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Regional Dimension of Foreign Direct Investment in Russia

EXECUTIVE SUMMARY

In the past decade Russia has become one of the key actors in the global foreign direct investment (FDI) market. Currently it is both one of the largest recipients and contributors of FDI in the world. This paper highlights the current state of inward and outward FDI in Russia, focusing on the regional dimension. Three main regional aspects of Russia-related investment flows are examined, namely inflows from and outflows to European countries; outflows to the countries of the Eurasian Economic Union (EEU); and inflows from the Asia-Pacific region (APR).

The EU countries have always been Russia's principal investment partners, but the crisis in Russia–West relations over the conflict in Ukraine has had a negative impact on this co-operation and actualised Russia's 'turn to the East' in terms of its investment strategy.

This repositioning of Russia's strategic investment focus – from Europe to Asia – was accompanied by other shifts: from the key role played by European Russia in attracting FDI to the rapid development of the country's Asian territories; from using fragmented and politically determined ad hoc instruments to attract FDI to implementing comprehensive mechanisms (ie, 'rapid development territories') in the Russian Far East; and from a fragmented and

passive policy on promoting outward FDI to the active policy that is especially necessary within the EEU. These shifts are likely to form the basis of Russian investment strategy in the near future. However, their success will be determined by more general factors: Russia's economic and institutional development and the growing crisis in its relations with Western countries.

INTRODUCTION

Russia is one of the largest recipients and contributors of foreign direct investment (FDI) in the world. This is partly the result of the widespread practice of 'carousel investment', where companies use tax havens or countries with favourable tax regimes to launder money and then reinvest it in Russia. However, Russia is also a huge market with a growing demand for consumer goods that remains attractive in spite of the considerable political risks and an unfavourable investment climate. At the same time, the largest Russian companies are highly capitalised and look for opportunities to diversify the locations of their activities.

This paper focuses on the regional structure of Russia's inward and outward FDI. Three groups of investment flows are highlighted:

- inflows from and outflows to European countries, historically Russia's major investment partners;
- outflows to the countries of the EEU (inflows from the EEU to Russia are not particularly large); and
- inflows from the APR (outflows from Russia to most APR countries are negligibly small), which is one of the newly established priorities of Russian policy.

For a long time the regional structure of Russia's inward and outward investments was stable, with Europe playing a dominant role. This is starting to change, reflecting the changing priorities in Russia's external policy. However, Russia's reorientation towards greater investment collaboration with Eurasian and APR countries is a very slow process that is far from completed.

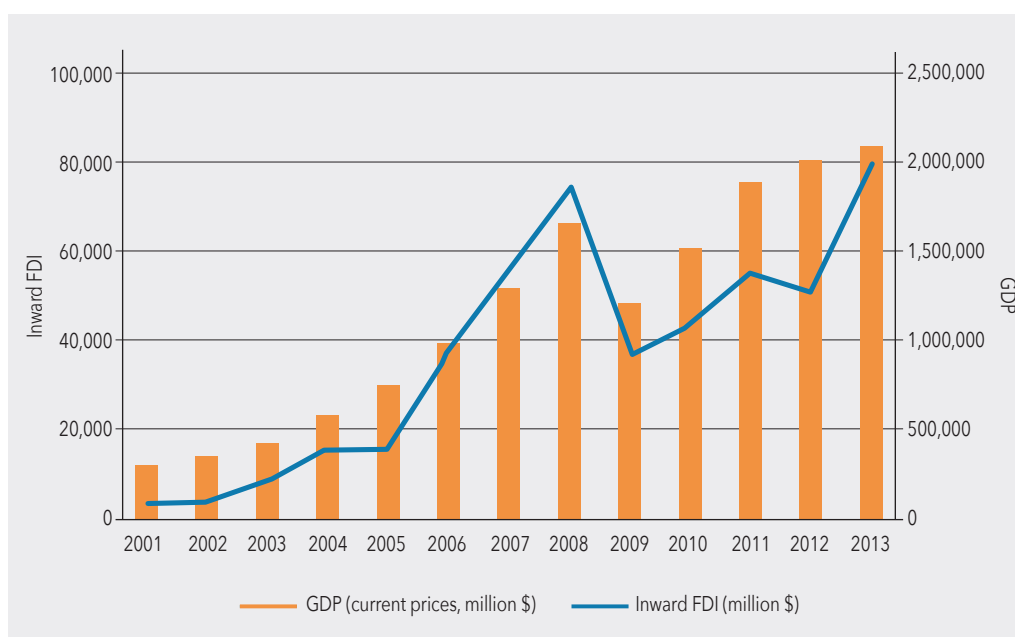
The paper then examines Russia's inward and outward FDI. Its third section examines the inward and outward investment flows into the three regional groups, while the final section reviews the evolution of Russia's policy to attract FDI and its reaction to global economic and political shifts in the past decade.

OVERVIEW OF FOREIGN DIRECT INVESTMENT IN RUSSIA

Volumes of Russia's inward and outward FDI

Since the upswing in its economic growth after the crisis of 1998, Russia has been increasingly attractive to inward FDI. From 2001 to the financial crisis of 2008, FDI in Russia grew from \$2.7 billion to \$74.8 billion annually (Figure 1). This dramatic growth was caused by a number of factors. First, the base level was very low. Second, the country had good prospects for economic growth fostered by high oil prices. Third, the country's internal financial system was underdeveloped and failed to provide firms with sufficient financial resources. Fourth, consumption grew rapidly and Russia became an attractive market for producers of consumer goods, especially because its domestic industry still retained a lot of Soviet-era features and failed to produce commodities of high quality.

Figure 1: Gross domestic product (GDP) and inward FDI to Russia, 2001–2013



Source: UNCTADStat, 'Foreign direct investment', Database, http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sRF_ActivePath=p,5&sRF_Expanded=p,5; World Bank, 'World development indicators', Database, <http://data.worldbank.org/data-catalog/world-development-indicators>

The rapid increase in FDI in Russia created a situation where (for the first time) Russia's position in the world in terms of attracting FDI started to correspond to its position in terms of GDP.¹ For example, in 2007 Russia ranked 11th in the world in terms of both inward FDI and GDP, while in 2008 it ranked 8th in terms of GDP and 6th in terms of FDI (Table 1).

1 Vercueil J, 'Foreign direct investments in Russia', in *Russia 2013 Yearbook*, French-Russian Center Observo, 2013.

Table 1: Russia's ranking by GDP and FDI inflows, 2001–2013

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Russia's ranking: FDI inflows	39	29	17	14	14	11	11	6	8	10	9	8	4
Russia's ranking: GDP	17	16	16	16	14	12	11	8	12	11	9	8	8

Source: UNCTADStat, 'Foreign direct investment', Database, http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sRF_ActivePath=p,5&sRF_Expanded=p,5; World Bank, 'World development indicators', Database, <http://data.worldbank.org/data-catalog/world-development-indicators>

The 2008 financial crisis resulted in decreasing investment in Russia, and by 2012 FDI still did not exceed 2008 levels. However, 2013 saw a dramatic jump – 57% – in FDI inflows to Russia, to \$79 billion.² It made Russia the world's fourth largest recipient of FDI for the first time. Not taking into account the British Virgin Islands, in terms of inward FDI flows Russia was only behind the US and China. The main cause of this jump was a single transaction by British Petroleum (BP), which acquired 18.5% of Russia's state oil company Rosneft as part of Rosneft's \$57 billion acquisition of TNK-BP.³

According to preliminary UN Conference on Trade and Development data, in 2014 FDI to Russia decreased by 70%, to \$19 billion,⁴ mainly as a result of the high political risk associated with the Ukrainian political crisis. Sanctions imposed on Russia by Western countries, along with an expected recession in Russia in 2015, contributed to the pessimistic outlook. The mitigation of political risks, institutional improvements and renewed economic growth are necessary to restore the trust of foreign investors.

