Current Issues of Foreign Direct Investment in Russia

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Russia's transition to a market democracy is impossible without direct involvement of international business. The inflow of private foreign direct investment may help to effectively apply modern technology in production and marketing of goods and services, as well as management techniques. It may also generate new jobs, raise the competitiveness of Russian products on international markets and help to satisfy domestic demand for a number of consumer and capital goods, consumer and business services.

The significance of foreign direct investment has been understood quite well since the start of market reforms in the former Soviet Union, and later in the Commonwealth of Independent States, including Russia. This understanding prompted the adoption of laws to regulate the inflow of foreign direct investment and operations of foreign-affiliated firms in the former Soviet Union, and, later, in Russia and other former Soviet Republics. The major purposes of these legislative acts were to provide a legal basis for the start of foreign direct investment and to create a comfortable investment climate. The sparse statistical and factual information available up to now indicates that the first purpose has been generally achieved, but raises doubts about achievement of the second.

1 Dynamics and Structure of Foreign Companies' Direct Investment in Russia.

More than 2600 joint-ventures were registered on the territory of the Russian Federation at the beginning of April 1992.[1] This is more than 18 times as many as in 1988, when foreign firms took their first steps to invest in the Russian (as well as Soviet) economy (see table 1). At the end of May 1992 the statutory capital of foreign-affiliated enterprises in Russia was estimated at about 2 billion dollars, approximately half of which was invested by the foreign partners. In 1988-1990 the USSR Ministry of Finance registered a monthly average of 80 to 100 new joint-ventures; in 1991-1992 the average monthly number of registrations is estimated at 300.[2]

Though companies from more than 60 nations have already made direct investments in Russia, the bulk of the capital (80%), has come from Western countries, six of which (Germany, Finland, USA, Great Britain, Austria, Italy) provide 45% of all foreign direct investment in Russia.[3]

Table 1
Joint-ventures registered in the Soviet Union, CIS, Russia and some other former Soviet republics in 1988-1991

	1988	1989	1990	1991
Soviet Union	191	1,274	2,905	5,000*
Russia	141	947	1,971	2,600**
Ukraine	9	83	209	...
Baltic Republics	20	134	479	...
Others	21	110	246	...

*CIS; **as of April 1, 1992.

Table 2
Joint-ventures in the former USSR which submitted reports on their operations in 1991

	Total	Type of operations			
		Sales on the Soviet market for roubles	Sales on the Soviet market for hard currency	Exports	Imports
Total, former Soviet Union	1,624	1,467	588	576	632
Russia	1,157	1,024	429	406	473
Ukraine	237	223	60	64	73
Belorus	93	90	25	42	33
Estonia	137	130	74	64	53

Table 3
Summary of operations of joint-ventures in the former USSR for 1991, thousand currency roubles

	Exports	Imports	Sales on the Soviet market for hard currency	Sales on the Soviet market for roubles, thousand roubles
Total, former Soviet Union	1,475,253.4	176,827.4	112,972.3	14,291,529.7
Russia	1,264,875.4	1,408,892.6	985,519.4	11,278,183.1
Ukraine	88,597.6	155,651.9	78,262.5	1,614,574.6
Belorus	17,700.4	53,329.5	23,055.9	603,543.7
Estonia	38,232.8	32,726.5	33,670.2	32,927.3

Western countries have a larger share in the volume of foreign direct investment in Russia than in the former USSR or the present CIS. This is a consequence of the relatively larger role played by several developing countries in some other republics of the former Union. In Kazakhstan, for example, the combined share of the eight largest investing countries from the developing world in the authorized capital of joint-ventures comprised almost 34% as of April 1, 1992 (Turkey – 11.6%, the two Koreas – 12.5% [South Korea – 9.6%, North Korea – 2.9%], China – 6.3%, Afghanistan – 1.6%, Taiwan – 1.2%, India – 0.3%, Iran – 0.3%.)[4] Firms from developing countries seem to prefer to compete with Western companies in less developed areas of the former Soviet Union. Socio-cultural, religious, political and geographical factors may sometimes play a very important, if not decisive, role in this.

