

Vysoká škola ekonomická v Praze
Recenzované studie

Working Papers
Fakulty mezinárodních vztahů

19/2008

**Russian Foreign Direct Investments
and their Governance**

Andrea Turečková

**Faculty of International Relations
Working Papers**

19/2008

**Russian Foreign Direct Investments
and their Governance**

Andrea Turečková

Volume II



Vysoká škola ekonomická v Praze
Working Papers Fakulty mezinárodních vztahů
Výzkumný záměr MSM6138439909

Tato studie byla vypracována v rámci Výzkumného záměru Fakulty mezinárodních vztahů Vysoké školy ekonomické v Praze MSM6138439909 „Governance v kontextu globalizované ekonomiky a společnosti“.

Název: Working Papers Fakulty mezinárodních vztahů
Četnost vydávání: Vychází minimálně desetkrát ročně
Vydavatel: Vysoká škola ekonomická v Praze
Nakladatelství Oeconomica
Náměstí Winstona Churchilla 4, 130 67 Praha 3, IČO: 61 38 43 99
Evidenční číslo MK ČR: E 17794
ISSN tištěné verze: 1802-6591
ISSN on-line verze: 1802-6583
ISBN tištěné verze:
Vedoucí projektu: Prof. Ing. Eva Cihelková, CSc.
Vysoká škola ekonomická v Praze, Fakulta mezinárodních vztahů
Náměstí Winstona Churchilla 4, 130 67 Praha 3
+420 224 095 270, +420 224 095 248, +420 224 095 230
<http://vz.fmv.vse.cz/>

VÝKONNÁ RADA

Eva Cihelková (předsedkyně)

Vysoká škola ekonomická v Praze

Vladimíra Dvořáková

Vysoká škola ekonomická v Praze

Olga Hasprová

Technická univerzita v Liberci

Zuzana Lehmannová

Vysoká škola ekonomická v Praze

Marcela Palíšková

Nakladatelství C. H. Beck, Praha

Judita Štouračová

Vysoká škola mezinárodních
a veřejných vztahů, Praha

Dana Zadražilová

Vysoká škola ekonomická v Praze

REDAKČNÍ RADA

Regina Axelrod

Adelphi university, New York, USA

Peter Bugge

Aarhus University, Aarhus, Dánsko

Petr Cimler

Vysoká škola ekonomická v Praze

Peter Čajka

Univerzita Mateja Bela,

Bánská Bystrica, Slovensko

Zbyněk Dubský

Vysoká škola ekonomická v Praze

Bernd Hallier

EHI Retail Institute, Köln,

Německo

Jaroslav Jakš

Metropolitní univerzita Praha

Vladimír Jeníček

Vysoká škola ekonomická v Praze

Eva Karpová

Vysoká škola ekonomická v Praze

Jaroslav Kundera

Uniwersytet Wrocławski, Wrocław,
Polsko

Lubor Lacina

Mendelova zemědělská a lesnická
univerzita, Brno

Václava Pánková

Vysoká škola ekonomická v Praze

Lenka Pražská

emeritní profesor

Mikuláš Sabo

Ekonomická Univerzita

v Bratislave, Slovensko

Margarita Shivergueva

Nov b'lgarski universitet, Sofie,
Bulharsko

Leonid Strowskij

Ural'skij gosudarstvennyj

techničeskij universitet,

Jekatěrinburg, Rusko

Peter Terem

Univerzita Mateja Bela,

Bánská Bystrica, Slovensko

Milan Vošta

Vysoká škola ekonomická v Praze

ŠÉFREDAKTOR

Jakub Krč

Vysoká škola ekonomická v Praze

Russian Foreign Direct Investments and their Governance

Andrea Turečková (aturecko@vse.cz)

Summary:

Foreign direct investment has a growing position in global business. Improving the business environment is one of the crucial elements for attracting the foreign capital. The aim of this paper is to give an overview about the conditions for investing in Russia, the main foreign direct investment inflows, but also to show the power of the Russian translational companies and their investment interests.

Keywords: governance, foreign direct investment, Russia

Ruské zahraniční investice a jejich governance

Andrea Turečková (aturecko@vse.cz)

Abstrakt:

Přímé zahraniční investice hrají vedoucí roli ve světové ekonomice. Jedním z rozhodujících faktorů pro příliv zahraničního kapitálu je podnikatelské prostředí. Cílem této studie je zhodnotit připravenost Ruska z hlediska podmínek pro vstup zahraničních investorů, poukázat na hlavní investice plynoucí do Ruska, stejně jako upozornit na rostoucí vliv ruských nadnárodních společností a jejich investiční zájmy.