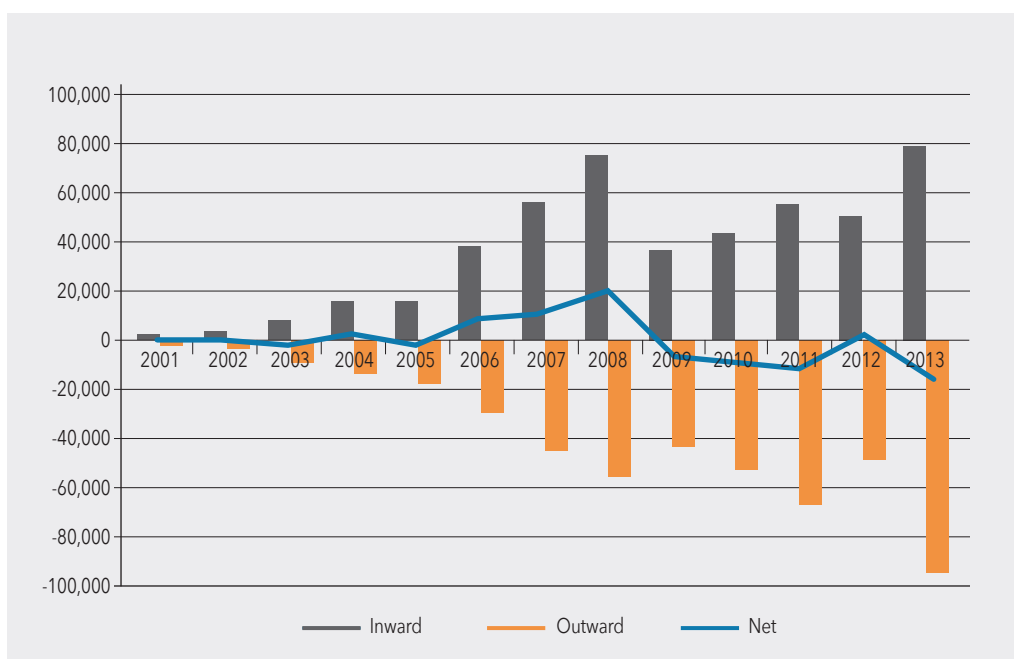
The large volumes of inward FDI flows to Russia are accompanied by even greater outward flows. In 2001–2013 Russia was a net exporter of FDI (Figure 2). The big investments in Russia are underpinned by capital that had previously been taken out of the country. This 'carousel' mechanism is primarily realised through tax havens. Some of these tax havens (the British Virgin Islands, Cyprus, Bermuda) top lists of both recipients and contributors of Russian FDI.

2 UNCTADStat (UN Conference on Trade and Development World Statistical Database), 'Foreign direct investment', database, http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sRF_ActivePath=p,5&sRF_Expanded=p,5.

3 UNCTAD, 'Global Investment Trend Monitor', 15, 28 January 2014, http://unctad.org/en/PublicationsLibrary/webdiaeia2014d1_en.pdf.

4 UNCTAD, 'Global Investment Trade Monitor', 18, 29 January 2015, http://unctad.org/en/PublicationsLibrary/webdiaeia2015d1_en.pdf; Vercueil J, op. cit.

Figure 2: Russia's annual inward and outward FDI, 2001–2013, million \$



Source: UNCTADStat, 'Foreign direct investment', Database, http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sRF_ActivePath=p,5&sRF_Expanded=p,5

Other outward FDI flows from Russia are associated with the activities of large Russian energy companies that are attempting to invest in strategic assets abroad.

Russia's FDI experienced significant changes over the past decade. In the 1990s and the early 2000s the increasing amount of outward FDI was primarily the result of companies' owners moving capital out of Russia to avoid political risks. Since 2005–2006 the motivation has become more rational and associated with commercial interests, such as gaining access to strategic assets or new technologies, and promoting and diversifying production, etc.⁵ As a consequence, while Russia's FDI abroad was initially viewed by the Russian government only as a loss of resources and an obstacle to economic growth,⁶ certain strategic investment projects have started to garner significant political support.⁷ Many researchers regard Russia's outward FDI as a foreign policy tool. Most of Russia's outward FDI is aimed at resource-related sectors, particularly energy and metals.⁸

According to preliminary estimates, in 2014 Russia's outward FDI was half the 2013 level, although overall capital outflows reached record-high levels. Large Russian companies

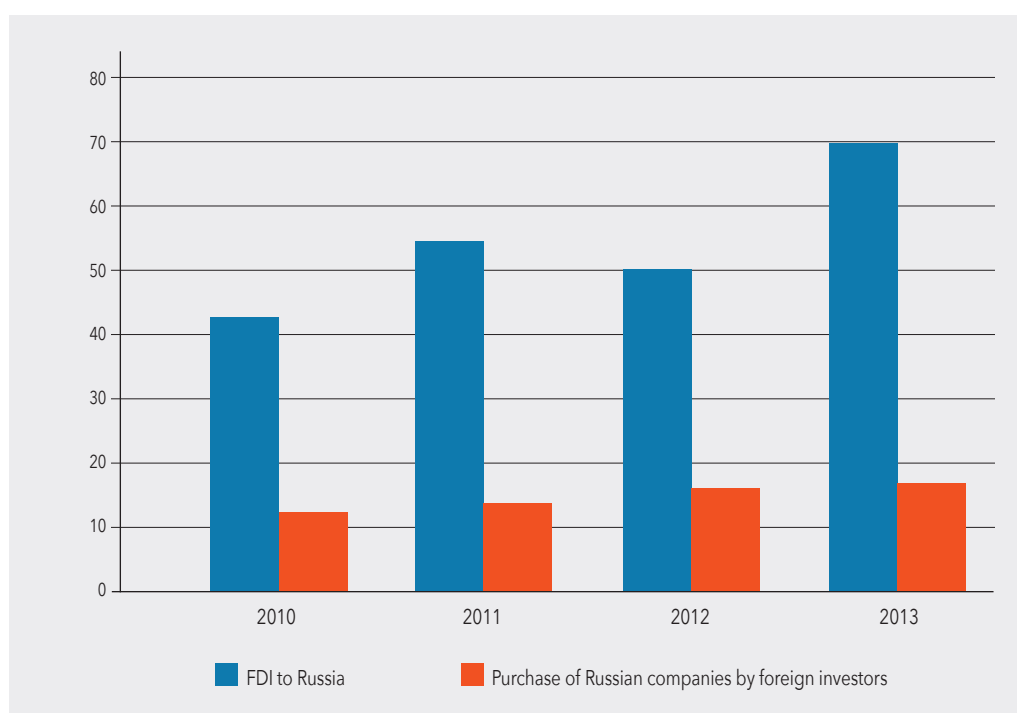
5 Pakhomov A, 'Eksport pryamikh investitsiy iz Rossii. Ocherki teorii i praktiki'. Moscow: Izdatel'stvo Instituta Gaidara, 2012.
 6 Kalotay K, 'The Crimean crisis and the future of Russian outward foreign direct investment', *Baltic Rim Economies*, 4, 31 October 2014.
 7 Pakhomov A, op. cit.; Kalotay K & A Sulstarova, 'Modeling Russian outward FDI', *Journal of International Management*, 16, 2, 2010.
 8 Liuhto KT & SS Majuri, 'Outward foreign direct investment from Russia: A literature review', *Journal of East-West Business*, 20, 4, 2014.

(including state-controlled enterprises) curtailed their activities abroad because of a scarcity of financial resources and fears of potential restrictions in countries condemning Russia's actions in Ukraine.⁹ Significant growth in Russia's outward FDI is unlikely until relations between it and the West stabilise. However, some increase in FDI to the BRICS countries, Central Asia and tax havens is possible and could mitigate the overall FDI decline.

Structure of Russia's inward FDI

None of the official data on FDI to Russia is categorised according to the choice of market entry mode: ie, mergers and acquisitions, greenfield investments or joint ventures. However, KPMG¹⁰ estimates that in 2013 the value of Russian assets purchased by foreign investors amounted to \$16.9 billion (Figure 3) – about 24% of total FDI to Russia. One could thus conclude that FDI to Russia is mostly in the form of greenfield investments and joint ventures, eg, building factories and infrastructure.

Figure 3: FDI to Russia, value of Russian assets purchased by foreign investors, 2010–2013, billion \$



Source: Central Bank of Russia, 'Foreign direct investment database', http://www.cbr.ru/statistics/?Prtid=svs&ch=PAR_30241#CheckedItem

⁹ Kalotay K, *op. cit.*

¹⁰ KPMG, 'Ryynok sliyanii i pogloschenii v Rossii v 2013 godu', Moscow, March 2014, http://www.kpmg.com/RU/ru/IssuesAndInsights/ArticlesPublications/Documents/S_MA_3r_2014.pdf.

