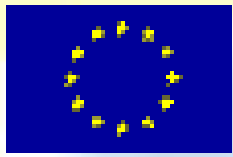


Foreign Direct Investment: Russia and the EU

**OECD-Russia Expert Meeting
on
Russia's Investment Policy**

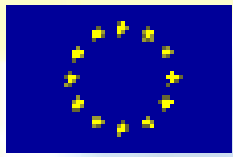
9 April 2008, Moscow, Russia

**Lúcio Vinhas de Souza
European Commission
Directorate General for Economic
and Financial Affairs (DG ECFIN)**



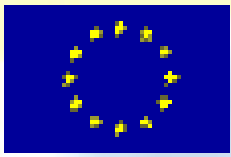
Outline of Presentation

- **Global FDI Trends**
- **FDI in Russia**
- **The EU as an Investor in Russia**
- **Russia as an Investor in the EU**
- **The legal framework**
- **Conclusions**



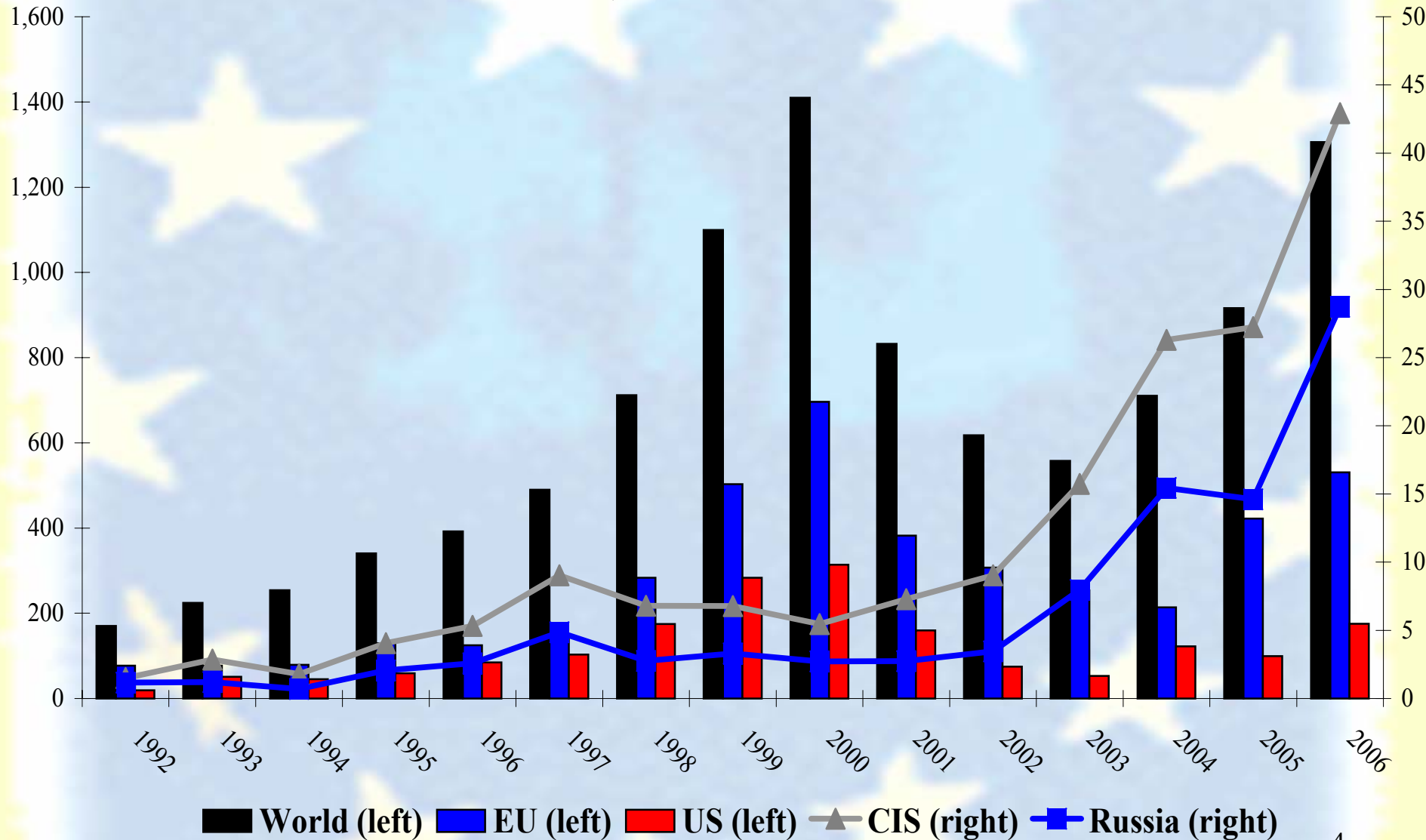
Global FDI Trends

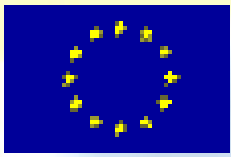
- On a global scale, inward FDI reached over USD 1.3 trillion in 2006...
- ...but this impressive figure –over 40% the 2005 one- is actually still below the peak reached in 2000, of around USD 1.4 trillion.
- In any case, the 2006 figure is more than 97 times the nominal USD figure for 1970.