Klíčová slova: governance, přímé zahraniční investice, Rusko

JEL: F21, F23, K20

Content

Introduction	7
1. Investment Conditions of Russian Federation	7
1.1 Characteristics of Foreign Investment	7
1.2 Russian Foreign Investment Law	8
1.3 Special Economic Zones	11
1.4 Agencies for Direct Investment Support	12
2. Foreign Direct Investment in Russia	13
2.1 Russian Inward FDI Performance	13
2.2 Origins of investment inflows	14
2.3 Sectoral distribution of investment inflows	16
2.4 Investment inflows by regions	16
3. Russian Outward Investments	17
3.1 Key figures and development	17
3.2 Destinations of Russian Outward Investment	17
3.3 The leading Russian companies abroad	19
Conclusion	19
References	21

Introduction

Russia is one of the ten largest economies in the world and the European Union's third largest trading partner. Moreover, it is an essential energy supplier. Russia has improved its business environment in recent years and became an important destination for foreign investment. On the other hand, Russian corporations are expanding abroad and play a key role in making Russia the second largest investor in terms of outward foreign direct investment stock.

There are two main primary producers of foreign direct investment data in Russia – the Central Bank of Russia and the National Statistical Office (Rosstat). Their foreign investment series are due to different methodology not comparable. Nevertheless, the Rosstat statistics are the only ones providing a breakdown by country of origin and sector of investment which brought me to use mostly them.

1. Investment Conditions of Russian Federation

1.1 Characteristics of Foreign Investment

We discriminate between two basic types of capital – loan capital and production. In the case of loan capital we get a pay-off in the form of some percentage. Regarding the production capital so called investment dividend is the bonus gained by this operation.

According to the methodology of the international financial institutions there are three groups of foreign investment – Foreign Direct Investment (FDI), Portfolio investment and other investment. These investments vary basically in the possibility to control the paid-in capital.

Organisation for Economic Co-operation and Development (OECD) defines *FDI* as the objective of obtaining a lasting interest by a resident entity in one economy in an entity resident in an economy other than that of the investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise (OECD 1999: 7-8). The FDI relationship consists mostly of a parent enterprise and a foreign affiliate. In order to qualify as FDI the investment must afford the parent enterprise control over its foreign affiliate in the form of owning 10% or more of the ordinary shares or voting power of an incorporated firm or its equivalent for an unincorporated firm.

Lower ownership shares are known as *Portfolio investment*. It represents passive holdings of securities such as foreign stocks, bonds, or other financial assets, which doesn't allow the control of the securities' issuer by the investor.

Under *Other investment* we understand advanced and accepted credits, for instance commercial credit, credits from international financial institutions or foreign government credits.

One of the big FDI's benefits for the host state is the enlargement of the financial capital, which can be used to economic growth. To other positive effects belongs implementation of modern technologies leading to increase in productivity of labour or more effective natural resources exploitation. The FDI's also push the governments to improve the institutional climate of the host state by making a better protection of property right, public administration functioning or business ethics. Moreover, governments often attract the FDI's by miscellaneous types of investment incentive. This conduces to successive liberalization in the market. The FDI's can therefore also help the national enterprises to expand into foreign market.

On the other hand the FDI's can bring as well some negative effects. One of the examples is the national investment crowd-out effect. The national companies are displaced by the more competitive foreign companies (transnational corporations). These use their own supplier-consumer chain and let the home suppliers lose out. The FDI's in the form of mergers and acquisitions (M&A) can cause higher unemployment rate and there is always a question of exporting the profit. By reason of capital surplus it appears that the domestic currency is strengthening and therefore influences their export possibilities.

1.2 Russian Foreign Investment Law

Russia needs more international investment to support its economic development and diversification. The decision of the companies where to invest is highly connected with the investment climate of each country. The investment climate involves political, economic and social factors as well as the legal framework.

The general legal framework for trade and investment in Russia is built by The *Constitution of the Russian Federation* (the Constitution), the *Civil Code of the Russian Federation* (the Civil Code) and other legislation on joint stock and limited liability companies.

Chapter 1 of the Civil Code governs certain types of business organizations and their conception. It covers requirements for foundation documents, name, location, governance and state registration of legal entities. It defines branches

and representative offices and governs reorganization and liquidation (PWC 2008: 31).

Foreign investors can choose from several different forms of business representation in Russia. Apart from representative offices and branches, there may be established various legal entities including joint-stock companies (JSC), limited liability companies (LLC) and partnerships.

Since the Joint-stock and limited liability companies are the most popular by the foreign investors, they are governed by additional legislation, particularly the Federal Law No. 14-FZ *On Limited Liability Companies* of 8 February 1998 and the Federal Law No. 208-FZ *On Joint Stock Companies* of 26 December 1995. From these two forms of corporate structure the LLC seems to be more popular as the procedure for the establishment and the operation of it not so complicated is. Especially the absence of necessity to issue shares in an LLC makes this form of legal entity more flexible in the cases of changing the basic capital of the company.

