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The Impact of Anti-Russian Sanctions on the Regional Investment Climate of Russia

Anna Yu. Kosobutskaya
Voronezh State University
Voronezh, Russia
E-mail: anna.rodnina@mail.ru

Annie V. Ravohanginirina
Voronezh State University
Voronezh, Russia
E-mail: vohangininie@yahoo.fr

Natalia A. Amosova
Financial University Under the Government of the Russian Federation
Moscow, Russia
E-mail: NAAmosova@fa.ru

***Abstract*—The article discusses the impact of "sectoral" financial sanctions imposed against the Russian Federation on the investment climate of the country and its regions (using the example of the Voronezh region), as well as on foreign direct investment (FDI). Despite the fact that simultaneously with the restrictions imposed on the economy of Russia and its regions, a number of other factors influence their importance for investment activities can be determined reliably. It is concluded that the negative impact of sanctions on the Russian investment climate was in short-term. Using the example of the Voronezh region, the influence of specific features of the region and the investment policy used to attract foreign investors is shown.**

Keywords*—*investment attractiveness; investments; region; sanctions; foreign direct investment; Voronezh region

I. INTRODUCTION

During the prolonged recession of the world economy, the post-crisis recovery for Russia was complicated by the economic and political sanctions and the Western countries discriminatory measures against Russian citizens and organizations. Restricting access to the world credit market and investment capital has significantly reduced the possibilities of financing and refinancing the activities of Russian enterprises.

The current geopolitical situation is specific: countries and regions compete with each other to create the most favorable conditions for business. The losing territories in this competition, are faced with an outflow of financial (and human) capital, they form a predisposition to further worsen of the economic situation. The trends of globalization and regionalization predetermine the role of investments as the most important source of development and economic growth of both individual regions and countries as a whole. The way out of this difficult economic situation requires a search for new approaches to increasing the investment attractiveness of the Russian Federation and its regions. Because of this, the improvement of theoretical and methodological approaches to the analysis of the investment climate and the investment attractiveness of the region, based on the convergence of the conditions of the global, national and regional levels, is a relevant and sought-after field of economic research. Additional research is needed on such issues as ways to improve the investment attractiveness of a country and a region, taking into account the levels of development of territories, the development of specific measures to increase investment attractiveness.

II. FINANCIAL SANCTIONS AND INVESTMENT ATTRACTIVENESS OF THE RUSSIAN FEDERATION

The theoretical basis for the study of economic sanctions and their impact on the national economy of the Russian Federation was the work of such Russian researchers as Glazyev S.Yu., Zagashvili V. G., Kazantsev S. V., Nureev R. M., Petrakov P. K., Eskindarov M. A. and others.

In the context of globalization, sanctions are often used to resolve international conflicts because they are a more attractive tool of foreign policy than wars. In March 2014, the Russian economy was subjected to the impact of economic sanctions (formally due to the annexation of the Crimea and the policy towards Ukraine) for its coercion into domestic and foreign policy, beneficial to the EU, the US and other Western countries. Subsequently, the imposed sanctions were extended and tightened [1].

Sanctions are introduced in many sectors of economy, but the most significant in terms of their negative impact are financial. The impact of financial sanctions on investment activity in Russia's economy can be considered in the following areas (as shown ion “Fig. 1”).

