

Punching Harder, but Still Below its Weight

In 2011, net FDI inflows into Russia reached its third highest level recorded, reaching \$52.9 bln, up 22% from \$43.2 bln in 2010, but still well below the 2008 peak of \$75 bln. Although the country has managed to attract a growing share of worldwide FDI flows during the past twelve years (from 0.2% in 2000 to 3.4% by 2011 in Figure 1), there is also evidence that Russia is underperforming and needs to do more to attract FDI in non-primary sectors and maximize FDI’s contribution on economic performance.



Source: UNCTAD, WIR, 2012

Monthly Overview

During the past twelve years, Russia’s performance in terms of attracting a growing share of the world’s FDI flows has improved. In 2000, net inflows into Russia reached \$2.7 bln and grew to a peak level of \$75 bln by 2008 before dropping almost by half in 2009 to just over \$36 bln. According to the latest UNCTAD *World Investment Report* (WIR) released this July, net FDI inflows reached \$52.9 bln, up 22% from \$43.2 bln in 2010. Although worldwide flows also increased generally over this period, Russia managed to increase its share from 0.2% in 2000 to 3.4% by 2011 meaning that inflows into the country outpaced the overall growth in FDI flows worldwide. This suggests that the rise in Russia’s inflows is due to more than just a larger quantity of FDI available.

The latest WIR cites Russia’s natural resources, affordable labor costs, rising productivity and growing domestic markets as part of the reason for the recent growth in net FDI inflows. According to UNCTAD’s *FDI Attraction Index*, which measures a country’s ability to attract FDI relative to its size, Russia’s rank relative to other countries has improved overall during the past ten years. Out of 182 countries, Russia ranked 95th in 2002 and has climbed to 17th by 2010 before falling slightly to 19th by 2011 (see Figure 3 in *Indicators*). Further, the report highlights Russia’s recent entry into the WTO as providing a strong stimulus for further investment climate improvements coupled with recent policy improvements, such as an investment ombudsman to resolve investors’ problems, and high resource prices as factors that should lead to the country’s ability to attract even more FDI in the medium term despite the fact that FDI flows worldwide are expected to grow little.

The report also, however, draws attention to several important challenges facing Russia. Despite improvement in rankings in terms of attracting FDI to 17th and 19th place in the past two years, much of this is due to natural resources component of the Index, for which it ranks 2nd place. The *Attraction Index* still ranks Russia relatively lower in terms of other specific components, such as enabling environment (31st), low cost labor and skills (24th), and market attractiveness (14th). The Report’s *Contribution Index* also draws attention to Russia’s weaker performance in terms of benefitting from the FDI it attracts. On this index, Russia ranks 66th due to weaker outcomes in terms of FDI’s impact

1 | The Business Climate Development Monitor is a joint effort with the NES and FIAC and provides a monthly glance at conditions and activities affecting Russia’s ability to attract and retain Foreign Direct Investments (FDI)

on employment, exports, tax revenue, wages and salaries, value added and R & D. Yet, in terms of the report's *FDI Potential Index*, Russia ranks in 6th place. This indicates that Russia needs not only to take measures to attract more FDI to approach its greater potential, but also to develop policies that seek to maximize the domestic outcomes that FDI can have on other aspects of economic performance, such as labor market outcomes and exports.

The report also drew attention to the role that primary-resource related activities play in FDI inflows into Russia and the issue of double tripping; that some of the FDI inflow is actually an investment outflow from Russia returning through another country such as Cyprus or the British Virgin Islands. Round tripping can mask weakness in assessing the quality of a Business Climate because it overstates the genuine level of FDI on the one hand while indicating that there is some reason to hide domestic investments through offshore channels on the other.

Although the latest World Investment Report highlights Russia's improvements during the last decade in terms of attracting a greater share of FDI flows and is optimistic about medium term FDI inflow growth, it also draws attention to Russia punching below its weight. The country ranks higher in terms of potential and needs to take additional measures to benefit from FDI inflows, diversify the attractiveness of non-primary resource sectors and deal with round tripping.

Monthly Highlights

BCDM's highlights aim to provide a brief summary of announcements related to new investment activity that can reflect changes in the quality of Russia's business climate from one month to the next that could be overlooked in less frequent or more aggregate reports.