Global FDI Trends

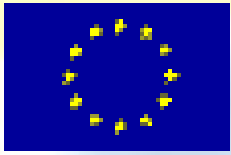
Inward FDI, in current USD mil.





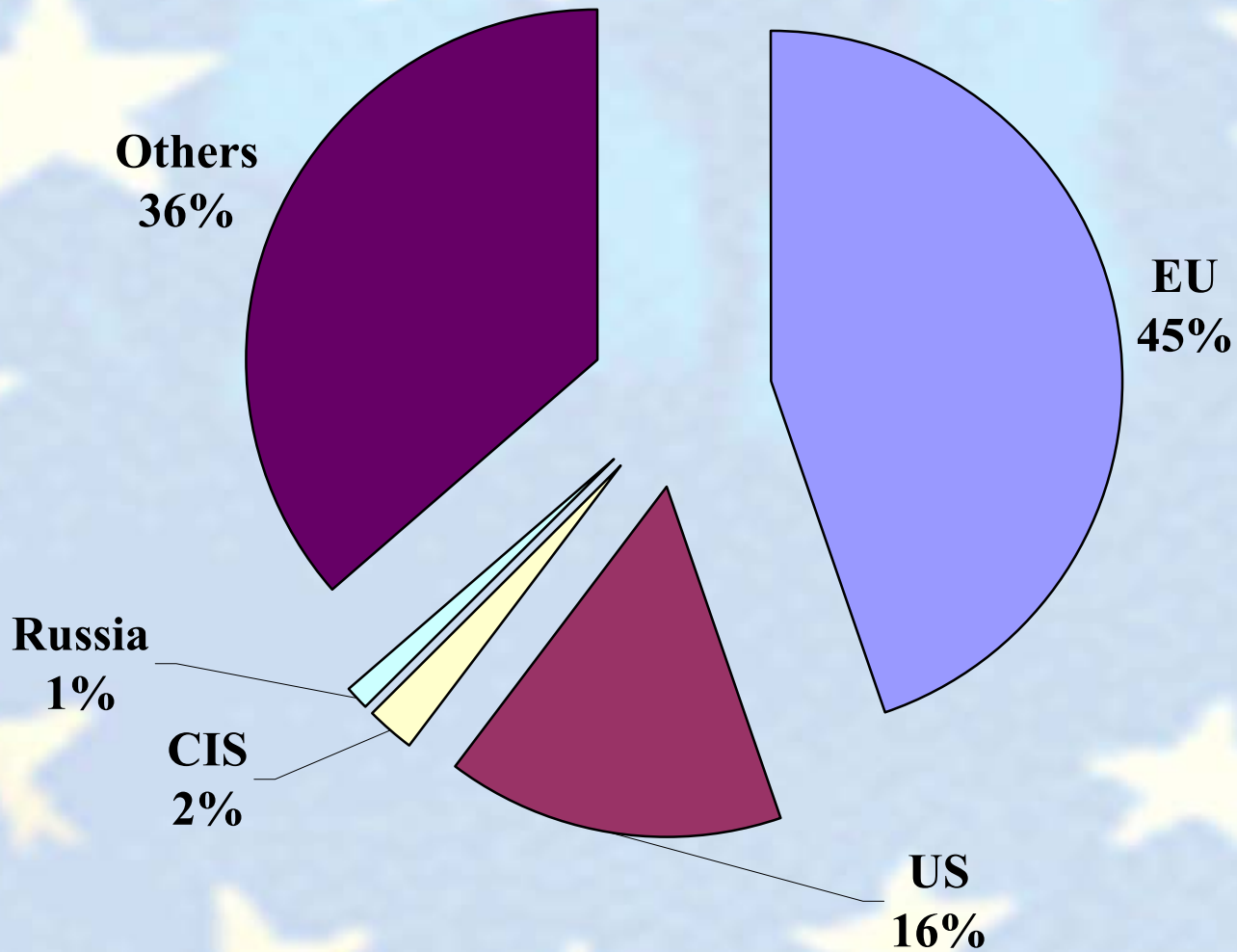
Global FDI Trends

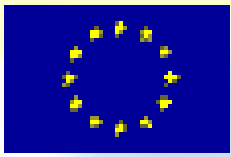
- The EU is the world's largest FDI receiver, with 45% of the cumulative FDI 2000-2006, followed by the US.
- Developed economic areas as the EU and the US have a smaller share of inward FDI than of outward FDI (i.e., they are net investors worldwide).
- As concerning Russia, the striking feature is that it received only half of the FDI invested in the CIS during 2000-2006, when Russia was over 75% of the CIS GDP (and over half its population), albeit this share jumped to close to 70% in 2006.