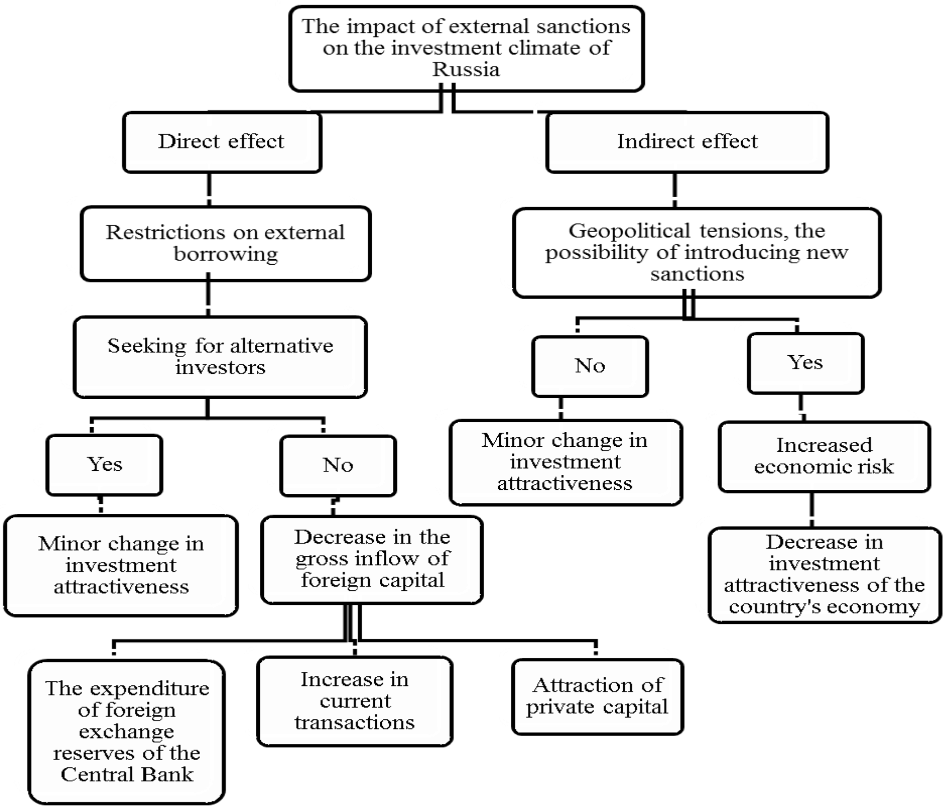

Fig. 1. The impact of external sanctions on the investment attractiveness.

The direct effect of sanctions primarily includes restrictions on foreign borrowing by Russian issuers. Thus, Russian banks and companies were forbidden to take loans for more than 30 days. Theoretically, you can find alternative lenders, but in the context of globalization of the financial system, their actual transformation into a single market, this possibility is not obvious. At the same time, persistent geopolitical tensions, the possibility of introducing new sanctions, the danger of increasing economic regulation (often observed in similar situations) are all perceived by investors as a powerful source of additional economic risks. Thus, the attractiveness of the Russian economy for Russian and foreign investments is drastically reduced. As a result, indirect effects of a decrease in net capital inflows due to increased financial risks are added to the direct effect of restrictions on access to foreign borrowing. So, if the direct effect limits external borrowing of issuers against which sanctions are imposed, and then indirect has more components: a reduction in borrowing of all other issuers and an inflow of foreign direct and portfolio investments, while an increase in Russian capital outflow is also possible.

In this case, sanctions are considered as the cause of the effect of sudden stops of capital, which is estimated at $ 22.5 billion for 2014–2015 (or 20 and 62% of the total capital outflow figures for 2014 and 2015, respectively) [2].

The decline in the real exchange rate leads to an increase in prices in national currency for imported goods. To combat volatility, the Bank of Russia has repeatedly raised its key rate. So, in 2014, the key rate increased from 5.5% to 17%, which led to a strong appreciation of loans. These measures of the Central Bank did not weaken, but, on the contrary, increased the negative impact of economic sanctions of the West. As a result, according to IMF experts, anti-Russian sanctions cost the country's economy 1–1.5% of immediate GDP growth, and cumulative losses from them could reach 9% growth [3], [4]. In absolute terms, according to experts, this amounted to 23 billion euros in 2014 and about 75 billion euros in 2015. Scientists note that the effect of sanctions was intensified by the fall in oil prices. Net capital outflow, triggered by sanctions, is estimated at $ 58 billion in 2014 and $ 160–170 billion in 2014–2017 [5]. Lost concessional loans and grants only from the EU for 2014–2017 estimated at least $ 11.1 billion [6].

According to analysts of the Central Bank of Russia, sanctions without falling oil prices would reduce investment in equity by 3.2% in 2014-2017, a decline in oil prices without sanctions would lead to a reduction in investment by 22.6% and under the influence of two shocks, investments will be lower by 24%.

As a result, the state of the investment climate in the Russian Federation deteriorated in 2014-2015. According to a study by Bloomberg Markets Global Investor Poll, Russia out of eight major world economies was the least attractive for investments. 56% of all respondents believed that Russia had poor investment opportunities, and 45% of them saw the most rational to sale Russian assets due to the situation in Ukraine. [7]

In general, the Russian investment climate is inferior to most countries of the world according to such criteria as social and political stability, dynamism of economic growth, the degree of liberalization of the foreign economic sphere, the presence of a developed industrial infrastructure, etc.