After reaching a peak in June in terms of the number of new investment announcements, there was a noticeable slowdown in July across sectors, although Energy related announcements continued to dominate.

Energy

- *Exploration:* **Petrovietnam** and **Zarubneft** are considering a second joint venture in Russia to explore for oil and gas in the Barents Sea, no investment sums have been disclosed, while **Rosneft** plans to invest in undertaking hydrocarbon exploration in the Sverdlovsk region pending an agreement with the regional government;
- *Gas-fuelling stations:* **Lukoil** plans to invest over RUR 300 mln to build five gasoline filling stations in the Murmansk region. The company also plans to expand its chain of stations in the Sverdlovsk and Moscow regions while **Rosneft** intends to build 25 gasoline filling stations and an oil depot in the Sverdlovsk region;
- In the Leningrad region, **Gazprom** will invest RUR 15.5 bln to increase gasification from 58.6% to 75% between 2012 and 2015;
- After signing an agreement with the regional government, US National **Oilwell Varco** will invest RUR 2.7 bln to construct a rig and oilfield equipment plant in the Kostroma region with a production launch scheduled in 2019;
- China's **AVIC Forestry** plants to invest about RUR 2.8 bln in the construction of a RUR1b 36-MW thermal power plant in the Tomsk region by 2014 that would operate on waste wood and gas;
- **SOCAR** plans to invest up to \$ 1 bln to create a new fleet of four offshore drilling rigs to conduct operations in the Caspian Sea;
- **HMS Group** will provide the construction of a second stage of an oil treatment station, a fuel filling station, and a wide range of infrastructure facilities on the Dulisma oil and gas

condensate field located in the Irkutsk region. The project is to be commissioned by the end of 2013 and the investment is estimated to be worth RUR 1.578 bln;

- **Rosneft** and **Eni** have entered an agreement to invest in geological works at three offshore Russian license blocks: the Fedensky and Central Barents blocks in the Barents Sea and the Western Chernomorsky block in the Black sea;
- **Samotlorneftegas**, a unit of TNK-BP, plans to invest an estimated \$ 1.086 bln to build its own gas-turbine power plant which will be implemented in 2013-2017.

Autos and Aviation

- China's holding company **Triangle** intends to invest EUR 250 mln to construct a tire plant in the Bashkiria Republic with a projected capacity of 4 mln tires per year;
- Italy's **AgustaWestland** and **Russian Helicopters** have signed a preliminary agreement to create a joint venture to develop and build a new 2.5 metric ton, single engine, helicopter capable of a range of applications that is estimated to cost \$250 mln to bring to market.

Metals, Minerals and Mining

- **Russian Platinum** intends to invest RUR 78 bln to develop the southern part of the Norilsk-1 deposit field with an estimated initial first stage of investment of RUR 58 bln;
- **Kuzbassrazrezugol**, a coal producer, increased its 2012 investment plan for development by 75% to RUR 28.035 bln from RUR 16 bln announced in May, the vast majority of which (RUR 24.398 bln) will be used for acquiring equipment;
- **Evrac Plc** has begun construction of a rail and steel mill as part of a large reconstruction investment project of the Evraz ZSMK Plant which will be capable of producing 100 meter rails. The investment is estimated at \$520 mln.

Transportation and Infrastructure

- *Telecommunications*: After winning licenses to operate 4G mobile high speed networks, the **Big 3** mobile operators and state owners telecommunications giant **Rostelecom** will invest \$1.8 bln per year constructing networks;
- *Power Distribution*: **IDGC Holding** plans to invest RUR 825 bln to develop a power distribution grid complex between 2012 and 2017 involving plans to launch over 76 000 km of power transmission lines and over 54 000 MVA of transformer capacity;
- **Bergauf Building Technologies** plans to invest RUR 400 mln to build a plant in the Novosibirsk region capable of producing 200 000 tons of dry building mixes;
- **Vagonmash Group** will invest RUR 200 mln to construct a water treatment systems manufacturing facility in the Kursk region, the investment sum and time frame have not been disclosed;
- **Rosneft** intends to build a fuel filling complex in Yekaterinburg's Koltsovo International Airport, no investment sum has been disclosed.