Global FDI Trends

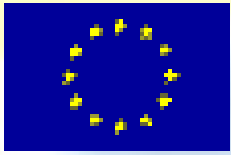
Share of Cumulative Inward FDI, 2000-2006





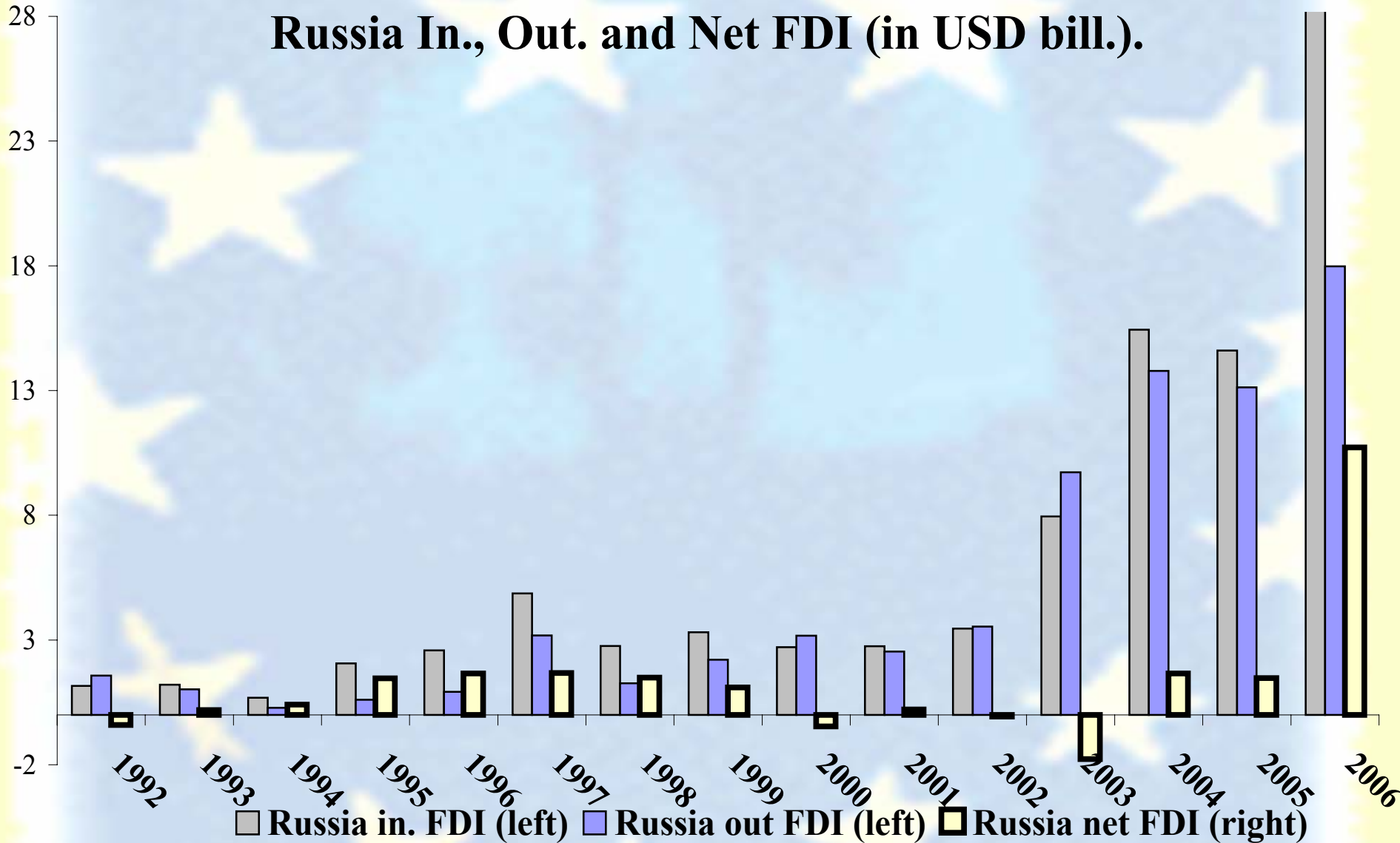
FDI in Russia

- Beyond receiving a relatively disappointing amount of FDI, Russia also suffered from –until recently- net FDI outflows.
- Russia (net positive) FDI reached a peak in the mid-1990, and entered into negative territory in the late 1990s.
- From 2004-2005 onwards, the situation *may* have started to change.

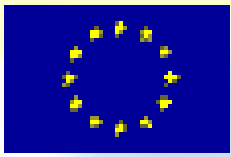


FDI in Russia

Russia In., Out. and Net FDI (in USD bill.).

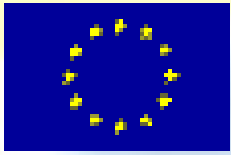


■ Russia in. FDI (left) ■ Russia out FDI (left) ■ Russia net FDI (right)