The same factors seem to contribute greatly to the difference in sources of foreign direct investment between Russia and Ukraine. In Kiev, the Ukrainian capital, 169 joint-ventures had been registered by the beginning of June 1992. Only 3.6% of their authorized capital was provided by partners from Germany, 3.0% – from Italy, 2.2% – from Austria. Finland is not even listed among the 13 largest investors. First place is held by the U.S.A.(33.6%), second by Switzerland (11.2%), third by Sweden (10.6%), etc.[5]

Estimates differ as to the proportion between Russian and foreign participation in the statutory funds of joint-ventures, but place the average share of the Russian side at between one-half and two-thirds. It is officially reported in Kazakhstan that the foreign share is one-third. In Kiev, where the overwhelming majority of Ukrainian joint-ventures has been registered, the average share of foreign partners is 47.8%.

Unfortunately there are as yet no published statistics on the pattern of capital formation of enterprises with foreign participation in Russia, so we have to use the latest available data on joint-ventures in the former Soviet Union, which give a general picture of capital formation for the year 1990. Monetary contributions to the combined assets of domestic and foreign partners amounted to 34%; the rest lay in machines, equipment, accessories and materials (36%), rights to use natural resources (8.8%), industrial property rights, technology and know-how (7.2%), premises and structures (14%). If taken separately, contributions by domestic and foreign partners reveal considerable differences. Domestic partners invest mostly money (38% of their share in the assets), real estate (22%) and rights to use natural resources; foreign investors provide machinery and equipment (nearly 59%), money (a little over 20%) and technologies (12%).[6]

Foreign direct investment has not yet created many jobs in Russia. Joint-venture employment at the beginning of 1992 reached 130,000, of whom 125,000 were Russian citizens, or 0.17% of total employment in Russia at that time. (For comparison 225 joint-ventures registered in Kazakhstan as of April 1 1992 employed 4750 persons).

Joint ventures do not play an important role in Russia's economy. In 1988-90 their imports cost more hard currency than their exports earned. In 1991 they earned a small surplus (exports were 687.5 million dollars, imports 625 million dollars) but in January-September 1992 the balance was again negative (see Table 4, and for data in "hard currency roubles" to end 1991, Table 3). Their sales on the domestic market in 1991 were 7.8 billion roubles, 1.5% of all goods and services sales in Russia; sales for hard currency on the Russian market were 0.5 billion dollars. In 1991 joint ventures accounted for only 1.7% of Russia's exports and 2.2% of its imports.

The commodity structure of foreign trade of joint-ventures generally repeats that of the overall trade of Russia. Their exports are dominated by unprocessed commodities. Three groups alone (fish and marine products, crude oil and other mineral fuels, timber and wood) account for 43.3% of joint-venture exports of goods and services (see table 5). Capital and consumer goods are the main import items. The balance of trade in goods is negative, the value of imports being 22.8% larger than the value of exports.[7]

The balance of trade in services, on the contrary, is positive. Exports of services by joint ventures are 58.3% greater than imports. The major types of services which are exported are in transportation, advertising, execution of feasibility studies, entertainment and recreation. Imports are dominated by assembly and repair, licensing of property rights, feasibility studies, advertising and engineering.

One of the major characteristics of foreign direct investment in Russia is significant regional variation in distribution of investment. According to the latest available data over 72% of all joint-ventures registered in Russia are situated in Moscow, 22% in Novosibirsk, about 11% in Sankt-Peterburg, less than 6% in the Far Eastern cities of Khabarovsk, Vladivostok and Magadan, and less than 2% in the northern port of Murmansk.

The regional pattern of foreign direct investment in Russia follows the differences in levels of economic, social and technological development of the various areas of the country. While the Moscow area has already entered the post-industrial stage of development, many other regions (especially big industrial areas in the Ural mountains, Omsk, Novosibirsk, Khabarovsk, Sankt-Peterburg and the like) are still in process of leaving the traditional industrial stage and face the problem of transition to new industrial technologies. At the same time vast regions in the North, and areas such as the Gorno-Altai Republic or some North Caucasus regions have not yet left the pre-industrial stage of development.

