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# Russian Multinationals FDI Outflows Geography: the Emerging Dominance of Greater Europe

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**Abstract.**
Moderation of Russian MNEs capital outflows has recently become a severe problem for the Russian economic policy regulatory, which are now in a great need of the real picture of the Russian outward foreign direct investment (FDI) geography without distortions by official statistics with its data on indirect FDI via offshores. This datum clearly depicts the dominance of European vector in the Russian outward FDI geography. At the end of the article, some measures for regulation of FDI outflows are offered for diversification of the Russian outward FDI orientation. Bilateral investment and double taxation treaties are main measures of institutional support and state insurance of investments discussed as a key element of support for mature projects abroad.
**Keywords:** Russian FDI; de-offshorisation; multinationals; MNEs; capital outflows supervising; regional distribution of foreign investments.

## Introduction

In Russia, in the last couple of years again has been reinvigorated the debate over the regulation of the outflows of the capital by Russian multinationals. On the one hand, more and more experts appalled with an excessive and uncontrolled offshorisation [18] of the Russian economy. [11] In the field of foreign direct investment (FDI), it manifests itself in an extremely high share in the geographical structure of offshore companies and other countries, used as a staging base for the capital, moving in a circle back to Russia or sent to a third country. Such “indirect” FDI often allow Russian businesses to hide the final beneficiaries and to evade taxes [8, pp. 544-545]. On the other hand, the authorities in Russia have finally realized that there is a great need to endorse those domestic multinationals (MNEs), which are using the export of capital in order to contribute the growth of the international competitiveness of the Russian economy. In particular, in 2013 the Agency for Insurance of Export Credit and Investment (EXIAR) launched insurance scheme for Russian investors abroad protect them against non-commercial risks. [6]

However, reasonable fiscal policy aimed at competent restrictions of one flows and simultaneous stimulation of other Russian FDI flows is unthinkable without knowledge of their real structure. So, this article is partly dedicated to clarification of this issue and is based on the newly collected empirical base. First, we have shown the way in which the official statistics on the geographical expansion of FDI is related to the actual distribution of long-term foreign assets of

Russian multinationals. Then author provide a detailed explanations for the dominance of Greater Europe and Russian investors motivation. Finally, in the last part of the article we propose some exact measures to diversify the geography of the Russian FDI aimed at strengthening the international competitiveness of the Russian economy.

**Geography of the Russian direct investments abroad**

According to the official data on the geography of Russian FDI published by the Central Bank of the Russian Federation, the key recipient of Russian capital is the EU and as a whole Greater Europe, whose boundaries encompass the East post-Soviet space and Turkey, in early 2012, had accumulated 78 % of Russian FDI (See Table 1.) However, the Central Bank of Russia fixes only country where capital entered directly from the Russian not its final beneficiaries. As a result, 11 out of the main 40 recipients of Russian FDI can be depicted in the "black list" of offshore zones which Russian Ministry of Finance considered inappropriate and include in the list of states and territories providing preferential tax treatment and (or) do not provide disclosure and provision of information about external financial transactions. While Cyprus (which, however, has been removed from the list since 2013) at the beginning of 2012 was accounted [4] as one third of accumulated Russian FDI and 43% of their network flows for the first three quarters of 2012.

The grand total share of all offshore jurisdictions markedly exceeds 50%. At the same time part of that capital of is eventually returned to Russia so that we have so called “fake FDI”. But also, very often such jurisdiction is used as staging bases for investment in third countries. For example, leading foreign assets holder, Russian oil and gas multinational "LUKOIL" exercises all its international projects for exploration and extraction of raw materials through Limited Liability Company "LUKOIL Overseas Holding", registered in the British Virgin Islands (BVI).

Many foreign companies, especially those working in the oil-gas and metal sectors, the Russian multinationals acquired by setting formal control over holdings in the UK, the Netherlands, Luxembourg, Ireland, Switzerland, and even Canada. Thus, "ARMZ" invested more than $ 2 billion in uranium mines in Kazakhstan, USA, Australia and Tanzania through the Canadian firm "Uranium One". Another thing is that a significant portion of Russian FDI in Canada’s ferrous metal industries is formally percept as investments in the U.S., where the headquarters of North American subsidiaries of Russian multinationals are based.