As the Russian economy's main competitive advantage is the country's abundance of natural resources, there is a widespread belief that resource-related activities attract the most FDI to Russia. This is a myth. In 2010 more than a half of all investment was directed at finance and insurance, as well as to wholesale and retail trade. In 2013 this share decreased to 39%, but it still remains dominant (Table 2). The large volumes of FDI directed at finance and commerce are explained by the fact that the economic growth seen in the 2000s created a strong urban middle class with Western-style consumer behaviour. This led to the boom in sectors such as retail, banking and construction. The share of high-tech industries in the total amount of FDI to the country is low and does not exceed 4–5%.

Table 2: Annual inward FDI flows to Russia by industry in 2010 and 2013, million \$

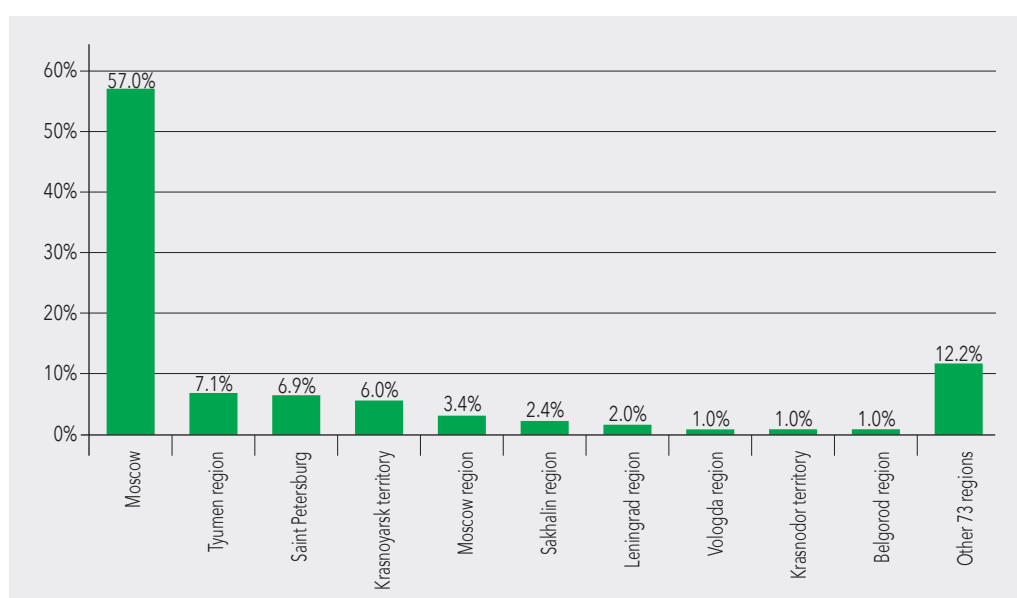
Industry	2010		Industry	2013	
	million \$	%		million \$	%
Total allocated	139,561	100%	Total allocated	189,097	100%
Financial and insurance activities	51,268	37%	Wholesale and retail trade; repair of motor vehicles and motorcycles	43,903	23%
Wholesale and retail trade; repair of motor vehicles and motorcycles	21,809	16%	Financial and insurance activities	31,102	16%
Mining and quarrying	10,683	8%	Mining and quarrying	26,219	14%
Real estate activities	7,523	5%	Coke and refined petroleum products	21,618	11%
Basic metal and fabricated metal products	6,644	5%	Basic metal and fabricated metal products	13,481	7%
Construction	5,859	4%	Other service activities	8,685	5%
Information and communication	5,555	4%	Real estate activities	7,732	4%
Food products, beverage and tobacco products	5,115	4%	Construction	5,771	3%
Professional, scientific and technical activities	4,771	3%	Information and communication	5,305	3%
Other service activities	4,190	3%	Food products, beverage and tobacco products	4,776	3%
Manufacture of motor vehicles, trailers and semi-trailers and other transport equipment	2,425	2%	Mining and quarrying, except of fuel and energy materials	3,453	2%
Electricity, gas, steam and air conditioning supply	2,144	2%	Chemicals and chemical products	3,121	2%
Chemicals and chemical products	2,065	1%	Transportation and storage	2,899	2%
Other	9,510	7%	Other	11,032	6%

Source: Central Bank of Russia, 'Foreign direct investment database', http://www.cbr.ru/statistics/?Prtid=svs&ch=PAR_30241#CheckedItem

As for extractive industries, foreign investors have shown interest but face a number of obstacles. Federal law N57-FZ 'On the procedures for foreign investments in businesses of strategic importance to Russian national defence and state security' of 2008 limits the participation of foreigners in businesses that are associated with the military, space and aviation, nuclear energy and cryptography, as well as in activities related to natural monopolies, fisheries, and the exploration for and extraction of natural resources in subsurface areas that have federal status.¹¹ According to the act, transactions as a result of which 'foreign states, international organisations or organisations under their control gain direct or indirect control over more than 25% of the total voting shares (stock) of the business entities of strategic importance to national defence and state security, or any other possibility to block decisions made by the management of such business entities, or acquire the right to directly or indirectly control more than 5% of the total voting shares' must be approved beforehand by a special committee headed by the prime minister.¹²

Inward FDI is unevenly distributed across Russia. For example, in 2013 nearly 70% of all the FDI inflows to Russia were directed at two main conglomerations (Moscow and the Moscow region, and St Petersburg and the Leningrad region), with 57% going to Moscow alone (Figure 4). Other top recipients – the Tyumen region, Krasnoyarsk territory and Sakhalin region – are resource-abundant regions where a number of large projects are operating with the participation of foreign partners.

Figure 4: Allocation of inward FDI flows to Russia by region, 2013



Source: Central Bank of Russia, 'Foreign direct investment database', http://www.cbr.ru/statistics/?Prtid=svs&ch=PAR_30241#CheckedItem

¹¹ Russia, Federal Law N57-FZ, 'Procedures for Foreign Investments in Business Entities of Strategic Importance for Russian National Defense and State Security', 2008, http://en.fas.gov.ru/legislation/legislation_50727.html.

¹² *Ibid.*

The National Rating Agency tried to exclude the FDI coming from tax havens from this data. In some regions tax havens' share reached 100%, and tax havens provided 65.4% of FDI flows to Moscow in 2013. This data revision led to less regional inequality in terms of FDI. Three oil- and gas-rich regions (the Nenets and Yamal Nenets autonomous okrugs and Sakhalin region) remain the leaders, but were joined by Primorye territory in the Russian Far East and two industrialised regions in Central Russia (the Kaluga and Tula regions). Moscow came seventh.¹³

RUSSIA'S INWARD AND OUTWARD INVESTMENT BY REGION

Europe

Europe is the largest contributor and recipient of Russian FDI. A considerable amount of Russian investment flows to Europe pass through tax havens, thus the official figures do not always reflect the real geographical distribution of outward FDI. The Institute of World Economy and International Relations of the Russian Academy of Science (IMEMO)¹⁴ estimates the foreign assets of the 20 largest Russian transnational companies as a proxy for the real distribution of investment by country (Figure 5). According to this data, accumulated investment in Europe amounted to almost half of all investments in 2009 (official statistics show a much lower level – 25% – for the same period).¹⁵

Europe's prominent role in FDI flows is the result of the structure of Russia's external trade, which is largely concentrated in Europe. Russian companies are interested in additional outward investment in the production chains, technological cycles, guaranteed product markets and supplies in Europe. However, taking into account Russia's current focus on Eastern markets, investment in European countries is likely to decrease in the coming years.

The main destinations of Russian FDI outflows to Europe are tax havens (eg, Cyprus and Luxembourg) or rich European countries that guarantee strict confidentiality and have favourable tax regimes (eg, the Netherlands, Switzerland and Austria). Usually such investments are aimed at securing tax benefits or laundering money, and suggest eventual reinvestment in Russia. From the data it is also clear that the share of investment outflows from Russia to European countries decreases as the share of non-European tax havens expands. For example, at the moment the largest recipient of Russian FDI outflows is the British Virgin Islands (increasing from 1.6% of total FDI from Russia in 2007 to 71.8% in 2013).¹⁶

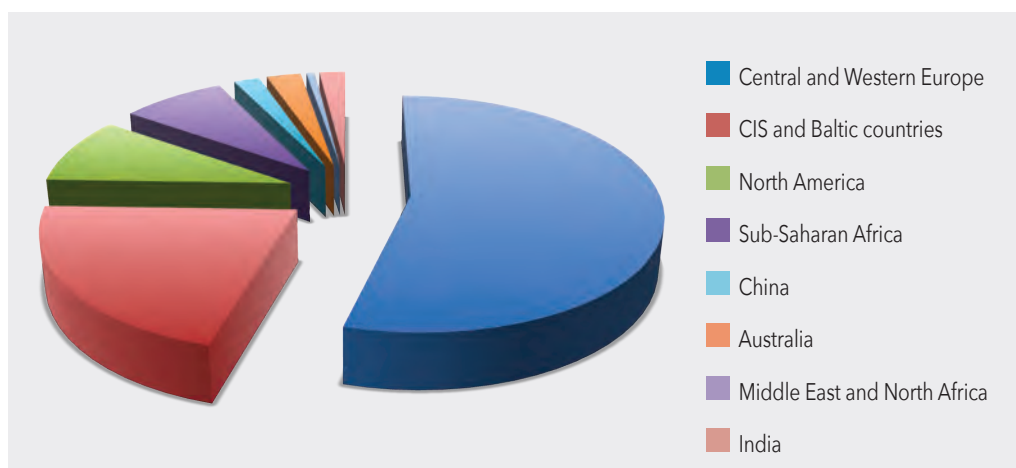
13 Natsional'noye reitingovoye agentstvo, 'Pryamyye inostrannyye investitsii v Rossii: regional'niy aspekt. Itogi 2013 goda'. Moscow, April 2014, http://www.ra-national.ru/uploads/rus/files/analytic/file_review/20.pdf.