There are also large differences between areas of Russia in levels of economic activity. According to a recent survey the four most active economic regions in Russia today are Central, North-Caucasus, Volga Basin and Urals.[8] The present Russian Government differentiates between economic regions according to their current economic behavior models, as follows:

– regions which under pressure from the current economic crisis are trying to restrain the fall in consumption and increase in food prices by

reducing interregional economic ties and transforming them into barter-type exchanges. These are mostly regions with well-developed agriculture and food production adequate for the needs of the local population;

– regions with mostly industrial economies, and with agriculture which does not produce enough food to provide even minimally for the needs of the local population. These regions are betting on fast privatization, creating market structures, establishing joint-ventures and attracting foreign investors;

– regions where the economy is dominated by extractive industries, and agriculture is poorly developed. These regions are trying to promote barter exchanges both with manufacturing and agricultural areas in Russia and abroad.[9]

Forecasts for economic development of the economic regions of Russia can be found in the President's Budget Message to the Supreme Soviet of the Russian Federation of January 14 1992. They show clearly that a few regions of the country will be in a much better relative economic position than the rest. They are the Urals, West Siberian, Volgo-Vyatka, North-West and East Siberian regions. There agricultural and industrial production is expected to suffer relatively less from the deep economic crisis than in the Central, Volga, Baltic, Northern and Far Eastern regions.

It can easily be seen that there is a very close correlation between the regional pattern of foreign direct investment in Russia, the map of business activity, and the map of relatively advantageous areas.[10]

It is natural for foreign investors to be attracted to the most competitive regions, in which the more active international interaction provides better conditions for survival in a period of radical economic transformation. Development of this trend may assist these regions to widen the existing gaps between their levels of development and those of numerous other areas, and to become enclaves of a transnational economy in the vast underdeveloped space of the Russian state.

It would be very helpful to Russia's economic and political future if these "fortunate" areas could play the role of locomotives or tugboats for the lagging regions. But inn the meantime some observers see a possibility that foreign economic (and, subsequently, political) control will be established over a number of them. Some speak of a real restoration of German influence in Kaliningrad province and Finnish in the Karelian Republic, or the possible economic absorption of various parts of the Russian Far East by Japan, China or South Korea.[11]

If the economy of these regions becomes integrated into that of the respective foreign nations "at the expense" of their links with the economy of the home country, not only will their ability to act as the vital tugboats for the rest of the country become doubtful, but strategic, geopolitical issues will also definitely arise.

Table 4
Joint-ventures in Russia: domestic sales and foreign trade in 1988-1992, million dollars and million roubles

	1988	1989	1990	1991	January-September 1992
Sales on the domestic market					
for roubles, mln.	9	597	2458	7800	...
for hard currency, mln. dollars	0.625	109	363	545	...
Exports, mln. dollars	5	68	118	687	1041
Imports, mln. dollars	2	203	456	625	1283

Table 5
Major commodities and services in the foreign trade of joint-ventures in Russia, 1991

Exports		Imports	
	%		%
Total	100.0	**Total**	100.0
Exports of commodities	90.5	**Imports of commodities**	94.9
Fish and marine products	19.4	Alcoholic and non-alcoholic beverages	6.0
Meat and fish products	4.2	Tobacco	1.1
Vegetables, canned	2.0	Clothes	5.7
Crude oil, mineral fuels	14.0	Other textiles	3.9
Organic chemicals	4.2	Footwear	2.0
Chemical fertilizers	4.6	Machinery	42.2
Timber and wood	9.9	TV and radio equipment	7.8
Jewelry	2.3	Transportation equipment, excl. railroad equipment	6.0
Copper and copper products	3.9	Furniture	2.7
Aluminum and aluminum products	3.2	Other	17.5
Machinery	4.0	**Imports of services**	5.1
Other	18.8	Assembling and repairs	1.1
Exports of services	9.5	Patent, license and know-how fees	1.1
Transportation services	3.8	Other	2.9
Advertizing	2.7		
Other	3.0		

Similar anxieties have been intensifying recently with the deepening of economic and political divisions between Russia and most other republics of the former Soviet Union. Among other things this means that Russian

provinces, formerly deep inside the country and very far from abroad, have suddenly become border provinces.

The collapse of the Soviet Union and the rise of new independent states have created a situation in which 10 of Russia's 11 official economic regions have direct access to foreign countries or to the ocean, whereas only six had it before, and 46 Russian provinces out of 76 have borders with foreign states, whereas only 29 did before. These borders are mostly geographical only, lacking even customs posts, let alone border guards.

This situation facilitates economic gravitation by some areas of Russia towards former Soviet republics which are now foreign countries. From a purely economic viewpoint such processes of integration can only be welcomed, but with the Russian central government's power much weakened recently they may have dubious geopolitical implications that outweigh the economic benefits of business interaction. The integration process, of course, is a two-way street, and other states may be similarly concerned about Russia.