Sajjad Faraji Dizaji and Peter A.G. van Bergeijk conducted a study of changes in the impact of sanctions over time and came to the conclusion that for the imposed sanctions only the first few years are critical, and in the fourth or fifth year the country's economy is already adjusting to the sanctions and continues further development [8].

Russian practice confirms these findings. According to the World Bank Group, in four years Russia managed to rise in the international ranking of “Doing Business” from 92nd to 35th position (2018) among 190 countries of the world. Russia conducted 36 reforms in the field of business climate [9]. Russia managed to make the last spurt to five positions in the rating up by significantly improving the conditions for connecting to power grids, executing contracts and obtaining loans.

Currently, the improvement of the investment climate in the industry is happening in several ways. This is the creation of special economic zones and territories of advanced development, which can be an effective tool for attracting investment in Russia. Of course, you need to carry out constantly activities to improve the overall investment climate in the industrial sector of Russia by introducing measures to reduce administrative barriers to doing business and improve the efficiency of the judicial and legal system. However, the targeted work of the government in creating special economic zones and territories of priority development will allow testing and developing a number of effective mechanisms to increase the investment attractiveness of individual regions of the country, which can be used later throughout Russia.

III. Influence of Sanctions on Direct Foreign Investment in the Russian Federation

A special place in the research of domestic scientists is occupied by the problem of the impact of sanctions on the volume and structure of foreign direct investment in the Russian economy. Currently, there is a tendency to an increase in the volume of direct investments and a decrease in portfolio investments. Attracting FDI is among the priorities of the Russian economic policy because they are more capable of ensuring the transfer of advanced technologies, equipment and know-how from abroad to Russia, the renewal of production equipment on this basis, and the revival and growth of industrial production.

Let’s estimate the impact of financial sanctions on FDI in the Russian Federation. The deterioration of the macroeconomic situation in Russia, the growth of inflation, the unstable ruble rate, difficulties in attracting financing, high interest rates, restrictions in foreign trade, etc. had a negative effect on the mood of foreign investors. FDI in the Russian economy in 2014-2015 drastically reduced. At the end of 2015, there was a reduction of 10 times compared with 2013 - from 69.2 to 6.9 billion US dollars (as shown in “Fig. 2”). This was due to the increased demand of companies and the public for foreign currency due to sanctions, which reduced the possibility of refinancing corporate debt, and the devaluation of the ruble.

However, in 2016 the situation changed: there was a significant increase in FDI, due to the stabilization of the economy after most of the sanctions measures have taken place, the ruble has stabilized, and many other factors leading to a corresponding recovery of the investment attractiveness of the Russian Federation [11].

At first, the increase in oil prices and the stabilization of the ruble exchange rate have begun again to attract investors to Russia. Oil price has increased since January 2016 from $ 32.3 per barrel to 69.22 by January 2018, more than doubled [12].

Secondly, there was a reorientation towards the Asian economy. Practically all of Europe, as well as some other countries, imposed sanctions on Russia, but only Japan from Asian countries did this. A significant share of investment in Russia is occupied now by Asian states. For example, in the first quarter of 2017 China increased its investments in Russia twice, and their amount exceeded $ 100 million. Singapore residents provided an inflow of investments in 2016 in the amount of $ 16.3 billion, which amounted to half of all foreign investment in the Russian Federation for the year [13].

Thirdly, offshore companies (Cyprus, British Virgin Islands, Bermuda, Bahamas, Luxembourg) played a large role in increasing investments. 58% of FDI comes to Russia from these microterritories, while Germany, the Netherlands, Sweden, France, Ireland, the United Kingdom, Austria, Finland and the United States, taken together, create only 32% of the total FDI. Investments are made primarily by organizations of Russian origin. At the same time, the return of capital occurs mainly in the form of loans from co-owners of enterprises, and not as investments, which essentially does not contribute to the influx of new technologies and the modernization of domestic production.

In accordance with the rating of the World Economic Forum, in terms of the “FDI and transfer technology” indicator the Russian Federation ranks 109th in the world (out of 130) [14]. According to academician S.Yu. Glazyev, “85% of foreign investments that we receive are offshore money, which our business returns from offshore companies, having previously laundered them from taxation, from law enforcement agencies, having lost half of the way, so to speak, well, half of them are returning”.