14 IMEMO RAN (Institute of World Economy and International Relations of the Russian Academy of Science), Export rossiyskih pryamih investitsiy stabilizirovalsya po mere okonchaniya mirovogo krizisa. Moscow: IMEMO, 23 June 2011, http://www.imemo.ru/files/File/ru/publ/2011/23062011_pr.pdf.

15 Central Bank of Russia, 'Foreign direct investment database', http://www.cbr.ru/statistics/?Prtdid=svs&ch=PAR_30241#CheckedItem

16 *Ibid.*

Figure 5: Location of foreign assets of 20 largest Russian companies, 2009



Source: IMEMO RAN, 'Export rossiyskih pryamih investitsiy stabilizirovalsya po mere okonchaniya mirovogo krizisa'. Moscow: IMEMO, 23 June 2011, http://www.imemo.ru/files/File/ru/publ/2011/23062011_pr.pdf

Table 3: Outward FDI to Europe by country, 2007 and 2013

2007				2013			
		\$ million	% of total FDI			\$ million	% of total FDI
1	Cyprus	14,700	32.8	1	Cyprus	7,689	8.87
2	Netherlands	11,991	26.8	2	Austria	5,265	6.07
3	UK	2,454	5.48	3	Switzerland	1,358	1.57
4	Switzerland	1,404	3.13	4	Spain	1,356	1.56
5	Germany	673	1.50	5	Germany	1,334	1.54
6	Luxembourg	497	1.11	6	Luxembourg	1,314	1.52
7	Spain	258	0.58	7	UK	1,294	1.49
8	France	257	0.57	8	Denmark	752	0.87
9	Czech Republic	248	0.55	9	Latvia	568	0.66
10	Austria	230	0.51	10	Bulgaria	554	0.64

Source: Central Bank of Russia, 'Foreign direct investment database', http://www.cbr.ru/statistics/?Prtid=svs&ch=PAR_30241#CheckedItem

The group of countries investing in Russia remains largely unchanged (six out of the top 10 countries appear on both the 2007 and 2013 lists), although the amounts vary. In some years more than half of Russia's inward FDI comes from tax havens (Table 4). Taking into account that most of this FDI and a significant percentage of that from tax-friendly European countries are Russian in origin, the total volume of FDI to Russia should not be overestimated.

Table 4: Inward FDI from Europe by investor country, 2007 and 2013

2007				2013			
		\$ million	% of total FDI			\$ million	% of total FDI
1	Cyprus	11,917	21.3	1	UK	18,927	26.8
2	Netherlands	10,268	18.4	2	Luxembourg	11,639	16.5
3	Germany	7,626	13.6	3	Ireland	10,399	14.7
4	Norway	1,300	2.33	4	Cyprus	8,285	11.7
5	Finland	677	1.21	5	Netherlands	5,751	8.14
6	UK	656	1.17	6	France	2,100	2.97
7	Sweden	529	0.95	7	Switzerland	1,086	1.54
8	France	415	0.74	8	Belgium	755	1.07
9	Switzerland	386	0.69	9	Hungary	736	1.04
10	Spain	366	0.66	10	Germany	319	0.45

Source: Central Bank of Russia, 'Foreign direct investment database', http://www.cbr.ru/statistics/?Prtid=svs&ch=PAR_30241#CheckedItem

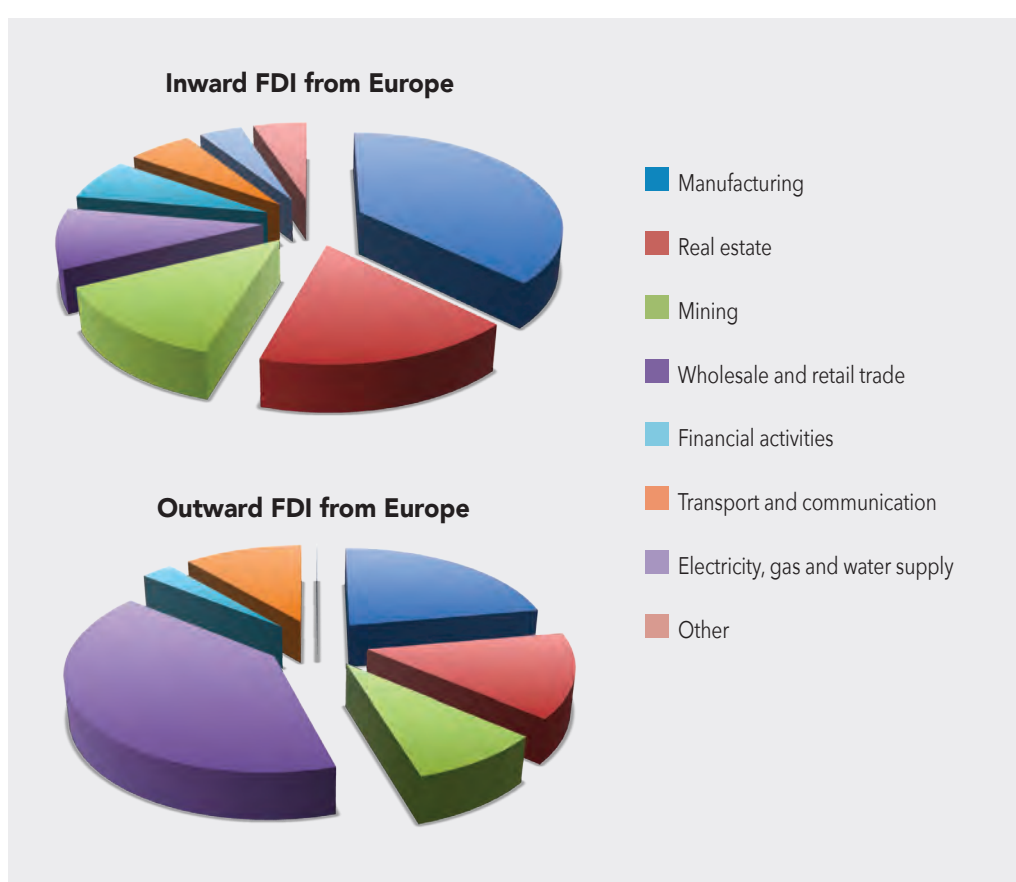
There are a few estimates of the share of pseudo-FDI, ie, reinvestments by Russian companies via tax havens. Kuznetsov estimates this share at 20%, IMEMO at 60–70%, and Solntsev at 50%.¹⁷ As a result, official estimates of the geographical distribution of FDI may not be precise. For example, according to official statistics Russia's main investment partners in Europe are based in the British Isles (UK and Ireland) and Western (Luxembourg, France) and

17 Kuznetsov A, 'Evolutsiya rossiyskikh TNK: Ot regionalnih kompaniy k globalnim', *Vestnik Federalnogo Gosudarstvennogo Uchrezhdeniya 'Gosudarstvennaya registratsionnaya palata pri Minyuste RF'*, 4, 2011.

Southern Europe (Cyprus), whereas the more geographically and historically close Central and Eastern European countries account for only 2.2% of FDI inflows and 4.1% of outflows.¹⁸

The main recipients of total FDI, including pseudo-FDI, from the EU to Russia are the manufacturing and real estate sectors. Together they account for more than 50% of all inward FDI stocks from Europe. Outward FDI is also not diverse. Two sectors – manufacturing and wholesale and retail trade – account for 62% of the FDI stocks from Russia to European countries.