For companies who are not willing to establish a Russian legal entity, but rather a body representing the interests of their own legal entity, a representative office would be the most suitable form of legal presence in Russia. Most representative offices are not subject to profits tax unless it is used by a foreign legal entity engages for regular commercial activity like the sale of goods or the provision of services. On the other hand a branch's legal status differs substantially from that of a representative office. If it is registered, it would be treated according to Russian law as "an enterprise with foreign investment". Therefore, while a registered branch can hold a licence to conduct regulated activities (such as oil field development), a representative office or unregistered branch may not (PWC 2008: 33).

Foreign investments are regulated by the Federal Law No. 160-FZ *On Foreign Investments in the Russian Federation* of 9 July 1999 (the Law on Foreign Investments). It guarantees foreign investors the right to invest and to receive revenues and profits from such investments. The Law on Foreign Investments emphasizes the role of both federal and regional legislation, and stipulates that foreign investors and investments must be treated no less favourably than domestic investments, with some exceptions (Baker & McKenzie 2007: 6).

Moreover, the Law on Foreign Investments contains in Article 9 a tax stabilization clause, also known as "the Grandfather Clause".¹ This clause can be used by Russian companies with more than 25% foreign equity ownership or either foreign investors or Russian companies with any foreign participation that

¹ A grandfather clause is an exemption which allows current businesses or property owners to continue operating under the previous laws.

are implementing “priority investment projects”. These projects are defined in Article 2 of the Law as project with foreign investment of at least 1 billion roubles, or where a foreign investor has purchased an equity interest of at least 100 million roubles. The investment project must also be included in a list of projects approved by the Russian Government. By the same mail it is necessary to point out that there are many restrictions and exceptions to the Grandfather Clause, which may let us doubt of the helpfulness for foreign investors.

The Law on Foreign Investment permits foreign investment in most sectors of the Russian economy: portfolios of government securities, stocks and bonds, direct investment in new businesses, the acquisition of existing Russian-owned enterprises, joint ventures, etc. Foreign investors are protected against nationalization or expropriation unless such action is mandated by a federal law. In such cases, foreign investors are entitled to receive compensation for any investment and other losses (Baker & McKenzie 2007: 6).

Apart from the Law on Foreign Investments, investments of foreign capital in banks, credit organization, insurance companies or non-commercial organizations are regulated under different Russian legislation. The securities market and securities transactions within the Russian Federation are mainly regulated by Federal Law No. 39-FZ *On the Securities Market* of 22 April 1996, the foundations of the Russian banking system are provided in Federal Law No. 395-1 *On Banks and Banking Activities* of 2 December 1990 and Federal Law No. 86-FZ *On the Central Bank of the Russian Federation* of 10 July 2002. The Central Bank of the Russian Federation is responsible for regulating banking activities.

Foreign investments in mining, oil, gas and other extraction sectors are conditioned in the Federal Law No. 225-FZ *On Production Sharing Agreements* of 30 December 1995 (PSA). Amendments to the PSA in June 2003 significantly reduced the benefits to foreign investors and made therefore the PSA largely ineffective in terms of attracting foreign investment into Russia.

Several sectors remain closed to foreign investment. Current regulations restrict foreign involvement in the banking sector and according to a proposed new law the government restricts foreign access to other strategic sectors. Any deals involving investment in so called strategic enterprises will be subject to approval by a commission. Russian Prime Minister Vladimir Putin has been appointed chairman of the commission. The legislation came into force in May 2008 and is valid for all foreign investors seeking to buy more than a 50% stake in a company in one of the 42 strategic sectors. State-controlled foreign companies are required to seek permission to acquire more than 25% of shares in strategic enterprises, which include oil, gas, the nuclear industry, arms production, fisheries, airspace and the media (RIA Novosti 9.7.2008).

1.3 Special Economic Zones

Positive Impact on investment is expected from the Federal Law No. 116-FZ *On Special Economic Zones in the Russian Federation* of 22 July 2005. A special economic zone (SEZ) is a territory in Russia selected by the government from proposals submitted by regional authorities. In these areas a special preferential regime for doing business is provided to encourage industrial development based on innovations as well as the development of transport infrastructure and other spheres. For this purpose, the Federal SEZ Management Agency was created by the Russian Government.