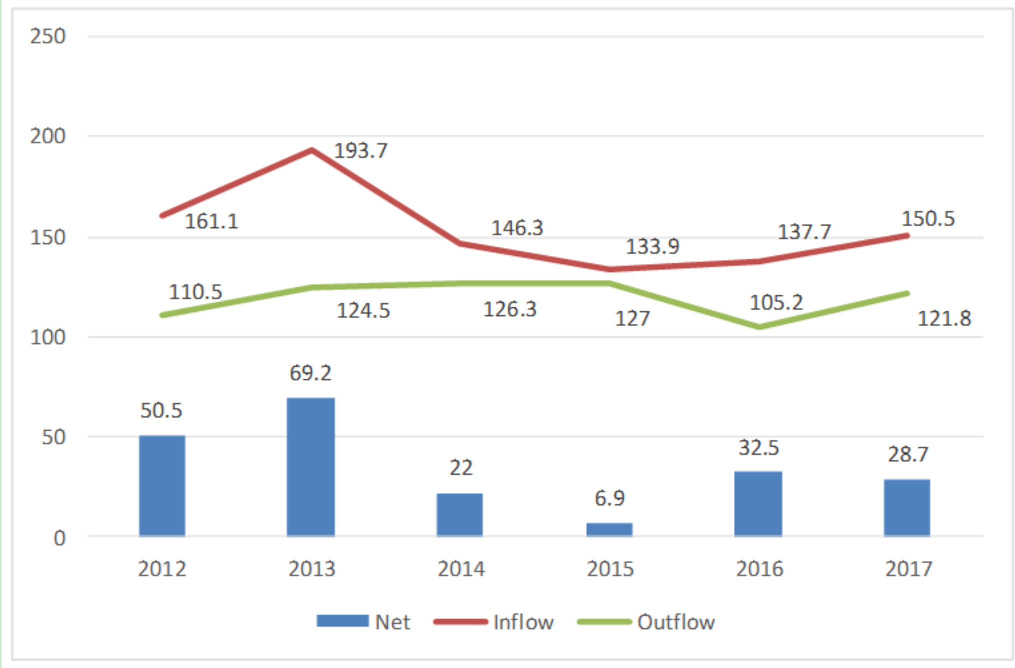

Fig. 2. Dynamics of foreign direct investment in the Russian Federation 2013-2017 [10].

Not only is the resource-based industry attractive for FDI in Russia. Over the past three years, trade has come to the fore due to the vigorous activity of international retail chains (in particular, Auchan, Metro, IKEA, REWE), the financial sector (international banking groups tend to establish themselves in the Russian market, because after Russia's accession in the WTO, the financial industry is becoming more accessible). Other sectors attracting a significant part of incoming FDI are real estate, information and communication, construction, energy and gas. High value-added industries, such as the production of machinery, electronic equipment, healthcare, etc., are currently not among the priorities for FDI.

Thus, attracting investment, especially foreign investment, depends not only on the potential of the country and regions. Therefore, at present it is necessary to create a modern infrastructure of the investment complex, in particular in the field of foreign economic cooperation and strategic partnership.

IV. Investment Climate of the Voronezh Region

Since the regions are limited in their investment opportunities and do not have an adequate supply of their own financial resources, the only way out for the majority of regional authorities is to create acceptable working conditions for investors. The Agency for Strategic Initiatives and the Ministry of Economic Development have developed a package of "road maps" designed to make life easier for local businesses. The implementation of these plans has been declared one of the most important economic priorities of the state. Thus, the responsibility of the regional authorities shifted to the area of providing an investment environment acceptable to investors, creating and incrementing an attractive infrastructure, which would allow preserving the pre-crisis quantity of investment.

It should be noted that, regions with a high proportion of agricultural production and the food industry are the locomotives of growth against the background of anti-Russian sanctions and the implementation of the policy of import substitution. Among them are Voronezh, Belgorod, Lipetsk, Kursk regions, Stavropol and Altai regions.

Let consider the impact of sanctions on the investment climate of the Voronezh region.

The implementation in the Voronezh region of a large number of huge investment projects in many sectors of industries, the actions of the regional government to improve the investor support system led to its leading position in the ratings characterizing investment development.

The variety of factors compiled by entrepreneurs is reflected in the methodologies for compiling investment attractiveness ratings of regions. Beginning in 2017, the Voronezh region is in the Top 20 regions according to the National Investment Rating of the members of the Russian Federation (7-8 in the rating) [15]. The Voronezh region is included in the list of the regions with the best dynamics in the regions' rating on the investment climate.