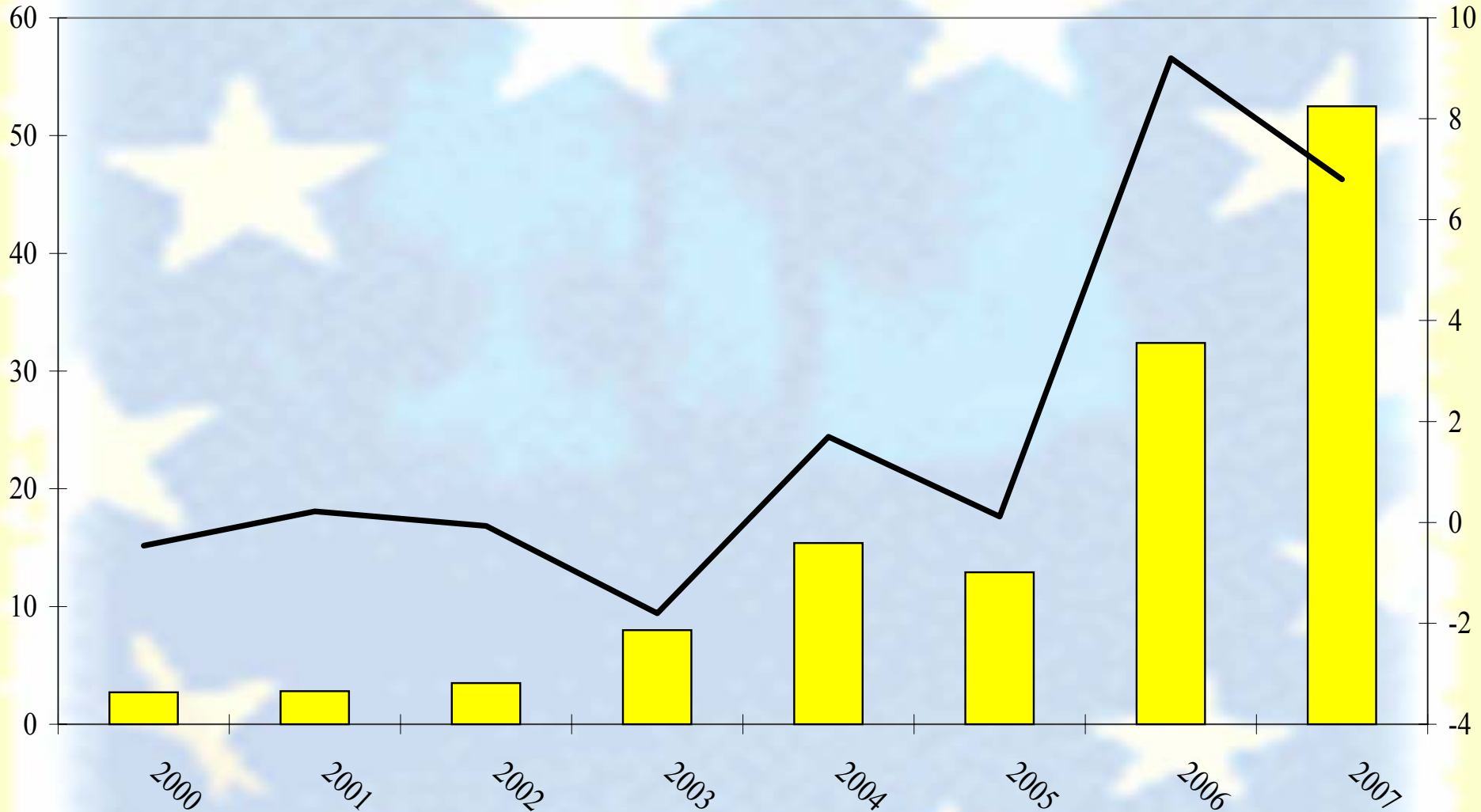


FDI in Russia

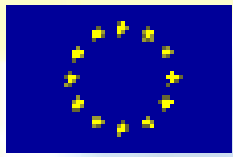
- Why? Due to a very significant increase in FDI total inflows. FDI grew by 20 times in 2000-06, reaching USD 52 billion in 2007, or 4% of GDP.
- The share of Russia in total FDI in the CIS jumps from 49% in 2005 to almost 67% in 2006.
- But the main change observed between 2005 and 2007 is the very significant reversal of net FDI.
- Net FDI into Russia jumps from USD -0.1 to USD +9.2 billion between 2005 and 2006. This trend persisted in 2007, with almost USD 7 billion net FDI.



FDI in Russia

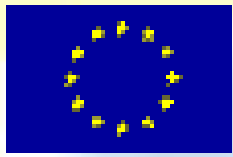


 Total FDI into Russia (USD bill, left scale)
 Net FDI Inflows (USD bill, right scale)