The sectional pattern of foreign direct investment in Russia is characterized above all by predominance of the services sector over the others. This sector accounts for more than half of all joint-ventures registered in the country, including about one-third of those registered in retail and wholesale trade, catering, tourism, hotels and restaurants, medical services, movie and videofilm production and the like. This sector accounts for 25% of all authorized investment in joint-ventures. About one-fifth of registered joint-ventures are operating in business services (engineering, consulting, business education, advertising, intermediary services).

Eighteen percent of joint-ventures are registered in basic industries - machinery, primary and secondary energy production, metallurgy, and the timber-chemical complex. (32% of authorized foreign direct investment is concentrated in these industries). However, only 10% of joint-ventures registered in the machinery sector were actually producing machines and equipment by the beginning of 1992. As a result more than 75% of shipments by machinery joint-ventures are generated by only 4 to 9 enterprises. Most joint-ventures established in the basic sectors are facing difficulties in starting production; they need relatively large amounts of initial investment, but financial resources are scarce and expensive. It is also difficult to locate reliable sources of materials and components; the volume of production saleable for hard currency is very limited.

These problems were exacerbated in the first half of 1992 by the fiscal policy of the Russian government, which annulled the tax holidays for joint-ventures previously established by law, introduced taxation on reinvested profits, increased taxes on the income of Russian partners in joint-ventures, and pumped out a large part of their foreign currency returns into the state budget by obliging joint-ventures to pay 10% of them into the so called fund for stabilization of the economy. It is therefore not surprising that 60% of all registered joint-ventures have shown themselves disinclined to start

operations, and a process of disinvestment began in spring 1992. In May alone about 20 joint-ventures ceased operations.

A substantial proportion of joint-ventures (about 12-13%) are registered in consumer goods production. They manufacture flour products (bread, noodles), meat products (sausages, frankfurters, smoked meats), footwear, electronic goods, etc. In summer 1991 enterprises with foreign capital participation manufactured 10% of all telephones, 7% of computing equipment, 4% of textile equipment and 2.3% of footwear produced in Russia. Foreign -affiliated firms have lately been paying particular attention to production of personal computers and software. This group of enterprises constitutes only 13% of the total number of joint-ventures in Russia, and only 8% of the authorized capital, but it accounts for 40-50% of all profits of joint-ventures.

Turning to the future regional and sectoral pattern of foreign direct investment in Russia, we can say that Moscow and Sankt-Peterburg appear to remain the most attractive places for international business. Formerly closed defense-related industrial regions, well-endowed with highly-skilled labor and professional staff, relatively modern equipment and a developed infrastructure, e g Nizhnii Novgorod (formerly Gorkii), Ekaterinburg (formerly Sverdlovsk), Perm, Tomsk, Chelyabinsk, Saratov, Kazan and Velikie Luki should be added, as should oil and gas producing regions such as Tyumen, Perm and the Tatar Republic, as well as the rich forest areas East of Lake Baikal and vast Far Eastern zones with their enormous marine resources.

Foreign investors are likely to be mostly attracted by sectors and activities such as modernization of crude oil production and refining, forestry, timber and automobile industries, conversion of defense-related enterprises, business education and services, finance and insurance, mineral and marine deposit concessions, consumer goods production, marketing and sales, and consumer services.

The major countries exporting direct investments to Russia are likely to remain as before, namely the G7 countries minus Japan, plus Finland, Austria and other West European countries.[12] We may also expect more investment from several Eastern Europe countries, above all Hungary and Poland, as well as from Turkey, India, South Korea, Taiwan and China.

Realization of these expectations depends on the way the Russian economy and investment climate develop. So far the conditions for foreign direct investment in the Russian economy cannot be considered favorable.

2 Major Obstacles to the Rise of Foreign Direct Investment and Changes in the Government's Policy.

Up to now the scale and dynamics of foreign companies' investment in Russia have not been very impressive. It is reasonable now to consider why this is so.

It can be said that it is only natural for foreign investors to be cautious, given the political uncertainties arising from the collapse, unprecedented in modern times, of a state as large as the USSR. It would be unwise to disagree with this statement, but only up to a point.