In 2017, the share of 25 regions with high investment attractiveness is 86% of the total amount of FDI.

In the Expert RA rating, the majority of all regions of the Russian Federation (46) belong to groups with low or insignificant potential and minimal or moderate risk. In 2017, the Voronezh region confirmed the 3A1 rating, which means "reduced potential — minimal risk". Since 2010, the Voronezh region has consistently occupied the 3rd place in terms of investments in equity, and in 2017 in terms of investments in equity per capita it occupied the 2nd place in the Central Federal District and 17th in Russia. Since 2012, the share of foreign and joint ownership in investments in fixed assets (9.7%) has steadily decreased and amounted to only 3.2% in 2017.

The data in “Table I” show that despite the continuous increase in investment in equity in actual prices during 2012-2017, the index of their physical volume, starting in 2013, has been steadily decreasing, but to a lesser extent than in the Russian Federation and in the Central Federal District (except 2017).

TABLE I. INVESTMENTS IN EQUITY IN THE VORONEZH REGION [10]

	2012	2013	2014	2015	2016	2017
Investments in equity (in actual prices), billion rubles	182,3	217,0	240,3	264,7	271,0	294,2
Index of physical volume of investments in equity (in comparable prices), as a percentage over the previous year	112,6	113,7	106,7	100,7	100,1	100,1

The following are the reasons why investors choose the Voronezh region [16]:

- Convenient geographical location: proximity to both European and Asian markets; Voronezh is a center of the intersection of transport and logistics routes (transport corridors "North-South", "West-East"); excellent transport infrastructure development (international airport, highways, railway, water transport); huge sales market: about 35 million people within a radius of 500 km.
- Rich human and scientific potential: labor resources are 1.4 million people with secondary (35.1%), vocational secondary (40.1%) and higher education (24.8%); second place in the Central Federal District (CFD) after Moscow by the number of universities and students.
- A wide range and simplicity of obtaining preferences by companies implementing investment projects and especially significant projects in the region (as shown in “Table II”): assistance in the selection of investment sites, support for investment projects from the initial stage of their implementation, ensuring effective interaction with government authorities.

TABLE II. INCENTIVES FOR INVESTORS IN THE VORONEZH REGION

Profit Tax	Rate reduction: up to 8 years
Tax on wealth	Exemption from payment: up to 8 years
Land lease	Preferential land lease terms
Subsidy	The interest rate on loans for the purchase of agricultural machinery, feed, livestock, fertilizers
Co-financing	Engineering infrastructure construction

- Industrial parks with developed infrastructure and co-financing of infrastructure by the regional government (roads, railways, electricity, gas, sewage treatment plants). Industrial Park "Maslovsky" — industrial production; “Liskinsky” — production of granulated feed; production of premixes, concentrates; "Bobrovsky" — food and processing industry; "Perspective" — processing industry, logistics.
- Experience in implementing huge investment projects (as shown in “Table III”).

TABLE III. IMPORTANT INVESTMENT PROJECTS IMPLEMENTED IN THE VORONEZH REGION

Company name	Volumes of investments, in million rubles
JSC “Concern Rosenergoatom”	131000
Eurocement Group	19800
JSC "Cherkizovo Group"	7900
Zarechnoye	5900
Bunge	3400
Siemens	2400

It should be noted that, starting in 2013, there has been a withdrawal of FDI (as shown in “Fig. 3”). For 4 years, the FDI balance has been striving for zero, which is associated with anti-Russian sanctions and changes in the national currency exchange rate.

