer global order, Fu Jing, China Daily, April 13, 2011, accessible from http://www.chinadaily.com.cn/cndy/2011-04/13/content_12314860.htm

5 Всемирный Банк поверил в Россию, Экономика, РосБизнесКонсалтинг, March 24, 2010, accessible from <http://top.rbc.ru/economics/24/03/2010/383833.shtml>

6 Экономика России растет на нефти, но ей не хватает хорошего делового климата, Андрей Остроух, Reuters, ИноСМИ.ru, March 31, 2011, accessible from <http://www.inosmi.ru/economic/20110331/167934389.html>

7 Экономическая ситуация в России, Россия в мировом сообществе, March 2, 2010, accessible from <http://www.mezhizn.ru/economics/198-economics.html>

8 World Economic and Financial Surveys, World Economic Outlook Database, International Monetary Fund, 2011, accessible from <http://www.imf.org/external/pubs/ft/weo/2010/01/weodata/index.aspx>

Intelligence Agency, composition of Russian GDP by sector in 2010 was as follows: agriculture (agriculture, hunting, forestry, fishing and fish farming) – 4%, industry (mining, manufacturing, production and distribution of electricity, gas and water, construction) – 36.8%, and services (wholesale and retail trade, transport and communications, finance, real estate, public administration and defense, health, education, culture, etc) – 59.1%.⁹

As it's seen from the information above, service sector dominates in the structure of the Russian economy. As regards the other two sectors related to the production of goods (agriculture and industry), after the collapse of the Soviet Union in 1991, the share of GVA (Gross Value Added) created in these two sectors significantly decreased in total amount of Russia's GDP: from 62% in 1991 to 35% in 2010.^{10 11}

According to statistics from the Federal State Statistics Service of the Russian Federation, among all industries in Russia three most powerful in 2010 were:

- crude oil and natural gas production, and services in these areas (7.4% of total GDP);
- construction (4.9%);
- production, transmission and distribution of electricity, gas, steam and hot water (3.3%).¹²

As Russian President Medvedev in February 2010 noted, "Fuel and energy complex accounts for almost one third of GDP and about 40% of all tax and customs revenues to the budget".¹³ Such a huge dependence of the Russian economy on Russian energy sector demands its structural changes, otherwise it has no future.¹⁴ As also the report of the World Bank reviewed, the influence of the global financial crisis on the Russian economy was worsened due to its structural vulnerability: dependence on oil and gas sector and narrow industrial base with the underdeveloped sector of small and medium enterprises.¹⁵ Real GDP growth in Russia only began in the early 21st

9 Russia, The World Factbook, Central Intelligence Agency, 2011, accessible from <https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html>

10 Годовые данные по разделам ОКВЭД произведенного ВВП в текущих ценах, Национальные счета, Федеральная служба государственной статистики, 2011, accessible from <http://www.gks.ru/wps/wcm/connect/rosstat/rosstatsite/main/account/#>

11 Валовой внутренний продукт, Раздел из книги "Российские реформы в цифрах и фактах", 2011, accessible from <http://kaivg.narod.ru/gdp.pdf>

12 Годовые данные в детализированной разработке произведенного ВВП в текущих ценах, Национальные счета, Федеральная служба государственной статистики, 2011, accessible from <http://www.gks.ru/wps/wcm/connect/rosstat/rosstatsite/main/account/#>

13 Стенографический отчет о совещании по вопросам развития энергетики, Дмитрий Медведев, Выступления и стенограммы, Администрация Президента РФ, February 12, 2010, accessible from <http://www.kremlin.ru/transcripts/6856#sel=4:1,4:20>

14 Медведев: кризис заставляет РФ менять структуру экономики, Экономика, РИА Новости, August 10, 2009, accessible from <http://ria.ru/economy/20090810/180373123.html>

15 Доклад об экономике России, No 18, The World Bank Russia Country Service, The world Bank Group, March, 2009, accessible from <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/RUSSIANFEDERATIONEXTN/0,,contentMDK:20888538~menuPK:2445695~pagePK:1497618~piPK:217854~theSitePK:305600,00.html>

century, and it was due, mainly, to rising prices for exported energy resources and metals.¹⁶ The dependence of the Russian economy on oil and gas led to that other industries ceased to grow with former pace, to make technological breakthroughs, and so on. But as the prices for oil and gas are subject to strong fluctuations, therefore it's very difficult to plan revenues from oil and gas trade and revenues of the state budget. So in 2008, Dmitry Medvedev said that innovation is critical for long-term economic growth of Russia, which is actually the basis of competitive industrial production in developed countries. The president cited statistics provided that – by that year – innovative products in the total industrial output constituted only 5.5%. He also stressed the need to develop not only innovative projects and innovative business sector, but also research and education.¹⁷

1.1.2. Central government debt and credit ratings

According to the Ministry of Finance of the Russian Federation, by October 1, 2011 the Russian external public debt totaled 36.01 billion US dollars; internal public debt – 3 542 billion RUB.^{18 19} In relative terms, according to IMF staff estimates, in 2011 Russian general government gross debt equals 11.7% of GDP. For comparison, in 2000 it amounted to 60% of GDP.²⁰ Below in Table 2 you can see credit ratings of Russia and the Czech Republic from world-wide recognized statistical rating organizations: Standard and Poor's and Moody's.

According to last Moody's credit opinion in June 16, 2011, assessment of Russia's foreign currency bank deposits is as follows: “Baa1 government bond ratings incorporate a moderate level of economic resilience: the benefits derived from the large scale of the economy are offset by the difficulties faced in diversifying the economy away from commodity exports (commodities make up over 80% of Russian exports). Diversifying the economy remains a challenging task as investment is concentrated in the oil and gas sector. The condition of the non-oil sector - encumbered by large unresolved debts and low collateral values - remains relatively weak, and this is holding back less volatile economic growth.”²¹

16 Валовой внутренний продукт, Раздел из книги “Российские реформы в цифрах и фактах”, 2011, accessible from <http://kaivg.narod.ru/gdp.pdf>

17 Медведев ставит на инновации, Роман Федосеев, Деловая Газета “Взгляд”, April 18, 2008, accessible from <http://vz.ru/economy/2008/4/18/161050.html>

18 Внешний долг, Государственный долг, Бюджетная система, Официальный сайт Министерства финансов Российской Федерации, October 2011, accessible from <http://info.minfin.ru/debt.php>

19 Внутренний долг, Государственный долг, Бюджетная система, Официальный сайт Министерства финансов Российской Федерации, October 2011, accessible from http://info.minfin.ru/debt_vnutr.php

20 Report for selected countries and subjects, World Economic Outlook Database, International Monetary Fund, September 2011, accessible from http://www.imf.org/external/pubs/ft/weo/2011/02/weodata/weorept.aspx?pr.x=72&pr.y=12&sy=2000&ey=2011&scsm=1&ssd=1&sort=country&ds=.&br=1&c=922%2C935&s=GGXWDG_NGDP&grp=0&a=

21 Credit opinion: Russia, Research, Moody's Investor Service, Inc., Moody's Analytics, Inc., June 16, 2011, accessible from http://www.moody.com/MdcAccessDeniedCh.aspx?lang=en&cy=global&Source=http%3a%2f%2fwww.moody.com%2fviewresearchdoc.aspx%3fdocid%3dCOP_600018920%26lang%3den%26cy%3dglobal

Table 2. Credit ratings of Russia and the Czech Republic from Standard and Poor's and Moody's

Credit agency	Russia	Czech Republic
• Standard and Poor's		
Local Currency Rating	BBB+	AA
Foreign Currency Rating	BBB	AA-
T&C Assessment	BBB	AA+
• Moody's		
Foreign currency bonds - long-term	A2	Aa1
Foreign currency bank deposits - long-term	Baa1	A1

Source: author's calculations according to the sources.^{22 23 24}

1.1.3. Economic forecast for 2011-2012

According to the World Bank, Russia recovered well after the financial crisis, but the World Bank sees some obstacles to its continued steady growth, reflected in a change of GDP in 2011 in its forecast in March, 2011, which dropped by 0.1% compared with the figure in the forecast in November, 2010 and amounted to 4.4%. It should be also noted that inflation level in 2011 in the World Bank's forecast is much higher than that in the Russian Government's forecast: 9-8% versus 6-7%. The World Bank warns that the main risk to the stability of the Russian economy is a rise in commodities' prices, which immediately will affect the purchasing power of the population – one of the main factors of economic growth for Russia in 2011, and the economy's dependence on revenues from oil and gas. That is why the World Bank urges the Russian government to concentrate on control of inflation and alignment of budget deficit in other economic sectors besides oil sector, which so far succeeds to reduce the deficit thanks to the strong oil prices.²⁵

It seems Russia manages to do so. In late February 2011 the Head of the Ministry of Finance Alexei Kudrin at a meeting with the Prime Minister defined nearly 2% of the budget deficit in 2011 – lower than the figure which was mentioned several weeks earlier. Moreover, expecting increase in oil prices, the Ministry of Finance decided to reduce borrowing and not to resort to the help of the Reserve Fund in 2011, which serves to ensure the state's spending obligations in case of declining

22 Sovereigns Ratings List, Ratings, Standard and Poor's Financial Services LLC, 2011, accessible from <http://www.standardandpoors.com/ratings/sovereigns/ratings-list/en/us?sectorName=null&subSectorCode=39>

23 Russia, Ratings, Moody's Investor Service, Inc., Moody's Analytics, Inc., 2011, accessible from <http://www.moody's.com/credit-ratings/Russia-credit-rating-600018920>

24 Czech Republic, Ratings, Moody's Investor Service, Inc., Moody's Analytics, Inc., 2011, accessible from <http://www.moody's.com/credit-ratings/Czech-Republic-credit-rating-600013456>

25 Экономика России растет на нефти, но ей не хватает хорошего делового климата, Андрей Остроух, Reuters, ИноСМИ.ру, March 31, 2011, accessible from <http://www.inosmi.ru/economic/20110331/167934389.html>

oil and gas revenues to the federal budget.²⁶ Later in April the Prime Minister Vladimir Putin stated that the federal budget deficit in 2011 will drop further up to 1-1.5% of GDP due to additional sources of income from the expected increase in oil price.²⁷ In general, the Prime Minister declared that contrary to previous predictions about the years 2013 and 2014, that “by early 2012 the Russian economy in corpore should compensate losses caused by the recession.”²⁸

Table 3 below shows the IMF's and Russian Government's forecasts concerning GDP and the inflation rate together with the above-mentioned World Bank's forecast. The World Bank and the IMF calculate the inflation rate as the average figure for the whole year, the Russian government – according to the rule "December to December".

Table 3. Forecast of GDP growth and inflation rate in Russia in 2011-2012

Indicator	Forecast figures from					
	World Bank		IMF		Russian Government	
	2011	2012	2011	2012	2011	2012
GDP growth compared to previous year (%)	4.4	-	4.8	4.5	4.2	3.5
Inflation rate (%)	6-7	-	9.3	8	-	-

Source: author's calculations according to the sources.^{29 30 31 32}

As for the Russian government's forecast of the GDP growth rate, according to the Deputy Minister of Economic Development of Russia Andrei Klepach, “the decreased GDP growth rate in 2012 is connected with the fact that by that time the effect of rehabilitation growth will be exhausted”.³³ As for the inflation rate, the IMF explained its 9.3% in 2011 with destroyed harvest after a severe drought in summer 2010, which Russia had to face, having led to the sky-rocketed prices on food since then. However, in 2012, anti-inflation measures of Russian government are

26 России предсказали экономический рост, Экономика, ООО “Ньюмедиа Старз”, Интернет-газета “Дни.Ру”, April 8, 2011, accessible from <http://www.dni.ru/economy/2011/4/8/210341.html>

27 Путин: Россия может ускорить экономический рост, Официальный сайт Партии “Единая Россия”, April 25, 2011, accessible from <http://er.ru/text.shtml?19/9557,110085>

28 ВВП России вырос в I квартале на 4.4% - Путин, Новости бизнеса и экономики, Новости, Thomson Reuters, April 20, 2011, accessible from <http://ru.reuters.com/article/businessNews/idRURXE73J0PU20110420>

29 Экономика России растет на нефти, но ей не хватает хорошего делового климата, Андрей Остроух, Reuters, ИноСМИ.ru, March 31, 2011, accessible from <http://www.inosmi.ru/economic/20110331/167934389.html>

30 России предсказали экономический рост, Экономика, ООО “Ньюмедиа Старз”, Интернет-газета “Дни.Ру”, April 8, 2011, accessible from <http://www.dni.ru/economy/2011/4/8/210341.html>

31 Путин: Россия может ускорить экономический рост, Официальный сайт Партии “Единая Россия”, April 25, 2011, accessible from <http://er.ru/text.shtml?19/9557,110085>

32 МВФ повысил прогноз роста российской экономики, Экономика, Новости, Государственный интернет-канал “Россия”, April 11, 2011, accessible from <http://www.vesti.ru/doc.html?id=444089&cid=6>

33 Экономический рост России поставлен под вопрос, Gzt.ru, Новости, Официальный сайт Рыжкова Владимира Александровича, April 21, 2011, accessible from http://www.ryzkov.ru/look_new.php?id=12515

expected to decrease the annual inflation rate to 8%.³⁴

Concerning the foreign sphere, in his annual message to the Federal Assembly in 2010 President Medvedev emphasizes the importance of Russia's integration into the world capital market, gradual raising of Russia's industrial exports, protection of Russian companies' interests abroad, diversification of export supplies of energy, capacity of Russia's industrial exports, etc.³⁵

Russia is a part of BRIC countries – countries with the most rapidly developing economies, among all BRIC countries Russia by far has the highest GDP per capita, 15 900 U.S. Dollars in 2010. Goldman Sachs Economic Research forecast in 2003 shows that Russia will be the only BRIC country to approach by 2050 income per capita level of the so-called “rich” club of next countries: USA, Korea, UK, Canada, France, Germany and Japan.³⁶

Goldman Sachs's Jim O'Neill predicts that Russia will lead the BRIC group in 2011 being the best-performing of its four members. The reasons for that he sees, for example, in soccer body FIFA's decision to award the 2018 Soccer World cup to Russia: the country starts building stadia, roads and hotels, which leads to increased investments into infrastructure stocks. But also forecasts of the economic growth in 2011 in the USA, India and China mean rise of the commodity and oil stocks (oil prices are expected 10% annual growth by the end of 2011) – either of which is economy's strengths of Russia.³⁷

However, many economists see some obstacles for such considerable economic changes in Russia, stressing that by 2050 Russia can self-destruct by overexploitation of its resources being heavily dependent on energy and raw materials. The country also suffers from high corruption level, poor business and investment climate, and it's better to concentrate on the development of innovation and sophisticated technologies and to ensure long-term acceptable level of budget deficit in other economic sectors besides oil sector, as well as to refrain from excessive spending due to the upcoming parliamentary in December, 2011, and presidential in March, 2012, elections.³⁸

1.1.4. Membership in international organizations

Russia is one of the key players in the international community. In international relations Russia is a legal successor of the USSR, including the membership of the USSR in the UN, where it

34 Regional Economic Outlook, Europe: Strengthening the Recovery, World Economic and Financial Surveys, International Monetary Fund, May, 2011, ISBN-13 978-1-61635-063-5

35 Экономическая ситуация в России, Россия в мировом сообществе, March 2, 2010, accessible from <http://www.mezhizn.ru/economics/198-economics.html>

36 Does Russia belong in the Brics?, Anders Aslund, Blogs, Comment, Economists' Forum, the Financial Times Ltd., January 20, 2010, accessible from <http://blogs.ft.com/economistsforum/2010/01/does-russia-belong-in-the-brics/>

37 Which BRIC? Russia scores late goal for 2010, Thomson Reuters, December 6, 2010, accessible from <http://blogs.reuters.com/globalinvesting/2010/12/06/which-bric-russia-scores-late-goal-for-2010/>

38 Экономика России растет на нефти, но ей не хватает хорошего делового климата, Андрей Остроух, Reuters, ИноСМИ.ru, March 31, 2011, accessible from <http://www.inosmi.ru/economic/20110331/167934389.html>

has been since October 24, 1945, and in all other bodies of the UN system. It is also of considerable importance for Russia to be a permanent member of the Security Council – the supreme executive body of the organization: since it helps peaceful settlement of conflicts, as well as to prevent them by means of political and diplomatic measures. As a permanent member Russia has a veto power to any decision taken by the United Nations.³⁹ The UN Secretary-General Ban Ki-moon during his official visit in Moscow in April 2011 stressed that “Russia has a special role to play in addressing regional and global challenges such as climate change, sustainable development, the food crisis, as well as the situations in the Middle East, Libya, Cote d'Ivoire and the Korean Peninsula.”⁴⁰

From June 1, 1992 Russia became a member of IMF – specialized agency of UN with the aims to facilitate global monetary and credit cooperation between its Member States and providing financial support by the use of credit arrangements. Every IMF member is determined with the amount of financial resources it's obliged to provide to the IMF, which also reflects a member's voting power in IMF decisions and the amount of financing a country can obtain from the IMF. The current formula of IMF quota says a weighted average of GDP (50% of the weight), openness (30%), economic variability (15%) and international reserves (5%). The current Russia's quota stands for 2.5% of the total quota share (5 945.4 millions of SDRs). Russia several times received financial assistance from the IMF during the period from 1992 up to 1998, when the country suffered a default. After the early repayment of debt to the IMF in 2005, Russia has no longer received any other loans.⁴¹ ⁴² As for the relations between Russia and World Bank, which is made of two institutions: the International Bank of Reconstruction and Development and the International Development Association, to date the World Bank at the request of the Government of Russia finances and assists with the implementation of 14 projects to the total amount of 1.51 billion US dollars with other 8 projects in a stage of development. The history of relations from 1992 includes more than 70 projects worth a total of 14.15 billion U.S. Dollars.⁴³

The Russian Federation is not only a part of the Group of Eight – group of the countries of eight major economies, but also of a large number of international and European organizations

39 Россия и международные организации, Россия в мировой политике и экономике, Clow.ru, 2011, accessible from <http://russia.clow.ru/text/645.html>

40 UN Secretary-General concludes his official visit in Moscow, News UN in Russia, UN in Russia, United Nations in the Russian Federation, Russia, April 21-23, 2011, accessible from <http://www.unrussia.ru/en/un-in-russia/news/2011-04-26>

41 Международный Валютный Фонд. МВФ и Россия, Рубрикатор статей компании “Эффективные бизнес решения”, Информационно-аналитический бюллетень компании “Эффективные бизнес решения”, Библиотека, Эффективные бизнес решения, 2011 accessible from <http://www.ebr.ru/library/74190/104568>

42 Russia and the IMF, Uegaki Akira, accessible from http://src-h.slav.hokudai.ac.jp/coe21/publish/no2_ses/1-3_Uegaki.pdf

43 World Bank's projects in Russia, Projects, Countries, The World Bank Group, 2011, accessible from <http://web.worldbank.org/external/default/main?menuPK=305631&pagePK=141155&piPK=141124&theSitePK=305600>

either as an equal member or an active participant. In the past such cooperation was often impossible due to political and military conflicts, but today Russia not only maintains direct links with other European countries, it also cooperates with them being present in the Organization for Security and Co-operation in Europe and the Council of Europe, maintaining relations with European Union (EU) and many others, including at the regional level: the Commonwealth of Independent States (Russia is the most powerful state among all members), the Council of the Baltic Sea States, the Organization of the Black Sea economic Cooperation, Eurasian Economic Community, Union State of Russia and Belarus, Customs Union of Russia, Belarus and Kazakhstan, etc.