For the beginning, six geographic locations in various parts of Russia were selected to create SEZ of two types – *High Technology Incubation Zones (TIZs)* and *Industrial Production Zones (IPZs)*. There are four TIZs located in the Moscow Region (Dubna and Zelenograd), St. Petersburg and Tomsk. Each zone has its own specialization. The zone in Dubna, where a nuclear centre is based, produces nuclear technology, the Zelenograd zone specializes in microelectronics, and the Siberian zone in new types of materials. The St. Petersburg zone is focused on research and IT products and equipment. The two remaining zones serve as TIZS. An industry zone in Yelabuga, in the Volga republic of Tatarstan, produces car parts in cooperation with Korea's Hyundai and the U.S. giant General Motors. The zone in the central Russian region of Lipetsk is specialized in household appliances and possibly furniture.

Another type of SEZ was introduced in 2006 – the *Zone of Tourism and Recreation (ZTR)* – to provide development of tourism as well as of health and recreational resorts. On February 2007 seven projects located in Altay, Buriatia, the Krasnodarskiy, Stavropolskiy and Altaiskiy Territories have been selected.

Finally, a *Port Zone* as another type of SEZ was created in October 2007 for the purpose of development stimulation of harbour equipment and the development of harbour services. Yet, there haven't been announced any concrete areas thus far.

In addition, there has been adopted an ad-hoc legislation in accordance with creating SEZ in several regions. Concretely it is the Federal Law No. 16-FZ *On the Special Economic Zone in the Kaliningrad Region* of 10 January 2006 and the Federal Law No. 75-FZ *On the Special Economic Zone in the Magadan Region* of 29 June 1999. This legislation is currently still active.

For SEZ is responsible the Federal SEZ Management Agency created by the Russian Government in 2005. To enjoy the benefits of the SEZ you have to become an SEZ resident. Foreign investors can apply only upon creation of a Russian subsidiary. The applicant has to sign an agreement on technology implementation activities with an SEZ Administration. The application should

be supported by a business plan. If they are successful following tax benefits will be at their disposal. They are exempt from Corporate Property Tax, Transport Tax and Land Tax for the first five years after a property is acquired. The Corporate Profits Tax is reduced to 20% from the usual 24%. The residents are also allowed to write-off expenditure on scientific research and development works. The Unified Social Tax on employees' salaries is ranging from 14% down to 2% instead of 26% down to 2% for TIZs. In the free economic zones the customs regulations are in force. Foreign goods are placed and used within the territory special economic zones without payment of customs duties and value added tax, as well as without application to the said goods of economic bans and restrictions, fixed in accordance with the legislation of the Russian Federation on state regulation of foreign economic activity, and Russian goods are placed and used on terms applicable to export in accordance with export customs regulations with payment of excise and without payment of export customs duties (CusSEZ 2008).

1.4 Agencies for Direct Investment Support

The building of agencies for direct investment support is a necessary part for stimulation the inward FDI. They are helping the foreign investors to pass through the information chaos and mediate between the officials. Today there are lots of agencies of this kind in Russia. Among the two most important we can account the *National Agency for Direct Investment* (NADI) and the *Trade and Investment Development Agency of Russia* (TIDA).

NADI was founded in 2001 to promote and facilitate investment in Russia, providing a one-stop shop for business development and investment services to both Russian & international firms & organizations (NADI 2008). The agency cooperates with the Multilateral Investment Guarantee Agency (MIGA), the World Bank member. It acts with federal governmental bodies, regional administrations, Russian and foreign companies, and international financial organizations. The activities of the agency are supported by the Ministry of Economic Development and Trade of the Russian Federation, the Russian Chamber of Trade and Industry, as well as regional Chambers of Commerce.

The important thing is that it works with both either Russian or foreign companies. It has therefore a good overview about needs in both side of the business. The agency participate also in forming the favourable investment conditions in the regions by setting up strategies for each region and supporting the regional agencies. It also helps to determine the priority fields and evaluate the key investment projects.

The other agency TIDA has wider spectra of activities. It works in the area of foreign trade, economic development and investment. TIDA has replaced the company InformVES which had been supporting the Russian and foreign markets for more than 30 years.

It is a subdivision under the Ministry of Economic Development and Trade of the Russian Federation and has its office in every Russian region. In addition, it implemented the UNCTAD program on the establishment of Trade Point which is a permanent member of the UN Centre to simplify the Trade Procedures and Electronic Business Transactions – UN CEFAC of the European Economic Commission (TIDA 2008). TIDA was so responsible for the development of the system on unification and standardization of the documents for foreign trade.

Beside the federal agencies there are many of the regional ones, for example the Sakhalin Investment Promotion Agency, the Khabarovsk Foreign Investment Agency or the Chelyabinsk Regional Agency for Entrepreneurship and Investments Attraction and many others. They have a similar strategy in attracting the foreign investment, but they are mostly closer to the regional authority bodies.