Table 1

**Geographical distribution of Russian FDI**

| Regions and countries | Russian FDI accumulated to the beginning of 2012 | | Russian FDI for three quarters of 2012 | |
|---|---|---|---|---|
| | Million USD | % | Million USD | % |
| **Countries in total** | 361 738 | 100 | 37 499 | 100 |
| **Wider Europe as whole** | 282 684 | 78.1 | 32 107 | 85.6 |
| **Former USSR without Baltic states** | 15 516 | 4.3 | 1 946 | 5.2 |
| Belarus | 4 633 | 1.3 | 436 | 1.2 |
| Ukraine | 4 395 | 1.2 | 554 | 1.5 |
| Kazakhstan | 2 514 | 0.7 | 684 | 1.8 |
| Armenia | 1 417 | 0.4 | 62 | 1.2 |
| Uzbekistan | 947 | 0.3 | 7 | 0.0 |
| Tajikistan | 626 | 0.2 | 21 | 0.1 |
| **EU countries** | 232 110 | 64.2 | 25 057 | 66.8 |
| Cyprus * | 121 596 | 33.6 | 16 110 | 43.0 |
| Netherlands | 57 291 | 15.8 | 1 388 | 3.7 |
| Luxembourg | 11 599 | 3.2 | 1 550 | 4.1 |

| | | | | |
|---|---|---|---|---|
| United Kingdom | 10 662 | 2.9 | 354 | 0.9 |
| Germany | 6 692 | 1.8 | 781 | 2.1 |
| Austria | 4 229 | 1.2 | 1 171 | 3.1 |
| Spain | 3 535 | 1.0 | 651 | 1.7 |
| Bulgaria | 2 748 | 0.8 | 621 | 1.7 |
| France | 1 989 | 0.5 | 280 | 0.7 |
| Ireland | 1 849 | 0.5 | 264 | 0.7 |
| Lithuania | 1 464 | 0.4 | 32 | 0.1 |
| Czech Republic | 1 463 | 0.4 | 193 | 0.5 |
| Italy | 1 435 | 0.4 | 279 | 0.7 |
| Sweden | 1 414 | 0.4 | 632 | 1.7 |
| Finland | 1 038 | 0.3 | 5 | 0.0 |
| Latvia | 750 | 0.2 | 182 | 0.5 |
| Other Europe | 35 058 | 9.7 | 5 104 | 13.6 |
| Switzerland | 12 679 | 3.5 | 208 | 0.6 |
| Jersey isle (British) * | 7 035 | 1.9 | 634 | 1.7 |
| Gibraltar (British) * | 5 701 | 1.6 | 93 | 0.2 |
| Turkey | 3 654 | 1.0 | 3 667 | 9.8 |
| Maine isle (British) * | 1 546 | 0.4 | 4 | 0.0 |
| Serbia | 1 496 | 0.4 | 59 | 0.2 |
| Montenegro | 1 072 | 0.3 | 132 | 0.4 |
| Monaco * | 626 | 0.2 | 76 | 0.2 |
| **Other regions** | 79 054 | 21.9 | 5 392 | 14.4 |
| Virgin (British) Islands * | 46 137 | 12.8 | 2 646 | 7.1 |
| U.S. | 9 501 | 2.6 | 540 | 1.4 |
| Bahamas * | 5 481 | 1.5 | 327 | 0.9 |
| Saint Vincent and the Grenadines * | 4 421 | 1.2 | 0.0 | 0.0 |
| St. Kitts and Nevis * | 2 681 | 0.7 | 655 | 1.7 |
| Bermuda (British) * | 2 497 | 0.7 | 926 | 2.5 |
| Beliz* | 1 211 | 0.3 | -948 | Red. |
| Vietnam | 1 078 | 0.3 | 67 | 0.2 |
| India | 982 | 0.3 | 45 | 0.1 |
| Canada | 850 | 0.2 | 224 | 0.6 |

Source: Statistics of the Central Bank of the Russian Federation (http://www.cbr.ru)

Eventually, the official statistics on the volume of real Russian FDI is strongly overestimated some countries and underestimated by others. Moreover, if we consider only the multinational corporations, excluding investments of individuals in real estate, we will have significantly reduced figures for such countries as Spain or the Czech Republic.