Russia is not a member of the EU, but the latter is able to conclude bilateral agreements and devise specific trading policies with third countries and regional areas, which are outside the WTO, and such bilateral relations are not a breach of the WTO conditions. The EU and Russia concluded a Partnership and Cooperation Agreement (PCA) in 1994, which was entered into force on December 1, 1997. The agreement initially came into force for a period of 10 years, but is being renewed annually since 2007 until replaced by a new one, which is currently under negotiation. This PCA is the framework for the EU-Russia relationships and primarily concerned with promoting trade, investment and harmonious economic cooperation.⁴⁴ Thus, Russia has close and constantly developing relations with EU member countries, especially with Germany, Italy and France. In 2010 a half (50.2%) of Russia's imports came from EU countries, and almost half of Russia's exports (44.8%) went to EU countries; by the EU: the share of total EU imports from Russia constituted 10.5%, and the share of total EU exports to Russia – 6.4%, making the country the third biggest trade partner of the European Union.⁴⁵ There are also some organizations which Russia due to different reasons: political, economic, geographical, etc can't be a part of, such as NATO or OPEC, but anyway cooperated with them at different times.⁴⁶

The history of relations between Russia and the WTO has spanned 18 years, ever since Russia for the first time in 1993 filed an official application to join GATT, replaced by the WTO in 1995. However, at various times a number of reasons prevented its entry, such as disagreements with the European Union and other countries, worsening the situation in the Caucasus, the global financial crisis, etc.⁴⁷ The one of the foreign policy's tasks for Russia is to join the WTO along with

44 Russia, Countries and regions, Bilateral relations, Creating opportunities, European Commission Trade, October 7, 2011, accessible from <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/russia/>

45 Russia, EU bilateral trade and trade with the world, June 8, 2011, accessible from http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113440.pdf

46 Россия и международные организации, Россия в мировой политике и экономике, Clow.ru, 2011, accessible from <http://russia.clow.ru/text/645.html>

47 Россия вступает в ВТО: плюсы и минусы, Деловой Петербург, ЗАО “Бонниер Бизнес Пресс”, December 8, 2010, accessible from http://www.dp.ru/a/2010/12/08/Rossija_vstupayet_v_VTO_pl

Belarus and Kazakhstan as a single customs territory in order to keep the Customs Union of Russia, Belarus and Kazakhstan which joined into force in July 1, 2010.⁴⁸ Russian President Dmitry Medvedev said that the process of Russia's accession to the WTO, country which economy is considered the largest in the world among the countries outside the WTO, could be completed before the end of 2011.^{49 50}

1.2. The Czech Republic: an overview

1.2.1. Economy: GDP and its structure

Czech Republic has one of the most developed industrialized economies with its strong industrial tradition dates to the 19th century and one of the most stable and prosperous of the post-Communist states in Central and Eastern Europe.⁵¹ The Czech economy is primarily driven by foreign demand for its goods, as exports constitute about 70% of GDP, and strongly dependent on inflows of foreign direct investment.⁵²

Right before the country's accession to the EU, during 2000-2003 the Czech economy, unlike other countries in Central and Eastern Europe, showed steady positive economic growth with the average annual rate reached 2.7% (see the Table 1). Maybe it's not that much, however, good enough in comparison with stagnation or even recession in some countries; and if compared to the economies of the EU – the growth was even above average. Among Central and European countries, the Czech Republic by GDP per capita in purchasing power standards in EUR conceded only to Slovenia, accounting for 59% of the average level in EU countries, that was mainly due to the increased purchasing power (economic development grew with the simultaneous stagnation of a number of population), which grew in this period even faster than GDP.⁵³ [p. 51] With the country's entry into the EU in 2004, the Czech economy continued in solid growth. Comparatively to the years 2001-2003, in the period 2004-2006 the average growth rate accelerated to 5.7% due to the positive contribution in terms of strong investment demand and foreign trade, especially in the year 2005, which was the best result since 1994 by that time. And though due to slowdown in real wages domestic consumer demand weakened, in 2006 the GDP per capita in purchasing power standards

48 Экономическая ситуация в России, Россия в мировом сообществе, March 2, 2010, accessible from <http://www.mezhizn.ru/economics/198-economics.html>

49 Экономика России растет на нефти, но ей не хватает хорошего делового климата, Андрей Остроух, Reuters, ИноСМИ.ru, March 31, 2011, accessible from <http://www.inosmi.ru/economic/20110331/167934389.html>

50 Америке нужна Россия в ВТО, Даг Палмер, Reuters, ИноСМИ.ru, April 15, 2011, accessible from <http://www.inosmi.ru/usa/20110416/168475738.html>

51 Population growth (annual %) in Czech Republic, Trading Economics, 2011, accessible from <http://www.tradingeconomics.com/czech-republic/population-growth-annual-percent-wb-data.html>

52 Economy, Czech Republic: Europe, Travel Document Systems, Inc., 2011, accessible from <http://www.traveldocs.com/cz/economy.htm>

53 Eva Karpová: Vývoj ekonomik zemí střední a východní Evropy v letech 1991 až 2003; Praha: Vysoká škola ekonomická v Praze, Fakulta mezinárodních vztahů, 2004, ISBN 80-245-0804-4

came up to almost 80% of the EU's average level for its 27 members.⁵⁴

In 2008 the GDP growth rate fell to 2.5% from 6.1% in comparison to the previous year. Throughout 2009 the conservative Czech financial system managed to remain relatively healthy, however, the GDP growth rate sharply dropped to -4.1% in 2009, mainly because the Czech Republic's main export markets as well experienced economic recession and as a consequence – lack of demand for the country's goods.⁵⁵ But in 2010 the situation stabilized and, according to the statistical data from OECD, GDP in 2010 grew by 2.2%, mainly due to the external demand, in particular from the Czech Republic's largest trading partner – Germany. In general, the economic growth in Czech Republic can be described as modest in comparison to developing and emerging countries, which enjoyed a robust recovery. Macroeconomic forecasts of GDP and inflation rate for years 2011-2012 can be found in Table 4 below.

As for the structure of GDP, according to the data of Central Intelligence Agency, composition of Czech GDP by sector in 2010 was as follows: agriculture (agriculture, hunting, forestry, fishing and fish farming) – 2.4%, industry (mining, manufacturing, production and distribution of electricity, gas and water, construction) – 37.6%, and services (wholesale and retail trade, transport and communications, finance, real estate, public administration and defense, health, education, culture, etc.) – 60%.⁵⁶ Comparing the Czech GDP structure with the Russian one, we can conclude, that composition of GDPs by sector are very much alike.

The principal sectors of the country are transport and transport-related equipment and machinery production, iron and steel production and metalworking, oil-refining products and chemicals, but also electronics, textiles, glass, ceramics, pharmaceuticals, service sector, and famously – brewing.⁵⁷

1.2.2. Central government debt and credit ratings

According to the Ministry of Finance of the Czech Republic, the Czech total central government debt by June 30, 2011 totaled 1412.9 billion CZK: of which internal debt constitutes 1108.3 billion CZK, external – 304.6 billion CZK.⁵⁸ In relative terms, according to IMF staff

54 The Czech economy after its entry into European Union, Vojtěch Spěváček, Růžena Vintrová, Eva Zamrazilová, Mojmír Hájek and Václav Žďárek, *Politická Ekonomie*, issue 3, 2008, accessible from <http://www.vse.cz/polek/abstrakt.php3?IDcl=641>

55 Czech Republic Economy 2011, Countries of the world, January 12, 2011, accessible from http://www.theodora.com/wfbcurrent/czech_republic/czech_republic_economy.html

56 Czech Republic, The World Factbook, Central Intelligence Agency, 2011, accessible from <https://www.cia.gov/library/publications/the-world-factbook/geos/ez.html>

57 Economy, Czech Republic: Europe, Travel Document Systems, Inc., 2011, accessible from <http://www.traveldocs.com/cz/economy.htm>

58 Central Government Debt by Type of Instrument – 2. q, Central Government Debt, Government Financial Statistics, Financial Sector, Ministry of Finance of the Czech Republic, 2011, accessible from http://www.mfcr.cz/cps/rde/xchg/mfcr/xsl/central_govern_debt_64159.html

estimates, in 2011 Czech general government gross debt equals 41.1% of GDP. For comparison, in 2000 it amounted to 18.5% of GDP.⁵⁹ In the Table 2 above you can see credit ratings of the Czech Republic from world-wide recognized statistical rating organizations: Standard and Poor's and Moody's.

According to last Moody's credit opinion in August 4, 2011, assessment of Czech foreign currency bank deposits is as follows: "A high economic strength assessment reflects the country's steady income convergence to the EU average in recent years. Relatively low wages, high educational attainment, and close proximity to core Europe have made the country attractive to foreign investment. High institutional strength is based on the advanced economic and financial integration of the country with the EU, which has benefited and helped further develop institutional quality and strengthened the policymaking framework of public sector entities."⁶⁰

1.2.3. Economic forecast for 2011-2012

According to the forecast for the Czech economy drawn up by the CNB's Monetary and Statistics Department from May 12, 2011, the Czech economic growth "is gradually slowing. ... The inflation pressures from the domestic economy are not significant and commodity prices are currently the main source of inflation. GDP growth will decrease this year as a result of the consolidation of public budgets, fading investment in inventories and slowing external economic growth. Growth will pick up markedly next year, with contributions coming from all components of domestic demand."⁶¹ [p. 6]

The apparent differences in GDP growth rate in comparison with the World Bank's and IMF's forecasts (see the Table 4), the CNB explains that the analysts have probably already taken into account the increase in the VAT rate by 4% to 14% in 2012, which the CNB has so far not included in its baseline scenario forecast.⁶² [p. 19] As for the inflation rate forecast, the IMF in its 2011 forecast for global inflation stressed that the Czech Republic in 2011 will have the lowest annual inflation rate at 2.0% throughout Eastern Europe. However, there is a risk of inflation to increase, which may be caused by the weak domestic consumption and a faster-than-expected increase in food prices (as well housing and energy costs, and expensive oil), despite investment

59 Report for selected countries and subjects, World Economic Outlook Database, International Monetary Fund, September 2011, accessible from http://www.imf.org/external/pubs/ft/weo/2011/02/weodata/weorept.aspx?pr.x=72&pr.y=12&sy=2000&ey=2011&scsm=1&ssd=1&sort=country&ds=.&br=1&c=922%2C935&s=GGXWDG_NGDP&grp=0&a=

60 Credit opinion: Czech Republic, Research, Moody's Investor Service, Inc., Moody's Analytics, Inc., August 4, 2011, accessible from http://www.moody's.com/MdcAccessDeniedCh.aspx?lang=en&cy=global&Source=http%3a%2f%2fwww.moody's.com%2fviewresearchdoc.aspx%3fdocid%3dCOP_600013456%26lang%3den%26cy%3dglobal

61 Inflation report / II, Czech National Bank, 79 pp./2011, ISSN 1803-2419, ISSN 1804-2465

62 Inflation report / II, Czech National Bank, 79 pp./2011, ISSN 1803-2419, ISSN 1804-2465

and export demand to go up.⁶³

Table 4. Forecast of GDP growth and inflation rate in the Czech Republic in 2011-2012

Indicator	Forecast figure from					
	World Bank		IMF		Czech National Bank	
	2011	2012	2011	2012	2011	2012
GDP growth compared to previous year (%)	2.2	2.7	1.7	2.9	1.5	2.8
Inflation rate (%)			2.0	2.0		2.0

Source: author's calculations according to the sources.^{64 65 66}

It's also worth mentioning the forecast of the OECD, as it presents the better performance of the Czech macroeconomic indicators than those given in the Table 4. The GDP growth rate in 2011 and 2012 constitutes 2.4% and 3.5% respectively. The main driven factors will be strong foreign demand with following increased consumption. In order to achieve such results, the OECD suggest the Czech government to concentrate on fiscal tightening.⁶⁷

1.2.4. Membership in international organizations

From 1948 until 1989, the Czech and Slovak Federal Republic (CSFR) followed the foreign policy directed by the Soviet Union; since its independence, the country has become a member of many international institutions. On March 12, 1999 the Czech Republic became a member of the North Atlantic Treaty Organization (NATO), thus according to the Article 5 of the North Atlantic Treaty having obtained collective defense guaranties and at the same time undertaking its participation in the defense of all its Allies.⁶⁸

Even before the division, since 1945 Czechoslovakia was one of the 51 original member states of the United Nations. On January 1, 1993, when the Czech Republic and the Republic of Slovakia were peacefully founded, both countries applied for admission to the UN as the

63 Regional Economic Outlook, Europe: Strengthening the Recovery, World Economic and Financial Surveys, International Monetary Fund, May, 2011, ISBN-13 978-1-61635-063-5

64 World Bank forecasts strong Polish GDP growth this year, even stronger in 2012, Remi Adekoya, Warsaw Business Journal, Valkea Media S.A., 2011, accessible from <http://www.wbj.pl/article-54230-world-bank-forecasts-strong-polish-gdp-growth-this-year-even-stronger-in-2012.html>

65 Inflation report / II, Czech National Bank, 79 pp./2011, ISSN 1803-2419, ISSN 1804-2465

66 Regional Economic Outlook, Europe: Strengthening the Recovery, World Economic and Financial Surveys, International Monetary Fund, May, 2011, ISBN-13 978-1-61635-063-5

67 Czech Republic – Economic forecast summary, Countries, OECD, May 2011, accessible from http://www.oecd.org/document/63/0,3746,en_33873108_33873293_45269183_1_1_1_1,00.html

68 Background note: Czech Republic, U.S. Department of State, August 19, 2011, accessible from <http://www.state.gov/r/pa/ei/bgn/3237.htm>

independent successors and were admitted to the organization on January 19, 1993.⁶⁹ Since then, the Czech Republic has been actively participating in the work of the UN, including particularly its seat of a non-permanent member of the UN Security Council during 1994-1995 term, its Presidency of the 57th session of the UN General Assembly in 2002-2003 and its activities in the Economic and Social Council.⁷⁰ For example, on May 20, 2011 the Czech Republic became one of 15 States responsible for strengthening the promotion and protection of human rights around the globe within the United Nations Human Rights Council being elected for the 2011-2014 term. Also the country served on the council previously during 2006-2007. Such a mission of UN policies' development in the field of protection and promotion of human rights is of considerable importance to the Czech Republic, as it not only relates to its historical experience, but constitutes one of the fundamental principles of the country's either domestic and foreign policies.^{71 72}

Since January 1, 1993 the Czech Republic has been a member of the IMF, succeeded its membership after the split of CSFR, which became in good time the 152nd member of the organization on September 20, 1990. The current quota for Czech Republic stands for 0.42% of the total quota share (1 002.2 millions of SDRs). The country graduated from IMF borrower status in 1994. Nowadays one of the major areas of mutual co-operation between the IMF and the Czech Republic are the Article IV consultations, which is aimed to assess the state of the Czech economy and to give recommendations for its further development.⁷³ It is obvious that the country became also a member of the World Bank simultaneously with its membership in the IMF. Since then the primary role of the World Bank has been to support the Czech Republic in its transformation to market economy after the 40 years of a command economy, and at the beginning accession with following successful integration into the EU. From April, 2005 the country paid off all its debts to the World Bank and these days despite some limited technical support from the World Bank, the Czech Republic enhances its role as a partner of the organization in development.⁷⁴

As part of the former Czechoslovakia, the Czech Republic was one of the 23 founder members of the GATT, predecessor of the WTO. After the split the Czech and Slovak Republics

69 Member States of the United Nations, Member States, United Nations, accessible from <http://www.un.org/en/members/index.shtml>

70 Czech Republic and the UN, Permanent mission of the Czech Republic to the UN in New York, accessible from http://www.mzv.cz/un.newyork/en/czech_republic_and_the_un/index.html

71 Czech Republic elected to UN Human Rights Council, Daniela Lazarová, Český rozhlas, May 23, 2011, accessible from <http://www.radio.cz/en/section/coraffrs/czech-republic-elected-to-un-human-rights-council>

72 Czech Republic, Human Rights Council, General Assembly, United Nations, April 7-18, 2008, accessible from http://www.upr-info.org/IMG/pdf/A_HRC_WG6_1_CZE_1_E.pdf

73 Czech Republic and the WTO, Czech Republic, Members, World Trade Organisation, 2011, accessible from http://www.wto.org/english/thewto_e/countries_e/czech_republic_e.htm

74 Basic information on WTO and DDA, World Trade Organization – WTO, International Economic Organizations, Foreign Trade, Ministry of Industry and Trade of the Czech Republic, accessible from <http://www.mpo.cz/dokument12222.html>

joined GATT, and later on as all other EU member states and the European Communities in its own right, the Czech Republic has been a member of the World Trade Organization since January 1, 1995. The position of the Czech Republic in the WTO has changed after its accession to the EU: it continues to be a member, but ceased to act on its own due to the principles of the EU common trade policy, thus the EU is represented in the WTO by the representatives of the European Commission, which speaks for the EU and its members in almost all WTO affairs. During the whole history of the Czech Republic's membership in the WTO, it was three times (before its accession to the EU) included in dispute settlement cases: once as a complainant against Hungary and in two cases – as a respondent against Hungary and Poland severally. However, all these cases ended in the phase of negotiations and the panel was not established.^{75 76 77}

In order to obtain membership in the EU, which was a key goal of the Czech government, the Czech Republic in the 1990s underwent structural and economic reform and expansion of its administrative capacity to make its economy more competitive, including reform of the labour market and privatization of state industries. The Czech Republic's integration into the EU was officially launched on February 1, 1995, and on May 1, 2004 the country became a European Union member. During the first half of 2009 under difficult conditions due to the economic crisis the country experienced its first-ever EU Presidency, however the Czech Republic achieved some meaningful results brokering more than 80 concrete measures in the European Parliament, addressing the issues of energy policy, climate protection, conflict in the Hamas-controlled Gaza Strip, pressing Russia and Ukraine to resolve a dispute over natural gas that started at the very end of 2008, etc. On December 21, 2007, the country became a part of the Schengen Convention allowing visa-free movement across national borders, however the Czech Republic has not yet decided to become a member of European Monetary Union.^{78 79 80 81}

The Czech Republic is also a member of other important organizations that focus on

75 Background note: Czech Republic, U.S. Department of State, August 19, 2011, accessible from <http://www.state.gov/r/pa/ei/bgn/3237.htm>

76 Czech Republic and the WTO, Czech Republic, Members, World Trade Organisation, 2011, accessible from http://www.wto.org/english/thewto_e/countries_e/czech_republic_e.htm

77 Basic information on WTO and DDA, World Trade Organization – WTO, International Economic Organizations, Foreign Trade, Ministry of Industry and Trade of the Czech Republic, accessible from <http://www.mpo.cz/dokument12222.html>

78 Background note: Czech Republic, U.S. Department of State, August 19, 2011, accessible from <http://www.state.gov/r/pa/ei/bgn/3237.htm>

79 Czech Republic and Slovakia, EU Facts, October 18, 2011, accessible from <http://www.civitas.org.uk/eufacts/FSMS/MS11.htm>

80 The Czech Republic integration into the EU – monetary and economic policy, International relations, technical assistance, Czech National Bank, 2011, accessible from http://www.cnb.cz/en/international_relations/cr_eu_integration/

81 Czech Republic at the helm, EU explained, News, European Commission, January 5, 2009, accessible from http://ec.europa.eu/news/eu_explained/090105_1_en.htm

political, humanitarian and economic development either on international and regional level. For example, on December 21, 1995 , the Czech Republic officially joined the Organization for Economic Cooperation and Development, however started to actively cooperate several years prior to the entry, which especially was helpful during the transition time to market economy in the beginning of 1990s, when the Czech Republic was provided with important databases, analyses and consultations. The Czech Republic is also a member of the Organization on Security and Cooperation in Europe, the European Bank for Reconstruction and Development, the Central European Free Trade Association and so on.⁸²

82 Membership in international organizations, Information about the Czech Republic, Embassy of the Czech Republic in Manila, Czech Foreign Ministry, accessible from http://www.mzv.cz/manila/en/information_about_the_czech_republic/membership_in_international_1/index.html

2 Trade relations between Russia and the Czech Republic

2.1. General information about trade relations up to 2004

Russia and the Czech Republic have a long history of bilateral relations. Foreign trade in Czechoslovakia has always been influenced by the political situation in the country. After 1948 soviet influence in the Czechoslovak foreign affairs was institutionalized through the economic alliance of the Comecon. The private sector stopped existing, and the entire national economy was nationalized. The whole economy was directed towards the interests of the Soviet Union. After having come to power in 1969, the alliance with the USSR was again highly emphasized by the Communist Leader Gustav Husak, thus in the late 1980s the Soviet Union took the central place for Czechoslovakia in its relationships among all the communist countries. Trade can be called with some certainty the most pressing issue affecting relations between Czechoslovakia and the Soviet Union, as it constituted almost 50% of the total trade volume. Any raise in the energy cost sharply affected Czechoslovakia's trade balance due to the heavy dependence on the Soviet energy exports.⁸³

It's worth mentioning as well that Czechoslovakia also came to depend on the Soviet Union for imports of raw materials. The adjustment in pricing system in 1975 led to the raise of prices on fuels and raw materials (primarily Czechoslovak imports) much more than the cost of imported manufactured goods (primarily machinery and various kinds of equipment). As the country needed to sell much greater quantities of exports to buy the same volume of imported materials – it caused trade imbalance in almost every area: for example, with the USSR it constituted about 1.2 billion US dollars between 1975 and 1979. Due to the Western European credit sources Czechoslovakia managed to achieve even a trade surplus with noncommunist countries by the beginning in 1980 and the lowest net hard-currency debts per capita in Eastern Europe in 1984 (after only Bulgaria), nevertheless with the Soviet Union it continued to run a substantial deficit, and almost 78% of total Czechoslovak foreign trade turnover was heavily concentrated with Comecon members.⁸⁴

Economic problems on the domestic market in the Czechoslovakia, such as low investment, declining productivity, and corruption, made it difficult to produce high-quality exports for the USSR, according to estimates, only 3-5% of which were of top quality. Thus Czechoslovakia followed even further integration of the Comecon network and particularly its connection with Soviet economy.