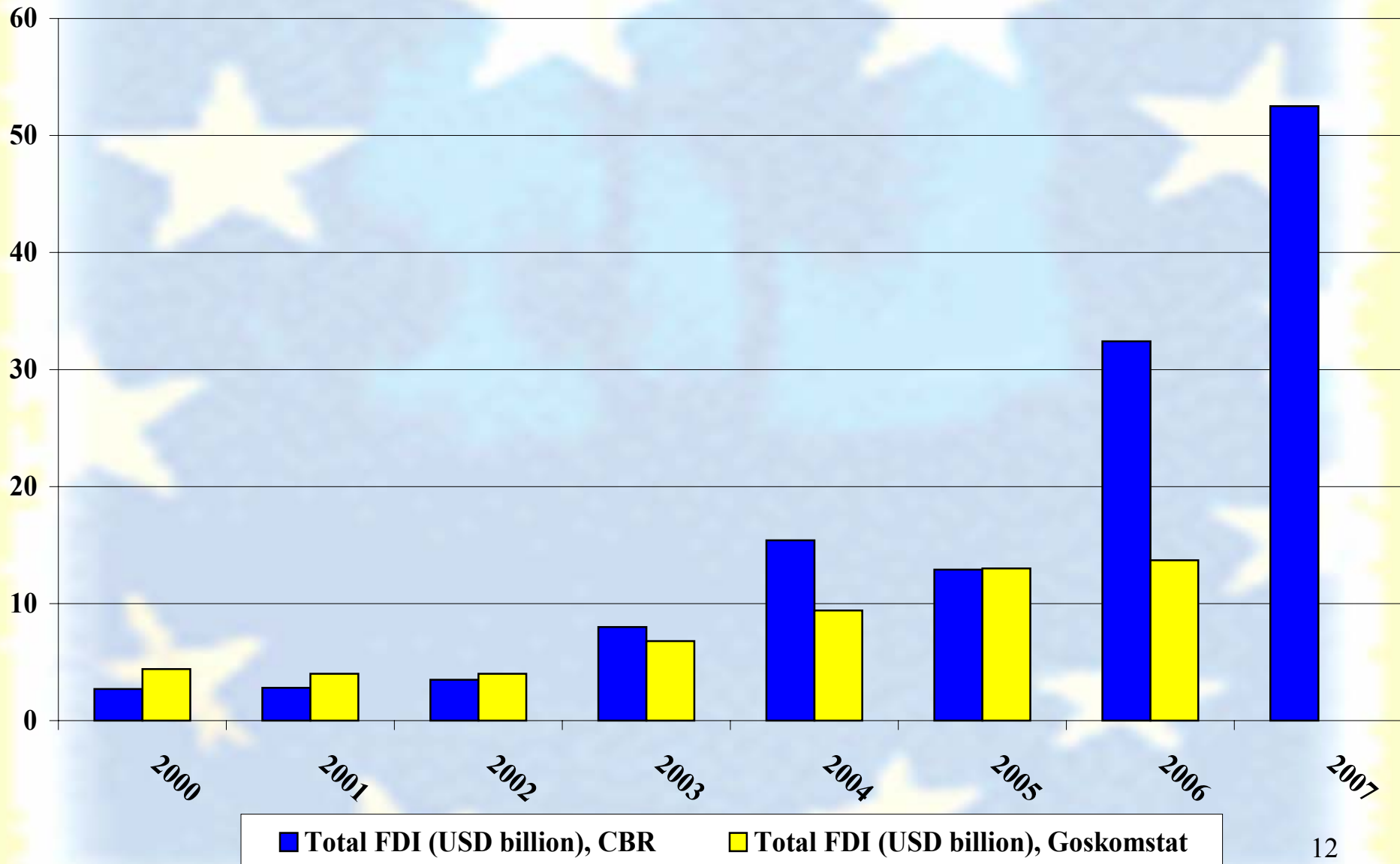


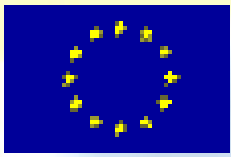
FDI in Russia: Data questions

- When talking about FDI in Russia, one should keep in mind the dissimilarities between the FDI data produced by the two main organisations responsible for it in Russia, the CBR and Goskomstat.
- They, due to significant methodological differences, diverge not only in *scale* but also in *trend*.
- There seem also to be some questions concerning the classification of FI and FDI data by Goskomstat.



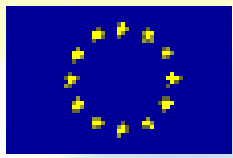
FDI in Russia: Data questions





The EU as an Investor in Russia: How Important?

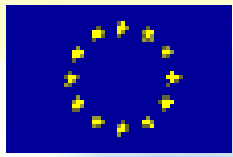
- Russia has a relatively small share of the EU's total external FDI, at 4%, but this is actually significantly more than China's.
- Despite that, the EU is by far the largest investor in the Russian economy.
- On the other hand, it seems that a significant part of the FI inflows, and also of the recent increase, may be Russian capital repatriated from abroad.
- The next table shows the 10 largest investors in Russia (with 86% of the 3Q2007 FI stock).



The EU as an Investor in Russia

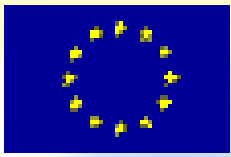
	2005 Total FI Stock (USD million)	2006 Total FI Stock (USD million)	3Q 2007 Total FI Stock (USD million)
	% of Investor Country	% of Investor Country	% of Investor Country
Cyprus (%)	17.2	22.6	19.8
Luxemburg (%)	18.8	16.0	15.3
Netherlands (%)	16.9	16.4	18.2
United Kingdom (%)	11.4	8.3	12.2
Germany (%)	8.7	8.6	5.8
USA (%)	6.1	5.4	4.1
France (%)	3.5	2.6	3.8
Virgin Is. (UK) (%)	2.2	3.0	2.1
Switzerland (%)	2.1	2.0	3.1
Japan (%)	0.5	1.9	1.5
EU, above (%)	78.7	77.4	77.2

Source: Goskomstat and Author's calculations.



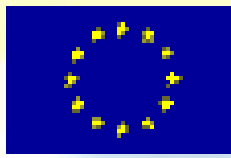
The EU as an Investor in Russia: Who?

