UDC 339.545:339.727.24(470)
Biblid 0543-3657, 74 (2023)
Vol. LXXIV, no. 1189, pp. 133–153
Original scientific paper
Received: 07/08/2023
Accepted: 10/10/2023
doi: https://doi.org/10.18485/iipe_mp.2023.74.1189.6

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War, sanctions, and foreign direct investment to and from Russia

SUMMARY

Russia's full-fledged war on Ukraine, which started in February 2022, added major uncertainties to foreign direct investment (FDI) to and from Russia and affected it negatively in the short, medium, and long run. The degree of the hit would depend on the exact contents of sanctions and countersanctions in constant development. However, the severe consequences of some of them were already visible early on, adding to the financial strain caused by the war. FDI to and from Russia fell drastically in 2022 and, depending on the length and depth of the conflict, would remain sluggish in the subsequent years if no exit strategy is found to stop the conflict and its eventual escalation. This article concludes that the fall in FDI would, in the end, hurt the economic capacities of Russia, already affected by a previous round of sanctions imposed in 2014. If it works, decoupling the Russian economy from FDI partners by applying sanctions would be effective only partially and at a relatively high cost. That, in turn, could thwart the very economic fundamentals of the war effort.

Keywords: FDI, Russia, sanctions, Russia-Ukraine War.

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Рат, санкције и стране директне инвестиције у и из Русије

САЖЕТАК

Свеобухватни рат Русије против Украјине, који је почео у фебруару 2022, створио је велике неизвесности за директне стране инвестиције (СДИ) у и из Русије и негативно утицао на њих у кратком, средњем и дугорочном периоду. Степен утицаја зависиће од тачног садржаја санкција и контрасанкција, које се стално развијају. Међутим, озбиљне последице неких од њих биле су видљиве рано, што је додатно повећало финансијски притисак изазван ратом. СДИ у и из Русије су драматично опале 2022. и, у зависности од дужине и интензитета сукоба, остаће споре у наредним годинама осим ако се не пронађе излазна стратегија за заустављање сукоба и његову евентуалну ескалацију. У овом чланку се закључује да би пад СДИ штетио економским капацитетима Русије, на које је већ утицала претходна рунда санкција које су уведене 2014. Ако успе, одвајање руске привреде од СДИ партнера применом санкција било би ефикасно само делимично и уз релативно високе трошкове. Ово би, заузврат, могло осујетити саме економске основе ратних напора.

Кључне речи: стране директне инвестиције, Русија, санкције, руско-украјински рат.

Background

On the morning of February 22, 2022, the Russian Armed Forces launched a large-scale invasion of Ukraine with the apparent aim of removing the Ukrainian government and replacing it with another one friendlier towards the policies of President Putin. With these steps, hostilities in Eastern Ukraine, which originated in March 2014, reached a new level, and death and devastation reached unprecedented levels not just for Ukraine but for the whole European continent since 1945. At the moment of writing these lines, it is unclear how the conflict would evolve, how long it would last, and how it would end. We do not even know if it would spill over to other countries or not.

On the first days of the conflict, the initial response of the international community was relatively limited, mostly a continuation of the countermeasures adopted in 2014 when Russia annexed Crimea. After the large-scale invasion, the reaction became more robust. At this point in time, new sanctions are adopted against Russia and Russian interests every day, and more and more countries join them. The list includes mostly the countries that are members of, or are linked to, the North Atlantic Treaty Organisation (NATO) and the European Union (EU), covering most of the European continent, North America, parts of Latin America, Australia, and

New Zealand. African and Asian countries and territories seem to have taken a more neutral stance so far, with some exceptions (e.g., the Republic of Korea, Singapore, and the Taiwan Province of China). The list of countries applying sanctions includes surprises such as traditionally neutral Switzerland, which aligned itself with EU policy, minus the one on supplying arms to Ukraine.

At the Security Council of the United Nations, binding action was blocked by a Russian veto. As a result, the case was referred to the Eleventh Emergency Special Session of the United Nations General Assembly, which adopted a new Resolution on the "Aggression against Ukraine" that reinforced Resolution 68/262 on the "Territorial Integrity of Ukraine" (March 2014) and went further by demanding an immediate halt to Russia's use of force and the immediate, complete, and unconditional withdrawal of all Russian forces from Ukraine's internationally recognised borders. The new Resolution was adopted by a large majority—the vote of 141 of the 181 countries present—reinforcing Russia's isolation on the scene of world politics (the 2014 Resolution had been adopted by 100 votes in favour). Of the 35 countries that abstained, there were some emerging powers such as China, India, and South Africa that did so as a "matter of principle" (not to position themselves in a dispute opposing the United States and Russia), although these countries, too, agreed with the need to respect the territorial integrity of Ukraine. The "no" vote of the Russian Federation was supported by only four more countries: Belarus, the Democratic People's Republic of Korea, Eritrea, and Syria.