Russia's attractiveness for foreign investors has not been significantly altered by the collapse of the Soviet Union. Relatively to most other members of the former Union Russia remains politically and socially stable. The disintegration of the USSR has not radically undermined the Russian economy, and it remains one of the largest in the world. Russia's share in the former Union's gross national product was 58.7%, of its industrial output – 66.4%, agricultural production – 46.2%, population – 51.3%, and of national wealth – 60% (1990). The relative indicators for the two next largest republics of the former Union were; Ukraine – 16.5%, 16%, 22.5%, 16.8%, 18%; and Kazakhstan – 5.3%, 3.5%, 6.9%, 5.3%, 5.8%. We may also add that Russia's level of economic development is higher than that of the other former Soviet republics except the Baltic republics and Belarus. Industrial productivity in Russia was 110% in 1990 (USSR = 100%), in agriculture – 108%, national wealth per capita – 117%, compared with Ukraine's 80%, 108% and 93%, and Kazakhstan's 90%, 100% and 91%. or Uzbekistan's 60%, 56% and 50%.[13]

The break-up of the Soviet Union is likely to weaken the attractiveness of foreign investment in most members of the CIS or other former Soviet republics except Russia. Their individual markets, detached from the common former Soviet (now CIS) market, are usually too small, supplies of necessary commodities and materials unstable, the workforce usually poorly-educated, etc. We can by no means completely exclude the possibility of an influx of foreign investment into such economies, e g Azerbaijan, Tajikistan, Moldova and the like, especially politically motivated and stimulated by some governments (e g, Turkey, Iran, Pakistan or Rumania). But such investment will undoubtedly be of limited scale relative to the potential influx of private capital into them if they stay within the CIS.

The increasing divergences in foreign direct investment legislation in the newly independent states are becoming a negative factor for foreign investors, as well as for the former republics of the Soviet Union themselves. Some of the differences are caused by intensifying competition between the former members of the Union for foreign entrepreneurial capital, others result from efforts to secure the national interest, as defined by each sovereign state.

For example, considerable differences exist in national legislative acts regulating the sectional structure of foreign direct investment. In Ukraine the foreign investor must obtain an official license if he intends to put money into mineral prospecting, production of pharmaceutical and chemical goods, hard liquor and beer, or medical and legal services. In Georgia a foreign company must obtain a licence if investing in development and extraction of natural resources, wireless communications, radio stations, production of movies or videofilms, hard liquor, toxic chemicals, legal or medical services,

education,or casinos. In Moldova a licence must be obtained if investing in production related to national security or the ecology.

In some republics investment projects must be approved by the government if above a certain value, in Uzbekistan 100 million roubles, in Belarus - 30 million roubles.

At the same time all governments designated industries and sectors to be given priority in promoting foreign direct investment. Investors in these industries and sectors are given significant advantages. In Kazakhstan they include agroindustry, consumer goods production, electronics, biotechnology, medical services,production of pharmaceutical goods, raw commodity processing, or production utilising latest patented technologies. In Moldova the equivalent list includes agroindustry, conversion of defense-related enterprises, medical services and pharmaceuticals. Kirgizstan adopted a much longer list of priority industries than Moldova, twenty-four in all.

There are important differences between the policies of the various governments towards participation by foreign parties in the privatization process. A privatized foreign-affiliated enterprise will enjoy certain privileges only if foreign capital constitutes at least 20% of the whole in Ukraine, or 30% in Russia, Belarus, Kazakhstan and others. Policies also vary considerably in respect of customs duties on the international trade operations of foreign-affiliated enterprises. Their exports must be officially licensed in Russia and Latvia, but not in most other republics of the former Soviet Union.

In most of the republics firms with foreign capital participation of more than 30% are exempt from obligatory sale of hard currency profits to the state banks, but in Ukraine the minimum is 20%, and in Uzbekistan there is no exemption. In Russia every joint-venture must pay 10% of its hard currency return to the state's stabilization fund. There are a number of other significant differences between the foreign direct investment regulations in the various states on the territory of the former USSR.[14] (Russian policies will be described in some detail in the final section of this paper).