- Cyprus (one of the smallest EU MS) is responsible for 20% of all *FI* accumulated into Russia until 3Q2007.
- When one factors in Luxemburg and the UK's Virgin Islands, their total share of the 3Q2007 FI stock is above 37%.
- As most of these territories are either EU MS or linked to a EU MS, the share of the EU in total FI inflows and stock into Russia is very high (almost 80%).



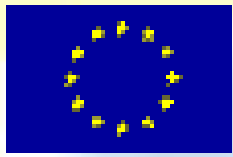
The EU as an Investor in Russia: In Which Sectors?

- Where are these inflows invested?
- Services have received between 50% and 60% of the total FI. Among the other sectors, natural resources and manufacturing attract roughly comparable amounts of FI (and close to their weights in Russia's GDP). But...
- ...the share of the energy sector is larger in FDI (i.e., without Portfolio and “Other Investments”). The share of the energy sector in the FDI inflows in the period 1Q-3Q 2007 seems to have been nearly 2/3 of the total.
- EU MS seem to be among the largest investors in virtually *all* the sectors of the Russian economy.



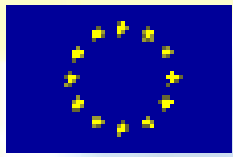
FI in Russia: In Which Sectors?

	2003	2004	2005	2006	3Q2007
Agriculture, Hunting and Forestry	0.5	0.3	0.2	0.6	0.3
Mining and Quarrying	19.3	24.5	11.2	16.6	17.3
<i>including:</i>					
<i>mining and quarrying of energy producing products</i>	17.3	21.6	9.6	14.1	16
<i>mining and quarrying, except of energy producing</i>	2	2.9	1.6	2.5	1.3
Manufacturing	22	25.3	33.5	27.5	24.6
<i>of which:</i>					
<i>manufacture of food products</i>	3.4	2.3	2.2	2.5	2.5
<i>manufacture of chemicals and chemical products</i>	1.2	1.9	2.7	2.8	1.2
<i>manufacture of metals and fabricated metal products</i>	10.3	12.6	6.4	6.8	12.6
<i>manufacture of transport equipment</i>	0.7	2.1	1.8	2.6	0.9
<i>manufacture of coke and mineral oil</i>	0.6	0.2	15.1	7.2	3.8
Services	58.2	49.9	55.1	55.3	57.8
<i>construction</i>	0.3	0.6	0.4	1.3	1.2
<i>wholesale, retail, repair activities</i>	36.1	32.9	38.2	23.7	42.3
<i>transport and communication</i>	3.8	5	7.2	9.6	6.5
<i>of which communication</i>	2.3	3.4	6.1	8.5	2.9
<i>financial intermediation</i>	2.6	2.5	3.4	8.5	12.4