2. Foreign Direct Investment in Russia

2.1 Russian Inward FDI Performance

Russia has enormous natural resources and market of 145 million inhabitants. Despite this fact, until recently it was not successful in attracting foreign direct investments accordant with its potential.

Tab. 1: Foreign investments in the economy of Russia (mln. USD)

Variable	1995	2003	2004	2005	2006	2007
Total investments	2 983	29 699	40 509	53 651	55 109	120 941
Direct investments	2 020	6 781	9 420	13 072	13 678	27 797
Portfolio investments	39	401	333	453	3 182	4 194
Other investments	924	22 517	30 756	40 126	38 249	88 950

Source: Rosstat, www.gks.ru, own calculations.

The table 1 indicates the development of investment flows from 1995 to 2007. We can see a huge progress in the total amount of capital coming to Russia. The Russian inward investments, including flows into the securities markets and credits, have jumped from USD 2.98 billion in 1995 to almost USD 30 billion in 2003. This means a tenfold growth in a period of eight years. In the next years, a slow increase is to be observed with USD 40.5 billion in 2004; USD 53.65 billion in 2005 and USD 55.11 billion in 2006. Another break came last year when the total foreign investment more than doubled to a record USD 120.9 billion.

Further interesting phenomenon we can observe is the reversal of the FDI inflows and a corresponding switch in the direction of other investment flows to Russia. Apart from that the amount of FDI inflows was with its USD 2.02 billion almost inconsiderable in today's view and with respect to the size of Russian economy in 1995, they participated almost 68% in the total inward investments whereas the part of other investment was around 31%. Looking at the 2007 year the score is 23% for FDI for the benefit of other investment with almost 70%. The share of portfolio investment flows hasn't changed much growing from 1.3% in 1995 to 3.5% in 2007.

The data about the inward foreign investment illustrate a positive development. The increase in total inflows is partially explained by the launch of a number of large Initial Public Offers (IPOs) in 2007 (notably those of the two largest state owned banks, Sberbank and VTB, which each attracted around EUR 6.7 billion) and also by the auction of the remaining assets of Yukos (Vinhas de Souza 2008a: 3). It seems that Russia experiences a FDI boom despite the Yukos case and the execution of strategic government policies (Liuhto 2008: 9). The trend as expected to continue.

When comparing the FDI stock per capita, the situation of Russia is still remaining modest. According to UNCTAD World Investment Report from 2003 Russia has received FDI per capita about USD 156 in 2002 which is the lowest rate among the Central and Eastern European countries as the same per capita figure for the Czech Republic is more than USD 3 700 and even Romania attracted two and half times more FDI per capita than Russia.

2.2 Origins of investment inflows

We can see the most important countries of origin of investments into Russia from 1995 to 2007 in Table 2. In long run we can observe that the share of United States investments has declined significantly since 1995, whereas the share of the European countries has increased except Germany and Switzerland.

Tab. 2: Origins of foreign investment inflows into Russia in %

Country or territory	1995	2000	2002	2003
UK	6	6	12	16
Cyprus	1	13	12	14
Netherlands	3	11	6	6
Luxembourg	0	2	6	8
France	4	7	6	8
Germany	10	13	20	15
Switzerland	15	7	7	4
USA	28	15	6	4
Virgin Islands (UK)	1	1	7	5
Others	33	25	19	17
	2004	2005	2006	2007
UK	17	16	13	22
Cyprus	14	10	18	17
Netherlands	13	17	12	16
Luxembourg	21	26	11	10
France	21	26	11	10
Germany	4	6	9	4
Switzerland	4	4	4	4
USA	5	3	3	4
Virgin Islands (UK)	2	2	4	2
Others	15	15	28	15

Source: Rosstat and own calculations.

Although it is difficult to ascertain the sources precisely, it seems likely that a very significant share of both the investment inflows into Russia and the recent increase is Russian capital returning to the country through tax havens for tax “optimisation” purposes (Vinhas de Souza 2008b: 67). For instance Cyprus has been among the four biggest investors since 2001. We can see the same trend also by Luxembourg, Switzerland and the Virgin Islands. When we take into consideration their share around 15-20% of the annual foreign investment flows to Russia, we can imagine approximately the proportion of the repatriation of Russian capital.

In any case, almost one third of total investment in 2006 came from EU Member States. By September 2007, over 80% of investment inflow was from the 8 most important EU-based investors.

We can observe a remarkable growth in the share of United Kingdom. Its investment is quadruple bigger than in previous year and means a first place among the foreign investments. The relatively high share of the Netherlands can be explained by the fact that it is a domicile for many multinational corporations.