A trend which could seriously undermine possibilities for foreign direct investment in Russia is the deepening regionalization of the national economic space. In their efforts to survive in a period of radical market reforms, and with no hope of financial and food assistance from central authority, local governments in areas rich in natural resources or with geographical or other advantages are joining a movement towards economic sovereignty. There are projects aimed at creating a Baltic Russian Republic in Kaliningrad province, a North-West Russian Republic uniting unite the provinces around Sankt-Petersburg and Karelia, a North Caucasus Republic of Krasnodar and Stavropol territories plus Rostov province, South Ural, North Ural, Siberian and Yenissey Republics among others. There are proposals to "restore" the Far Eastern Republic on the Pacific coast of Russia, and that the island of Sakhalin should become independent.

These regional disintegrative trends appear temporary in nature. They are expressions, first of an objective spontaneous process of redistributing

political and economic power between the former imperial center and the local communities in the new conditions, and, second, of the response of local authorities to the challenges of a new economic environment. In these hard times there is also an undeniable wish by the provinces to blackmail the "severe" but weak Moscow government, using the threat of secession to acquire as much economic assistance and political power as possible. Ultimately, however, the trend towards interregional and national integration will again become dominant, though on the basis of a market economy and a new balance between central and local power.

Meanwhile, the regionalization processes clearly play against the interests of foreign investors. Local authorities try to introduce local currencies, different types of taxation and various international economic regulations, thus erecting artificial barriers between the segments of the Russian market. Separatist movements create social and political instability, especially when they aggravate interethnic relations.

The impediments to foreign direct investment created by the trends described above cannot be easily removed. It will take time and effort to establish a clear division of functions and responsibilities between federal and local governments, overcome the social instability and interethnic tensions that exist in some regions of Russia, and create a normal bilateral commercial relationship between Russia and CIS or non-CIS members of the former Soviet Union.

Short- and medium-term central and local government efforts to mitigate the deterrent effects of the chaotic business climate and political and economic risks for the foreign investor are, nevertheless, quite feasible. International and domestic businessmen and experts have by now supplied enough information on the obstacles to investment in Russia to facilitate their speedy removal.[15]

Among the most serious obstacles deterring foreign investment are instability and uncertainty in laws and regulations. There are "bodies of conflicting, overlapping, and rapidly changing laws, decrees and regulations affecting domestic and international commerce. Rather than offering contract and property protection allowing business to take place, the regulations tend to support an ad-hoc and unpredictable approach. Confused and overly rapid application of laws and decrees (often on a retroactive basis with no grandfathering provisions) makes long-term and even short-term business planning virtually impossible."[16] Especially dangerous are sudden and arbitrary tax changes; the varieties and rates of taxes have been changed repeatedly and radically, generally without warning, and sometimes retroactively. Moreover, the fluidity of laws is compounded by difficulties in obtaining information about them. Sometimes new regulations are treated as internal documents, not accessible to those affected by them.

Other major obstacles are uncertainties over ownership, particularly of natural resources, compounded by disputes and overlapping jurisdictions among various levels of government; currency inconvertibility, worsened by

collapse of the banking system, by regulations making counter trade difficult and by unpaid debts. A serious lack of commercial, legal, and market information, the high cost and difficulty of establishing offices, serious visa restrictions and internal travel difficulties aggravate the problems of international investors. Other obstacles include the complicated bureaucratic system of decision making, the inadequate business ethics of many Russian partners, a poor industrial business and legal infrastructure, and unsatisfactory protection of intellectual property.

It is widely felt among foreign businessmen that if the Russian government really wants to attract foreign capital it should take energetic steps to reduce the risks and costs to them. American businessmen have formulated a program of actions which they would like the Russian authorities to take quickly. They include the following: "Guarantee Contracts. – Major investments need questions of ownership and contract sanctity to be settled, particularly in natural resources. In the meantime many firms would invest if contracts were grandfathered and backed by guarantees or commitments to the U.S. government or multilateral organizations . . ."

– "Grandfather Tax Regimes. – Significant investment will not occur as long as there is risk of radical tax increases that cannot be insured against. The Russian Government should grandfather tax regimes and offer incentives comparable to those in other countries."[17]

Other measures include easing the convertibility problem, establishing a sound banking regime, making arrangements to pay existing commercial debts, providing transparency in laws and directives by publishing them in an orderly manner, eliminating visas or making multiple entry visas easier to obtain, and settling jurisdictional questions within government so that companies would to know who is authorized to sign contracts, issue licences, etc.

These major and minor shortcomings, which make Russia's foreign investment policy subject to such heavy criticism, stem mainly from an incorrect approach, common in Russia several years ago, towards an influx of private capital from abroad.

