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Investing in Russia is a Gamble, Whatever the Government Says

The Russian government wants more investment. But new proposals don't address the real reasons investors aren't stumping up.

By Alexandra Prokopenko

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The Kremlin has proposed a number of policies to encourage companies to invest more. **Alexander Avilov / Moskva News Agency**

Private investment has become the Russian government's most longed-for dream. Unless investment triples from its current level, the economy will not see the 3% growth demanded by President Vladimir Putin. For officials, that means the national goal will not be fulfilled, and the government will not meet its KPIs.

Conditions for investment in Russia are good right now, the government insists: inflation is at historic lows, there is a budget surplus, the ruble is stable, and the country's position in the international Doing Business rating is improving.

In practice, however, the government's incessant attention to the investment climate is paradoxically adding to investor doubts and holding back investment activity. Despite the favorable macroeconomic conditions, the overall economic situation is becoming less and less predictable.

Investors are worried about whether the siloviki will make trouble for them, whether tax rates will change, and when the rules and conditions will finally stop changing. So long as these questions remain unanswered, investment in Russian projects remains a lottery with dubious prospects of winning for those who do not enjoy a special relationship with the state.

Spending the surplus

Economic growth is impossible without new capital investment, Finance Minister Anton Siluanov has been repeating for years. The government's task, therefore, is to create an environment conducive to investment and support investors. But in the current cycle, the government is in danger of missing its KPI: under the Economic Development Ministry's forecast, the Russian economy should be seeing 3% annual growth by 2021. The Finance Ministry has already drawn up the budget based on these figures.

The forecast does note that such rapid acceleration — this year, GDP growth may not exceed 1% — is conditional on making the Russian economy more competitive and on investment. The government KPI for investment is that it should make up 25% of GDP. The only explanation of where this accelerated growth will come from is some vague words about structural changes and improving the investment climate. It seems the forecast is based on a hypothesis that private business will start to invest in development and increase production, rather than saving.

The basic conditions for this hypothesis are in place: organizations have amassed more than 20 trillion rubles ($311 billion) on their books, according to estimates by the Accounts Chamber and the State Statistics Service. Growth in profits should mean companies are more willing to invest, but in recent years, the proportion of profit used for capital investment has declined. In the first half of this year, investment in capital assets grew by just 0.6 percent. Most major businesses preferred to pay interim dividends than to invest in projects.

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Economic Development Minister Maxim Oreshkin blames the hiatus in investment on the central bank, saying that high interest rates are holding back corporate borrowing and, consequently, investment. However, in the first nine months of this year, corporate borrowing grew even more slowly than last year — 3.6% compared with 5.5% in 2018 — when interest rates were even higher. And if enterprises aren't even investing their own profit, on which they wouldn't have to pay interest, the problem is not the interest rate on loans.

The government believes that the 20 trillion rubles ($311 billion) held by companies is evidence of deferred demand that will be realized if a law introduced to the State Duma by the cabinet in November to protect and stimulate capital investment is passed. Siluanov says that the law ensures conditions for raising investment will not change. Yet the government has already promised not to raise taxes, only to instead introduce obligatory business tariffs that are not included in the tax code itself, such as the Platon toll system affecting truck transport, and labeling requirements.

New promises

The bill to stimulate capital investment grew out of presidential aide Andrei Belousov's proposal last year to collect 500 billion rubles from metals and minerals companies. Back then, the mere publication of Belousov's letter with presidential approval cost minerals companies 400 billion rubles in share capital in just one day.

Now, a year later, the government proposes to introduce two investment regimes: a general one, and one for specific projects. Under the first, investors are guaranteed a three-year grace period before any regulations that would worsen the conditions for investment activity, or changes in tariffs and basic taxes, would apply to them.

Under the second regime, which would apply to projects worth upward of 50 billion rubles in which more than 10 billion rubles of a company's own money was being invested, the terms would be fixed for at least six years, or in the event of profits being reinvested, for fifteen to twenty years.

Unlike the general regime, the project-specific scheme would be established on an individual basis under an agreement signed with the state. If the state violates its conditions, state structures will be liable to compensate the investor from the state budget for any losses incurred.

The bill looks suspiciously like a way for officials to meet their KPIs. Nearly 75% of new investment projects are launched by big business, the explanatory note to the bill says. That means that the main beneficiaries would be state-friendly capitalists and state monopolies.

In promising not to pass regulations that will make life more difficult for business, Siluanov has not said exactly what that means. His promise certainly doesn't cover initiatives included in the hazy realm of "national interests," such as the sovereign internet law, or the recent bill to ban foreigners from owning more than 20 percent of internet companies deemed to be "significant."

While the discussion continues over what proportion exactly foreign owners should be allowed to hold, barely any attention is being given to the question of who will determine a company's significance for the economy, and what criteria they will use to do so. Federal officials say it will most likely be a government commission or authorized body.

For modern businesses, which are increasingly digital, this would mean restrictions on their development. After all, the government — or an authorized body — could decide at any moment that the company is significant for the country's internet infrastructure, and force it to change its ownership structure.

Siloviki fears

Then there is the fear of pressure on businesses from the siloviki. Nearly 85% of 200 entrepreneurs who have faced legal proceedings believe that it is not safe to do business in

Russia, according to a survey conducted by the Federal Protective Service. For nearly half of those polled (45%), their court cases ended not in a judicial sentence, but in the loss of their business.

The Kremlin finds itself intervening in conflicts between business and the siloviki with increasing frequency, but this intervention is selective: the U.S. investor Michael Calvey and his French business partner Philippe Delpal are under house arrest, while their Russian partners Ivan Zyuzin and Vagan Abgaryan remain in pretrial detention over the same case.

The Russian authorities' attempts to improve conditions for entrepreneurs are not very predictable: the introduction of special investment regimes and efforts to advance in international ratings on the one hand, and on the other, a steady flow of protective and restrictive initiatives, changes to the rules — like the Finance Ministry's idea of reducing the time period used to decide tax residency — and excessive regulation of existing benefits.

The new special investment regime is constructed in such a way that through exemptions and subsidies, state control over investment projects will only grow, and most state support will go to state capitalists and companies close to them. It seems that the authorities simply don't have a consistent policy on how to improve the investment climate on an economy-wide scale. For state officials, it's more important that they meet their KPIs.

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