2.3 Sectoral distribution of investment inflows

There are two main motivations to invest in Russia – either resource or market seeking. A study made in 2003 among foreign investors mainly in manufacturing sector reported that the most important reason for FDI was the size of the market (Liuhto 2004: 69). Due to the increasing domestic demand the interest of foreign investors has been widened from the traditional sectors as fuel and petrochemicals, extractive industry, metallurgy and machinery to telecommunications, financial and consumer sectors.

The service sectors have been receiving the largest amount of foreign direct investment during 2003 and 2007. The natural resource sectors and manufacturing attract almost the same amounts of investment. The investment in the energy sector has declined more than by half in 2005. This is mainly connected with the Yukos affair, but is mostly recovering in following years.

Among the largest investors to Russia were by the oil extraction the Royal Dutch Shell Group, the French Total, British Petroleum and the American Exxon Mobile. They all are mostly connected to oil and gas field development in Sakhalin and gasoline station chains creation. In the automotive field we can name companies Ford, Renault, General Motors, Toyota, Volkswagen or Nissan. There have been also made multiple investments in building hypermarket chains in a number of Russia cities, e.g. by IKEA, Metro or Auchan. Regarding the telecommunications, the Norwegian company Telenor has still a leading position on the market.

2.4 Investment inflows by regions

Foreign direct investments are extremely unevenly distributed among the Russian regions. Over half of it goes to Central Federal District with the capital city Moscow. It is followed by North-Western, Southern and Far Eastern Federal District. Some important FDI receivers are also Volga, Ural and Siberian Federal District.

Many of the regions with highest accumulated FDI are the ones with million-cities. Nine of the thirteen million-cities in Russia are listed in the table. The Far-Eastern regions of Sakhalin and Magadan with low population and Moscow as the capital city have then the highest per capita figures. Besides of being the biggest city in Russia, Moscow is also the business centre and the centre of foreign trade in Russian Federation, and as such, a natural destination for most FDI (Liuhto; Pelto; Lipponen 2004).

3. Russian Outward Investments

3.1 Key figures and development

Russian outward foreign direct investments (OFDI) have increased significantly since the end of 1990s. They started to grow with USD 3 billion in 1995, through USD 20 billion in 2000 and continued with USD 210 billion in 2006. With this amount, Russia is the second largest outward direct investor among the emerging market economies after Hong Kong (China), and Russian companies are indisputably the leaders among the transnational corporations (TNCs) based in South-East Europe and the Commonwealth of Independent States (CIS) (Liuhto; Vahtra 2007: 118).

Russia's OFDI have surged from USD 20 billion to USD 210 billion in only six years. This more than tenfold increase could have been possible owe to record-high energy and raw material prices and their impact on Russian economy. The recorded FDI covers only a small part of the total capital outflow from Russia abroad: capital flight, which represents the core of Russian capital overseas, has to be taken into account when trying to provide a rough estimate of the total amount of the Russian capital abroad (Vahtra; Liuhto 2004: 12).

3.2 Destinations of Russian Outward Investment

The main recipients of Russian outward FDI are the neighbouring regions, in particular Europe and CIS. A recent survey among the top 25 Russian multinationals for instance shows Western Europe as the leading destination, accounting for 52% of foreign assets, followed by the CIS with 22% and Eastern Europe with 11% (Nestmann; Orlova 2008: 5). However, taking into account the large amount of round-tripping investment, the actual share of the CIS might be significantly higher. In recent years, we can also observe Russian OFDI to non-traditional locations, such as Africa, Latin America and the United States.

The expansion of Russian corporations started in the member countries of the CIS during the 1990s. Due to trade connections from the Soviet Union time as well as a lack of foreign investors from elsewhere, Russian companies could establish a relevant position to their close markets. The Russian natural resource-based companies already hold a strong grip on some particular segments of the CIS markets and have moved their focus beyond the CIS, whereas the manufacturing and telecommunication companies have more recently entered into their first investment projects in the CIS region (Vahtra 2005: 9). As the following table shows, Belarus has been the largest recipient of Russian investments over the past years, followed by Ukraine and Kazakhstan. Armenia received the third largest amount of Russian OFDIs in 2005. As other

important objective of Russian OFDI can be mentioned Kyrgyzstan, Tajikistan, Uzbekistan or Moldova.