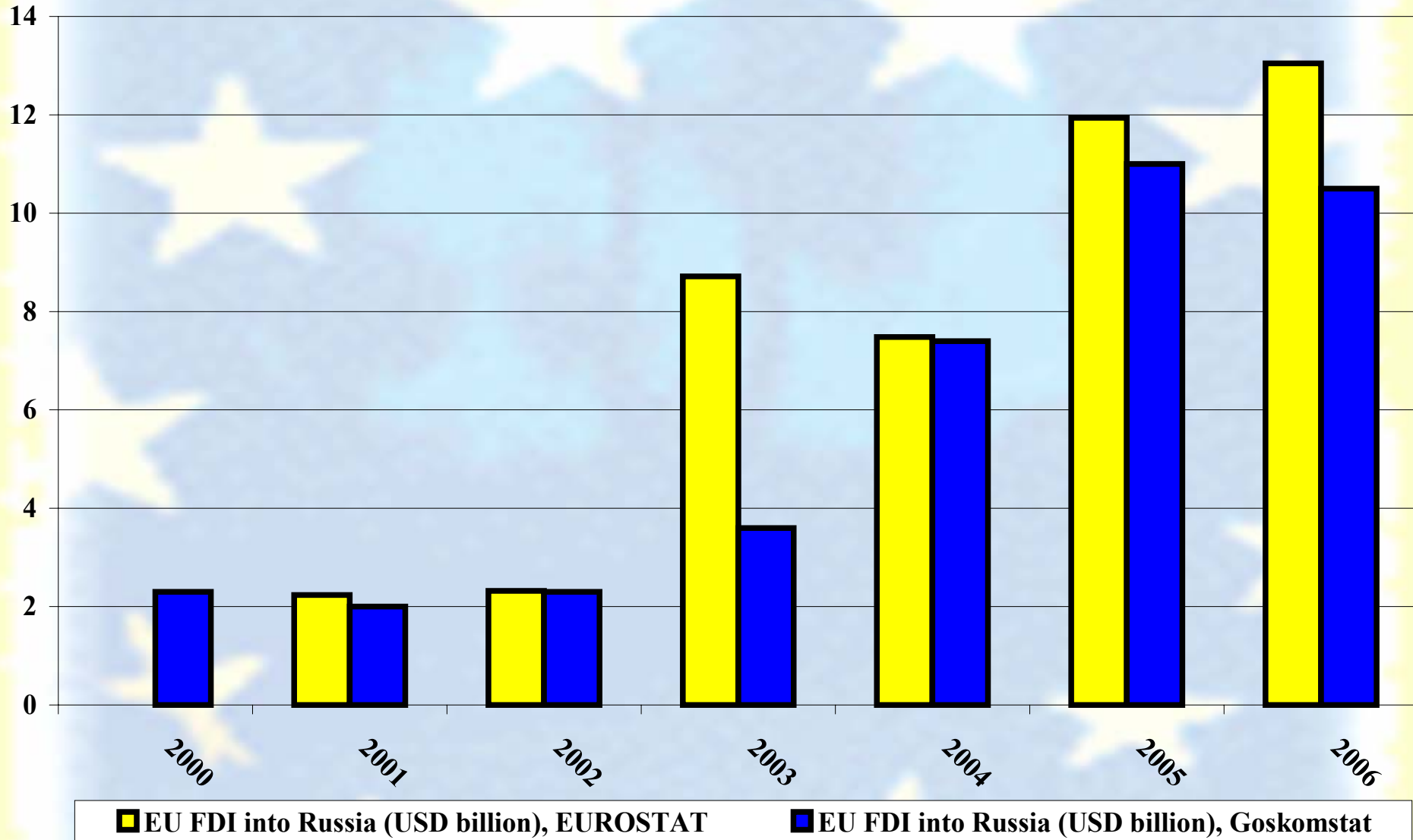


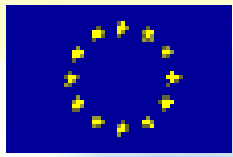
EU FDI in Russia: Data questions

- The differences among the EU FDI in Russia data produced by EUROSTAT and Goskomstat *seem to be less severe than the ones between Goskomstat and the CBR, but they still exist.*



