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Russia's Foreign Direct Investment Attractiveness in 2012

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Abstract. The article, basing on Ernst & Young's 2012 survey of Russia, devoted to Russia's foreign direct investment attractiveness. 208 international companies take part in this research. Of the companies, 65% (135 out of 208) have established operations in Russia. Divided into five main sectors, the businesses surveyed are representative of the key European and global economic sectors: industry, automotive, energy, private and business services, chemical and pharmacy, hi-tech.

Keywords: foreign direct investment (FDI); survey of Russia; global economy; economic crisis; economic sectors; investors; creation of jobs; infrastructure; manufacturing; WTO.

Introduction. The global economy started to show signs of recovery in 2011. It was weak and unbalanced, but there was optimism. As a result of the financial crisis, the growth trends of rapid-growth economies have declined. However, many developing economies demonstrated robust growth, and the group of 25 RGMs should recover to achieve overall GDP growth of 5.9% in 2013 and 6.5% in 2014.

Materials. Despite the economic and financial crisis, global FDI increased by 16% to reach 1.5 trillion US dollars in 2011, exceeding the pre-crisis level. In comparison, Russia's inflow of foreign investments (FDI) increased by 22%. According to the United Nations Conference on Trade and Development (UNCTAD), investors were motivated by the continued growth of local consumer markets and manufacturing opportunities.

Economic volatility and lower growth prospects around the world have caused business leaders to re-evaluate their selection criteria. In 2011 investors cited transportation and telecommunications infrastructure as the top two factors in their location decisions.

But this year, executives clearly have market appeal and the stability of their investment destination at the top of their agenda. Almost 40% of investors questioned in 2012 said that, when deciding to invest, a country or region's domestic market is now their top concern.

Russia's attractiveness as an investment destination (19%) increased by eight percent over the previous year, the largest increase of any region. In 2011, Russia was ranked far behind India, North America, CEE and Brazil. However, this year, the "attractiveness gap" between these regions closed substantially. While Russia overtook Brazil in terms of its attractiveness profile, it is also in very close competition with India, North America and CEE.

An abundance of natural resources continues to be Russia's most globally competitive feature, according to 43% of investors. Russia's domestic market comes a distant second (19%). Investors recognize Russia as a key global energy player and a large market.

In 2012, investors highlight Russia's domestic market as its key strength. Education, telecommunications infrastructure, labor costs and skills are also recognized as some of Russia's most attractive features.

In terms of weaknesses, investors remain concerned about Russia's political, legislative and administrative environment; its transport and logistics infrastructure; and limited incentives for sustainable development. The country's leaders continue to emphasize the need to improve environment for innovation processes and business in Russia.

Three-quarters of investors continue to be impressed with Russia's domestic market. With a population of more than 142 million, Russia is the ninth most populous country in the world and the largest in Europe. It also enjoys the highest GDP per capita (US\$16,700) among all BRICS countries. As a result of rising wealth levels over the past decade, 25% of Russia's population (nearly 40% of its workforce) is now part of the "middle class." And this number is growing.

According to the Ministry of Economic Development of Russia, the middle class will grow to 37% of the population by 2020 and 48% by 2030.

Sixty-two percent of investors consider that Russia's political, legislative and administrative environment requires improvement. Russia's ranking of 120 out of the 183 economies in the *World Bank's Doing Business 2012 report* confirms the operating and administrative challenges faced by investors in the country.

Investors have mixed views on the current conditions of Russian infrastructure. While 45% do not find Russia's infrastructure attractive, 44% consider the transport and logistics infrastructure as advantage. According to the OECD, more than 60% of federal and regional highways do not meet standards. *The World Economic Global competitiveness report 2011-2012* ranks Russia 130 out of 142 for the quality of its roads.

According to the recent *OECD Innovation Review of the Russia*, innovation processes in the country are not developed because of very low levels of R&D and relevant activities in corporations, weak framework conditions for innovation, and inadequate infrastructure.

In 2011, Russia attracted 128 investment projects. There is a decline of 36% comparing with a previous year. Political uncertainty caused by the electoral cycle and Eurozone debt crisis made companies think carefully about investment in the country.

After a continuous decline since 2007, jobs started to pick up in 2011 due to a rise in labor-intensive industrial activities. Investment projects in 2011 generated the previous year. The investment projects created 65000 jobs in 2011.

In 2011, Russia was the 17th-largest recipient of investment projects in Europe, having been the 4th-largest in 2010. In terms of FDI job creation, Russia was the 6th in Europe. While the number of projects declined in 2011, the average size of projects by number of jobs created in Russia was the largest in Europe.