83 Czechoslovakia: Relations with Communist Nations, Nations Encyclopedia, Country Studies Series by Federal Research Division of the Library of Congress, August, 1987, accessible from <http://www.country-data.com/cgi-bin/query/r-3737.html>

84 Czechoslovakia: Foreign Trade, Nations Encyclopedia, Country Studies Series by Federal Research Division of the Library of Congress, August, 1987, accessible from <http://www.country-data.com/cgi-bin/query/r-3711.html>

As most socialist countries during the mid-1980s, including trade, economic and technological cooperation, the relations of both states remained active: for example, for Czechoslovakia its relations were especially close with Ethiopia, the People's Democratic Republic of Yemen, and the Mongolian People's Republic; of Soviet-aligned but noncommunist countries – with Syria and Libya.⁸⁵

Since the Velvet Revolution in November 1989 the Czech Republic experienced great political and economic changes: transformation to a market economy, launch of privatization process, etc. The main priorities of the Czech foreign policy during those years were accession to the NATO and the European Union, and development of relations particularly with Western countries. The country's goal was to switch over its imports and exports from the Comecon countries to the countries with a developed market economy, mainly EU countries – just before its entrance to the EU, the largest amount of Czech export, over 70%, came to the EU member states.

As you can see from Table 5 below, up to 2005 the Czech Republic had been experiencing trade deficit. Only in 2005, for the first time since 1993, the country managed to reach a positive foreign trade balance. According to the industry and trade minister, Milan Urban, “in terms of euros per capita, the Czech Republic's foreign trade results exceeded those of countries like Spain and Greece, and were on the same level as the United Kingdom.” However, a new stage in relations between Russia and the Czech Republic started in 2003, when the new president of the Czech Republic was elected. In his statements Vaclav Klaus expressed intention to establish friendly relations among two states.^{86 87 88 89} [pp. 62-63]

Table 5. Trade balance between the Czech Republic and the world during 1993-2007 (in billion USD)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Trade balance	-0.15	-1.37	-3.75	-5.64	-4.74	-2.49	-1.86	-3.13	-3.07	-2.18	-2.44	-1.01	1.67	1.7	4.24

Source: author's calculations according to the source⁹⁰

85 Czechoslovakia: Relations with Communist Nations, Nations Encyclopedia, Country Studies Series by Federal Research Division of the Library of Congress, August, 1987, accessible from <http://www.country-data.com/cgi-bin/query/r-3737.html>

86 Czech Republic records lowest foreign trade deficit for over 10 years, Český rozhlas, data as of February 4, 2005, accessible from <http://www.radio.cz/en/section/news/news-2005-02-04#1>

87 Политические отношения между Чехией и Россией, prag-travel.ru, accessible from <http://www.prag-travel.ru/czechia/politikachii/>

88 History of foreign trade, Aleš Martinek, the Official website of the Czech Republic, data as of January 25, 2010, accessible from <http://www.czech.cz/en/87958-history-of-foreign-trade>

89 Eva Karpová: Vývoj ekonomik zemí střední a východní Evropy v letech 1991 až 2003; Praha: Vysoká škola ekonomická v Praze, Fakulta mezinárodních vztahů, 2004, ISBN 80-245-0804-4

90 Trade exchange between the Czech Republic and the world, Ministry of Industry and Trade of the Czech Republic,

2.2. Descriptive and analytic analysis of bilateral trade relations between Russia and the Czech Republic

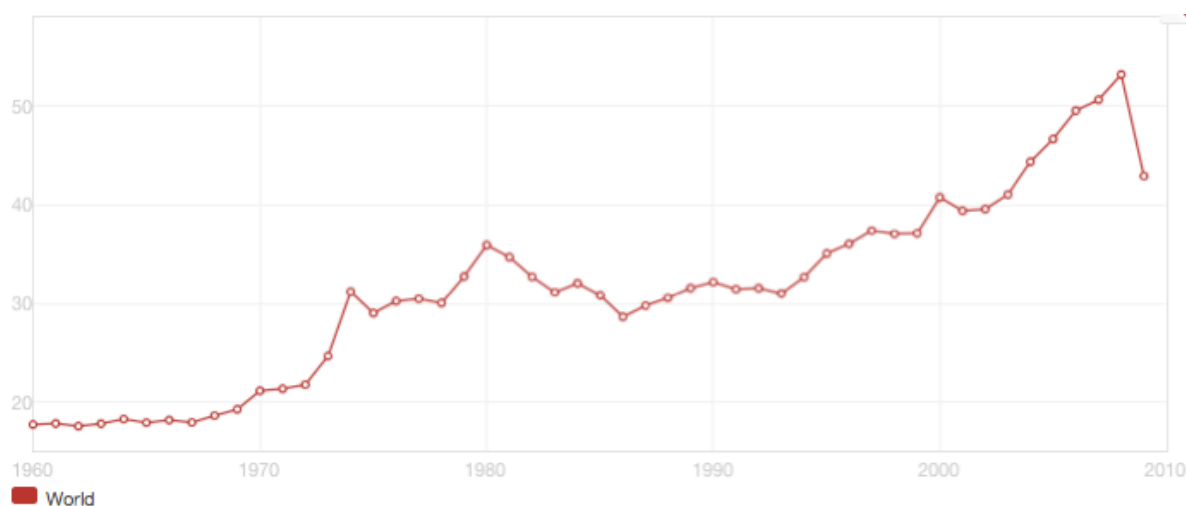
As it can be seen from Table 6 and Chart 1 below, on the basis of examined indicators through the years 1948-2009, external trade forms an increasing part of the world economy, which is done through the influence of globalization, as well as rapidly growing exchanges with developing economies. For the Czech Republic – it is mainly with the Russian Federation.

Table 6. World trade in 1948, 1953, 1963, 1973, 1983, 1993, 2003 and 2009 (in billion USD)

	1948	1953	1963	1973	1983	1993	2003	2009
Exports	59	84	157	579	1838	3676	7376	12178
Imports	62	85	164	594	1882	3786	7689	12421

Source: The World Trade Organization⁹¹ [pp. 11-12]

Chart 1. World trade in goods during 1960-2009 (% of GDP)



Source: The World Bank⁹²

For each of the key trade partners with the EU, and Russia is one of the largest, the values of both exports and imports of goods increased considerably through the period 1998-2008. Followed global economic and financial crises in 2008 affected the world economy, which can be easily demonstrated by the sharply decreased trade volumes all over the world. The world recession also brought bilateral trade between Russia and the Czech Republic into decline, when both exports and

data as of May 2, 2007, accessible from <http://www.mpo.cz/dokument30217.html>

91 International Trade Statistics 2010; World Trade Organization 2010, ISBN 978-92-870-3739-8

92 Indicators, The World Bank Group, 2011, accessible from <http://data.worldbank.org/indicator>

imports dramatically decreased (see Table 8 below). Although up to 2008 the two countries gradually expand their trade volumes, as it can be seen from Table 7 below.

For the examination of any country's trade policy one should pay attention to the following characteristics: turnover (total amount of exports and imports), trade balance, commodity structure, terms of trade and shares of exports and imports in the total amount of country's GDP – the last one is used for measurement of the level of country's involvement in foreign trade. For example, the structure of foreign trade of the country can determine its specialization, and the trade balance will show whether the country is the world "Supplier" (when there is excess of exports over imports) such as Russia, or the "Buyer" (when there is excess of imports over exports) such as the United States, and the purchase or sale of what kind of products the country's economy depends on. On the basis of two following Chart 2 and Chart 3 below, which show shares of exports and imports of goods and services in total amount of GDP of each country, we can examine the level of involvement of Russia and the Czech Republic in foreign trade. In general, we can conclude, that the economy of the Czech Republic is more dependent on external trade, as shares of exports and imports in GDP were gradually increasing during the last 20 years and constituted more than 60% in 2010. As for the same data for the Russian Federation, here we can see comparatively minor shares, which were slightly, little by little decreasing through the last decade.

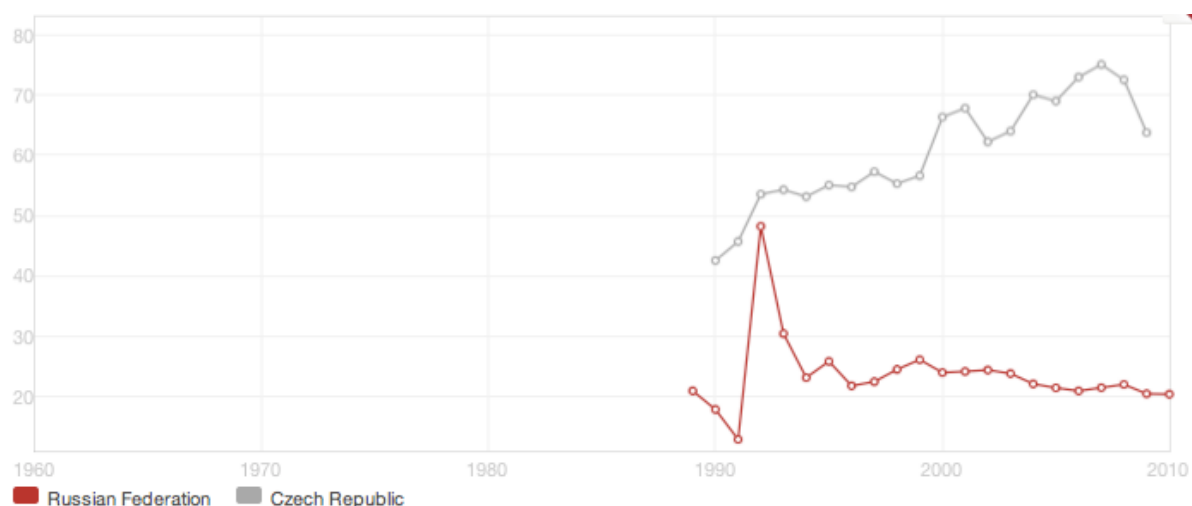
Chart 2. Exports of goods and services (% of GDP)



Source: The World Bank⁹³

93 Indicators, The World Bank Group, 2011, accessible from <http://data.worldbank.org/indicator>

Chart 3. Imports of goods and services (% of GDP)



Source: The World Bank⁹⁴

However, any figures should be considered in the dynamics, as it can help to identify the trend and its changes, and fluctuations can help to explain what world-wide events or changes in the national economy could influence that trend. Therefore, further in this part we will discuss development of trade relations between Russia and the Czech Republic for the period from 2004 to date, with the greatest emphasis on the period of 2010-2011.

Russia was the 4th largest trade partner in exports and the 3rd largest partner in imports of the EU in 2009. Even though the share of the Czech Republic in the total trade volume between the EU and other non-EU member states constituted in 2009 only 1.1% (12.4 billion EUR) in exports, and 1.4% (16.6 billion EUR) in imports, the trade volumes in relations between this country and Russia remain significant. According to 2009 statistics, Russia is the 9th most important economic partner of the Czech Republic in exports (2.3%), and 7th – in imports (5%).⁹⁵ Main products for Czech exports are machines and means of transport (this category is the largest one of exports of goods from the EU-27 to non-member countries in general); Russian imports to the Czech Republic consist mainly of energetic commodities, raw materials and mineral oil – 83%.⁹⁶ In two following Tables 7 and 8 below we can see the trade volumes in exports and imports for the country in its relations with the Russian Federation through the period from 2001 to January-May, 2011.

⁹⁴ Indicators, The World Bank Group, 2011, accessible from <http://data.worldbank.org/indicator>

⁹⁵ Eurostat: External trade by Member State, In: External and intra-European Union trade – Data 2004-09, 104 pp./ 2011, ISSN 1606-3481

⁹⁶ Eurostat: Trade, In: Europe in figures – Eurostat yearbook 2010, 657 pp./ 2010, ISSN 1681-4789

Table 7. Czech Republic: Trade with Russia during the period 2002-2008 (in billion EUR)

	2002	2003	2004	2005	2006	2007	2008
Exports							
Total	40.7	43.1	55.5	62.8	75.6	89.4	99.8
Russia	0.5	0.5	0.8	1.1	1.5	2.1	2.9
Russia (% of total)	1.2	1.2	1.4	1.8	2.0	2.3	2.9
Imports							
Total	43.0	45.7	56.3	61.5	74.2	86.2	96.6
Russia	1.9	2.2	2.2	3.4	4.2	3.9	6.0
Russia (% of total)	4.4	4.8	3.9	5.5	5.7	4.5	6.2
Balance							
Total	-2.3	-2.7	-0.8	1.3	1.4	3.2	3.2
Russia	-1.4	-1.6	-1.4	-2.3	-2.7	-1.8	-3.1

Source: Eurostat⁹⁷

As we can see from the Table 7, the trade balance of the Czech Republic differed strongly in the period up to 2004 in comparison with the following period. In the years 2001-2003 the average annual growth rate of GDP reached only 2,7%, during 2004-2006 the growth accelerated to 5,7%. The economic growth measured by the indicators of real GDP was even faster, and it was not least caused by positive contribution of the terms of foreign trade. Among others the main contributing factors were labour, total factor productivity, and growing domestic demand. As it's seen from the figures of trade balance in the Table 7, the contribution of foreign trade becomes apparent and makes substantial gap after 2003, and then becomes positive in 2005. In 2006 the Czech Republic managed to reach almost 80% of the average level in EU-27 in terms of the GDP per capita in purchasing power standards.⁹⁸

Amount of the Czech exports to Russia during the period from 2002 to 2008 has increased steadily either in absolute terms – by 2.4 billion EUR, having grown from 0.5 billion EUR in 2002 to 2.9 billion EUR in 2008, which is almost 6 times in 6 years; and more than doubled in relative terms of total amount. As for the Russian exports to the Czech Republic during the same period: the figure increased by 4.1 billion EUR in absolute terms, which means that the trade balance between countries changed in favor of Russia by 1.7 billion EUR, which indicates that from 2002 and before

97 Eurostat: External trade by member state, In: External and intra-European Union trade – Data 2002–07, 104 pp./ 2009, ISSN 1606-3481

98 The Czech economy after its entry into European Union, Vojtěch Spěváček, Růžena Vintrová, Eva Zamrazilová, Mojmír Hájek and Václav Žďárek, Politická Ekonomie, issue 3, 2008, accessible from <http://www.vse.cz/polek/abstrakt.php3?IDcl=641>

the world economic crisis started both amounts of Czech exports and imports were steadily increasing (with an exception of small declining in imports in 2007) with a little preponderance of the latter.

Table 8. Czech Republic: Trade with Russia during the period from 2008 till May 2011 (in billion EUR)

	2008	2009	2010	January-August 2011
Exports				
Total	99.2	81	100.3	76.5
Russia	2.7	1.9	2.7	2.2
Russia (% of total)	2.7	2.3	2.7	2.9
Imports				
Total	96.5	75.3	95.5	71.9
Russia	6.2	3.9	5.1	4.1
Russia (% of total)	6.4	5.2	5.3	5.7
Balance				
Total	2.7	5.7	4.8	4.6
Russia	-3.5	-2	-2.4	-1.9

Source: Czech Statistical Office⁹⁹

Amounts of export and import in the Czech Republic in the second quarter 2009 in comparison with the same period of previous year fell by about 19% each. Prior to the beginning of 2008 external trade grew at a faster pace than GDP, however afterwards the reduction levels in trade volumes were more significant than the fall of GDP figure. Industrial output in the Czech Republic, which is a main driver for country's exports in its relations with Russian Federation, dropped sharply from the beginning of 2008 by 18%, and this decline was also much sharper than that recorded for GDP.¹⁰⁰

However, later in 2009 both countries have seen a continuous recovery in foreign trade with an upward dynamic. In 2010, it is obvious from the statistics published by the Ministry of Industry and Trade of the Czech Republic that Czech exports grew by 17.7%, while Czech imports – by 20.3% (both figures slightly differ from the data given in the Table 8, where they are converted to EUR). Due to the growing global economy and as a consequence – the increasing demand from

⁹⁹ External trade database, External trade in goods according to the movement, External trade in goods, Economy, Czech Statistical Office, 2011, accessible from <http://apl.czso.cz/pll/stazo/STAZO.STAZO?jazyk=EN>

¹⁰⁰ Eurostat: Trade, In: Europe in figures – Eurostat yearbook 2010, 657 pp./ 2010, ISSN 1681-4789

abroad on products of processing industries, the Czech economy managed to improve results of the external foreign trade that year. There was a positive figure from the Russian economy on turnover. As we can see from the Table 8 above, in accordance with the data from the Czech Statistical Office, in 2010 2.7% of the total Czech exports were directed to the Russian market. Compared to 2009, exports to Russia increased by 42%, which represents a contribution of 2.7% of the total export amount. By far the volume of bilateral trade in 2008 between Russia and the Czech Republic was at its historical maximum – 8.9 billion EU; however, in 2011 there's a good chance to break this record, mostly due to growing exports of the Czech Republic. As regards the goods structure within the foreign trade of the Czech Republic, general export of goods in 2010 experienced an increase in the leading group of machines and means of transport from 53.6% to 54.2%, and general import of goods – an increase in raw materials and mineral fuel from 11.5% to 12.3% - the main export commodities from Russia to the Czech Republic.¹⁰¹

As it was mentioned before main products for Czech imports from Russia are mainly energetic commodities, raw materials and mineral oil, which, as it can be seen from Table 9 below, in 2009 constituted 87% of the total amount of imports from Russia.¹⁰² In general the country imports about 90% of total consumption of mentioned group of commodities, where more than two thirds come from Russia, and the rest – from Norway. Along with most other European countries the Czech Republic is very much dependent on deliveries of Siberian oil and above all gas. Prior to every New Year the European Union, which imports about a quarter of its gas from Russia, stands still waiting “gas wars” from Russia and Ukraine and their disputes over the next year's gas contract, as 80% of that amount travels through pipelines across Ukraine. As it was on the first day of 2009, when Gazprom, Russia's state-run gas monopoly, cut gas transmission to its Ukrainian customers arguing that Naftogaz, Ukraine's state-run gas company, had failed to pay an over 2 billion debt for gas deliveries in 2008 in full, which completely stalled further negotiations on price for 2009. By January 5 the Czech Republic had already registered dips in supply.¹⁰³ On January 7, Russia completely cut any gas transmission to Europe – from this time on Norwegian gas together with large storage capacities helped the Czech Republic to cope with cut of gas import; two weeks later, on January 20, Gazprom resumed gas supply to Ukraine and transit to Europe.