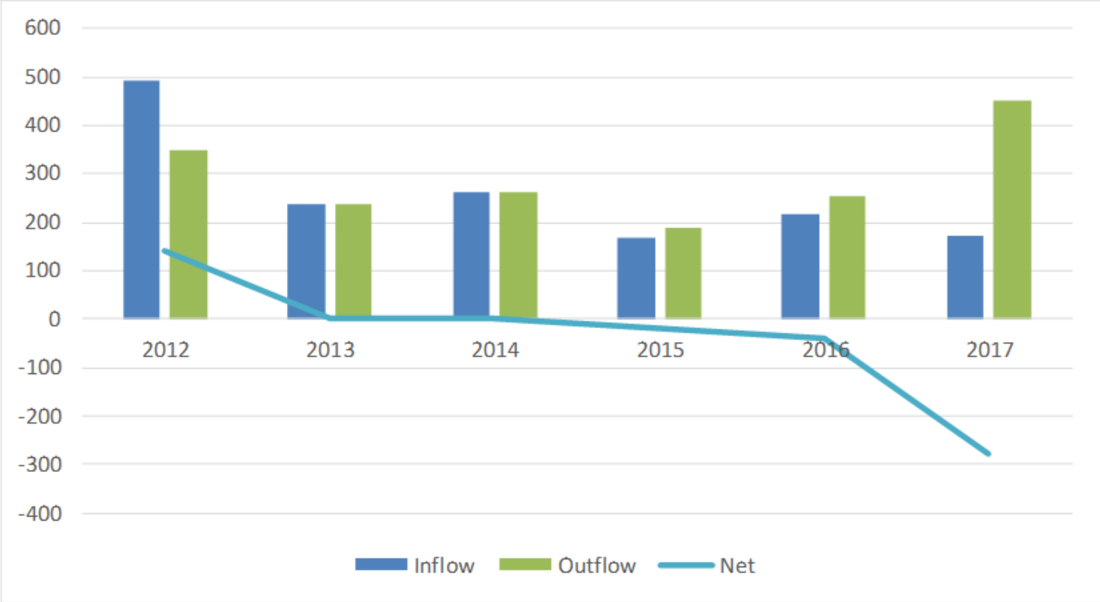

Fig. 3. Dynamics of Voronezh Region's FDI [10].

The following countries were the most active in the Voronezh region: Germany (Tonies Fleisch, EKONIVA — cattle breeding, Bionorica — pharmaceuticals, Siemens — transformer factory, METRO Cash & Carry — trade), Switzerland (Eurocement Holding AG — cement production), USA (MARRIOT, RAMADA PLAZA — hotel business, Bunge, PepsiCo — food industry), United Arab Emirates (U-GLOBAL RU, LLC — creation of a grain terminal), France (Lesaffre — food yeast production, Auchan, Leroy Merlin - trade), Czech Republic (Agrostroj Pelhrimov — engineering products, assembly of agricultural machinery and commercial vehicles), Italy (Pirelli — tire production and auto chemical goods), Holland, Sweden, Denmark, Japan, Cyprus.

V. Conclusion

A review of publications on the impact of sanctions on the economy of the Russian Federation and its investment climate [17], [18], [19], and the results of the analysis, made it possible to draw the followings conclusions.

Financial sanctions of Western countries against the Russian Federation have had a short-term negative impact on the investment climate of the country and its regions. Along with the negative impact of "sectoral" sanctions, there is also a positive effect on the national economy and its economic potential. In particular, import substitution can be considered as a positive process, especially in strategic sectors of the Russian economy, which has led to an increase in the global competitiveness of the Russian Federation.

Sanctions violate the foreign economic relations of the financial sector. They cause a shortage of financial resources, which causes them to rise in price, i.e. interest rates start to rise. Moreover, interest rates are rising on credit operations and on raising funds as well (financial institutions tend to stimulate the flow of funds within the country instead of foreign financial resources).

In the context of sanctions, the problem of rising interest rates is closely related to the problem of the depreciation of the national currency. The fall in the value of the national currency in combination with rising interest rates causes inflation. Together, all these factors reduce the efficiency and competitiveness of the country's financial sector. The problems of the financial sector are rapidly becoming problems of the country's economy because the above negative phenomena have a logical consequence of a decrease in investment volumes. Moreover, investments are declining due to not only a shortage of borrowed funds, rising interest rates and inflation, but also a rapidly declining investment attractiveness of a country under sanctions [20].

Attracting investment resources on a national and regional scale is one of the priorities of state economic policy in the context of financial sanctions. The share of gross investment in GDP in Russia does not exceed an average of 21% in the last 5 years. Academician Senchagov V.K. noted that this share should be brought up to 28-30%, because capital-intensive industries dominate in the structure of the Russian economy. It is also necessary to ensure the inflow of FDI (their share is currently very low) and loans, to make even more efforts to develop financial interaction with countries that have not joined the sanctions (for example, China and other wealthy Asian countries). The most important condition is to ensure a favorable climate for foreign investors.

The Government can help to revive investment demand and improve the investment climate by simplifying administrative barriers on doing business and implementing investment projects, for example, through the creation of special economic territories and advanced development zones that can really help attract foreign investment in the domestic economy and expand the domestic credit market. When creating these economic zones, emphasis can be placed on certain regions, which can later be used throughout the country.

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