The project, initiated by the Eurasian Development Bank, has carried out detailed monitoring of Russian FDI in the CIS and Georgia. Accounting of created or acquired foreign assets and investment based on its actual location showed that the accumulated Russian FDI in post-Soviet space is understated by the Central Bank official statistics at about three times [10, pp.18-28].

Unfortunately, similar studies have not yet been conducted for other regions, therefore currently that is not possible to accurately determine the share of Greater Europe (especially taking into consideration the significant contribution of mendacious FDI, a round trip or traveling in a circle capital). However, in the framework of an international research program almost all leading multinationals from emerging and post-socialist countries has been studied including the geography of the Russia's top 20 non-financial MNEs foreign assets. At the beginning of 2012 the total foreign assets of these companies were amounted as to 111.2 billion dollars, and their non-current outward assets are estimated at 83.3 billion dollars, allowing us to appraise the general extent of FDI. Meanwhile, the share of Greater Europe exceeded 2/3 of grand total or more. For instance, some large multinationals, such as "GAZPROM" or "INTER RAO UES", share is striving to be approached at 100%. However, the two steel companies ("SEVERSTAL" and "MMK") share of Greater Europe did not reach even 10% [9, pp. 14-15].

**The regional nature of the majority of Russian multinationals**

Phenomenon, conventionally referred as "regional multinational corporations" (RMC) is a typical and widespread for many countries [14, pp.3-18]. However, the reasons for the dominance of FDI in the geography of the surrounding countries vary greatly. In our opinion, in case of Russian multinationals it is possible to identify three basic explanations for the concentration of their investments in Greater Europe, mainly in the main areas of EU - Russia - CIS integration reference points. In this association, for example, European and Central Asian countries could be merged and considered as one region for the sake of conventional analysis of the impact of Russian multinationals. Such generalization is justified due to the powerful influence of "neighborhood effect", which is critical for regional MNEs.

Widely acknowledged that neighboring countries are the most comfortable environment for most companies - beginners in the process of internationalization, thus vast majority of Russian multinationals is not an exception. Strongly marked "neighborhood effect" in the geography of FDI is stipulated by fine familiarity of multinationals only with nearby regions, plus low language and cultural barriers matters (in the case of Russian MNEs are manifested not only in the CIS case but also in South-East Europe). Another thing is that this effect cannot be taken literally as it is; great variety of different individual exceptions and derivations are present [7, pp.83-101].

In addition, Russian multinationals' dominating FDI motives related to sales support, whereas the other three main groups of motives - cost reduction, development of resources and technological access [5, p.50] occur less frequently in comparison with the other G20 economies. Perhaps, among significant recipients of Russian FDI in Greater Europe orientation to raw materials is strongly expressed only in Kazakhstan and Uzbekistan. Marketing orientation is accepted by even the leading Russian oil and gas multinationals investing abroad mainly in the *processing* of raw materials or sales infrastructure, rather than mining companies. Thus, according to the Federal Customs Service of Russia (FCS), in 2012, the EU countries accounted for 53% of Russia's commodity exports, the post-Soviet space without the Baltic States - another 15%, and in general on Wider Europe (mainly due to the addition of Turkey and Switzerland) were accumulated more than 3 / 4 [17].