Today Europe is not only vulnerable to gas crises once a year, but every month, when Ukraine should pay for gas in accordance with its contract with Russia. This problem makes many

101Foreign trade 2010, Ivana Jenerálová, the Official website of the Czech Republic, data as of June 12, 2011, accessible from <http://www.czech.cz/en/104192-foreign-trade-2010>

102Russian Federation, Facts on foreign trade of the Czech Republic 2009, Ministerstvo průmyslu a obchodu, November, 2010, accessible from <http://www.mpo.cz/en/foreign-trade/statistics/>

103Behind the Russia-Ukraine Gas Conflict, Miriam Elder, BLOOMBERG L.P., January 3, 2009, accessible from http://www.businessweek.com/globalbiz/content/jan2009/gb2009013_045451.htm

policymakers seek diversification in terms of energy sources and transport routes, as being the world's largest importer of oil and gas Europe is planning to increase from 82% to 93% for its oil imports, and from 57% to 84% for its gas imports over the next 20 years. For example, Gazprom hopes to solve it by shipping gas directly to Europe, having plans to build pipelines through the Balkans, which were temporarily postponed due to the world crisis. Because such great projects need lots of investments, it eventually will require the EU not only as a customer but as an investor.

Europe should also think about improving its relations with energy-rich countries in Central Asia and North Africa in order to get rid from the over-reliance on a single oligopolistic energy supplier – Russia. One of such solution is pipeline project called Nabucco, which would link gas suppliers from the Caspian basin to Austria, however, in this case there is another threat hidden – changes of Russia to Turkmenistan or Iran, and of Ukraine to Turkey could not fundamentally affect the situation.

As Russia's economic growth in later years has largely been driven by its energy exports, and total export share has grown not only due to skyrocketing world-market prices, but also steadily growing export volumes, that will not be so easy to bypass Russia as a main gas supplier at least due to the reason that Europe's dependency on energy imports is higher than Russia's dependency on energy exports, as Russia can at any time close its pipelines to Europe and meet China's insatiable demand for energy. “Russia's energy strategy seeks to make Europe increasingly dependent on Russian oil and gas. The Kremlin has advanced this strategy through a series of policies. It creates dependency by locking in demand with energy importers, consolidating the supply of oil and gas by signing long-term contracts with Central Asian energy producers, and securing control of strategic energy infrastructure in Europe and Eurasia.”

Taking into account predicted expanding dependency from Russian natural resources, it is of high importance for the EU to work out a crisis management in case of future gas supply conflicts and negotiations about a new treaty framework for energy co-operation with the Russian Federation in order to increase predictability and transparency in energy markets.” Even though both Russia and Europe are seeking ways of how to diversify their energy exports and imports, there is anyway a need for them to further improve cooperation and development of their relations.¹⁰⁴

However, it should also be noted that the Czech Republic enjoys a greater energy security relatively other Central European countries, basically because, from the strategic point of view, the general approach of the country is to step to reduce its dependency on importing from Russia oil and natural gas, and it manages to do that by diversification of energy suppliers (e.g. Norwegian oil)

¹⁰⁴Europe's Strategic Dependence on Russian Energy, Ariel Cohen, Research Reports, The Heritage Foundation, November 5, 2007, accessible from <http://www.heritage.org/research/reports/2007/11/europes-strategic-dependence-on-russian-energy>

and transit routes (e.g. oil pipeline from Ingolstadt, Germany), building new transmission capacities, expansion of alternatives, for example, nuclear power capacity, etc. Some of these necessary steps have been made long before the country's entry into the EU, not least due to the lack of trust towards Russia, and the general perception of this country as threat and source of anticipated problems, especially after the Russian-Ukrainian gas crises in 2006 and 2009.¹⁰⁵

As it was mentioned above, the greatest share of Czech exports is represented by machinery and transport equipment, with Škoda Auto – a leader in this category, which is by far the biggest exporter in the Czech Republic; followed by other commodities and industrial products. However, Czech products were not always perceived of sufficient quality, which significantly affected demand on the external market. They were at some stage and for no particular reason rather perceived as low-quality products in comparison with those manufactured in euro zone, which was probably due to the relatively low prices, in turn as a consequence of low labour costs. However, the accession of the Czech Republic to the EU led to that wage levels in the Czech Republic and other EU countries are gradually balancing out, and the country's membership in the EU considerably helped Czech producers to improve their position on global markets.¹⁰⁶ Thanks to increasing external demand, the Czech Republic managed to increase industrial production output in manufacturing industries, in 2010 it was by 11.1%.¹⁰⁷

As we can see from the Table 9 below, high volumes of Czech exports of machines and means of transport to the Russian Federation can also be explained by underdeveloped industrial construction in the latter. This is also the reason that these outfits rank the first in imports of Russia, making the half of the total import volume in 2010. Even if the export of Russian machining tools and engineering equipment to the Czech Republic constantly has been growing since 2007 (see Table 10), its share in total amount of Russia's exports to the Czech Republic so far remains insignificant – 2.9%, and generally Russian exports of this group of commodities constituted only 5% of the total amount of export structure in 2010. All this testifies to the serious weakness and non-competitiveness of Russian engineering industry, as a consequence Russian companies prefer to import high-technology equipment from developed countries which from year to year makes its market more open for foreign companies including Czech manufactures.¹⁰⁸

105Lessons from Prague: How the Czech Republic Has Enhanced Its Energy Security, Andrej Nosko and Petr Lang, Archive, Journal of Energy Security, July 26, 2010, accessible from http://www.ensec.org/index.php?option=com_content&view=article&id=258:how-the-czech-republic-has-enhanced-its-energy-security&catid=108:energysecuritycontent&Itemid=365

106Foreign trade commodity structure, the Official website of the Czech Republic, data as of January 5, 2010, accessible from <http://www.czech.cz/en/67036-foreign-trade-commodity-structure>

107External trade development in 2010, Archive, Czech Statistical Office, 2011, accessible from <http://www.czso.cz/csu/csu.nsf/enginformatce/avzo020711analyza11.doc>

108Russia's foreign trade, Intersolution Ltd., February 11, 2011, accessible from <http://www.intersolution.eu/english/news/6.html>

Table 9. Foreign trade of the Czech Republic by commodity with Russia in 2009 (in thousand CZK)

	Imports		Exports	
	CZK	% (share)	CZK	% (share)
Total	102603828	100	49618222	100
Food and live animals	42636	0.04	781100	1.6
Beverages and tobacco	27526	0.03	377901	0.8
Crude materials, inedible, except fuels	2644604	2.6	289512	0.6
Mineral fuels, lubricants and related materials	89280562	87	112518	0.2
Animal and vegetable oils, fats and waxes	6556	0.006	244	0.0005
Chemicals and related products	1840880	1.8	6415983	12.9
Manufactured goods classified chiefly by material	5353127	5.2	6149276	12.4
Machinery and transport equipment	2986654	2.9	30898725	62.3
Miscellaneous manufactured articles	421282	0.4	4592962	9.3

Source: Ministry of Industry and Trade of the Czech Republic¹⁰⁹ [pp. 74-75]

Table 10. Export of Russia by commodity “Machinery and transport equipment” in 2007-2010 (in thousand USD)

	2007	2008	2009	2010
Machinery and transport equipment	80 953	103 731	159 176	263 197
Growth rate (%)	0	28	53	65

Source: Czech Statistical Office¹¹⁰

Dmitry Medvedev, the Russian president, launched a program of modernization of the economy, in order to avoid the country's flooded budget with mostly oil and gas export revenues, and to diversify the Russian economy. One of the steps taken was a project of a Russian version of Silicon Valley in Skolkovo. However, there are still a lot of questions left: how to attract investors; how to transfer researchers' brilliant ideas to the real economy; etc. Among other obstacles one can name the recent hike in oil prices, which “could again make the government less willing to follow the modernization agenda, especially as 2011 is a pre-election year in Russia. Even if oil prices

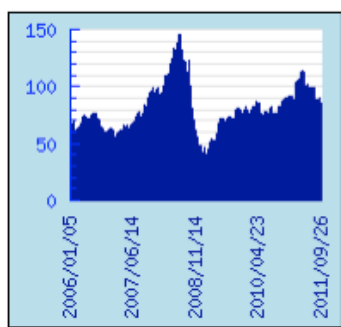
¹⁰⁹Russian Federation, Facts on foreign trade of the Czech Republic 2009, Ministerstvo průmyslu a obchodu, November, 2010, accessible from <http://www.mpo.cz/en/foreign-trade/statistics/>

¹¹⁰Zahraniční obchod podle zboží a zemí, Český statistický úřad, accessible from <http://apl.czso.cz/pll/stazo/STAZO.STAZO>

remain high, it would be impossible for Russia to enjoy high oil revenues without investing heavily into new technologies.”¹¹¹ Therefore, there is an urgent need for Russia to concentrate on the development of high-technology equipment and on support of engineering industry in order to continue growth in the proportion of non-raw material exports and engineering production. So far, there are still a lot of possibilities for foreign producers in this sphere in the Russian market.

As it can be seen from the Table 9 above, main products for Czech exports to Russia are machinery and transport equipment; for Czech imports from Russia – mainly energetic commodities, raw materials and mineral oil, which share from Russia constitutes 83% of the total amount of Czech imports in this category. If we consider export structure of the Russian Federation in 2010, it shows that mineral commodities are doubtless leaders among exported goods making great share of 70%, taking into account the fact that the country is one of the most resourced ones in the world. Dynamics of Russian exports largely relates to the prices for oil produced in Russia, which in turn depend on the price of crude oil in the world markets. Below in Chart 4 you can see the dynamics of crude oil price during the period from November 10, 2005 to September 26, 2011.

Chart 4. Oil price during the period from 10-11-2005 to 29-07-2011 (in USD)



Source: author's calculations according to the source¹¹²

Prior to the world financial crisis on July 11, 2008 world oil prices reached a historical high of over 147 USD dollars per barrel.¹¹³ Nevertheless in 2009 the export volume of mineral commodities from Russia changed significantly, mainly because of influence of world-wide economic trends: world recession and oil and gas price downturn. Since drop in oil prices led to decrease of Russian export volume, and the prices of raw hydrocarbons sharply dropped during the period from the end of 2008 till the mid-2009, tracing the lowest figure in oil price on February 12,

¹¹¹Will Russia ever reduce dependence on oil and gas exports, Konstantin Rozhnov, Business reporter, BBC News, April 28, 2011, accessible from <http://www.bbc.co.uk/news/business-13213340>

¹¹²Crude oil price, data as of September 30, 2011, accessible from <http://www.oilprice.com/>

¹¹³Заветная сотня долларов за баррель, Владимир Ревенков, Экономика, Особая буква, August 23, 2010, accessible from <http://www.specletter.com/ekonomika/2010-08-23/zavetnaja-sotnja-dollarov-za-barrel-.html>

2009, at 34.75 US dollars per barrel (according to www.xroilprice.com), that highly affected turnover from the Russian export to the Czech Republic including, and clearly can be demonstrated from the Table 7, where this figure dropped by 63% from 6.2 billion EUR in 2008 to 3.9 billion EUR in 2009.¹¹⁴

According to the forecast of Goldman Sachs Group Inc., spinning up world economy during the second half of 2011, spare production capacity, and exhausted inventories will lead to increasing demand for crude oil and its growing price even further later this year and into 2012 up to 130 USD per barrel. “The IMF, for its part, in the updated World Economic Outlook (WEO) for 2011, puts the assumed price for oil based on futures market at 105.25 US dollars in 2012.¹¹⁵ If these forecasts come true, the oil revenues of the Russian Federation from its exports this and next years will further increase trade surplus of the country in its trade with the Czech Republic, will help Russia to reduce the federal budget deficit and to meet the state's spending obligations.

Besides the oil price changes which have an influence on trade balance between countries, the volatile prices on other commodities have affected external trade balance in 2010. In comparison to the same period of 2009, in the period from January to November 2010 export prices decreased by 1.3%, which decreased the exports value more than by 39.0 billion CZK. Import prices, on the contrary, went up by 1.6% on average, which caused the imports value to rise by approximately 10.0 billion CZK. As for the bilateral relations between Russia and the Czech Republic, changes had occurred and were particularly considerable in those groups of commodities, which take greatest shares in the trade structure of each country. For the Czech Republic, for example, it had a negative impact on external trade: loss both from exports and imports, and during this period of time in general accounted for about 49.0 billion CZK of loss on turnover from the external trade in total.¹¹⁶

Fluctuations in exchange rate have also an influence on trade balance between Russia and the Czech Republic. For example, due to depreciation of the Czech crown (CZK) against the Russian ruble (RUB), external trade grows faster in CZK than external trade expressed in RUB.¹¹⁷

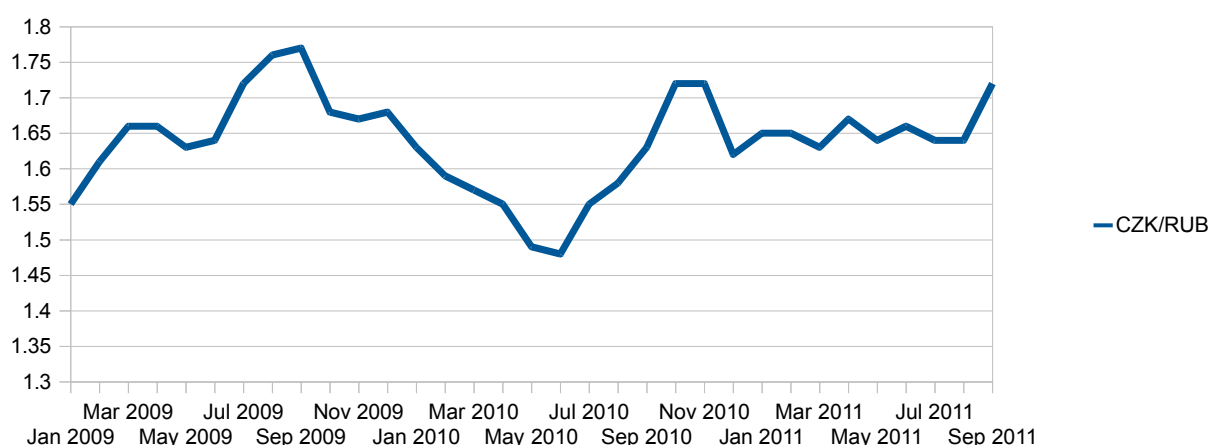
114Russia's foreign trade, Intersolution Ltd., February 11, 2011, accessible from <http://www.intersolution.eu/english/news/6.html>

115Tighter oil supply in 2012, Steve Austin, Oil-price.net, August 1, 2011, accessible from <http://oil-price.net/en/articles/tighter-oil-supply-in-2012.php>

116External trade development in 2010, Archive, Czech Statistical Office, 2011, accessible from <http://www.czso.cz/csu/csu.nsf/enginformace/avzo020711analyza11.doc>

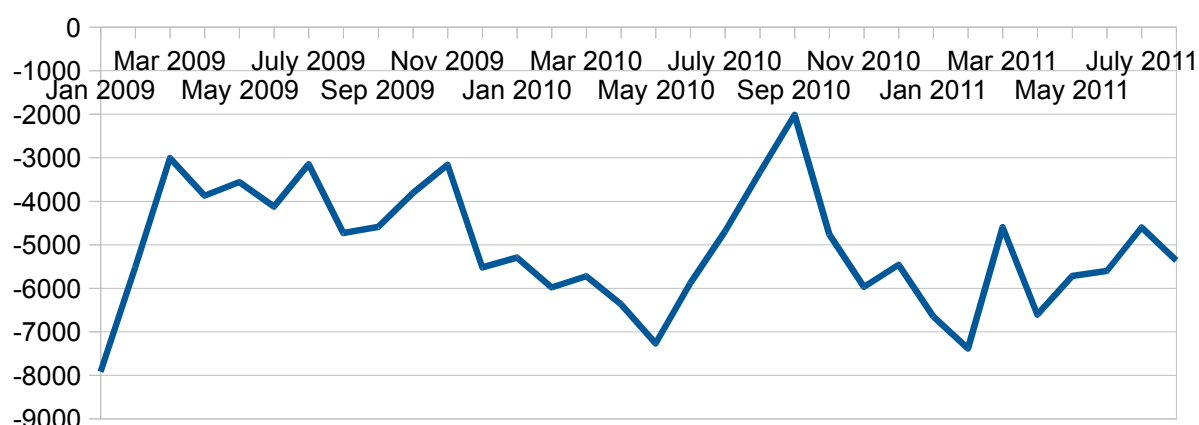
117The real economy, Financial Stability report 2010/2011, Czech National Bank, 2011, accessible from http://www.cnb.cz/miranda2/export/sites/www.cnb.cz/en/financial_stability/fs_reports/fsr_2010-2011/fsr_2010-2011_real_economy.pdf

Chart 5. Exchange rate CZK/RUB during the period from January 2009 to September 2011



Source: www.exchangerate.com¹¹⁸

Chart 6. Trade balance between the Czech Republic and Russia (in million CZK)



Source: Czech Statistical Office¹¹⁹

As we can see from the Chart 5 and the Chart 6 above, the trade balance improved in favor of the Czech Republic from the second quarter of 2009 to the first quarter of 2010, which can be explained at least partly by the depreciating exchange rate of CZK against RUB in 2009. If the currency of the contract is EUR, USD, or any other (which is often made in order to avoid exchange rate risk), turnover from that contract will depend on fluctuations of that currency. For example, in May 2011 compared with May 2010 due to appreciation of the CZK against EUR and USD in 2010,

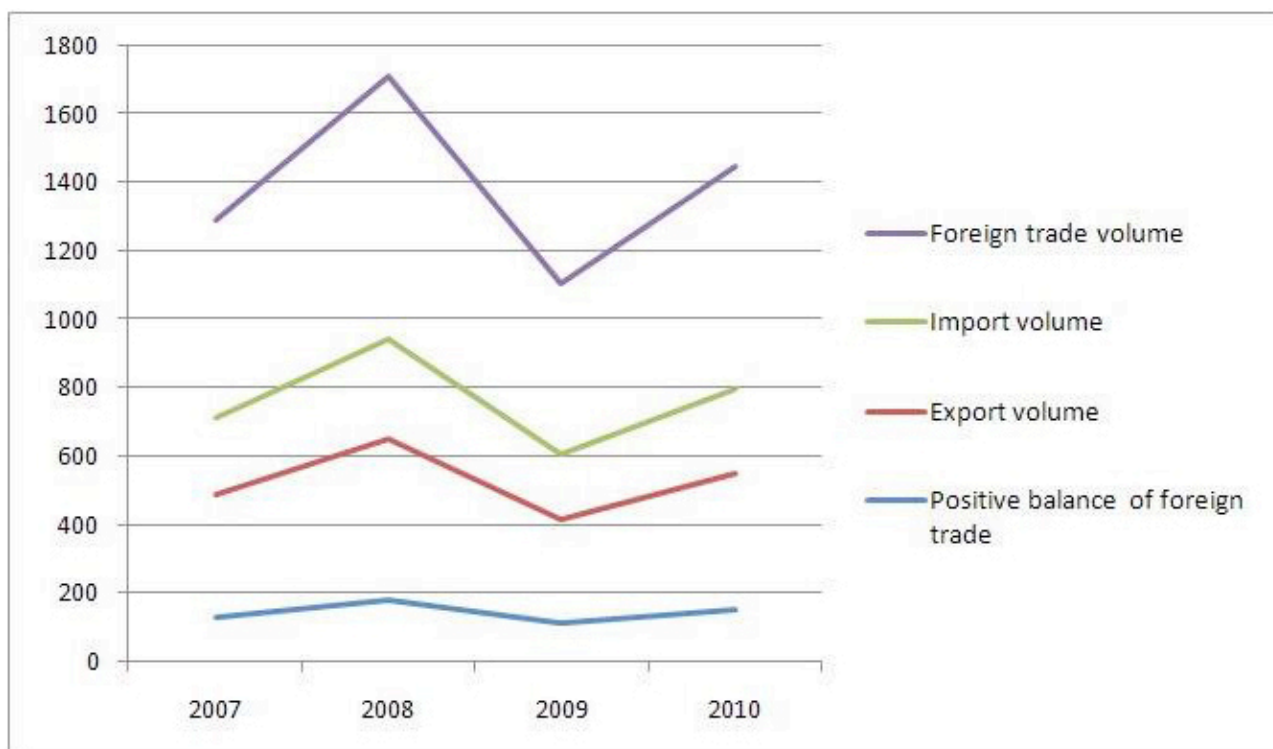
¹¹⁸Exchange rate of CZK/RUB, Currency calculator, accessible from http://www.exchangerate.com/past_rates.html?letter=&continent=Europe&cid=63¤cy=192&last30=&date_from=01-01-2009&date_to=08-04-2011&action=Generate+Chart

¹¹⁹Statistika zahraničního obchodu, Český statistický úřad, accessible from <http://apl.czso.cz/pll/stazo/STAZO.STAZO>

external trade grew faster in EUR (exports +24.4% and imports by +23.7%) and in USD (exports +42.0% and imports +41.3%) than external trade in CZK.¹²⁰

To consider Russia's foreign trade activity, let's have a look at Chart 7 below.