The first steps in national policy towards foreign direct investment in Russia were based largely on a belief, widespread among the general public as well as legislators, that just opening the Russian economy to foreign investment would be enough in itself to attract considerable amounts of private capital from abroad. It was common belief that international companies were eagerly waiting just to be allowed to invest in "exploitation" of the rich natural and labor resources of Russia. Every statesman remembered from his schooldays Karl Marx's statement that capitalists would do anything to get superprofits. So popular opinion held that investment in Russia could provide unique opportunities to earn such profits, Russians could expect huge inflows of foreign capital and would have only to think how to channel incoming investment into the needy sectors.

Whether Marx was right or not, it soon became clear that expectations of gigantic foreign investment had been wrong. Realization slowly dawned that the opportunities provided by Russia were not so unique, and that many countries in the world were competing strongly for foreign capital, granting international business many favors and privileges, not to mention providing a more stable political, economic and ecological environment.

By mid-1992 it had become clear that radical changes in foreign investment policy could be postponed no longer. The Russian Committee on foreign investment began writing a new law on investments, which will stipulate three major methods for inducing foreign nations to inject capital into the Russian economy. The new legislation will provide, first, a program regulating the activity of foreign capital, second, a national program for attracting foreign investments, and, third, a preferential program for investors putting capital into "priority sectors" of the economy.[18]

According to the Program for Deepening the Economic Reforms, the Russian government intends to establish a stable legal basis for foreign investors in the coming months. They will receive adequate property rights; the regulation for obtaining 99-year leases on land will be clearly formulated; they will be guaranteed proprietary right to the land beneath the buildings, structures and enterprises they buy. Mortgage and bankruptcy laws will be adopted, and law of contract will be strengthened. The government will introduce ruble convertibility for current and capital operations by residents or non-residents, and the limits on repatriation of profits will be abolished. International agreements on mutual protection of investment will be ratified. The maximum rate of personal income tax will be 30%.

All in all, the Moscow reformers intend to provide national treatment for foreign investors identical to that in the U.S.A. During the initial stages of the economic changes, however, foreign investors will be granted privileges to minimize the risks of investment. They will be able to deduct first-year losses from profit tax payments. Tax regulations in force at the time a contract is concluded will remain in force for the whole period of profitable operations. The right to tax holidays of joint-ventures registered in 1990-1991 will be confirmed.

The present sectoral structure of foreign direct investment does not appear to satisfy the Russian government. Under the new policies, the priority sectors for foreign investors are storage, processing and distribution of foodstuffs, conversion of defense industry, revitalization of the energy complex, establishment of import-substituting production of specially important items, including pharmaceutical goods and consumer chemicals.

At the same time, the government intends to control foreign direct investment in a number of sectors. Judging from preliminary information, the regulated sectors will include military production, space vehicle and missile production, electricity generation, uranium production, use of land and natural resources, professional sea fisheries, the construction industry, engineering and operation of communication systems, real estate, the

extraction, use and realization (sale) of precious stones and metals; air, sea, river transport and servicing them, execution of government contracts, access to official credits and loans, banking, operations with currencies and bonds, participation in the privatisation process, insurance business, access to state subsidies, and mass media.

Details of the regulations were still not clear at the beginning of October 1992. It was known, however, that foreigners could invest in transportation but not conduct it as crew members, could purchase existing newspapers but not found new ones, and that foreigners and foreign firms not members of a stock exchange could participate in its operations only through intermediaries, but those who were members could act on their own behalf.

It can be seen that some of the new regulations apparently make government policy no more predictable than before. But proof of the pudding will be in the eating.

One significant change in Moscow's approach to foreign direct investment is a decrease in the importance attached to establishment of large Free Economic Zones. Even though the Moscow government has already approved creation of Free Economic Zones in large territories (in some cases entire provinces), the new policy supports the development of only two, one in Kaliningrad province on the Baltic coast, the other on the island of Sakhalin. Large zones require too much investment to develop their infrastructure before they are ready to attract foreign investment; therefore the government is more inclined to promote the creation of a limited number (5-6) of small, specialized free trade zones at large centers of international air, sea or rail traffic.