Figure 6: Inward FDI stocks from Europe to Russia and outward FDI stocks from Russia to Europe, 2013



Source: Russian Federal State Statistics Service, <http://www.gks.ru/>

¹⁸ Central Bank of Russia, 'Foreign direct investment database', http://www.cbr.ru/statistics/?Prtd=svs&ch=PAR_30241#CheckedItem

Eurasia

Russia is making a concerted effort at greater integration with the Eurasian region in which the post-Soviet space is usually understood. The Eurasian Economic Community (EAEC) was founded in 2000 and consists of Belarus, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan (whose membership is currently suspended). It was established to promote a customs union and a single economic space, co-ordinate member states' policies and integrate them into the world economy. The Eurasian Customs Union (or the Customs Union of Belarus, Kazakhstan and Russia) was established in 2010, and the EEU, which features greater economic integration, was established on 1 January 2015. The EEU consists of Russia, Belarus, Kazakhstan, Armenia and Kyrgyzstan (which joined in May 2015). In contrast to the EAEC and Eurasian Customs Union, the EEU envisages the formulation of common trade, monetary and fiscal policies and the establishment of supranational agencies, including an economic commission, commodities commission and international investment bank.

Currently, FDI inflows from EEU members to Russia amount to 0.7% of its total FDI inflows, and FDI outflows from Russia to member countries account for 1.9% of its total outflows, according to official data of the Central Bank of Russia.¹⁹ However, this data is not entirely relevant due to the large amount of FDI flows to and from Russia via tax havens. The Eurasian Development Bank gives estimates of FDI flows between the Eurasian countries from the official Central Bank of Russia's data. The biggest gap is between the official and estimated outflows from Russia to Kazakhstan (Table 5).

Table 5: FDI stocks by country, EEU members, 2009–2013, billion \$

	2009		2010		2011		2012		2013	
	^a MMI	^b CBR	MMI	CBR	MMI	CBR	MMI	CBR	MMI	CBR
Kazakhstan	10.3	1.7	10.0	2.0	10.7	2.6	10.9	2.5	9.3	2.8
Belarus	4.0	5.7	5.2	5.7	7.4	4.7	7.7	3.8	7.9	4.1
Armenia	1.9	1.5	2.0	1.8	2.1	1.4	2.2	1.6	2.2	1.4
Kyrgyzstan	0.4	0.1	0.6	0.1	0.6	0.1	0.7	0.2	0.6	0.2
Total	16.6	9.0	17.8	9.6	20.8	8.8	21.5	8.1	20.0	8.5

Note: ^aMMI = Monitoring of Mutual Direct Investments in the Commonwealth of Independent States;

^bCBR = Central Bank of Russia

Source: EABR (Eurasian Development Bank), 'Monitoring of Mutual Direct Investments in the Commonwealth of Independent States countries', Report No. 26, St Petersburg, 2014; Central Bank of Russia, 'foreign direct investment database', http://www.cbr.ru/statistics/?Prtid=svs&ch=PAR_30241#CheckedItem

¹⁹ *Ibid.*

Table 6: Accumulated FDI by country, EEU members, 2013, billion \$

Recipient country	Investing country			Total
	Belarus	Kazakhstan	Russia	
Armenia	-	0.01	2.2	2.21
Belarus	-	0.02	7.9	7.92
Kazakhstan	0.05	-	9.27	9.32
Kyrgyzstan	-	0.5	0.64	1.14
Russia	0.39	2.96	-	3.35
Total	0.44	3.49	20.01	23.94

Source: EABR, 'Monitoring of Mutual Direct Investments in the Commonwealth of Independent States countries', Report No. 26, St Petersburg, 2014

Russia is the principal investor in all regional states (Table 6), with the largest flows directed to Kazakhstan and Belarus. FDI flows in the opposite direction are much lower. Investments to Russia come mostly from Kazakhstan, as it is a second-largest investor in the region.

Further deepening and expansion of integration is expected to increase interregional investment flows. At the same time, the potential for investment expansion is limited. First, most transnational Russian companies are already active in this market. Second, most of the available attractive assets have already been acquired. Third, competition for this market has increased in recent years as Western Europe and especially China are showing growing interest in it.

From the Russian perspective the members of the EEU – Belarus, Kazakhstan, Kyrgyzstan and Armenia – are of the greatest interest.

Belarus

Investment flows in Belarus are strictly regulated by the authorities, thus the public sector is the source of most investments, both foreign and domestic. As Belarus and Russia have strong economic ties, almost half of FDI in Belarus is Russian. The largest investment project financed by a Russian company has been the purchase of natural gas company Beltransgaz by Gazprom for \$5 billion. Experts do not envisage any comparable projects in the foreseeable future.²⁰ The second-largest project is valued at a sixth of the Beltransgaz

²⁰ EABR (Eurasian Development Bank), 'Monitoring of Mutual Direct Investments in the Commonwealth of Independent States countries', Report, No. 26, St Petersburg, 2014.

acquisition (MTS Belarus, which is a joint venture by MTS Russia [49%] and Beltelecom [51%]). As for investment opportunities, the government of Belarus is considering selling its 51% share in MTS Belarus, but the Eurasian Development Bank²¹ estimates that the deal will not net it more than \$1 billion. This means that closing the deal would increase Russian FDI in Belarus by only 10%. Another possible forthcoming deal is the purchase of the Mozyr oil refinery by Rosneft as part of Belarus's privatisation programme. However, it is unlikely that Rosneft will be prepared to pay the announced \$4 billion. The Russian banking sector is also interested in expanding into Belarus, which could increase FDI flows. In 2012 the total authorised capital of Russian banks' Belarus subsidiaries increased by \$237 million; in 2013, by \$85 million.²² Russian companies in other service sectors could be interested in additional investments to increase their sales in Belarus. However, it is unlikely that investments in the oil refinery, service and financial sectors will significantly increase FDI in Belarus in the near future.

Kazakhstan

Kazakhstan is a country of increasing investment opportunities coupled with rising competition. Key competitors are Chinese companies (which are mostly interested in getting access to natural resources) and Western European companies (which are interested in meeting local companies' demand for Western technology). Infrastructure projects are attractive to both Russia and China, and not only in Kazakhstan but also in other Central Asian countries. However, currently most Chinese and Russian investors' projects are concentrated in the energy sector. China and Russia are often competitors in the field of oil and natural gas extraction. At the moment, Russian investments are much smaller than those of the Chinese. Thus, Lukoil invested about \$3 billion in Kazakhstan. Gazprom's investments are steadily increasing and amount to \$0.3 billion, while Russia invested an additional \$0.2 billion in the Kazakh section of the Caspian pipeline syndicate. In comparison, China's CNPC invested more than \$12 billion in oil and gas production in Kazakhstan and an additional \$6.2 billion was directed at the construction of pipelines. Sinopec invested \$1.4 billion in fossil fuel production, CITIC and China Investment Corp. invested \$0.95 billion and a few relatively minor companies invested \$0.7 billion.²³

Excluding oil and gas projects, Russian FDI in Kazakhstan is fairly small, albeit increasing. In 2013 Atomredmetzoloto bought uranium mines, and in 2014 Evraz established a joint venture – Evraz Caspian Steel (light-section rolling mill) – in the steel industry (its share

²¹ *Ibid.*

²² *Ibid.*

²³ *Ibid.*

amounted to 65%), according to the Evraz Group.²⁴ Examples of other projects in the manufacturing sector are the development of the Kok-Jon phosphate rock deposit and the planned construction of a fertiliser complex by EuroChem, and the acquisition of 50% of Kazakhstan's locomotive factory (Locomotive Kurastyru zauyty) by Transmashholding.

China is planning to develop its Silk Road Economic Belt in Central Asia, which promises \$40 billion in Chinese investment in the near future. Russia's President Vladimir Putin and China's President Xi Jinping signed a statement on co-operation on the development of the joint EEU and the Silk Road Economic Belt on 8 May 2015.²⁵ The document forms the basis for the co-ordination of the two projects and is aimed at building a common economic space in Eurasia.

Armenia and Kyrgyzstan

In Armenia there is limited potential for Russia to expand its investments as there is a dearth of attractive projects and Russian companies already have a large presence in the market. About 40% of the country's FDI is Russian.