Agriculture

- *Deep Wheat Processing*: **Rosva**, a biotechnological complex company, has entered an agreement with the Government of the Kaluga Region to build a deep wheat processing plant worth RUR 6.4 bln to be launched in 2014 while **Biomil**, a Czech company, plans to invest RUR 8 bln to construct a deep wheat grain processing complex in the Rostov region with a capacity of 500 000 tons of grain per year;

- **Siberian Agrarian Group** has launched a pig farm in Buryatia worth RUR 3 bln which is forecast to reach capacity by July 2013 producing 12.9 thousand tons of meat in live weight;
- **Rusagro** will construct a slaughterhouse with an annual capacity of 1.8 mln head in the Tambov region which will require an estimated investment of RUR 3.5 bln and will be commissioned in 2014;
- Russia's **Talex Group**, a frozen fish supplier, has launched a meat processing plant near Voronezh. The investment is estimated to be RUR 1.4 bln.

Tourism

- **Rizzani de Eccher**, an Italian development company, will invest EUR 1 bln to develop tourism infrastructure in the resorts of Russia's North Caucasus;
- **Abrau-Durso**, a sparkling wine producer, may invest \$ 120 mln to build cottage villages in the Krasnodar region within 10 years.

Non-energy sector investment activity

- *Industrial Clusters:* **Sberbank** plans to invest RUR 175 bln to develop industrial clusters in 2014;
- *Pharmaceuticals:* **RCI-Sintez**, a subsidiary of Russia's Pharmasintez, will invest more than \$ 70 mln to construct an antitumoral drug production facility in a SEZ in St Petersburg that is set to begin operations by the end of 2014;
- China's AVIC Forestry plans to build a RUR1.3b fibre board plant with a capacity of 200 000 m³ of board per year in the Tomsk region;
- Russia's confectionary holding **Lubimy Kray** intends to invest RUR 1 bln to build a second bakery and confectionary factory in the Leningrad region with its first production line of 16 000 tons annually to begin in 2013;
- **Philips** is considering opening an assembly plant for lighting equipment in the Republic of Tatarstan, no investment sums have been disclosed;
- **Campanella Group**, an official distributor of Polaroid in Russia, is planning to launch consignment self-service hypermarkets in St Petersburg by the end of 2012 with further plans to open three to five similar hypermarkets this year, ten more next year and a network of similar shops in Moscow and other major cities;
- Russian Footwear **Obuv Rossii** group will invest RUR 460 mln to move its production facilities to the city of Ob in the Novosibirsk region from the Dzerzhinsk locality to increase output and improve its distribution center;
- Venture Capital: Mikhail Vinchel, a co-founder of Mail.ru Group, plans to invest through investment company **Buran Venture Capital** \$ 50 mln in Russian start-ups focusing on the seed stage over the next four to five years;
- Russia's **Essen Production** company plans to invest RUR 1.02 bln to open a confectionary factory in the Republic of Tatarstan in 2013.

Outward New Investment Announcements

Outward new investment announcements were down from June and were primarily related to energy exploration and mining.

- *Exploration:* After signing an MOU with Ecuador, **Gazprom** will explore opportunities for the Amistad natural gas field at Block 6 in the Gulf of Guayaquil with the country ;