Chart 7. Russia's foreign trade indexes



Source: Intersolution Ltd.¹²¹

As it's clearly seen from the Chart 7, growth rate of foreign trade activity for Russia in 2008 was quite high, which later was hardly hit by the world economic crisis. In 2010 the country was gradually recovering from recession 2009, however, indexes of foreign trade of 2010 still fell behind of indexes of 2008. Nevertheless, Russia is stepping out from the crisis, and in accordance with experts' opinions the positive dynamics will continue in 2011 either and the country probably will manage to achieve its pre-crisis level already in 2011.¹²² Anyway, the world economic recovery and improvements in external demand will gradually ensure the upward trend in bilateral trade between Russia and the Czech Republic.

In the period January-May 2011, exports and imports of the Czech Republic rose by 19.4%

¹²⁰Exports grew faster than imports: External trade – May 2011, Czech Statistical Office, July 7, 2011, accessible from <http://www.czso.cz/csu/csu.nsf/engineering/cvzo070711.doc>

¹²¹Russia's foreign trade, Intersolution Ltd., February 11, 2011, accessible from <http://www.intersolution.eu/english/news/6.html>

¹²²Russia's foreign trade, Intersolution Ltd., February 11, 2011, accessible from <http://www.intersolution.eu/english/news/6.html>

and 20.1% respectively, on a year-on-year basis (y-o-y). The trade surplus accounted for 80.5 billion CZK with an increase of 7.9 billion CZK in comparison with the same period of a previous year. The trade balance improved mainly in “machinery and transport equipment” and made surplus of 39.5 billion CZK. On the contrary, deficit increased in “mineral fuels, lubricants and related materials” by 20.3 billion CZK. In May 2011 alone the trade gap with non-EU countries increased by 2.3 billion CZK to amount of 41.7 billion CZK, when 1.6 billion CZK constituted a drop in deficit with the Russian Federation due to increasing exports.¹²³

2.3. Organizations and events affecting Russian-Czech bilateral trade and economic relations

2.3.1. The WTO

For a long time there have been hot discussions about Russia's accession to the WTO, but also benefits and drawbacks of such a process. However, by the end of 2011 the question of Russia's accession to the WTO can be resolved in the affirmative. Through an intermediary of Switzerland, in October 2011 Russia and Georgia finally came to an agreement about an external monitor Abkhazia's and South Ossetia's borders with Russia, which was a Georgia's condition of approval of the Russia's WTO accession. Thus, negotiations on Russia's accession to the WTO is almost completed and will be submitted to the Ministerial conference, scheduled for December 15-17, 2011. In case of acceptance of Ministers – Russia will become a WTO member 30 days after the ratification of documents in the Russian Federation.^{124 125} Thus, later in this part we will examine how Russia's entry could affect the future development of bilateral relations between Russia and the Czech Republic.

The bulk of world trade is carried out under the supervision of international economic organizations, which are founded to promote and strengthen trade and economic relations between countries. Russia's share in world trade is not that big on a global scale, but sphere of foreign trade is of considerable importance for it, as Russia (the only major international economy which is not yet a member of WTO) is a huge market for goods, services and capital, and bilateral relations between Russia and other countries are gradually growing, that is why Russia for several years has been trying to join the WTO. Russia's accession to the WTO will undoubtedly contribute to predictability and transparency of foreign trade regime of the country.

123Exports grew faster than imports: External trade – May 2011, Czech Statistical Office, July 7, 2011, accessible from <http://www.czso.cz/csu/csu.nsf/enginformace/cvzo070711.doc>

124О завершении переговоров по ВТО официально объявят на следующей неделе, Экономика, РИА Новости, November 3, 2011, accessible from <http://ria.ru/economy/20111103/479736519.html>

125Россия станет членом ВТО до конца года, Георгий Двали, Экономика, “Коммерсантъ-Online”, ЗАО “Коммерсантъ. Издательский Дом”, November 3, 2011, accessible from <http://kommersant.ru/doc/1809765>

But there are completely opposite points of view formed concerning the issue of Russia's accession to the WTO in terms of benefits for the country. Proponents of Russia's membership in the WTO assure that Russia's place in the organization is of fundamental importance in order to continue economic development of the country and ensure Russia's participation in international trade on equal terms. Their opponents believe that the accession to the WTO will result in irreparable damage to all industries of the national economy, and will deprive the country's independence in making certain economic decisions important for the country's stability, etc. Moreover, the WTO promotes trade of mainly high value-added products, labour-intensive and science-intensive, whereas:

- at least two-thirds of Russia's foreign trade accounts for the countries, with which it supports MFN on a reciprocal basis, or has free trade area, customs union, or some trade preferences;
- the basis of Russia's exports mostly constitutes raw materials and fuels, which are already permitted to foreign markets without or almost without any restriction, and it will not be that easy to change the existing structure of Russian exports as a result of some inhibition of technological progress in the country.¹²⁶

The EU strongly supports Russia for its WTO membership, their negotiations over the country's accession and new Partnership and Co-operation Agreement, which will replace the existing one, are at the centre of EU-Russia relations at present. The agreement regulates the relations in political and economic spheres and is the legal basis for the EU's bilateral trade and investment relations with the Russian Federation.¹²⁷ But at present Russia can import to the EU with very minor restrictions, being a beneficiary of the Generalized System of Preferences – system, which gives preferential treatment in the forms of granted reduced or zero tariff rates over the Most Favored Nation rates. Thus, the existing rules grant Russia more flexibility in setting of unilateral tariff measures. However, according to the reviewed GSP accepted on May 13, 2011, from January 1, 2014, after a transitional period of one year, Russia will be excluded from the scope of beneficiaries.^{128 129}

The New Partnership and Co-operation Agreement should establish a new framework for bilateral relations with stable, predictable and balanced rules; but, nevertheless, the EU can't be sure in the new agreement as an adequate tool to constrain Russia's behavior until Russia remains

¹²⁶Россия в мировой торговле, Агафонова М.С., Баранникова Н.А., Воронежская Государственная Лесотехническая Академия, accessible from <http://www.rae.ru/forum2011/pdf/article163.pdf>

¹²⁷Countries: Russia, European Commission, 2010, accessible from <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/russia/>

¹²⁸Council backs more equitable trade preferences, EU2011, May 14, 2011, accessible from <http://www.eu2011.hu/news/council-backs-more-equitable-trade-preferences>

¹²⁹Generalized System of Preferences, UNCTAD, 2011, accessible from http://www.unctad.org/en/docs/itcdtsbmisc62rev5_en.pdf

outside the WTO, and thus complaints cannot be taken to the WTO for dispute resolution.¹³⁰ Thus the EU position can't be called equitable. Moreover, the EU has a common trade policy, but individual EU member countries and Russia favor various approaches to mutual cooperation, and agreements, rules, and pricing are subject to frequent changes.¹³¹

The U.S. government also supports Russia in its intention to join the WTO, having concluded a bilateral WTO accession agreement as far back as late 2006. The U.S. Administration caused a few problems that impeded it, among which were also the differences with Georgia, which blocked the accession of Russia into the organization.¹³²

Czech Foreign Minister Karel Schwarzenberg is also concerned about how Russia builds its relations with Georgia, taking a deployment of a large number of military garrisons in Abkhazia and South Ossetia as a potential new war against Georgia.¹³³ When the war started in August 2008, Czech Prime Minister Mirek Topolánek said that the Czech Republic supported Georgia's sovereignty, independence and territorial integrity, including its regions of South Ossetia and Abkhazia.¹³⁴ The Russian-Georgian differences certainly adversely affect opinions of Czech authorities about foreign policy of Russia with regards to its neighbor. In the past the Czech Republic experienced political pressure of the USSR, only in the last decade became ready to rebuild relationships with its successor. However, the decision of the Russian officials about intervention into Georgia and deployment on its territory of military operations causes resentment in many countries, and the Czech Republic especially acutely perceives the aggressive actions of its former ally. That's why differences between countries with regards to the foreign policy may lead to a further decision of Czech authorities to slow down the development of mutual relations, including trade cooperation, with Russia.

As for the consequences of Russia's accession to the WTO, they may be different. Further we will consider some of the options that can affect trade relations between Russia and the Czech Republic and try to analyze them from different points of view. Therefore, Russia's accession to the WTO can lead to:

- Attraction of foreign advanced technologies to Russia. There is underdeveloped industrial

130Countries: Russia, European Commission, 2010, accessible from <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/russia/>

131Foreign trade drives cooperation between Russia and EU, Russia CEIC Database Team, ISI Emerging Markets Blog, March 15, 2011, accessible from <http://blog.securities.com/2011/03/foreign-trade-drives-cooperation-between-russia-and-eu/>

132Обама поддерживает стремление России вступить в ВТО, Кэрл Лл, ИноСМИ.ру, May 27, 2011, accessible from <http://www.inosmi.ru/usa/20110527/169925404.html>

133Глава МИД Чехии обеспокоен отношением России к ее соседям, Новости, Канал ПИК, May 23, 2011, accessible from <http://pik.tv/ru/news/story/10817-glava-mid-chexii-obespokoien-otnoshenim-rossii-k-ee-sosediam>

134Czech Republic to send aid of 150 million crowns to Georgia, News, Tbilisi's Blog – News, Events, Comments..., August 20, 2008, accessible from <http://tbilisiwebinfo.wordpress.com/2008/08/20/czech-republic-to-send-aid-of-150-million-crowns-to-georgia/>

construction, and serious weakness and non-competitiveness of Russian engineering industry, since the average level of obsolete basic assets of Russian firms is 70% and more in different sectors. The problem of technical and technological backwardness of Russia and the need to considerably modernize the domestic industries make Russian goods rather weak competitors within the WTO. Thus, the WTO will help to strengthen the position of foreign products, including the Czech products, on the Russian market, which will make them increasingly difficult to catch up with.

At the same time, however, in light of Russia's drive to modernize and diversify its developing economy, Czech manufacturing has a lot to offer to Russian producers in many spheres. As the majority of Czech exports to Russia include transportation units, machinery, equipment, engineering and machining tools; demand for Czech goods and services should only rise. For the Russian companies – it is an opportunity to modernize their technically obsolete means of production, thus improving process of manufacturing, and later reaching higher sales not only in the domestic market, but external – including the Czech one.

- Attraction of foreign investments to Russia. The worn-out Russian production facilities require large investments, but the ability to provide high ROI in an open market for commodities within the WTO is indefinitely long-term. Foreign banks may give Russian companies the opportunity to use larger, longer and cheaper credit resources. Eventually, foreign companies will be able to finance the Russian manufacturing and science-intensive industries. But at the same time, foreign companies, including Czech ones, will be able to move production to Russia, using their technologies, taking advantage of cheap labor and energy resources, which will give them additional competitive advantage over Russian enterprises.

Also, concentration of foreign investments in only some particular industries can lead to unequal distribution of economic growth in Russian sectors of economy. The greatest expansion of production is expected in key export sectors (oil and minerals) of the Russian economy. In industries, where exports share is insignificant and high protection of the domestic market from imports exists, production is expected to decrease, with the largest decline in the manufacturing industries, including in engineering – the main export sector of the Czech Republic to Russia.

All this may lead to the ruin of the most Russian companies or to the very considerable reduction in their income, which in turn will greatly reduce their viability and competitiveness in foreign markets. Thus, possible outcome: the increase in exports of the Czech Republic in terms of machinery and transport equipment to Russia, and at the same time decline in this part of Russian exports.

Russian companies should try to “integrate” their business into the global economic system and at most use the benefits of Russia's entry into the WTO – namely, to use the resources of the

world economy, to implement market expansion beyond national borders, to attract foreign investments and foreign advanced technologies through joint ventures, etc. For this purpose, the Russian enterprises should strengthen their competitiveness: implement innovations (new products and new technologies), improve product quality and quality of management.^{135 136}

2.3.2. EU vegetable crisis in 2011

On June 2, 2011, along with some other countries, Russia banned the supply of vegetables from the whole EU, because of the spread of *Escherichia coli* (*E. coli*) in Europe, in consequence of which thousands of people were infected, with the highest number – in Germany. Possible sources were named: the Spanish cucumbers, sprouts of soya and Dutch beet. However, in early July, it was found that the infection was probably brought to Europe from Egypt with a party of the seeds of legumes.

Eventually, Russia abolished the ban on the import of vegetables from Belgium, Denmark, Greece, Spain, the Netherlands, Poland, France and the Czech Republic, and later from Italy and Hungary, but with one condition – special certificates for all vegetables from these countries – as a confirmation of the products' safety.

On July 26, 2011 upon the German Institute for Disease Control's statement, an epidemic of intestinal infection in Europe ended. On August 9, Russia lifted the last restrictions on the imported vegetables from the EU.^{137 138}

The reaction from the Czech authorities occurred immediately in the Czech newspaper “Right” (in Czech “Právo”) from June 3, 2011. It was reported that the Head of the South Moravian Region M. Hasek stated his negative attitude with regard to the ban imposed by Russia on imports of fruit and vegetable crops from the EU, considering that as a protectionism measure of the Russian market. Besides, M. Hasek insisted that I. Fuksa, the Minister of Agriculture of the Czech Republic, agreed to conclude a separate agreement with Russia that would facilitate the import of Czech food products to Russia.¹³⁹

135Последствия вступления России в ВТО, Внешнеэкономическая деятельность, Ульяновская торгово-промышленная палата, February 10, 2009, accessible from <http://www.ultpp.ru/ved/118-posledstviya-vstupleniya-rossii-v-vto.html>

136Последствия вступления России в ВТО, И.С. Сокол, Российский институт стратегических исследований, March 18, 2010, accessible from <http://www.riss.ru/?commentsId=78>

137Россия отложила рассмотрение вопроса об отмене запрета на ввоз овощей из ЕС, КМ онлайн, July 26, 2011, accessible from <http://www.km.ru/v-rossii/2011/07/26/gennadii-onishchenko/rossiya-poka-ne-gotova-razreshit-vvoz-ovoshchei-iz-vsekh-st>

138Россия сняла все ограничения на ввоз овощей из Европы, КМ онлайн, August 9, 2011, accessible from <http://www.km.ru/v-rossii/2011/08/09/borba-s-epidemiymi-i-infektsiyami-v-rossii/rossiya-snyala-vse-ogranicheniya-na->

139О событиях, способных повлиять на двусторонние торгово-экономические связи, июнь 2011г., Портал внешнеэкономической информации, Министерство экономического развития Российской Федерации, July 4, 2011, accessible from <http://www.ved.gov.ru/news/2225>

As a consequence of that intestinal infection many European farms suffered enormous loss. The European Commission perceived the Russian ban on imported vegetables with absolute disapproval taking such action as an over-measure for this situation. Since over a quarter of EU exports of fruits and vegetables is supplied to the Russian market for a total of 3-4 billion euros annually, and some part of this amount is the share of the Czech Republic, one should expect a reduction, even though slight, in turnover from the exports of agricultural products in the annual report for the period June-July 2011.¹⁴⁰

2.4. Sources of support and development of Russian-Czech bilateral trade and economic relations

The future accession of Russia to the WTO, on the one hand, provides tremendous opportunities to enterprises of both countries in expanding their positions in the world markets, but on the other – it considerably increases demands on their competitive ability. Therefore, a comprehensive support (especially from the national government) of domestic organizations of various levels of business is of significant importance in order to strengthen their positions in the foreign market of the partner country. As for the state support: the effective development of trade relations requires at least minimum conditions such as the creation of state system of incentives, flexible banking credit system, loans and insurance of Russian exports, as well as active promotion of mutual economic cooperation through establishment of governmental agencies entities.

In general, both Russia and the Czech Republic are interested in improvement of the overall structure of exports of the country, and there are a lot of ways how both parties promote external trade and strengthen bilateral relationships between them.

In order to promote Czech export companies, increase their competitiveness, and facilitate cooperation with foreign entrepreneurs on the world market, in May 1997 CzechTrade was established by the Ministry of Industry and Trade of the Czech Republic. It's a non-commercial organization which is financed from the state budget of the country. Nowadays there are 37 CzechTrade offices operated in 33 states worldwide. The agency not only helps the Czech companies in the foreign markets, but also companies from abroad in the Czech market, providing information services, such as search for suitable Czech-based supplier of goods and services. In Russia, which is called its export priority, CzechTrade opened its agency: in 2003 in Moscow and Ekaterinburg, and in 2004 one more – in Saint-Petersburg.¹⁴¹ For Russian companies entering the

¹⁴⁰Кишечная палочка повысит градус инфляции, Анастасия Башкатова, Независимая Газета, June 3, 2011, accessible from http://www.ng.ru/economics/2011-06-03/1_vegetables.html

¹⁴¹Czech business partner search, Services, CzechTrade, 2010, accessible from <http://www.czechtradeoffices.com/services/czech-business-partner-search/>

Czech market, or looking for Czech business partners, co-operation through CzechTrade is easily accessible and reliable source with a huge database of firms and related consulting services.