Tab. 3: Investments of Russia in the economy of the CIS countries, 2000-2007

Country	2000		2005	
	Thou. USD	%	Thou. USD	%
Total	130 981	100	620 522	100
Azerbaijan	26	0.0	6 734	1.1
Armenia	5	0.0	138 185	22.3
Belarus	77 238	59.0	102 438	16.5
Georgia	133	0.1	60	0.0
Kazakhstan	3 453	2.6	204 314	32.9
Kyrgyzstan	7	0.0	1 247	0.2
Moldova	31 224	23.8	4 904	0.8
Tajikistan	-	-	496	0.1
Turkmenistan	2 934	2.3	-	-
Uzbekistan	929	0.7	6968	1.1
Ukraine	15 032	11.5	155 176	25.0
Country	2006		2007	
	Thou. USD	%	Thou. USD	%
Total	4 127 757	100	2 696 763	100
Azerbaijan	6 661	0.2	8 994	0.3
Armenia	3 168	0.1	3 907	0.1
Belarus	572 329	13.8	1 314 092	48.7
Georgia	328	0.0	433	0.0
Kazakhstan	189 231	4.6	445 068	16.5
Kyrgyzstan	112 094	2.7	207 718	7.7
Moldova	44 131	1.1	4 248	0.2
Tajikistan	22 315	0.5	105 683	3.9
Turkmenistan	-	-	0.4	0.0
Uzbekistan	176 174	4.3	93 040	3.6
Ukraine	3 001 326	72.7	513 580	19.0

Source: Rosstat (2008).

In Europe, Russian total OFDI flows have been concentrated with only two countries – Cyprus and Luxembourg. As already said, these investment flows might return as investment to Russia or can be redirected to other countries. Netherlands and Germany are then the next European countries with significant Russian OFDIs.

3.3 The leading Russian companies abroad

The main Russian OFDI are made by natural resource-based groups. Russia's vast energy resources provide the country with a substantial political leverage, not only in the CIS countries but also throughout Europe (Liuhto; Vahtra 2007: 126). Russia is the world's largest energy exporter and also one of the largest producers of steel and several non-ferrous metals. The unimaginably high export revenues have provoked the Russia's leading industrial conglomerates to seek investment targets abroad.

More than 90% of the aggregate foreign assets of the 10 leading Russian transnational companies (TNCs) are in the hands of the energy, metals and mining companies. The only three companies outside this sector and among the top 10 Russian TNCs are mobile telecommunication service providers. While the oil and gas industry remains the leading foreign investing industry by total assets, the growth has been notably stronger in the metal sector, which already accommodates aggregate foreign assets comparable to those of the oil and gas companies (Ehrstedt; Vahtra 2008: 7). In the oil and gas sector, Lukoil and Gazprom hold around 90% of the sector's aggregate foreign assets.

The state-owned gas giant, Gazprom, produces over 80% of the Russia's natural gas. It practically holds a gas monopoly in Russia. Gazprom has over 60 foreign subsidiaries and affiliates mainly in the EU and in the CIS countries. On the other hand, the privately-held Lukoil remains the biggest independent Russian oil producer. Lukoil is active in more than 30 countries worldwide.

If we look in the CIS, the state-owned energy supplier RAO UES, which has invested in energy distribution chains in Armenia, Georgia, Moldova and Ukraine, can be mentioned as an example of Russian OFDI. Gazprom controls infrastructure assets in Kazakhstan and Moldova.

As already mentioned, Africa has become a new destination for Russian investors. The state-owned diamond company Alrosa, controls a quarter of the global market and owns mining facilities in Angola. Further, the large metallurgy company Norilsk Nickel holds raw material reserves in South Africa, Gabon, Guinea and Nigerian. Apart from resource-based companies, Russian telecommunications firms are also expected to expand in the African continent.

Conclusion

In general, the business environment in Russia is continually improving since the transition from a centrally controlled planned economy to a free market. Many reforms have been implemented, the tax system is becoming more transparent and Russia is increasingly integrating with global markets. However,

real progress remains to be made to reduce the bureaucracy, corruption, the unsatisfactory work of customs and customs legislation and a judiciary lacking independence. The level of restrictions on foreign investment remains above the OECD average. Russia's formal barriers to FDI are high in insurance, electricity and transport, whereas the access to some other sectors such as distribution and business services has been improved.

Therefore, Russia has attracted relatively little foreign direct investment, particularly in comparison with other transition economies in Europe. Low FDI inflows let the country to suffer from a low rate of capital investment which finally restricts its economic growth potential. Still, the country does not suffer from a lack of investment opportunities. Growing GDP, rising household consumption and a huge market potential make Russia beside its enormous natural resources an attractive investment destination. The European Union stays the largest investor in Russia.

Russian outward foreign direct investment has expanded considerably since the beginning of the decade. The expansion of the largest companies stays mostly in the oil, gas and metals sectors; however, it is extending to other sectors, especially in telecommunications. The expansion of Russian corporations started in the former Soviet Union countries, continued in Europe and other developed markets and have more recently also been carried forward to Africa. Nevertheless, due strong economic growth in some of the CIS countries, the region should stay an attractive market for Russian direct investment also in the future.