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So despite the gigantic difficulties created by the breakup of the Soviet socialist system and the process of transition to a market democracy, there are considerable opportunities for foreign direct investment in Russia. There is great interest among Western and other companies in investing in Russia. The increase in foreign direct investment in less than four years (1988-1992) was manifold, and capital for joint-ventures came from dozens of countries of the world. Nevertheless, the scale and pattern of investment do not satisfy the Russian government, nor is its investment policy satisfactory to foreign investors. There are many reasons why foreign businessmen have been disappointed. Some are fundamental and long-term in nature, so cannot be eliminated by government decree. Others, on the contrary, can be removed by authoritative decisions consistently implemented. Signs of positive change in Russia's foreign investment policies have appeared since mid-1992. Their implementation may signal the start of a second round of more energetic investment by international business in the Russian market.

Notes

1 The term "joint-venture" in this paper means any enterprise with any direct participation by foreign capital. As substitutes, the terms "firms with participation by foreign capital," "foreign-affiliated enterprises" and the like will be used by the author. The term "statutory capital" is similar to "authorized capital."

2 According to other estimates, the total amount of statutory capital of joint-ventures registered on the territory of the former USSR was 3.3 billion roubles by January 1 1990, of which 1.4 billion roubles, or 42.4%, was the property of foreign investors. By January 1 1992 the statutory capital of joint-ventures had reached a level of 6 billion roubles, of which about 2 billion roubles (33.3%) were invested by the foreign parties. – "Launching Issue," *Russian Business Review* (1990), pp. 36-37; *Ekonomika i zhizn'*, No. 24 (1992), p. 9.

3 According to other data, the shares of the leading investors in the former USSR, as of January 1 1990, were as follows: Germany – 6.6%, Finland – 5%, U.S.A. – 4.9%, Great Britain – 3.2%, Austria – 3.1%, Italy – 2.9%. – "Launching Issue," *Russian Business Review* (1990), p. 37.

4 The share of the U.S.A. is 12.2%, Germany – 14.2%, Italy – 5.8%, Great Britain – 4.4%, etc. – *Interfax/Soviet Business Report*, 19 July (1992), p. 20.

5 *Delovoi Mir*, 10 June (1992), p. 9.

6 *Business in the USSR*, June (1991), p. 19.

7 *Otchet o vneshneekonomicheskoi deyatel'nosti sovmestnykh predpriyatii (forma 1- VES) za 1991 g. Goskomstat SNG*, vol. 2 (Moscow, 1992), pp. 274-297.

8 *Delovoi Mir*, 22 February (1991), p. 5.

9 *Programma uglubleniya ekonomicheskikh reform*, June (Moscow, 1992), p. 213.

10 It may be added that similar trends have been developing recently in other republics of the former Soviet Union. In Kazakhstan, for instance, 50.2% of registered joint-ventures are situated in the capital city of Alma-Ata, 6.7% – in Chimkent Region, 4.4% – in Karaganda Region.

11 See, for example, *Delovoi Mir*, 19 February (1991), p. 4; 6 June (1992), p. 6.

12 The reasons for Japanese abstention are well explained in Shinichiro Tabata, "The Japanese-Soviet Economic Future," *Acta Slavica Iaponica*, No. 9 (1991). See also my article "Russian Economic Opportunities in the Asia-Pacific," *Asia and Africa Today*, No. 9 (1992).

13 *Vneshnyaya Torgovlya*, No. 11 (1991), p. 36.

14 *Ekonomika i zhizn'*, No. 23 (1992), p. 13.

15 See, for instance; *Ekonomika i zhizn'*, No. 5 (1992), p. 13; No. 24 (1992), p. 9; *Business MN*, No. 21 (1992), p. 1; *Nezavisimaya Gazeta*, 11 June (1992), p. 2; 5 June (1992), p. 2; *Business in the USSR*, June (1991), p. 20; *Delovoi*

Mir, 11 June (1992), p. 9; "Beyond Perestroika: The Soviet Economy in Crisis," Paper prepared by the Central Intelligence Agency and the Defense Intelligence Agency for presentation to the Technology and National Security Subcommittee of the Joint Economic Committee, Congress of the United States 14 May 1992; "Obstacles to Trade and Investment in the New Republics of the Former Soviet Union," *A Review of Impediments as Seen by The U.S. Business Community* (Washington: U.S. Department of Commerce, 1992).

16 "Obstacles to Trade and Investment . . .," *op. cit.*, p. 6.

17 *Ibid.*, p. 2.

18 *Interfax Financial Report*, 10 July (1992), p. 6.