Another specialized institution, part of the state export support programme, is EGAP, which stands for the Export Guarantee and Insurance Corporation. It is a state-owned export credit agency founded on June 1, 1992, which is aimed to ensure Czech export companies with credits against political and commercial risks and to provide them with insurance services. During the period 1992–2010, EGAP received state subsidies of a total amount of 6.7 billion CZK, and returned about 1 billion CZK in taxes back to the budget. With state support the company issued export credits, bank guarantees and investments abroad worth 67.2 billion CZK in 2010, the aggregate amount of outstanding commitments represented the total sum of 155.9 billion CZK as at December 31, 2010. The company co-operates almost with all the banks on the territory of the Czech Republic and with some abroad which finance Czech exports. For example, Czech Export Bank, joint-stock company, in 2010 had a share of 81% of the total amount of all the outstanding commitments of EGAP.¹⁴²

Czech Export Bank (CEB), founded in 1995, is a specialized banking institution and one of the key supporters of the government's pro-export policy system. Primarily the CEB finances export operations that require long-term financing at more favorable interest rates and volumes which exporters can't get on the domestic banking market.¹⁴³ The governmental support of CEB is provided in three different forms: government contribution to basic capital CEB, state guarantees of provided export credit, and subsidies from state budget for coverage of differences between accepted and provided credits.¹⁴⁴ The largest share of the credit portfolio of the CEB accrues to Russia and amounted to 48% (27 345 million CZK) as at December 31, 2010.¹⁴⁵

Either in Russia and in the Czech Republic the legislative framework was created and continues to be improved to support the external economic ties among countries. For example, in Russia it includes allocation of financial funds according to governmental resolutions such as, for example, on October 1, 2010 the Government of the Russian Federation adopted the Resolution No 781 "On measures of state support in 2010 for small and medium enterprises, producing and (or) selling goods (services) for export", which provides financial aid in the form of subsidies to the regional budgets in the total amount of 2 billion RUB.¹⁴⁶ For the Czech Republic in terms of

142O nás, Informace o Exportní garanční a pojišťovací společnosti, 2011, accessible from <http://www.egap.cz/o-nas/index.php>

143O nás, Česká exportní banka, accessible from <http://www.ceb.cz/>

144Credit Support for Export: Robust Evidence from the Czech Republic, Karel Janda, Eva Michalikova and Jiri Skuhrovec, p.5, September 27, 2010, accessible from

<http://iatrc.software.umn.edu/activities/annualmeetings/themedays/pdfs2010/2010Dec-JandaMichalikovaSkuhrovec.pdf>

145Základní údaje o úvěrovém portfoliu banky, Česká exportní banka, December 31, 2010, accessible from

http://www.ceb.cz/index.php?option=com_content&task=view&id=8&Itemid=51

146Постановление Правительства Российской Федерации от 1 октября 2010 г. N 781 г. Москва "О мерах государственной поддержки в 2010 году субъектов малого и среднего предпринимательства, производящих и

legislation, as a member of the WTO, some measures, available for Russia, are not applicable. External trade relations are governed in particular by legal regulations of the European Communities and national legislation. From year to year both Russia and the Czech Republic develop its legislation in the sphere of trade and economic relations in order to improve cooperation with other countries.

For a comprehensive system of export support, Ministry of Economic Development of the Russian Federation developed a single portal of external information at <http://www.ved.gov.ru/>, which is a major public information resource on the Internet in the sphere of foreign economic activities and promotion of Russian goods and services in foreign markets. At the present time the site is running in test mode and accessible in two languages, however it is already a fairly complete database that is constantly updated with information provided by the structural units of the Ministry, missions of the Russian Federation on trade and economic issues in foreign countries, Administrations of the Russian regions, business and industry unions and associations, as well as directly by Russian exporters.¹⁴⁷

Similar site, the Export Helpdesk, was created by the European Commission in 2004 as a single point of access for online information about exporting to the European Union. The site is intended to facilitate market access to countries from outside the EU and contains all the necessary information required by exporters, particularly developing countries, interested in supplying the EU market. The Export Helpdesk operates at <http://exporthelp.europa.eu/> and available in 6 languages.¹⁴⁸

Interregional cooperation between Russia and the Czech Republic is dynamically developing. At the regional level, there are also governmental authorities which promote the development of mutual economic relations, such as the Moscow Agency for Export and Investment Promotion. Subjects of Russia develop their international ties in accordance with the Constitution of the Russian Federation, Federal Law of January 4, 1999 No 4-FZ “On Coordination of International and External Economic Relations of the Russian Federation” and other legislative acts and with the assistance of the Ministry of Foreign Affairs of the Russian Federation and other federal bodies of executive power.¹⁴⁹ “As of June 1, 2004, more than 20 subjects of the Russian Federation have

(или) реализующих товары (работы, услуги), предназначенные для экспорта”, Российская Газета, October 6, 2010, accessible from <http://www.rg.ru/2010/10/06/tovar-eks-dok.html>

147Портал Внешнеэкономической Информации, Министерство Экономического Развития Российской Федерации, accessible from <http://www.ved.gov.ru/>

148About the Export Helpdesk, Export Helpdesk, accessible from http://exporthelp.europa.eu/thdapp/display.htm?page=intro/intro_Welcome.html&doctype=main&languageId=EN

149Концепция внешней политики Российской Федерации, Администрация Президента РФ, July 15, 2008, accessible from <http://kremlin.ru/acts/785#sel=>

signed memorandums of cooperation with the Czech Republic and its regions”.¹⁵⁰

Exports of regional goods and services to foreign markets are highly important, as it provides considerable financial resources to the region. For example, in the Russian Federation the Department of Foreign Economic Activity of Krasnodar Region developed a long-term program “Support for export of Krasnodar Region in 2010-2012”. The program is designed to promote a favorable external environment for the growth of competitiveness and the development of the region's economy by increasing the volume and quality of goods of Cuban production which is exported. The measures of state support for exports include subsidies, consultancy services, etc.¹⁵¹ Other governmental measures of financial support for exports of industrial products include export crediting, guaranteeing for export operations, partial reimbursement of interest rates on export credits.

A very significant factor in establishing business contacts between enterprises of two countries is the presentation of domestic products in competitions and international exhibitions and fairs either domestically and abroad. Therefore, Ministry of Economic Development of the Russian Federation is the main body of the government which is entrusted with the coordination of exhibitions and fairs within the priorities of state policy in foreign economic and trade.¹⁵² For Czech exporters, oriented towards the Russian market, the official Czech business web portal businessinfo.cz publishes a complete list of the largest events regarding the different industries, which are held on the territory of both countries.¹⁵³

Also, business delegations, conferences and meetings regularly take place at the level of senior states officials for improving conditions for external trade. For example, on March 16, 2011 in Ostrava, the Honorary Consul of the Russian Federation in Ostrava A. Zednik together with the Trade Mission of Russia in the Czech Republic held a conference “Doing business with Russia”, which brought together over 100 leaders and representatives of Czech and Russian companies with significant export and innovation potential.

In his report, “The outlook of development of trade and economic relations between Russia and the Czech Republic”, the Trade Representative of the Russian Federation in the Czech Republic, A. Turov, pointed out the main principles of state regulation of foreign trade and trade

150Российско-чешские экономические отношения, accessible from <http://diplom-gotovie.ru/freeware.php?item=3798>

151Долгосрочная краевая целевая программа “Поддержка экспорта Краснодарского Края на 2010-2012”, Департамент внешнеэкономической деятельности Краснодарского края, 2011, accessible from <http://www.kubanexport.ru/>

152Финансовая поддержка экспорта, Министерство экономики Калининградской области, accessible from <http://economy.gov39.ru/poddergka-exporta/gos-podderzhka-exp/>

153Akční plán pro Rusko, Zahraniční obchod, Oficiální portál pro podnikání a export – BusinessInfo.cz, accessible from <http://www.businessinfo.cz/cz/clanek/rusko/akcni-plan-pro-rusko/1000580/53638/>

policy of Russia, and the main factors influencing the development of bilateral trade and economic cooperation between countries. A. Turov stressed a declining share of energy resources in the total share of Russian exports, as well as an increase of other groups of trade classification, but also stated Russia's interest in diversifying exports to the Czech Republic and a further increase in its share of processed goods, including high-technological.¹⁵⁴

In addition, as one of the methods of promoting Russian enterprises-exporters Ministry of Industry and Trade of the Russian Federation established the contest "Best Russian Exporter", which is held to support the export of industrial products. Winners are determined by a specific method based on the consolidated export statements of those enterprises.¹⁵⁵

Along with a bulk of international information resources based on the Internet, in Russia, for example, there are many commercial internet organizations which offer a comprehensive promotion of Russian firms in the multilingual markets of the whole world, including the possibility to go to the Czech market. The services can include search of partners and affiliates abroad, building of brand awareness, sales promotion, etc.

After the Velvet Revolution in 1989 Russophobia became popular in the Czech society. Modern relationships can't be still called absolutely trustworthy. As the common history of two countries and current negative attitudes arising from those events show, there is need for mutual communication which exists both in Russian and the Czech society. Recently Russia and the Czech Republic are actively developing ties in the field of science, culture and education, examples of this are the numerous exhibitions, conferences and festivals taking place in both countries, for example – “Russian Days in Ostrava” on June 13-17, 2011, etc.¹⁵⁶ All this positively impacts improvement of mutual relations and increase of trust between countries. Thus, Russian-Czech relations in business have changed dramatically in recent years, resulting in an annual increase of numbers of Russian companies operating on the Czech market and vice versa.

Achieved success and future plans in the relationships between the two countries should help to resolve the long-term issues of the economic ties, the fundamental of which is the imbalance in trade, where there is quite a big difference between exports and imports (see the Table 8), and an imbalance in the structure of export of Russian raw materials to the Czech Republic in exchange for exports of Czech machinery and transport equipment.

154Конференция “Делаем бизнес с Россией”, Торговое Представительство Российской Федерации в Чешской Республике, March 16, 2011, accessible from <http://www.rustrade.cz/the-news/137-16032011>

155Минпромторг России объявляет о начале проведения конкурса на звание “Лучший российский экспортер года”, Минпромторг России, June 30, 2011, accessible from <http://www.minpromtorg.gov.ru/fea/inter/152>

156О событиях, способных повлиять на двусторонние торгово-экономические связи, июнь 2011г., Портал внешнеэкономической информации, Министерство экономического развития Российской Федерации, July 4, 2011, accessible from <http://www.ved.gov.ru/news/2225>

3 Investment relations between Russia and the Czech Republic

3.1. General information about investment relations up to 2004

The "Velvet Revolution" in 1989 gave impetus to the beginning of the economic reforms in the Czech Republic, including an open investment climate with lots of investment incentives to its foreign partners. At that time maintaining a favorable investment climate was a priority of the Czech government's policy, which led to large inflows of foreign investment to the country. FDI made a substantial contribution to the economic growth during the transition process from a communist, centrally planned economy to a market economy. The Czech Republic became the first among post-communist countries which received an investment-grade credit rating by international credit institutions.¹⁵⁷

As we can see from Chart 9 below, around the year 2000 the economy of the Czech Republic was receiving considerable inflows of foreign investments – higher than any other Central and Eastern European country as a proportion of GDP.¹⁵⁸ Later in 2004 it became a member of the European Union. With an advantageous central location in Europe, a relatively low cost infrastructure, and a well-qualified workforce, the Czech Republic has been enjoying a significant amount of foreign investments. Since then the scale of the Czech Republic's economic reconstruction has been expanding increasingly.

Even though FDI inflows to Russia doubled from 2002 to 2004, it did not succeed as much as the Czech Republic. For example, in 2002, FDI inflows to the Russian Federation constituted 27.6 USD per head of population in comparison with 817.8 USD – to the latter. Therefore, the Russian government had been concentrated on changing general FDI legislation, streamlining its tax administration, adopting the OECD's Principles of Corporate Governance, and reforming land law, its customs code and foreign exchange regulation.¹⁵⁹

3.2. Descriptive and analytic analysis of bilateral investment relations between Russia and the Czech Republic

According to the OECD, Foreign direct investment (FDI) is a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other

¹⁵⁷Background note: Czech Republic, U.S. Department of State, August 19, 2011, accessible from <http://www.state.gov/r/pa/ei/bgn/3237.htm>

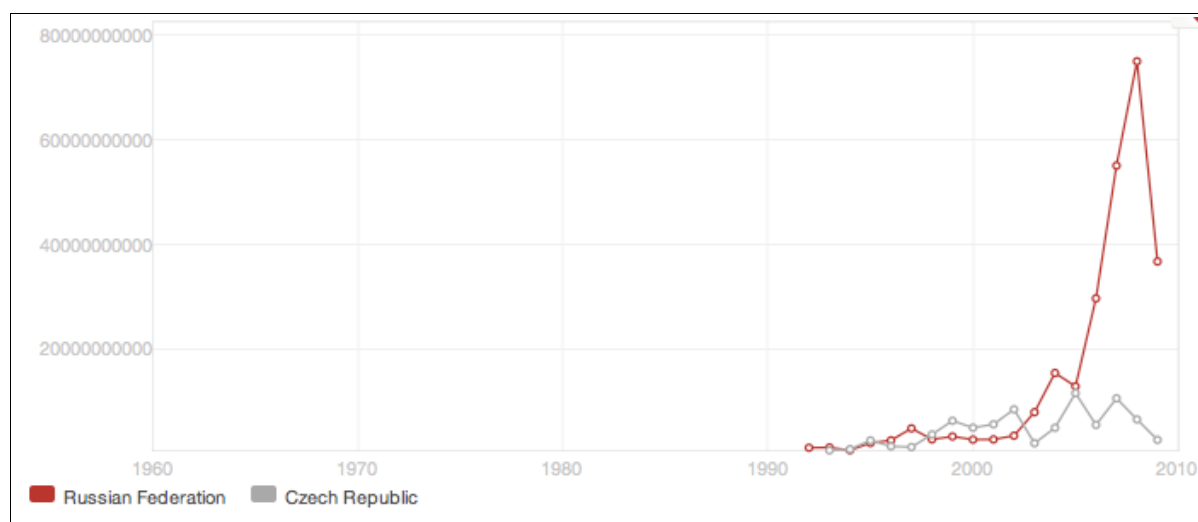
¹⁵⁸The economy of the Czech Republic, European Economy news, European Commission, Economic and financial affairs, Issue 8, October, 2007, accessible from http://ec.europa.eu/economy_finance/een/008/article_6172_en.htm

¹⁵⁹Russia discusses OECD policy options to boost foreign direct investment, Organisation for Economic Co-operation and Development, 2004, accessible from http://www.oecd.org/document/32/0,2340,en_2649_201185_32389792_1_1_1_1,00.html

than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship.¹⁶⁰ In this chapter we will examine mutual investment relations between Russia and the Czech Republic, try to understand the reasons for their current level, to forecast their development in the near future, and give some recommended actions for the improvement of Russia's policy and investment climate for attracting FDI.

During the period 2003-2008 the Central and Eastern European (CEE) countries in total experienced a five-fold increase in FDI inflows to 155 billion USD in 2008. The majority of these additional investments (a 29% share of all FDI inflows to the region) was obtained by Russia, which experienced the largest increase over the period in value: from less than 8 billion USD in 2003 to more than 70 billion USD in 2008. (see Chart 8) That put the country among the world largest both recipients and sources of FDI.

Chart 8. Foreign direct investments, net inflows (Balance of Payments, in current USD)



Source: The World Bank¹⁶¹

The historic amount of FDI in a country helps to understand its longer term attractiveness. In order to compare FDI flows of several countries, it is better to be done in per capita terms or per GDP. Further two Charts 9 and 10 provide the comparative analysis of FDI flows as percentage of GDP in Russia and the Czech Republic.

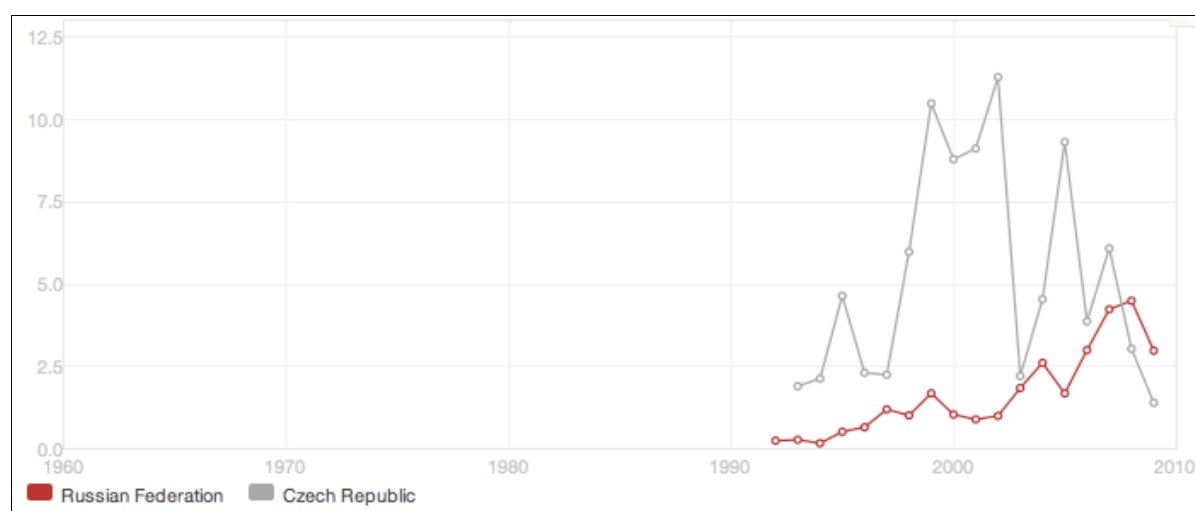
¹⁶⁰Glossary of foreign direct investment terms and definitions, Organisation for Economic Co-operation and Development, accessible from <http://www.oecd.org/dataoecd/56/1/2487495.pdf>

¹⁶¹Indicators, The World Bank Group, 2011, accessible from <http://data.worldbank.org/indicator>

National economy of the Czech Republic is strongly dependent on flows of FDI, which can be clearly seen from the Chart 9 below, where inward investments constitute a large share of the total amount of country's GDP. The share of FDI in the total amount of GDP around 2000 in the Czech domestic economy was around 10%, and remained at a high enough level up to the economic slowdown. As a consequence of the financial crises FDI inflows to the whole CEE region dropped by half in 2009 when compared to 2008, but the Czech Republic experienced a much smaller decline than the region overall – by 19%. According to the Ministry of Industry and Trade, the inflow of FDI dropped by more than half: from 110 billion CZK in 2008 to 52 billion CZK in 2009. However, only during the first three quarters of the next 2010 the inflows of FDI increased to 117 billion CZK. The main sectors hit by the economic downturn were automotive, real estate and alternative energy, which saw declines in FDI of around 65% in automotive equipment and components combined and 30% in real estate and alternative energy.

As for Russia, the country experienced a 48% decline in FDI inflows in 2009 – to less than 40 billion USD from 75 billion USD in 2008, which was mainly caused by a collapse in investment in the real estate and extractive industries. Both these sectors in 2008 constituted half of all FDI coming to Russia, for example, only the real estate sector brought an excess of 1 billion USD in 2008.^{162 163}

Chart 9. Foreign direct investments, net inflows (% of GDP)



Source: The World Bank¹⁶⁴

¹⁶²Foreign Direct Investment in Central and Eastern Europe: a case of boom and bust?, Economic views, PricewaterhouseCoopers, March, 2010, accessible from

http://www.pwc.com/en_RS/rs/publications/assets/FDIinCEE-Final-report-March_10.pdf

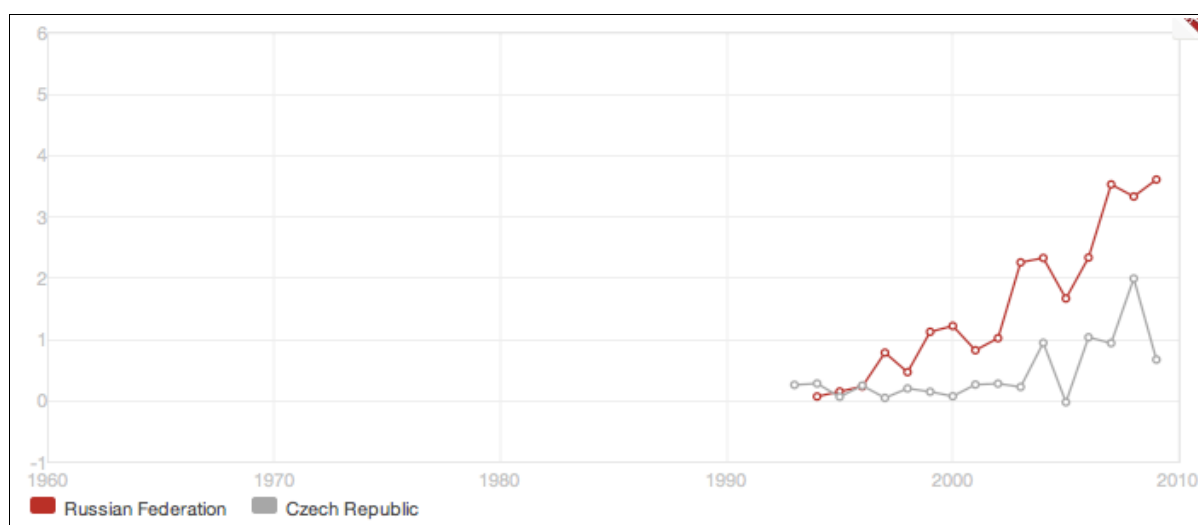
¹⁶³Background note: Russia, U.S. Department of State, March 16, 2011, accessible from

<http://www.state.gov/r/pa/ei/bgn/3183.htm>

¹⁶⁴Indicators, The World Bank Group, 2011, accessible from <http://data.worldbank.org/indicator>

While the number of FDI source countries in the Czech Republic is quite large, just some countries account for the sums invested: only the Netherlands, Germany and Austria accounted more than 10% each of the total amount in 2009. Russia does not come in the first Top 5 and has rather small amounts of investments in the Czech Republic, even though it has shown an increasing interest during the recent years. The major proportion of FDI from Russian investors is drawn for the metalworking and engineering industries, power engineering, infrastructure, tourism and recreation spheres.¹⁶⁵

Chart 10. Foreign direct investments, net outflows (% of GDP)



Source: The World Bank¹⁶⁶

As we can see from the Chart 10, Russia contributes in average two times more that the Czech Republic in the total amount of FDI outflows as a share of GDP. A more accurate assessment of investment relations between two countries can be done with the help of data from the Balance of Payments of the Russian Federation given in Table 11 below.