Production units account for 51% of projects and 92% of job creation. Investors come to Russia to manufacture goods for the local market, but also distribute globally. Over the past five years, 51% of FDI in Russia has gone into manufacturing, with 402 FDI projects, the 4th-largest in Europe. Between 2007 and 2011, manufacturing projects created 51,445 jobs.

Russia's industrial sector attracted more FDI projects than any other sector. Business services, machinery and equipment are the two sectors in Russia that recorded a rise in their number of FDI projects in 2011 compared with the previous year.

Automotive sector has been the key sector attracting FDI in Russia over the last five years, with 90 projects and 16,787 jobs created. Investors focus on the automotive sector which is increased further this year, with 14% of the total FDI in Russia, compared with 12% between 2007 and 2011. Russia is the second-largest automotive market in Europe, and the fourth-largest in the world after China, USA and Germany.

Forty two percent of FDI projects are concentrated in the Moscow and St. Petersburg regions. The capital city has attracted 231 projects which led to the creation of 3,735 jobs in the last five years. FDI in Moscow has been concentrated in sectors such as business services, financial intermediation, machinery and equipment and software.

St. Petersburg is another prominent FDI location. Between 2007 and 2011, the largest number of FDI jobs were created there (9,843) by 92 projects. St. Petersburg is a major financial and industrial center in Russia.

From 2007 to 2011, Kaluga was the 3d-largest region in terms of FDI projects (39), which created the second highest number of jobs in the country (7,260). Sectors that received major investment include automotive, machinery and equipment, transport, food and pharmaceuticals.

Nizhny Novgorod is another developing area for foreign investments. It recorded 14 FDI projects from 2007 to 2011. These projects have primarily been directed at the automotive, metals, financial intermediation, food and non-metallic mineral products sectors. The region is also one of the main centers for IT and software businesses.

German entrepreneurs continue to regard Nizhny Novgorod as the region offering the most promising investment opportunities. Manufacturing in the Moscow region costs very much today. For this reason Nizhny Novgorod is a very good location for doing business.

Despite the wave of negativity around the Eurozone crisis, investors continue to show confidence in the Russian market and optimism about the future. Nearly 80% of investors already presented in Russia plan to increase or maintain their operations in the country. Only 3% of these

investors are not optimistic and plan to relocate or withdraw their operations from the country. The percentage of investors looking to enter the Russian market also increased from 7% in 2011 to 12% this year.

More than 40% of the investors who established business or increased operations in Russia plan to do so in the short term. 27% percent plan to invest within 6 months and 14% in 6 to 12 months. 26% percent of leaders plan to expand their existing facilities while 17% will increase their employee numbers in Russia. However, only 2% of investors have acquisition plans in Russia, highlighting the country's difficult and lengthy approval process.

When we speak about investor's expectations significant factor appears: Russia's accession into WTO. After almost 18 years of negotiations, Russia is ready to become a member of the WTO. The overall consequences of Russia's accession to the WTO are expected to be positive. More than 60% of investors believe Russia's accession will have a significant impact on the country's investment attractiveness.

According to the World Bank, in the medium term, the growth should be about 3% of GDP per year, with wages rising 4%-5% and more than 99% of households gaining income. In the long run, the growth should be about 11% of Russian GDP per year, with wages rising 13%–17%.

Russia offers investors a high-growth economy, a large domestic market and highly skilled labor at competitive cost. But its reputation for difficult business conditions deters investors. Doing business in Russia is fraught with challenges associated with corruption, government bureaucracy and a lack of transparency. Investors continue to suggest that improving the effectiveness of the rule of law (53%), reducing bureaucracy (47%) and improving transparency of business regulations (37%) are the top three priority measures to enhance Russia's investment climate.

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Инвестиционная привлекательность России в 2012 году

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Аннотация. Данная статья посвящена инвестиционной привлекательности России в 2012 году. Часть материалов, содержащихся в статье, основана на результатах исследования инвестиционной привлекательности России в 2012 году, проведенного компанией Ernst&Young. В выборку данного исследования вошло 208 международных компаний, из которых 135 работают на российском рынке. Опрошенные компании являются представителями пяти крупнейших секторов европейской и мировой экономики: промышленность, автомобилестроение, энергетика, сектор услуг, химическая промышленность, информационные технологии.

Ключевые слова: прямые иностранные инвестиции; исследование России; мировая экономика; экономический кризис; секторы экономики; инвесторы; создание рабочих мест; инфраструктура; производство; ВТО.