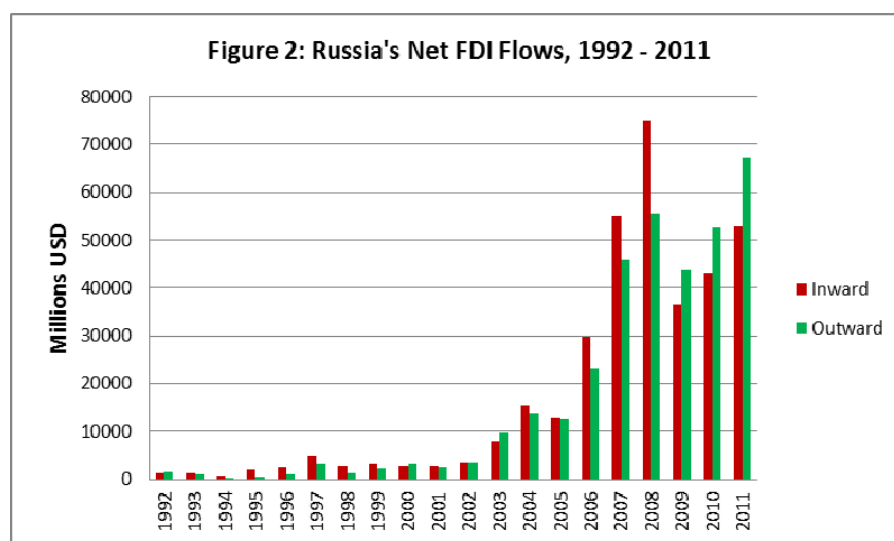
- **RMK**, a Russian copper company, plans to invest about \$ 400 mln over the next four years to develop projects in Kazakhstan;
- **Innopolis**, a scientific center being created outside Kazan, will open an office in Silicon Valley, no investment sums have been disclosed.

Business Climate Indicators

BCDM's indicators aim to provide a monthly snapshot reflecting important trends, challenges, and changes related to Russia's business climate.

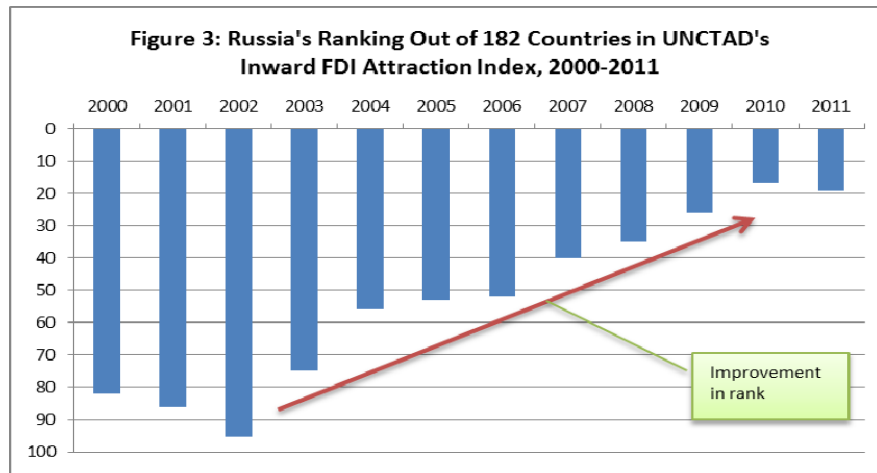
Although Russia has improved in terms of its ability to attract FDI inflows as well as seizing investment opportunities abroad, the country still appears to be performing below its potential.

- **Figure 2** shows Russia's net inflows and outflows of FDI between 1992 and 2011. After little activity during the 1990s, both flows grew rapidly since 2002 at the same time that FDI flows experienced rapid growth worldwide. Russia managed, however, to increase its share of FDI inflows from 0.2% in 2000 to nearly 3.4% by 2011 indicating that FDI flows into the country outpaced the overall growing amount of FDI flowing worldwide.
- After reaching a peak in 2008 of \$75 bln, net FDI inflows fell sharply before reaching their third highest peak ever in 2011 at \$52.9 bln. Outward FDI also reached a peak in 2011 at \$67.3 bln



Source : UNCTAD, WIR, 2012

- **Figure 3** shows Russia's ranking out of 182 countries according to UNCTAD's *FDI Attraction Index* measuring a country's ability to attract net FDI inflows relative to the size of the economy. Since 2002, Russia's performance on this index improved from a rank of 95 to 17 in 2010 before falling slightly to 19th place in 2011.



Source : UNCTAD, WIR, Table 31

Despite the appearance of Russia's recent ability to attract a greater share of the world's FDI flows, the country ranks higher in terms of the WIR's *Potential Index* (6th place) and lower in terms of the contribution FDI makes to the economy (66th place on the *Contribution Index*). These additional rankings coupled with the dominant role natural resources play indicate that Russia needs to further improve its Business Climate to not only attract a higher level of FDI, but in other sectors as well as improving the impact inflows can have on other aspects of economic performance.