As it can be seen from the Table 11, percentage of the Czech investments in 2007-2010 to Russia is stable at 0.2% of the total amount of inflows into the country. In consequence of the financial crisis FDI in 2009 fell by 28%, and in 2010 failed to get pre-crisis level, having reached only to a third. As for the Russian investments to the Czech Republic: this number is significantly higher comparing to the Czech inflows during the whole period 2007-2010, so in 2010 the difference exceeded 4 times. The world economic downturn also had a negative impact on outflows of FDI – with a reduction of 45% in 2009 compared to 2008, but in 2010 Russian investors have

¹⁶⁵Инвестиционное сотрудничество с Чешской Республикой, Торговое Представительство Российской Федерации в Чешской Республике, 2011, accessible from <http://www.rustrade.cz/invest-czech>

¹⁶⁶Indicators, The World Bank Group, 2011, accessible from <http://data.worldbank.org/indicator>

already succeeded to go beyond the pre-crisis level by 12.5%. Thus, Russian FDI to the Czech Republic as of January 1, 2010 totaled 1 336 million USD.¹⁶⁷ According to the Central Bank of the Russian Federation in the 1st quarter of 2011 the Russian inflows from the Czech Republic constituted 23 million US dollars (almost 0.2%), the Russian outflows to the Czech Republic – 83 million US dollars (0.5%). According to the Czech National Bank in the 1st quarter of 2011, the Czech FDI to the Russian Federation amounted to 40.2 million US dollars, which is 17.3% of the total amount; and FDI in the Czech Republic from Russia – to 24.3 million US dollars, constituting share of only 2.5%. Unfortunately it is quite impossible to compare data from the Russian Balance of Payments with the data from the Czech Balance of Payments. These discrepancies could be considered due to the use of different methods of calculation.

Table 11. FDI between Russia and the Czech Republic based on the BoP of the Russian Federation during the period 2007-2010 (in million USD)

to / from Russia	2007		2008		2009		2010	
	USD	% of total	USD	% of total	USD	% of total	USD	% of total
From the Czech Republic	88	0.2	130	0.2	36	0.2	72	0.2
To the Czech Republic	248	0.5	319	0.6	142	0.3	359	0.7
Balance	-160		-189		-106		-269	

Source: The Central Bank of the Russian Federation^{168 169}

Inflow of FDI into the country can only be performed in the presence of a number of conditions – a country should possess certain economic, social, and institutional backgrounds which include political and economic stability, the size and growth potential of the market, transparent legal and regulatory environment, corruption level in the country, availability of technologies, infrastructure and transportation, quality of labor, etc. Further in this chapter we will examine these criteria: their present situation in each of two countries, impact on investment flows, etc.

The constant increase of investment flows into the country can definitely be considered one of indicators of continuous improvement of investment climate. The Czech Republic has made

167Прямые инвестиции из Российской Федерации за границу по состоянию на 1 января 2010 г., Центральный Банк Российской Федерации, May 5, 2011, accessible from http://www.cbr.ru/statistics/print.aspx?file=credit_statistics/dir-inv_out_country.htm&pid=svs&sid=ITM_58823

168Прямые инвестиции в Российскую Федерацию в 2007 году - I квартале 2011 года, Центральный Банк Российской Федерации, May 3, 2011, accessible from http://www.cbr.ru/statistics/print.aspx?file=credit_statistics/inv_in-country.htm&pid=svs&sid=ITM_23050

169Прямые инвестиции из Российской Федерации за границу в 2007-2010 годах и I квартале 2011 года, Центральный Банк Российской Федерации, May 26, 2011, accessible from http://www.cbr.ru/statistics/print.aspx?file=credit_statistics/inv_out-country.htm&pid=svs&sid=ITM_43221

significant progress towards creating a stable and attractive investment climate in the country; Russia, however, still lags behind. According to the Global Competitiveness Index 2009-2010 calculated by the World Bank, Russia ranks 63rd in the list of 133 countries, while the Czech Republic – 31st place.¹⁷⁰ [p. 128, 268] But the main difficulty is not how to start a business, but rather how to keep it running later.¹⁷¹ Thus, in the ranking “Doing business” by International Finance Corporation, in accordance with “Ease of doing business” Russia ranks only 123 comparing with the 63rd place for the Czech Republic, mainly due to difficulties with starting / closing a business, paying taxes and dealing with corruption in the country – the most problematic factor for doing business, as the corruption level in Russia is estimated at the level of 2.1, which makes the 154th rank against Czech's 4.6 with 53rd rank in the rating, which is presented by the Transparency International and based on an assessment of 178 countries.¹⁷² ¹⁷³ According to Euromoney's Country risk rating, ranking countries with respect to political and economic stability and evaluating their investment risk, risk of losing direct investment, etc - as at March, 2011, the Czech Republic is at place 24th and Russia – 57th of countries around the globe.¹⁷⁴ Some other indexes calculated by the World Bank and presented in the Global Competitiveness Report 2009-2010 concerning the topic of this chapter you can see from Table 12 (see Annex), which later we will often refer to. The data used is based on the assessment of 133 countries.

As we can see from the Table 12 (see the Annex), Russia lags behind the Czech Republic in all the indexes, that uniquely refers to the fact, that to date the Czech government has been more successful in creating more favorable conditions for foreign investors in its market.

The size of the country and its development level influence the size of FDI it receives. Russian market growth potential is the major factor that often influences companies' decision to invest into the country. Russia has a population of 141.9 mil people in 2009, with a vast potential for consumption. Even though the country's per capita GDP is still very low, almost two times, in comparison with the Czech level (see the Table 1), Russia is experiencing rapid economic growth and continuously increasing purchasing power. According to PriceWaterHouseCoopers report, Russia will be of similar size to France by 2050 at both market exchange rates and in PPP terms.¹⁷⁵

170Klaus Schwab: The Global Competitiveness Report 2009-2010, Geneva: the World Economic Forum, 2009, ISBN-13: 978-92-95044-25-8, ISBN-10: 92-95044-25-8

171Экономика России растет на нефти, но ей не хватает хорошего делового климата, Андрей Остроух, Reuters, ИноСМИ.ru, March 31, 2011, accessible from <http://www.inosmi.ru/economic/20110331/167934389.html>

172Economy Rankings, Doing Business: measuring business regulations, International Finance Corporation, the World Bank Group, June, 2010, accessible form <http://doingbusiness.org/rankings>

173Corruption perceptions index 2010 results, Transparency International, 2010, accessible from http://transparency.org/policy_research/surveys_indices/cpi/2010/results

174World Risk Average, Euromoney Country Risk, 2011, accessible from <http://www.euromoneycountryrisk.com/>

175The World in 2050, John Hawksorth, PriceWaterHouseCoopers, March 2006, accessible from <http://www.pwc.com/gx/en/world-2050/pdf/world2050emergingeconomies.pdf>

Geographical location plays an important role as well. Russia is close and has business connections in the Balkans, Caucasus and Central Asia, the Czech Republic in its turn is almost literally situated in the heart of Europe, being a link between Eastern and Western countries, these facts make companies in both countries attractive for further investment in neighboring regions.

Lower costs for resources are another important factor. The accession of the Czech Republic to the EU gradually balanced out wage levels in the Czech Republic with levels in other EU countries.¹⁷⁶ In Russia, in comparison to these countries, production and labour costs are relatively low. Russia is also rich with such assets as good universities and scientific institutions, qualified researchers, and skilled workforce, and although in terms of these characteristics Russia still lags behind the Czech Republic, the situation can't be considered unfortunate.¹⁷⁷

The Czech government actively supports foreign investment into its economy creating a favorable investment climate in the country, thus many Czech firms partially or fully have passed into the ownership of western companies. For example, about 90% of the Czech's banking sector belong to foreign owners today. Or one can give another example of automobile company Skoda, 70% of shares which in 1991 were bought by another automobile giant Volkswagen (VW) Group, and the remaining 30% in 2000 – which made the VW company the sole owner of Skoda Auto. Such a transition of formerly the national companies into the foreign hands has beneficial effects: the market began to receive high-quality and inexpensive Czech products.^{178 179 180} But also foreign companies appeared to be more profitable than domestic ones, which means more tax flows into the national budget. Using the same example of Skoda company, we can also see an improvement of investment climate in the Russian Federation. On June 14, 2011 Company “VOLKSWAGEN Group Rus” and “GAZ Group” concluded a contract about assembly of vehicles Volkswagen Jetta, Skoda Octavia and Skoda Yeti at the GAZ plant in Nizhny Novgorod, with a total production of over 100 thousand cars per year. The decision was made in consequence of the increasing popularity of Skoda brand within the class of urban vehicles among the Russian population.

Another reason for arrival of the foreign investor to foreign market is a distinct lack of financial resources in the hands of domestic companies for carrying out a business. For example

176Foreign trade commodity structure, Czech Republic – The Official Website, Operator – Ministry of Foreign Affairs, accessible from <http://www.czech.cz/en/67036-foreign-trade-commodity-structure>

177European FDI in Russia: Corporate strategy and the effectiveness of Government promotion and facilitation, Elena Rogacheva and Julia Mikerova, September, 2003, accessible from http://www.ococonsulting.com/resources/publications/fdi_in_russia_final.pdf

178Информация о Чехии, Hobbit Studio, prag.ru, 2011, accessible from <http://www.prag.ru/inform-czech/inform-czech-16.html>

179The economy of the Czech Republic, European Economy news, European Commission, Economic and financial affairs, Issue 8, October, 2007, accessible from http://ec.europa.eu/economy_finance/een/008/article_6172_en.htm

180Škoda Auto: od vtipů k vlajkové lodi, E15.cz Zprávy, April 11, 2011, accessible from <http://zpravy.e15.cz/byznys/prumysl-a-energetika/skoda-auto-od-vtipu-k-vlajkove-lodi>

representatives of Czech breweries are dissatisfied of excise taxes raise by a third in 2010, which led to the fact that the consumption of beer in the country began to decline, and breweries do not have sufficient funds for investment. However, all this has a positive effect on foreign investment inflows – Czech beer and Czech breweries become more and more attractive for Russian investors: not only for importation to Russia, but also for entering the Czech beer market. Russians have already invested dozens of millions crowns in the modernization and reconstruction of Czech breweries, and Russian businessman S. Chernichkin also intends to invest further 30 million euros in the brewery in the town of Kynperk in the Karlovy Vary Region.^{181 182}

In its turn, lack of foreign investment could adversely affect the economic well-being of the country. Years of very low FDI can explain antiquated and highly inefficient situation of the Russian industry today, although Russia was one of the most industrialized countries of the former Soviet republics.¹⁸³ According to the Global Competitiveness Index 2009-2010 calculated by the World Bank, Russia poorly performs in such areas as innovation and sophisticated factors.¹⁸⁴

One of the key priorities of the presidency of Dmitry Medvedev is modernization of the Russian economy, which is of high importance for its diversification and withdrawal from the oil and gas dependency. Aimed to turn Russia into a technologically-advances country, the program of modernization was developed with its main project Skolkovo, for which the government pledged 85 billion RUB (about 3 billion USD) over four years. But today all that has been done to implement this project is a number of memorandums signed between the Skolkovo Fund and foreign companies, including e.g. Microsoft. There are some reasons named such as little time passed since September, 2010, when law regulating Skolkovo's activities was approved; responsible people's lack of experience in the high-tech business; difficulties with the commercialization of the results of science, research, development and innovation, etc. Moreover, V. Malkin, managing partner at Transitional Markets Consultancy LLP believes there is another important question left – why should investors choose Russia over other countries, which have equal or even more favorable business conditions?¹⁸⁵ And one can name at least one reason, related to the unwillingness of foreign investor to go to Russia, it is technical backwardness of the country: unavailability of latest

181О событиях, способных повлиять на двусторонние торгово-экономические связи, июль 2011г., Портал внешнеэкономической информации, Министерство экономического развития Российской Федерации, August 4, 2011, accessible from <http://www.ved.gov.ru/news/2413>

182Rusové investují miliony do pivovarů v Česku, *Hospodářské noviny*, June 6, 2011, accessible from <http://HN.IHNED.CZ/c1-52023870-rusove-investuji-miliony-do-pivovaru-v-cesku>

183Background note: Russia, U.S. Department of State, March 16, 2011, accessible form <http://www.state.gov/r/pa/ei/bgn/3183.htm>

184Экономика России растет на нефти, но ей не хватает хорошего делового климата, Андрей Остроух, Reuters, ИноСМИ.ru, March 31, 2011, accessible from <http://www.inosmi.ru/economic/20110331/167934389.html>

185Will Russia ever reduce dependence on oil and gas exports, Konstantin Rozhnov, Business reporter, BBC News, April 28, 2011, accessible from <http://www.bbc.co.uk/news/business-13213340>

technologies, low firm-level technology absorption, low level of FDI's technology transfer into the country, etc. (see the Table 12 in the Annex)

As for the Czech Republic, in order to pursue the Europe 2020, in the document “Investing into European Competitiveness: Contribution of the Czech Republic to Europe 2020 Strategy”, the Czech investment policy concerning innovations includes support for economic growth based on research and innovation. Even though the Czech economy is strongly focused on industrial production, the sustainability of industrial production is impossible without appropriate research in a particular sphere. Thus National Reform Programme of the Czech Republic 2011 poses certain problems, which are necessary to solve in order to enhance the competitiveness of the country, with concrete reform priorities.

For example, one of the problems concerns financing structure and spending mechanism. The share of expenditure on research, development and innovation was gradually increasing since 1995, but diminishing since 2006, and in 2009 amounted 1.53% of GDP, which is low compared to the EU average. As for the distribution between the public and private sector – most of these resources are consumed within the business sector. Even though considerable progress has been made (the adoption of amendment to Act No 130/2002 on the support of research, experimental development and innovation and the National Research, Development and Innovation Policy for 2009–2015), many problems remain unresolved, such as lack of a rational and transparent system for the allocation of public resources according to national priorities, etc.

In general, the National Reform Programme's “main targets in the sphere of research, development and innovation are an overall increase in quality and thus in the competitiveness of institutions in this area, along with closer alignment with demand in the business sector.” Even though the situation in part of innovative potential is much better in the Czech Republic than in Russia (see the Table 12 in the Annex), both countries' governments understand the necessity of R&D as a key area for the future development of national economies, and of long-term investments in this sector, including the involvement of FDI. However, in order to support innovation potential and its development in both states, it is necessary to improve the legal environment, and that is another problematic issue – FDI needs advanced and transparent legal system.

The attractiveness of the country for FDI in terms of legal environment is based on the investment-friendly and transparent legal system.

In the very document “Investing into European Competitiveness: Contribution of the Czech Republic to Europe 2020 Strategy” the Czech government also expresses its intention to develop measures which will contribute to the simplification and better predictability of the legal environment for business in the country – in particular reduction of the administrative burdens on

businesses by 2012 compared to 2005 by 30% in such areas as entry into business, commercial law, licensing, employment conditions, tax payments, etc. For example, current legislation on intellectual property protection is still insufficient and not always clear. Unnecessary or inefficient requirements in regulations that exceed the requirements of EU law will also be eliminated in order to make the country more attractive for foreign investments.¹⁸⁶

In general, the country's legal system is notable for its stability, clarity, and positive incentives for foreign investor. For example, according to the tax legislation corporate profit tax in the Czech Republic is 19%, making the country one of the lowest taxed countries in the EU.¹⁸⁷

As for the legal environment in Russia, an imperfect legal system was one of the main reasons for the fact that after the Russian market was opened, in the first decade since 1991 inflows of FDI remained low relatively economic potential of the country and its huge capital requirements. Even though a lot has been changed and improved since then, Russia is still a long way from having a smooth functioning legal culture – foreign investors are often faced with many obstacles, which are primarily related to the nature of the national legal system. Some problems in this area are:

- new legal rules usually come into effect from the time of their publication, and often without proper publicity. That is why, it is often difficult not only to find out the release of the new law, but also to find time to switch over to it in accordance with the changing legal environment;
- there is a huge amount of by-laws that often contradict each other. Moreover, it is difficult to determine exactly which standard act applies in each case, etc.

In Russia there are many obstacles for foreign investors in the sphere of legal protection, in practice of implementation of customs and tax legislation, and foreign-exchange regulations, etc. In this connection, wrong investment decision can lead to unpredictably high costs, and under these conditions many foreign investors will be faced with a choice: accept these expenses or just give up on the investment.¹⁸⁸ In order to build investors' trust, one should to ensure efficient laws, transparent and stable legal system, simplification of the legal system, non-discriminatory approach with regards to all groups of investors and investment projects, abrogation of bureaucratic and complicated administrative procedures (which are considered to be the major obstacle to business by most investors), and other measures guarantying protection of foreign investors on the territory

186Investing into European Competitiveness: Contribution of the Czech Republic to Europe 2020 Strategy, National Reform Programme of the Czech Republic, 2011, accessible from http://ec.europa.eu/europe2020/pdf/nrp/nrp_czech_en.pdf

187Инвестиционное сотрудничество с Чешской Республикой, Торговое Представительство Российской Федерации в Чешской Республике, 2011, accessible from <http://www.rustrade.cz/invest-czech>

188Правовые аспекты реализации стратегии развития инвестиционной политики государства в топливно-энергетическом комплексе РФ, Е.Н. Комиссарова, Вестник Югорского Государственного Университета, Issue 4 (15), p.65-67, 2009, accessible from <http://www.ugrasu.ru/science/journal/15/11/documents/65-67.pdf>

of the Russian Federation.

Infrastructure (industrial, social, transport, etc) of the country also plays an important role for the country's economic growth as a reason and incentive for FDI. Further in this part we will consider, as an example, transportation infrastructure of Russia and the Czech Republic, its current state, potential for growth, and place in governmental programs. A quality transportation infrastructure allows full advantage to be taken of the strategic location of projects where there is a potential to invest. Thus a foreign investor pays his attention at transportation system in the country, which include advanced network of roads, railway tracks, waterways, and airways (their quantity and quality), distances between major cities either within the country and with neighboring states, etc.