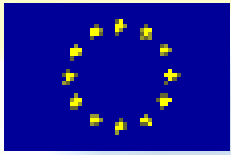
EU FDI in Russia: Data questions



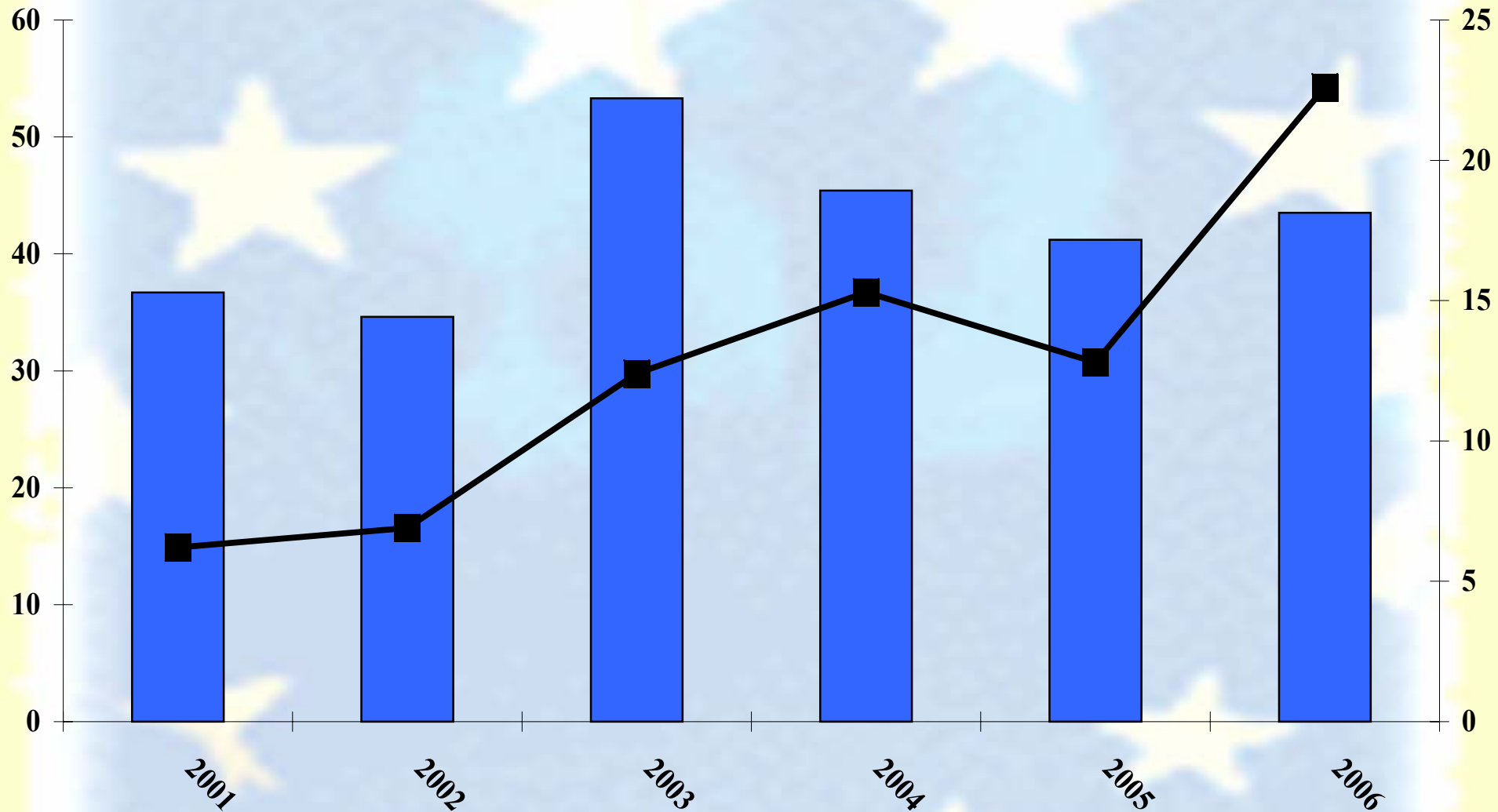


Russian FI in the EU

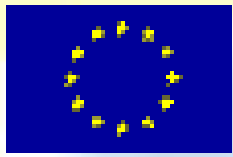
- As the overall economic relationship between the EU and Russia, the FDI one is *mutual*.
- The EU is also a large receiver of the growing Russian FI outflows (over 42% in 2001-2006).
- Those outflows are not only “capital flight”, but represent investment by Russian companies abroad, and are therefore a positive sign of the growing international integration of the Russian economy.



Russian FI in the EU

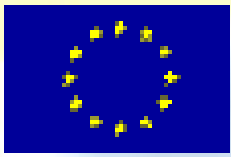


■ Share of Russian FI in the EU (% , left scale)
■ Value of Russian FI in the EU (USD billion, right scale)



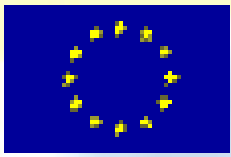
Russian FDI: Examples of Large Outgoing FI by Russian TNCs in 2006-2007.

Investor	Industry	Company	Share Acquired	Value of deal (mill USD)
Evraz	Steel	Oregon Steel Mills (USA)	100%	2300
VTB	AeroSpace	EADS (France/Germany)	5%	1170
NLMK	Steel	Steel Invest (Finland)	50%	805
Vimpelcom	Mobile telecom	Armentel (Armenia)	90%	436
Norilsk Nickel	Metals	Nickel business of OM Group (USA)	100%	408
Interros	Energy	US Plug Power (USA)	35%	241
Rusal	Construction	Strabag SE (Austria)	30%	1500
AirBridge	Airline	Malev (Hungary)	100%	210
Rusal	Metals	Alscon (Nigeria)	77.50%	n.d



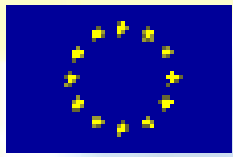
Investment Climate

- How does the investment climate in Russia compares with other emerging markets?
- One can do that sort of comparison using the World Bank's *Doing Business 2008*. Russia ranks 106th out of 178, above Brazil and India, close to the CIS average but below China. The areas in which Russia performs worst are “licensing requirements”, “dealing with workers” and “trading across borders”. But it does It ranks *above* the OECD and the EU average in some items.



Investment Climate

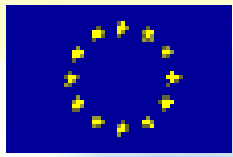
- Using the World Economic Forum's *Global Competitiveness Report 2007*, Russia ranks 58th out of 131 countries – the highest rank of all CIS countries covered and ahead of three EU member states and Brazil, but below China and India. Russia's main weaknesses here are “institutions” and “goods market efficiency”.
- In other terms, Russia performance is not as bad as one might expect, which is not to say that there are not areas for improvement. There are, and one such one is the legal framework.



The Legal Framework

New Russian Law on “Strategic Sectors”

- In early April 2008, the Duma adopted in third reading a law on strategic sectors.
- The law establishes an authorisation procedure for 42 sectors that are considered to be of strategic importance to national security.
- The energy sector is also covered by this new law, with stricter thresholds than for other sectors.



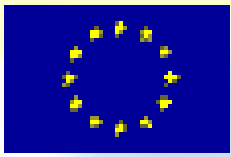
The Legal Framework

- **Positive points:**

- The law clearly defines a specific number of sectors that are considered to be of strategic importance for national security and where specific authorisation procedures apply to foreign investment.
- This will give more clarity and predictability to foreign investors.

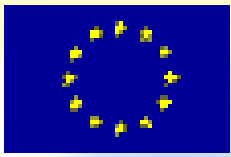
- **Less positive points:**

- questions remain on some provisions, for example the stricter conditions applying to the energy sector, as well as some remaining unclear aspects in the authorisation procedure.



Conclusions-I

- Russia *may* have started to correct its traditional underperformance in terms of FDI.
- The EU is by far the largest investor in Russia.
- Nevertheless, there is still a large margin for improvement, in terms of FDI attraction into Russia.
- Mutual relationship: Russia also invests a significant share of its own growing FDI outflows in the EU.



Conclusions-II

- The investment climate in Russia does not fare as badly as one might expect, when compared to the CIS and/or other large emerging markets.
- In any case, improvements are still necessary.
- For example, some aspects of the FDI legal framework could still be improved.
- This will assure that the 2006-2007 developments *do become a sustainable trend.*
- Some questions concerning the availability of data remain.

The background of the slide is the flag of the European Union, featuring a circle of twelve gold stars on a blue field. The text is centered over this background.

Thanks for your attention!

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