Kyrgyzstan is likely to be politically unstable in the foreseeable future. Frequent government-sanctioned property redistribution in this country impedes FDI inflows. Russia is among three key investors in Kyrgyzstan, along with China and Canada. Russian investment in Kyrgyzstan is mostly directed at the energy sector – in 2014 Gazprom bought Kyrgyzgazprom for the symbolic amount of \$1 but undertook to invest about RUB²⁶ 20 billion (\$0.5 billion) in fixed assets over a five-year period. The Kyrgyz government also signed a sale agreement with Rosneft for 51% of Manas airport. Co-operation is expected to increase since Kyrgyzstan has joined the EEU.

Asia-Pacific region

The countries of the APR have never been major partners of Russia in terms of investment co-operation. Japan had a negative experience in the Sakhalin-2 energy project, which was initially driven by Anglo-Dutch Shell (55%), Japanese Mitsui (25%) and Mitsubishi (20%). In 2007 the controlling stake was transferred to Gazprom. South Korea proposed a number of joint logistic projects in the Primorye region for the Asia-Pacific Economic Co-operation Summit in Vladivostok in 2012, but the Russian party seemed unmotivated.²⁷ China has always been interested in investing in Russia, but until recently Russia has not been very

24 EVRAZ, 'Structure', <http://www.evraz.com/about/structure/>.

25 'Joint statement of the People's Republic of China and the Russian Federation on cooperation on the development of the joint EEU and the Silk Road Economic Belt', 8 May 2015, <http://kremlin.ru/supplement/4971>.

26 Currency code for the Russian rouble.

27 Makarov IA *et al.*, *Toward the Great Ocean – 2, or Russia's Breakthrough to Asia*. Moscow: Valdai Discussion Club, 2014

enthusiastic about the prospect. Many businesspeople confirm that there have been informal limitations to Chinese participation in strategic projects in Russia. The Russian government has always viewed Chinese economic expansion in Russia as a threat, and feared that it would be followed by demographic expansion. While the population of the Russian Far East (6.2 million km², or 36% of Russia's territory) is 6.2 million, China's three north-eastern provinces (total area of 810 000 km²) are populated by 110 million people. This is the main reason why Russia's resource sector has been closed to Chinese investors, as have been all projects that required a Chinese labour force. As for the more advanced industries in European Russia, such as logistics or automobiles, Chinese investment was blocked because of fears that this would lead to the import of Chinese technologies (which have different standards relative to Russian ones and thus could undermine complementary economic activities based on Russian standards) and that China would monopolise the market.²⁸ As a result, in 2012 the APR countries provided only about 1% of inward FDI in Russia.

However, Russia's investment in the APR used to be even smaller (Table 7). The Asian market environment is very different from the European or post-Soviet one and Russian companies still lack the necessary skills and experience. There are only two significant exceptions among the APR countries. The first is Singapore, which is a global financial centre, and the second is Vietnam, which has been one of Russia's major partners since the Soviet era. A joint energy company, Vietsovetpetro, was established in 1981 and still operates today. In 2000 another joint enterprise – Vietgazprom – was created. Both successfully developed oil and gas projects in Vietnam a decade ago, but since then their activities have contracted.

Russia's investment co-operation with the APR countries started to change in 2012. The transformation of the global economic and political landscape led to changes in the regional priorities of Russia's foreign policy – Russia began to 'turn to the East'. This necessitated intensifying both political ties and trade and investment co-operation with Asian countries, which should result in Russia's full-scale integration into the Asia–Pacific region.²⁹

These changes in Russia's external economic policy were initiated in parallel with the rapid development of Russia's Eastern territories. Russia's Far East became a platform for intense collaboration with other APR countries (see below). Russian state agencies and companies signed memorandums of understanding (MoUs) on participation in investment projects in the Far East with a dozen large foreign companies, including Marubeni, Mitsubishi, Toyota Tsusho, Sumitomo, Mitsui & Co, and Itochu.³⁰

28 Gabuev A, 'A troublesome partnership', *Russia in Global Affairs*, 13, 5, 2014.

29 Makarov IA *et al.*, *op. cit.*

30 Ministry for the Development of the Russian Far East, 2014, <http://minvostokrazvitia.ru/>.

Table 7: Inward FDI from the APR to Russia and outward FDI from Russia to the APR in 2012, \$ million

	Inward investment		Outward investment	
	2012 (flow)	2012 (stock)	2012 (flow)	2012 (stock)
China	450	2152	63	234
Hong Kong	65	373	9	133
Japan	596	2571	-	21
South Korea	119	1340	19	32
Singapore	577	749	1,262	1,252
Vietnam	-26	386	99	412
Thailand	10	108	79	163

Source: UNCTADStat, 'Foreign direct investment', database, http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sRF_ActivePath=p,5&sRF_Expanded=p,5

This co-operation is now being decelerated because of the conflict in Ukraine. Japan joined the sanctions against Russia, which made some joint projects impossible. South Korea has preferred to take a wait-and-see attitude. However, Russia–China investment co-operation has been developing rapidly. In 2012 the Russian Direct Investment Fund and China Investment Corporation established the Russia–China Investment Fund (RCIF). According to the official press release, 'RCIF focuses on projects that foster economic cooperation between the two nations and will invest at least 70% of its capital in Russia and Commonwealth of Independent States countries and up to 30% in China.'³¹ A number of joint projects have already been launched. Since 2013 all the informal limits on Chinese participation in Russia's strategic projects have been removed.³² In 2013 China's CNPC acquired 20% of the ambitious Yamal liquefied natural gas project in the Russian Arctic operated by Russian gas company NOVATEK. Russia's largest oil company, Rosneft, started to attract finance from China's energy companies in exchange for future oil supplies and shares in Russia's oilfields. In 2014, 78 agreements were signed during meetings between Putin and Jinping in May and September, most of which were commercial. Another 32 agreements were signed in May 2015. Chinese firms have gained access to many Russian

³¹ RDIF (Russian Direct Investment Fund), website, http://rdif.ru/Eng_Index/.

³² Gabuev A, *op. cit.*

industries, including energy, logistics, automobile and food. However, Russia's FDI in China is much more limited. The largest confirmed project is an oil refinery in Tianjin, in which Rosneft holds a 49% share.

Russia–China investment co-operation is likely to accelerate in the near future. Russian companies need project finance, which now cannot be provided by either internal sources or Western firms. In order to attract finance from China, Russian firms will have to agree to favourable conditions for China's participation in investment projects in Russia. Co-operation is expected to be especially strong in the energy sector, where Russia's assets are the most attractive, while the relevant Russian companies also suffer the most under Western sanctions.

RUSSIA'S POLICY ON FDI

In terms of FDI, the Russian government has thus far focused on attracting inward investment rather than promoting outflows. The lack of policies supporting outward FDI can be explained by the continuous capital flight from Russia. For a long time any capital outflows were considered to be a negative phenomenon. The Russian government has only recently begun to provide political support to outflow investments, and then mainly to large energy companies whose investments in developing or transitioning economies have both commercial and geostrategic significance.³³

Other companies (including small and medium enterprises) still receive little support. One of the functions of the state-controlled Export Insurance Agency of Russia, established in 2011, is to provide financial support to outward FDI, but due to its limited authorised capital it is unable to provide sufficient support to both exporters and investors. Russia's diplomatic corps, trained in the Soviet era, work primarily on political issues and have insufficient experience in promoting Russian companies abroad. As a result, governmental support of Russian FDI abroad is fragmented and inconsistent.

Russian policies aimed at attracting FDI to the country are much more developed and comprehensive. According to an Ernst & Young survey, FDI in Russia created more than 13 000 jobs in 2012. In terms of jobs created by FDI, Russia ranked second in Europe.³⁴ Yet despite these encouraging numbers, job creation has never been considered to be Russia's main objective in attracting FDI. Russia has a low unemployment rate (5.5% in 2013),³⁵ and in large cities, which are the most attractive for FDI, it is close to zero. Nevertheless, attracting FDI has for a long time been one of the top priorities of Russian economic policy.

33 Pakhomov A, *op. cit.*

34 Ernst & Young, 'Ernst & Young's attractiveness survey: Russia 2013 – Shaping Russia's future', 2013, [http://www.ey.com/Publication/vwLUAssets/2013-Russia-attractiveness-survey-Eng/\\$FILE/2013-Russia-attractiveness-survey-Eng.pdf](http://www.ey.com/Publication/vwLUAssets/2013-Russia-attractiveness-survey-Eng/$FILE/2013-Russia-attractiveness-survey-Eng.pdf).