Finally, it is worth mentioning that Russia's leading multinationals are largely controlled by oligarchs who became its major owners (often close to monopoly in the industry) after dubious privatization of the late 1990s. [1, pp. 139-143] In the context of proclaimed strengthening of the vertical of power in Russia in the early 2000s' tycoons ability to extract economic benefits from obtained in property assets has been limited, consequently in 1990s' some Russian businessmen endeavored their power to use foreign subsidiaries in Europe to "insure" at least some of their assets from encroachment by both competitors and the state [3, pp.77-81]. In the late 2000s' such a trend has been accelerated, although the influence of above mentioned "normal" FDI motives grew faster. Owners of the leading Russian companies have realized that getting into "the world's business elite" could significantly increase their bargaining power. However, while the leading western MNEs use (though not always successfully) their negotiation power in order to create a comfortable system of international business regulation or preferential conditions in the recipient country for themselves [2, pp. 119-143], Russian multinationals having extended branched merchandising chains begin to behave themselves more independently in the dialogue with the Russian authorities. Indeed, the lobbying activity of Russian multinationals, for instance, in the EU is still weak [15, pp. 49-63], but inside Russia for some of them state regulation is severally weakened (e.g. in the case of monopoly pricing expertise) under the threat of reorientation supplies flows from Russian to overseas refineries.

At the same time, Russian multinationals activity in EU - CIS countries does not correspond to upcoming trend towards diversification of Russian foreign relations. In these circumstances, the state support of investment expansion beyond neighboring countries could accelerate the output of domestic multinationals on the global level.

**Ways of encouraging the expansion of Russian multinationals outside Europe**

State support for domestic multinationals abroad on the early stages of internationalization allows medium-sized businesses to use their limited competitive advantage to procreate. In fact, such a trend mainly accomplishes in the disclosure of multinationals' overseas expansion potential in emerging world [13, pp.41-47]. In our opinion, state support should be carried out both at the preliminary stages of preparation of FDI and during investment projects fulfillment. In the preliminary stages the state support consists of three elements.

*First*, Russian multinationals have a great need in information support through using both, resources of public institutions (such as trade missions) and specialized research organizations (including the use of public-private partnership schemes). On the one hand, the Russian business may not be aware of the possibilities that are now opening up in various countries in Asia, Africa and Latin America. On the other hand, each emerging country has its own specific business environment. However, representatives of domestic business often confidently rely on their own analytical units, seeking state after making series of fatal mistakes.

*Secondly*, the government should expand and diversify institutional support tools. In particular, Russia so far do not have a significant number of countries with signed ratified bilateral agreement on mutual protection of investments, so that some of that agreements is superficial with no ability for providing real mechanisms for defending the interests of Russian multinationals. Moreover, Russia markedly inferior to many leading states by number of double taxation avoidance agreements. In 2013, such agreements were acted with 81 countries, including all CIS and EU Member States (excluding Malta and Estonia). However, outside of Greater Europe Russia agreed on avoidance of double taxation with only 37 countries, and has only recently with six those states in Latin America - (with Mexico in 2009, Brazil and Venezuela in 2010, Cuba in 2011, Argentina and Chile in 2013).

*Thirdly*, diplomatic assistance is inevitable when it comes to using formal measures (non-issuance of visas to the Russian top management, unexpected renegotiation of privatization, etc.) as a tool for investment protectionism against Russian multinationals. Often, the courts cannot formally prove the fact of targeted actions against Russian investors, although there was a series of "random" coincidences. On the stages of investment projects implementation the main instrument of state support should be investment insurance against non-commercial risks. This will create an incentive for the "second tier" of Russian multinationals more often implement FDI in developing countries with relatively high political risk, but less competitive pressure from multinationals from leading Western countries. Furthermore, state support should be destined exclusively for officially registered Russian projects abroad, the insurance system should be transparent and accessible, though have specific priorities. For instance, it can be completely closed for companies who thanks to confusing offshore schemes hide the ultimate beneficiaries.

In summary, we must not forget at the same time about the purposeful creation of a positive and attractive image of Russian business abroad. Still we have to deal with the extendedly created politicized typologies of Russian multinationals. For instance, companies are placing on the coordinate system, not only on the basis of transparent / opaque business environment, but also on the principle of one's belonging to "patriots" (percept in the negative sense as Kremlin's foreign policy agents) / "independent" [12, pp. 117-144]. However, it is inevitable to start to work on the image of Russian companies at home [16, pp.57-66], and that noble goal requires not only the state propaganda conducted thorough newly formed INA "Russia Today", but the real positive changes in the business practices of local entrepreneurs. The state needs to work on the business through the introduction of real economic incentives for transparency, social responsibility and innovation activity.

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