References

BAKER & McKENZIE (2007): *Doing Business in Russia*. Moscow: Baker & McKenzie. Available at: <http://www.bakernet.com/NR/rdonlyres/0A544F03-7B79-4292-AFC1-07A3E223000E/0/dbirussia07.pdf>.

CUSSEZ (2008): Customs Regulations in the SEZ. Available at: <http://eng.www.rosoez.ru/oez/custom/>.

EHRSTEDT, S.; VAHTRA, P. (2008): *Russian energy investments in Europe*. Pan-European Institute. Available at: http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Ehrstedt_Vahtra_42008.pdf.

LIUHTO K. (2008): *Genesis of Economic Nationalism in Russia*. Pan-European Institute. Available at: http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Liuhto_32008.pdf.

LIUHTO, K.; PELTO, E.; LIPPONEN, K. (2004): *Where to Do Business in Russia?* Pan-European Institute. Available at: http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Liuhto_Pelto_Lipponen_52004.pdf.

LIUHTO, K.; VAHTRA, P. (2007): *Foreign operations of Russia's largest industrial corporations – building a typology*. in *Transnational Corporations*, Vol. 16, No. 1. Available at: http://www.unctad.org/en/docs/iteit20071a5_en.pdf.

NADI (2008): National Agency for Direct Investment. Available at: <http://www.napi.ru/en/about>.

NESTMANN, T.; ORLOVA, D. (2008): *Russia's Outward Investment*. Deutsche Bank Research. Available at: http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD000000000224964.pdf.

PWC (2008): *Doing business and investing in the Russian Federation*. Moscow: PWC. Available at: [http://www.pwc.com/extweb/pwcpublications.nsf/docid/E70BAEC31B0C17D8802571FC005699D4/\\$file/PwC_doing_business_in_russia08.pdf](http://www.pwc.com/extweb/pwcpublications.nsf/docid/E70BAEC31B0C17D8802571FC005699D4/$file/PwC_doing_business_in_russia08.pdf).

OECD (1999): *OECD Benchmark Definition of Foreign Direct Investment*. Paris: OECD. Available at: <http://www.oecd.org/dataoecd/10/16/2090148.pdf>.

OECD (2006): *Russian Federation – Enhancing Policy Transparency: Overview and Recommendations*. Paris: OECD. ISBN 92-64-02592-8

RIA Novosti (9.7.2008): *Putin heads government commission to monitor foreign investment*. Available at: <http://en.rian.ru/russia/20080709/113636574.html>.

ROSSTAT (2008): Federal State Statistics Service. Available at: <http://www.gks.ru>.

RUSSEZ (2008): Federal Agency for Management of Special Economic Zones. Available at: <http://eng.www.rosuez.ru/>.

TIDA (2008): Trade and Investment Development Agency of Russia. Available at: <http://www.tida.ru/content/index.php?topics=7>.

UNCTAD (2007): *World Investment Report 2007. Transnational Corporations, Extractive Industries and Development*. United Nations, New York and Geneva. Available at: http://www.unctad.org/en/docs/wir2007_en.pdf.

UNCTAD (2007): *World Investment Prospects Survey 2007 – 2009*. United Nations, New York and Geneva. Available at: http://www.unctad.org/en/docs/wips2007_en.pdf.

VAHTRA, P. (2005): *Russian Investments in the CIS – Scope, Motivations and Leverage*. Pan-European Institute. Available at: http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Vahtra_92005.pdf.

VAHTRA, P. (2007): *Expansion or Exodus? - The new leaders among the Russian TNCs*. Pan-European Institute. Available at:

http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Vahtra_13_07.pdf.

VAHTRA P., LIUHTO K. (2004): *Expansion or Exodus? – Foreign Operations of Russia's Largest Corporations*. Pan-European Institute. Available at: http://www.tse.fi/FI/yksikot/erillislaitokset/pei/Documents/Julkaisut/Vahtra_Liuhto_82004.pdf.

VINHAS DE SOUZA, L. (2008a): *Foreign investment in Russia*. in ECFIN Country Focus, Vol 5, No 1. Available at: http://ec.europa.eu/economy_finance/publications/publication10969_en.pdf.

VINHAS DE SOUZA, L. (2008b): *A different country – Russia's economic resurgence*. Brussels: Centre for European Policy Studies. ISBN 13: 978-92-9079-767-8.



University of Economics, Prague
Faculty of International Relations
Náměstí Winstona Churchilla 4
130 67 Prague 3
<http://vz.fmv.vse.cz/>



Vydavatel: Vysoká škola ekonomická v Praze
Nakladatelství Oeconomica

Tisk: Vysoká škola ekonomická v Praze
Nakladatelství Oeconomica

Tato publikace neprošla redakční ani jazykovou úpravou

ISSN 1802-6591