35 Russia's Federal State Statistics Service, website, <http://www.gks.ru/>.

Russia's main objectives in attracting FDI are diversifying and modernising the economy, introducing new technologies and encouraging innovation. FDI from Western countries is necessary as a source of new technologies and modern management practices – both of which are scarce in Russia.

Thus the most valuable investments for Russia are those aimed at high value-added industries, especially high-tech. The biggest success story of the past decade has probably been the development of the automotive cluster in the Kaluga region. A combination of geographical proximity to Moscow's fast-growing car market, flexible regional management and a favourable tax and administrative regime provided by the federal and regional governments made it possible to attract such companies as Volkswagen, Volvo, Peugeot, Citroen and Mitsubishi Motors in 2007–2008. In 2012 the 500 000th VW was produced in Kaluga. Three plants together with 22 suppliers comprise one of the most successful business projects in Russia and created 12 000 jobs in a region that had not seen any industrial development previously.³⁶

After Dmitri Medvedev had succeeded Putin as president in 2008, support for high-tech industries was declared one of the main state priorities. Skolkovo Innovation City was built near Moscow in order to support researchers, entrepreneurs and investors focusing on information technology, energy efficiency, biomedicine, space, nuclear technology, etc. Another technopark was built near Kazan and has become one of the largest in Eastern Europe. This technopark was organised in the form of a special economic zone. Another high-tech-oriented special economic zone was created in Tomsk city in western Siberia. It has already managed to attract some large companies, such as Nokia Siemens Networks, Darim International and Rovi Corporation.³⁷ The initial results of these initiatives have been mixed: some start-ups were launched successfully and technoparks see positive investment dynamics, but none of the expected breakthroughs has materialised yet.

Another important objective of attracting FDI is creating poles of economic growth outside Moscow and resource-rich regions. In 2005 Federal Law N116-FZ 'On Special Economic Zones in the Russian Federation' was passed. The aim of the law was to install special tax and administrative regimes in those territories with competitive advantages in order to attract investors. This economic activity should help to advance the complex development of regions, furthering economic growth without direct state support. Thus far 30 special economic zones have been created (the last one – a special economic zone for the automotive industry – in August 2014 in Vladivostok). They are divided into four groups: industrial; innovation; tourism; and ports and logistics. Industrial and innovation zones are

³⁶ Crouch D, 'Russian automotive: Kaluga creates cluster template', *Financial Times*, 26 June 2013.

³⁷ Ernst & Young, *op. cit.*

the most developed. Investors have access to the necessary infrastructure at preferential terms, with a favourable administrative and special tax regime (Table 8).

Table 8: Financial incentives in industrial and innovation special economic zones

	Russia	Special economic zones	
Profit tax, %	20	2–15.5	
Wealth tax, %	2.2	0	
Land tax, %	1.5	0	
Transport tax, euro per horsepower	0.1-3.5	0	
Payroll tax, %	30	Operating personnel	Research and development personnel
		30	14
Price of land	100% market price	4–50% of cadastral price	

Source: JSC ‘Special economic zones’, <http://eng.russez.ru/>

According to a report published by Russia’s Audit Chamber in 2013,³⁸ the state has spent RUB 122 billion (about \$3.7 billion) on special economic zones since 2006. Despite significant administrative and tax incentives, these zones have failed to attract investors. Only one zone – Alabuga in Tatarstan – is viewed as a success. All the tourism and logistic zones have failed; some have not attracted one new investor since their launch. In 2010 one of the tourism zones in Krasnodar territory was closed. In 2014 two more zones became moribund: the logistic zone in the Murmansk region and the tourism zone on Russkiy Island in Vladivostok.³⁹

There are many possible explanations for the failure of these special economic zones. The industrial and innovation zones are too small and therefore unable to stimulate regional economic development. In some cases they have not been integrated into the transport,

38 Schyotnaya palata Rossiiskoi Federatsii (Accounting Chamber of the Russian Federation), ‘Otchyot o rezul’tatakh kontrol’nogo meropriyatiya “Audit effektivnosti ispol’zovaniya gosudarstvennykh sredstv, napravlennykh na sozdaniye I razvitiye osobykh ekonomicheskikh zon’, *Bulleten*’ Schyotnoy palaty, 3, 2014, <http://www.ach.gov.ru/upload/uf/fac/fac89025a3b0198bcdedfb9d1962bec.pdf>.

39 Zabavina J & P Netreba, ‘Mineconomrazvitiya predlagaet zakryt’ dve osobyie ekonomicheskie zony’, *RBC Daily*, 19 August 2014, <http://rbcdaily.ru/economy/562949992170761>.

economic and social networks of the region. Sometimes the locations of zones have been chosen on the basis of political rather than economic criteria (this affects primarily tourism special economic zones). In 2010 several zones were created in the North Caucasus, including in such unstable regions as the republics of Ingushetia and Dagestan. This was done for political reasons and as a result no new investors have been registered in these zones since their establishment.

Another example of political logic prevailing over economic realities is the establishment of two regional special economic zones: the Kaliningrad region (effective from 1996 to 2031) and the Magadan region (from 1999 to 2025). The former is an exclave separated from the main part of Russia by the Baltic states, while the latter is located in the east of Russia on the Pacific Ocean. In the 1990s both had strategic importance in terms of national defence and preventing separatism. Special economic zones were created there to mitigate political risk, and economically they are insignificant.

The most recent regional special economic zone was created in the Crimea in November 2014. It is considered a tool to revive economic activity in the republic and has a notable political dimension. However, it is unlikely to attract FDI, as political risks tend to outweigh potential benefits, however sizeable the latter may be.

On the whole, the measures undertaken by the Russian government to attract foreign investors have had limited success as a result of the negative investment climate in the country. Russia's accession to the WTO has not improved this significantly. In the World Bank's annual 'Doing Business' rankings, before 2013 Russia was consistently ranked outside the top 100 countries – in 2012 it ranked 112th out of 189 countries.⁴⁰

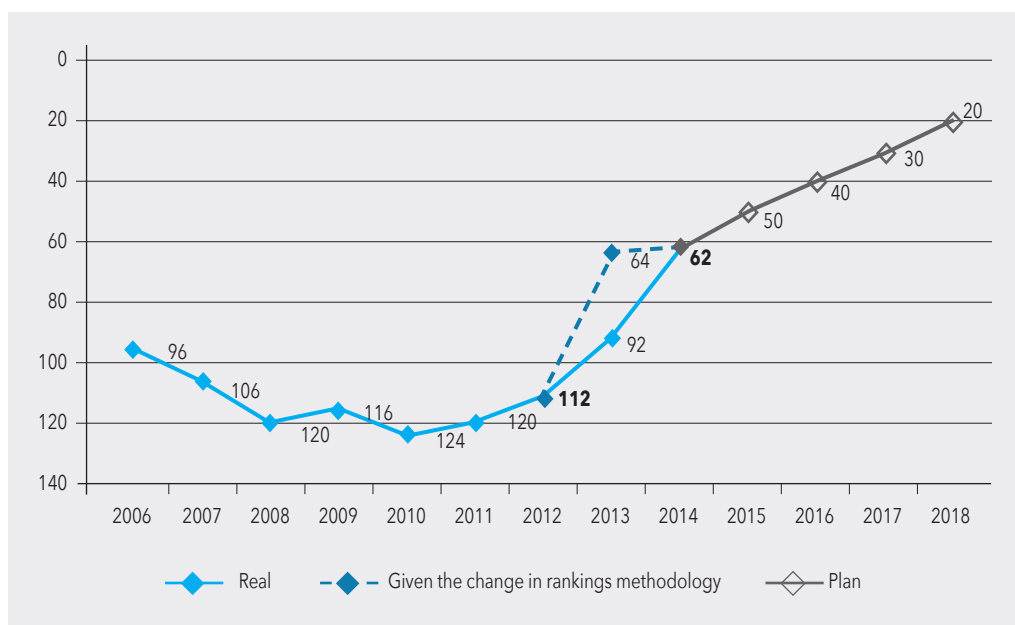
The problems inherent in a negative investment climate are well understood by the government. Putin has set an objective of Russia's being ranked 20th by 2018. This does not seem impossible: in 2013 Russia was ranked 92nd, and in 2014 62nd (the latter breakthrough is mostly the result of a change in calculating the rankings – according to the new algorithm Russia was already 64th in 2013; see Figure 7).⁴¹ However, future progress will be more complicated: in the last few years the government has addressed the most evident official barriers to foreign investment, such as bureaucratic interference. Further progress will require structural measures. It should also be mentioned that the rankings only consider data for Moscow and St Petersburg, while the investment climate in other Russian cities is usually worse.⁴²

40 World Bank, 'Doing Business Rating', 2014, <http://www.doingbusiness.org/>

41 *Ibid.*

42 Kuvshinova O & M Lutova, 'Rossiya voshla v pervuju sotn'u Doing Business – 2014', *Vedomosti*, 29 October 2013, <http://www.vedomosti.ru/finance/news/18071661/galvanizaciya-rossii>.