The Czech Republic's entry into the EU increased the significance of the country as a transit hub. Nowadays the country has one of the most advanced transport networks in Central and Eastern Europe, and due to its location serves as a link between Eastern and Western countries (primarily Germany and the rest of the EU), playing a key role either within traffic of goods and within passenger traffic. The density of Czech railway network is one of the highest in European countries – above 100 km per 1 000 km²; but the density of motorway roads is quite low, which is below 10 km per 1 000 km², and their quality is not at the appropriate level. Thus, in general the current state of the Czech transport network, with respect to quality and functionality, is below the level of the original 15 EU countries.^{189 190} These facts were the reason that today the Czech Republic's new Transport Policy for 2014–2020 and the Transport Sector Strategy, as more other programs and projects concerning improvement and support of transport infrastructure, are under development, as the transport structure considerably contributes to the competitiveness of Czech economy, and vice versa – the strong export orientation of the Czech economy places high demands on the capacity and quality of the Czech transport network.¹⁹¹

Poor state of transport infrastructure and its insufficient financing are some of the major constraints for the development of the Russian economy (only 39.6% of the roads in Russia corresponds to the transport and operational standards), and the country lags far beyond the Czech Republic especially in terms of quality and functional status of motorway roads (see the Table 12 in the Annex). According to the World Bank estimations in 2010, the annual repair and maintenance of

189Transport infrastructure, CzechInvest, January, 2011, accessible from <http://www.czechinvest.org/data/files/fs-16-transport-infrastructure-80-en.pdf>

190Transport infrastructure at regional level, European Commission, Eurostat, March, 2010, accessible from http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Transport_infrastructure_at_regional_level

191Investing into European Competitiveness: Contribution of the Czech Republic to Europe 2020 Strategy, National Reform Programme of the Czech Republic, 2011, accessible from http://ec.europa.eu/europe2020/pdf/nrp/nrp_czech_en.pdf

the road network in Russia lacks 1.2% of GDP. Russia not only lacks sufficient financial resources for repair and maintenance of transport infrastructure, but every year there is an increasing need for construction of new highways and regional road network in the country, which in itself provides many opportunities for investment in this sector of the economy. It is also worth considering the fact that in some areas difficult of access, due to harsh climatic conditions, their remoteness, etc, there is no any other alternative instead of use of air service; but aircrafts are in such a poor state due to their age and disrepair, which is shown by numerous air accidents.¹⁹²

Modernization of the national transport system is one of the priorities of the project “Infrastructure in Russia”, which was approved April 15, 2009 in order to ensure the transition to innovative development of the country. A lot of conferences and congresses is devoted to this subject each year, such as on April 21, 2011, Moscow hosted the International Forum “Transport Infrastructure in Russia – an innovative way of development”, which also discussed mechanisms of financing and investment into the priority transport infrastructure projects.^{193 194} On the topic of Russia's transport infrastructure and bilateral cooperation between Russia and the Czech Republic, on October 18, 2010, the Czech Republic hosted a forum “Partnership for modernization: the bilateral cooperation of business circles Russia-Czech Republic”. The aim of the forum was to attract Russian and Czech business community to develop and implement business projects on a bilateral basis, including a program of financing the building of the railway Salekhard-Nadym, which the Czech Export Bank expressed willingness to invest in.¹⁹⁵ Generally, in the Czech Republic transport infrastructure of the Russian Federation is considered perspective sector to invest in.¹⁹⁶ Thus, taking all the above mentioned into account, we can conclude that in the Czech Republic transport infrastructure – is primarily the reason for investing in various projects; in Russia - the industry for investment.

3.3. Support of the Russian-Czech investment relations

The system of investment incentives in the Czech Republic is regulated by the Act No 19/2004 Coll., according to which investment incentives may be granted to a newly established or

192Инфраструктура сегодня — препятствие развития России, Информационно-дискуссионный портал Newsland, July 15, 2010, accessible from <http://www.newsland.ru/news/detail/id/533144/>

193Проект “Инфраструктура России”, Единая Россия, 2011, accessible from <http://infros.ru/>

194Первый Международный Форум «Транспортная инфраструктура России 2011 - инновационный путь развития», Partnership for international business development, April 21, 2011, accessible from <http://www.pibd.ru/tr2011/>

195Энергетика и финансы: интеграция систем / Россия и Чехия: Партнерство для модернизации, Петр Баратов, Россия: Третье тысячелетие, Вестник актуальных вопросов, December 12, 2010, accessible from <http://www.vestnikrf.ru/journal/post/229/>

196Perspektivní obory pro vývoz do Ruské federace, Zahraniční obchod, Oficiální portál pro podnikání a export – BusinessInfo.cz, accessible from <http://www.businessinfo.cz/cz/clanek/rusko/perspektivni-obory-pro-vyvoz-do-ruska/1000580/53640/>

existing company belonging to either Czech or foreign investors in manufacturing sector or one of the high-tech sectors from the list of the Act. Such an incentive can be: a partial or complete income tax allowances for a period of up to 10 years, financial support for the creation of new jobs and for training of personnel, etc.¹⁹⁷ The government supports investment activities through its different established institutions, one of which is the Investment and Business Development Agency – CzechInvest, established in 1992 by the Ministry of Industry and Trade. The CzechInvest's “task is to contribute to strengthening the Czech economy competitiveness through support for small and medium-sized enterprises, business infrastructure and innovation, and by attracting foreign investments in the areas of manufacturing, business support services and technology centers” through aid programs financed with domestic resources or more recently with funding from European Union programs. Both domestic and foreign investors can get such services as information about business climate in the Czech Republic or any sector of the economy, help in the search of resources for the specific investment project and business partners, etc.¹⁹⁸

Both Russia and the Czech Republic are the members of Multilateral Investment Guarantee Agency (MIGA) – member of the World Bank Group, which promotes foreign direct investment into developing countries by providing political risk insurance to investors and lenders against losses caused by noncommercial risks. So far, through the assistance of MIGA they have not had any mutual investment projects.¹⁹⁹ However, a number of agreements in the sphere of foreign economic cooperation has been achieved. For example,

- the Convention between the government of the Russian Federation and the government of the Czech Republic on avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital of November 17, 1995;
- Agreement between the government of the Russian Federation and the government of the Czech Republic on the promotion and reciprocal protection of investments of April 05, 1994.²⁰⁰

That shows that Russia and the Czech Republic actively cooperate with each other at the level of state authorities. President of Russia Dmitry Medvedev and president of the Czech Republic Vaclav Klaus met several times over the past few years, discussing various issues

197Investment Incentives Act, Ing. Martin Kavka, Ministry of Industry and Trade of the Czech Republic, July 26, 2004, accessible from <http://www.mpo.cz/dokument12478-strana2.html>

198CzechInvest Services, Czech Business Web Portal, 2011, accessible from <http://www.businessinfo.cz/en/article/czechtrade-and-czechinvest-services/czechinvest-services/1001753/53851/>

199Multilateral Investment Guarantee Agency, World Bank Group, 2011, accessible from <http://www.miga.org/>

200Договорно-правовая база, регулирующая торгово-экономическое сотрудничество между Российской Федерацией и Чешской Республикой, Торговое Представительство Российской Федерации в Чешской Республике, October 30, 2008, accessible from http://www.rustradecz.ru/index.php?menu_lang=RU&menu_id=383&menu_parent_id=356

including the development of bilateral foreign economic relations. The Trade Representative of the Russian Federation in the Czech Republic actively operates and collaborates with Czech representatives of government and business. Foreign economic goals of the Representative in promoting investment activities are: promotion of Russian investment projects in the Czech Republic, assistance in the implementation of investment projects and investment activities of Russian investors in the Czech Republic, participation in trade negotiations towards the liberalization of market access for Russian investments on the territory of the Czech Republic, and so on.²⁰¹

The main legislative act regulating the activities of foreign investors in Russia is Federal Law of July 9, 1999 No 160-FZ “On Foreign Investments in the Russian Federation”, which however does not apply to investments in credit, insurance and nonprofit organizations.²⁰² At the national level, in Russia there is the National Agency for Direct Investment (NADI), established in 2001 to assist Russian and foreign companies in attracting investment and business development, as well as industries and regions of the Russian Federation. NADI actively cooperates with federal authorities, regional administrations, with Russian and foreign companies, and international financial institutions. Since its establishment, the Agency had carried out more than 100 projects either for public authorities and private companies. Currently, NADI and MIGA realize a joint project for the development of infrastructure to support investment activities in Russia.²⁰³ One can name another non-profit organization established for the purpose of implementing the Investment Opportunities in Russia project and assisting attracting investment in the country is Institute of Direct Investments Foundation. That is an information internet-system that supports a network of investment opportunities and business plans of investment projects initiated by Russian companies and classified by regions, industries, capacities, and ways of financing.²⁰⁴

In Russia it is possible to note the passivity of the state as an investor – that negatively affects the investment climate in general, as a weak state's participation in the investment process leads to a decrease in private investors' confidence in the investment process. Also in the banking sector, the state's role as a regulator of investment flows in the most efficient sectors of the economy is absent; however, the role of banks in the Russian-Czech economic relations should play a special role with priority task – financing of investment activities. In this regard, it is necessary to ensure a system of attraction of foreign capital to Russia, which includes a broad and competitive network of

201Информация о Торгпредстве, Торговое Представительство Российской Федерации в Чешской Республике, 2011, accessible from <http://www.rustrade.cz/tp-overview>

202Закон об иностранных инвестициях в Российской Федерации, Информационно-юридический портал flexa.ru, 2011, accessible from <http://www.flexa.ru/law/zak/zak019.shtml>

203История, Национальное агентство прямых инвестиций, 2009, accessible from <http://www.napi.ru/ruhistory>

204Institut of direct investments Foundation, Investment opportunities of Russia, accessible from <http://www.ivr.ru/>

public institutions, commercial banks and insurance companies (for foreign investments' insurance against political and commercial risks), specialized centers which provide information and mediation services for potential investors and selection for them of projects topical for Russia, as well as to support the creation of small and medium enterprisers, which will contribute to the development in the first place – big business, which in turn will be able to implement their projects working with these SMEs.

Both countries also organize different specialized fairs and exhibitions with a focus on searching for investment opportunities in the Czech Republic, to name some of them, the Czech ones: “Urbis Invest” in Brno and “For Invest” in Prague.²⁰⁵ In Russia, for example – “International Investment Forum”, which takes place in Sochi on September 15-18, 2011.

3.4. Recommendations

Due to large and dynamic domestic market, country location, abundant natural resources, low costs relatively to Western Europe, skilled labour, and other favorable conditions, Russia has a huge potential for attracting market-seeking, efficiency-seeking, and resource-seeking FDI. In order to increase attractiveness of the Russian Federation for foreign investors, I propose further actions to take into account:

= Modernization of energy sector. Despite the huge potential in such sectors as food and automotive industry, consumer products, and real estate; Russia welcomes investment in the transport and energy sector, including renewable energy since there are such problems as uneven power consumption and distribution of energy.

Czech entrepreneurs, seeking to enter the Russian market, agree that energy, transport and investment are three pillars of the future Czech-Russian economic relations, while energy sector is considered more perspective among all others. The main problem of the Russian energy sector is in its poor condition, since the “youngest” power stations is at least thirty years old, and in Russia it's not usual to revive the old power station, but the much more expensive building of new ones. Czech companies are ready to provide Russia as with new energy technologies and the necessary equipment for power stations. For example, new thermal power station was opened in the Vologda region in 2009, built with the direct participation of Czech businessmen.²⁰⁶

The Czech Republic is an industrialized country and has moved a long way ahead in the development from Russia in terms of high-tech technology and equipment. Therefore, I see the need

²⁰⁵Trade fairs and exhibitions, Czech Business Web Portal, 2011, accessible from <http://www.businessinfo.cz/en/section/trade-fairs-and-exhibitions/1001071/>

²⁰⁶Чешские технологии – в помощь российской экономике, Российский Центр науки и культуры в Праге, Представительство Россотрудничества в Чехии, 2009, accessible from http://rsvk.cz/?page_id=522

for Russian business to enter into joint projects with the Czech Republic in the use of Czech innovative technologies and equipment and in the creation of infrastructure facilities in energy and transport sectors, either at the national and regional levels between countries, and then the transmission of technology from FDI to the domestic economy functions via imitation.

= Adoption of Czech best practices. However, in addition to transference of the Czech technologies, there is a need for Russian companies to adopt the Czech experience in the modernization and optimization of the energy industry, introduction of innovative technologies, training of workers, etc.

= Involvement of credit institutions. Implementing of investment projects requires huge financial resources and faces challenges such as volatility of world energy prices, significant sunk costs and usually long-term returns on investment. But in Russia there is no organized system of transformation of savings of citizens and legal entities in the investments. Thus governments of both countries must get credit institutions involved, including banks and investment companies, into the process of long-term investment projects' financing.

= Improvement of the business environment. Over the past few years Russia has conducted a large number of legislative reforms: improving customs and tax legislation, reduction of administrative barriers, abolition of corruption, etc. However, there is a need for further improvement of investment laws, regulations and procedures in order to ensure Russia has a competitive advantage over other countries. The governmental actions should also include either support of existing investment promotion agencies and assist the establishment of new independent bodies in their work to attract FDI and to facilitate foreign investors' access to the Russia Federation.

Conclusion

Stable economic growth, the implementation of progressive structural changes, and the increase of the economy's efficiency significantly depend on the successful development of foreign economic relations. To what extent will foreign policies of Russia and the Czech Republic be successful this year? We will probably be able to judge this by considering the following results: how the volume of foreign trade will change and the structure of exports and imports as a whole, whether the new investments will come into the country – and not only in the context of economies, but also in the context of better social and political relations, as well as improved infrastructure, science, research, innovation, education, etc.

Russian-Czech economic and trade cooperation before the world financial crisis were developing sufficiently rapidly. However, the crisis affected the bilateral trade between countries having led to its decrease in 2009. As for the year 2010, Russia and the Czech Republic could not achieve the record pre-crisis level of 2008 mainly due to “low” prices for Russian energy resources in 2010 relatively to 2008. Moreover, during 2010 the share of energy resources was gradually decreasing in the total volume of Russian exports to the Czech Republic, which is not in the least due to the Russian-Ukrainian gas disputes in recent years. Thus, according to the Czech Statistical Office, the figure dropped by almost 5% compared to 2009, and in 2010 it constituted 82.2% of Russian exports. Also it is worth mentioning the growth of Russian machine-building products in total exports during 2009–2010, although small – its share in 2010 was only 3.9%. But until Russia sees stable growth in the output of competitive products, it will be too early to speak of a stable economic growth pattern.

All that mentioned above indicates that the opportunities for further growth of trade volumes due to the increase of Russian energy supplies and raw materials have almost been exhausted. Thus, there is a need for the country's move from the dependence on the international raw material and oil markets to the technological restructuring of the economy, which is crucial for planned modernization of Russia. However, the country can't fulfill this only on its own, having neither a sufficient level of modern technological equipment or the massive financial resources. But for actual investments to flow and capital flight to be reversed, much will have to change. In this regard, for Russia to be able to productively and for a long-term perspective develop foreign economic relations, a priority should be the improvement of the business and investment climate in the country. It concerns the transparent and stable legislative framework, comprehensive tax reforms, anti-corruption measures, reduction of administrative barriers and risks, support of FDI and provision of preferential treatment to foreign investors in the areas of new technologies and

innovations, etc.

In this context, further close co-operation with the Czech Republic becomes very important, since today the country “is one of the most important and reliable economic partners of Russia (18th place in terms of turnover in 2010). Russia is also among the main foreign trade partners of the Czech Republic (8th place in terms of turnover in 2010).”²⁰⁷ The Czech Republic has a long history and successful experience in building industrial model of the economy, and is one of the fastest growing countries in Eastern Europe, so the mutual trade and its involvement as an investor can bring to Russia not only new production capacity and financial resources, but priceless contribution in terms of experience gained. In other words, transformation of current mutual relations between two countries by expanding investment and innovation cooperation, establishment of cooperation in the production of modern high technology equipment, processes, licenses and exchange of “know-how”.

The role of state is an essential part as well. A lot has already been done and is being done: bilateral inter-governmental treaties and agreements on mutual cooperation, meetings at various levels of government including representatives of business towards the improvement of external economic relations, etc. However, what has been achieved to date is not in itself enough to guarantee a long-term growth of the economy. It is also worthwhile paying attention by national authorities to credit institutions' involvement as financial intermediaries (since current mechanisms for transforming savings into investments are ineffective), to the system of incentives such as tax relief on some operations, to pro-export policy including assistance to Russian companies' presence in the Czech market, to support SMEs as the potential business partners of Czech companies, to development and continued support for regional trade and investment promotion agencies, etc.

However the Russian market potential is high, therefore, most companies plan to increase production in the near future and in the long term invest more, since for the Czech companies the opportunities for trade and investment are immense. The Czech economy is one of the most open in the world, with a dominant export orientation making the country highly dependent on external economic relations and on the economic growth of those countries to which the Czech exports are headed. All this makes Russia and the Czech Republic mutually dependent on each other and in need of bilateral collaboration.

The dominant role of the Czech export policy belongs to industry, which continues to be regarded as an objective also for the coming years with predicted further growth in this sector. However, the country should consider the transition to more sophisticated products by drawing on

²⁰⁷Торгово-экономическое сотрудничество России и Чехии, Торгово-экономические отношения, Торговое представительство Российской Федерации в Чешской Республике, October 27, 2011, accessible form <http://www.rustrade.cz/trade-economy>

their price competitiveness, innovations and new technologies. Even though the business environment in the Czech Republic is favorable and open to foreign investment, supported by the fact that most companies operating in the country are in the hands of foreign investors, the Czech investment policy requires its long-term retention and attraction of new FDI in the sectors which so far do not make any considerable contribution to GDP of the country.

While the situation in mutual cooperation between countries has started to change since Vaclav Klaus became new president of the Czech Republic, the Russian-Czech relations still reflect the history of two nations during the 40 years of communist regime. Thus the countries should not only concentrate on the development of external economic cooperation, but also on establishment of confidential, long-term, and politically stable relations.

In addition, other main factors influencing the development of bilateral economic and trade cooperation between two countries, which are impossible to influence, include fluctuations in world currencies and in energy prices. Here it should also be mentioned that while Russia is not a member of the WTO, a stable investment environment is impossible without reliance on legal frameworks to address disputes. If Russia as it's forecasted will become a WTO member state, it will positively affect the flow of investment into the country and the improvement of conditions for international trade, although it will have a negative impact on the viability of certain uncompetitive industries, at least in short-term perspective.

To conclude, I would like again to stress that both countries have a lot of trade and investment opportunities with each other, and further strengthening cooperation would not only benefit the development of mutual relations, but also the growth of domestic economies.

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Annex

Table 12. Some indexes from The Global Competitiveness Report 2009-2010

Index (based on data of 2008)	Rank	
	Russian Federation	Czech Republic
Protection of minority shareholders' interests	127	88
Transparency of government policymaking	114	103
Quality of overall infrastructure	86	52
Extent and effect of taxation: what impact the level of taxes in your country has on incentives to work or invest	99	45
Total tax rate: this variable is a combination of profit tax (% of profits), labor tax and contribution (% of profits), and other taxes (% of profits)	87 (48.7%)	85 (48.6%)
Number of procedures required to start a business (number of procedures)	60 (8)	60 (8)
Time required to start a business (number of days)	80 (29)	41 (15)
Prevalence of foreign ownership: how prevalent foreign ownership of companies is in the country	120	32
Business impact of rules on FDI: to what extent rules governing FDI encourage or discourage it	124	12
Restriction on capital flows: how restrictive regulations are in the country relating to international capital flows	122	24
Strength of investor protection	71	71
Local supplier quality	110	15
Availability of latest technologies	102	48
Firm-level technology absorption	104	35
FDI and technology transfer: to what extent FDI bring new technology into the country	103	14
Quality of scientific research institutions	42	19
Government procurement of advanced technology products: whether government procurement decisions foster technological innovation in your country	69	23

Source: World Economic Forum. The Global Competitiveness Report 2009-2010²⁰⁸ [pp. 128-129, 269-269]

²⁰⁸Klaus Schwab: The Global Competitiveness Report 2009-2010, Geneva: the World Economic Forum, 2009, ISBN-13: 978-92-95044-25-8, ISBN-10: 92-95044-25-8