Figure 7: Russia's position in the World Bank's 'Doing Business' rankings



Source: World Bank, 'Doing Business Rating', <http://www.doingbusiness.org/>

As one of the measures to attract FDI to Russia, the Russian Direct Investment Fund (RDIF) was established in 2011. It is a \$10 billion fund aimed at making equity investments and securing co-investments in the Russian economy. The RDIF has already invested \$1.3 billion in joint projects. Another \$6 billion came from its international investment partners. The total sum of FDI attracted by the RDIF is estimated at \$15 billion.⁴³

In 2012 Russia initiated its 'turn to the East' policy and the Asian regions of Russia, ie, the Siberian and Far Eastern federal districts, became the focus of state investment policy. These territories are sparsely populated, some are characterised by severe climate conditions and they lack transport and social infrastructure. However, they also hold an abundance of natural resources: oil and gas, coal, gold and other metals, fresh water, forests, fish and arable land. Probably the most important competitive advantage of Siberia and the Russian Far East is that they are close to the rapidly developing Asian countries with their rising demand for natural resources and resource-intensive production. In order to develop Russia's Eastern territories, the Ministry for the Development of the Russian Far East was established in 2012. The rise of Siberia and the Russian Far East is increasingly considered a potential driver of the economic growth of the whole country. In December 2013 Putin identified it as a 'national priority for the whole 21st century'.⁴⁴

⁴³ RDIF, *op. cit.*

⁴⁴ President of Russia, 'Presidential Address to the Federal Assembly', 12 December 2013, website, <http://en.kremlin.ru/events/president/news/19825>.

In October 2013 the new model for the development of the Far East was approved. It is based on developing industries oriented at exports to Asia-Pacific and at attracting FDI. A presidential decree signed in September 2013 cut the tax rate on the profits made within investment projects realised in certain regions of Siberia and the Russian Far East from 1 January 2014. For the first five years the tax rate on company profits was reduced to 10% (and may be further reduced by regional governments to 0%); while for the following five years the maximum tax rate on profits is 18% (and may be further reduced by regional governments to 10%).⁴⁵

The main aims of the current state policy on the Russian Far East are:

- developing transport infrastructure (primarily railways);
- offering financial support to large investment projects initiated by Russian companies (primarily in the resource extraction and processing sectors); and
- organising the so-called advanced special economic zones, or rapid development territories.

These rapid development territories are the main instruments to attract FDI to the Russian Far East. They differ from special economic zones and are regulated by a separate law. Federal Law N 473-FZ 'On the Territories of Rapid Social and economic development in the Russian Federation' was passed in December 2014. Unlike special economic zones, rapid development territories take into consideration the competitive environment. They should be able to compete for FDI with similar territories in the other APR countries. Taking into account that, in terms of starting economic positions, the Russian Far East lags behind Singapore, Korea, China, Japan, etc., if it wants to be competitive it should provide investors with the best tax, administrative and investment regimes in the entire region. Thus the regulatory framework for rapid development territories was elaborated so that each individual element of the investment regime should be equal to the best the APR countries offer (Table 9): eg, the profit tax should be as low as in Korea, logistic costs as low as in Singapore, power costs as low as in the US, etc.

In order to reach such ambitious targets, two sets of incentives are provided to investors in rapid development territories. The first set involves a number of measures aimed at deregulating economic activity, while the second concerns tax breaks. Minister for the Development of the Far East Alexander Galushka presented the incentives in the following manner:⁴⁶

⁴⁵ PWC, 'Tax breaks in the Russian Far East are introduced', *Tax Flash Report*, 36, October 2013, http://www.pwc.ru/en_RU/ru/tax-consulting-services/assets/legislation/tax_flash_report_36_eng.pdf.

⁴⁶ President of Russia, 'Meeting with government members, 30 July 2014', website, <http://eng.kremlin.ru/news/22750>.

Table 9: Target characteristics of rapid development areas in the Russian Far East

Conditions in Asia-Pacific countries	Korea	China	Singapore	US	Canada	Japan	Russia – today	Russia – target
Profit tax, %	10	15	17	33	23.5	26.4	13.5	10
Inbound and outbound logistics cost, \$ per 20-foot container	700	550	440	1 320	1 660	970	1 800	440
Power cost, US cents per 1 kWh of electricity	7.3	7.4	13.6	6.9	7.4	17.9	11.7	6.9
Payroll taxes, %	8.8	26.7	16	7.7	8.7	25.6	14	7.7
Dealing with construction permits, days	29	67	26	27	163	193	244	26
Connection to the system power supply, days	28	41	36	68	142	105	254	28
Export support, score based on the volume of export support measures	5	4	4	4	5	3	2	5
Protection of intellectual property, rank score (rating IPRI)	2	3	4	5	4	5	3	5
Labour power	High	High	High	High	Middle	High	Low	High
Availability of suppliers	High	High	High	High	Middle	High	Low	High

Source: Ministry for Development of the Russian Far East, presentation for potential investors, 2014, <http://minvostokrazvitia.ru/upload/Ministry%20%20Russian%20Far%20East%201.pptx>

As far as deregulation goes, the key principle is to use the one window system for investors in the zones. This makes it possible to greatly simplify and reduce the amount of administrative formalities involved. It offers a free customs zone at the sites, reduces the time it takes to conduct the necessary checks, offers preferential rental rates and connection to engineering networks at the sites, allows investors to bring in the needed qualified workers outside of quotas, and offers a simplified procedure for land allocation.

As far as tax breaks go, we have approved the following provisions: investors who enter the advanced growth zones [rapid development territories] during the first three years following their establishment will benefit from an insurance deductions rate of 7.6 percent for the first ten years; tax holidays on profit, land and subsoil extraction taxes; and a simplified and fast-track procedure for reimbursing VAT.

The original list proposed by the Ministry for the Development of the Russian Far East consisted of 14 rapid development territories. Currently only nine such territories have been established.

The introduction of rapid development territories is a new instrument that has yet to prove its efficiency. According to the proposals of the Ministry of Economic Development, if successful this instrument should be rolled out to the other regions of Russia. However, the Ministry for the Development of the Far East argues that it should be unique to the Eastern territories, and that its advantage lies in its concentration of financial resources and ensuring the effect of scale.

Whatever the decision about the location of rapid development territories, it is evident that they will be at the heart of Russia's investment strategy for the near future. When the economic growth model based on extracting and exporting fossil fuels is no longer viable, the new model based on using Russia's other competitive advantages with the help of foreign partners could be attractive. However, foreign investors' pessimism over Russia's economic prospects and the political crisis in Ukraine must be overcome. Despite various MoUs no foreign partners have yet invested in the established rapid development territories.

CONCLUSION

Although it is hardly possible to give an accurate indication of the success of a long-term policy consisting of a wide range of initiatives, Russian investment policy over the last two decades has seen more failures than triumphs. Outward FDI became the mechanism of capital flight from the country; most FDI inflows were the result of high economic growth rates and rising oil prices rather than government efforts; and most government initiatives aimed at attracting FDI failed to return any significant results.

Russia is now in the process of transforming its investment strategy. At least four shifts are taking place:

- from a focus on attracting European investment to a focus on attracting FDI from the APR countries, primarily China;
- from European Russia playing a key role in attracting FDI to the rapid development of the Eastern territories;
- from using fragmented and politically determined ad hoc instruments to attract FDI to implementing comprehensive mechanisms (rapid development territories) in the Russian Far East; and

- from a fragmented and passive policy to promote outward FDI to the active policy that is necessary within the EEU.

At the moment all four shifts reflect the objectives and expectations of the Russian authorities rather than changes in Russia's position in global FDI flows. They have only recently been followed by concrete measures and are still far from complete. Their success is not evident, especially given the negative trends in the country's economic development. With the crisis in Russia–West relations, both inward and outward FDI in Russia is especially sensitive to political risks. Despite this, Russia still has significant potential to attract FDI from abroad and serve as an important source of FDI to neighbouring countries.