General considerations on the effects of the war and sanctions

There is no war without death and destruction. The invasion of Ukraine is no exception to that rule. The blunt of that blow is falling on Ukraine, where the fighting goes on. It also has collateral negative effects on Russia, and not only in terms of dead soldiers, whose real number was made a top secret on the first days of the conflict. War is extremely costly for the state budget. It has been speculated that each day of war could cost various billions of dollars (a much more limited intervention in Syria had allegedly cost about 4 billion dollars per day). The reserves built up before the war can evaporate quickly, especially if some of the resources parked outside Russia become non-accessible due to their freezing (see also below).

Due to the status of Russia as a nuclear superpower, the sending of troops to Ukraine is excluded for third countries. Their reaction is limited to financial assistance, the sending of military assistance, and sanctions against Russian interests. From the point of view of the economic consequences of the war for Russia, sanctions deserve particular attention. It is to be stressed that the ones that would bind all United Nations members are excluded as Russia holds veto power in the Security Council, where they should be adopted. As a "second-best" choice, the "Western powers" mentioned above started their own systems, trying to coordinate between themselves and convincing others to adhere to their own free will. However, no third country would be obliged to join them, and Russia adopted its own countermeasures to counterbalance them (e.g., exchange controls on export proceeds, but also mandatory surrender of assets in case of divestment from Russia).

This analysis attempts to ask what the potential impact of sanctions and countersanctions on foreign direct investment (FDI) inflows to and outflows from the Russian Federation would be, taking into consideration the limitations and inconveniences. Sanctions do not fully stop economic links; rather, they result in higher costs and less ease in doing business. It is also evident from the lessons of the ones imposed after the annexation of Crimea in 2014 that they have hurt not only Russia but also the issuing countries. Paradoxically, the winners have been the "free rider" countries. It is also to be noted that Russia has managed to somewhat increase its economic independence and diversification since 2014. As a result, the new wave of sanctions had to be much more severe to bite.

This, however, does not mean that the impact of past sanctions would be fully negligible. It is quite likely that they have contributed to the growing lag of Russian GDP growth vis-à-vis the rest of the world. In the period 2009–2013, that difference was 1.1 percent. In the period 2014–2018, it more than doubled to 2.4 percent (Table 1). Sanctions and countersanctions also resulted in a declining share of Russia in world inward FDI from 2.5 percent in the period 2009–2013 to 1.4 percent in the period 2014–2018, and also in world outward FDI from 3.2 percent to 2.8 percent (Table 2). It is to be added that Russia cannot fully replace its FDI links with the West by FDI links in the emerging countries as the technological content and the value chain configurations of the two are different.

Table 1. Annual average growth rate of the real gross domestic product in Russia and in the world, 2009–2018 (in percent)

Source: the author's calculations, based on UNCTAD data

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Russia	-7.8	4.5	4.3	3.7	1.8	0.7	-2.0	0.3	1.8	2.5
World	-1.3	4.4	3.3	2.8	2.8	3.0	3.1	2.7	3.4	3.1
Difference	-6.6	+0.1	+1.0	+0.9	-1.0	-2.3	-5.1	-2.4	-1.6	-0.6

Source: the author's calculations, based on United Nations data.

Table 2. Share of Russia in global FDI inflows and outflows, 2009–2018 (in percent)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Share in inflows	2.2	2.3	2.3	2.0	3.7	2.1	0.6	1.8	1.6	0.9
Share in outflows	2.9	3.0	3.0	2.2	5.0	4.7	1.6	1.7	2.1	4.1

The effects of sanctions and countersanctions add to the effects of the war. In general, war situations do dissuade FDI. In general, war is a blow to economic growth due to its shock to production, even in countries where the economic effects have been 'planned' meticulously and preventive measures have been taken to protect the treasury of all firms, especially the multinational enterprises that have to operate across borders (in this case, the Russian multinational enterprises). If the conflict goes on or if too many assets are lost both at home and abroad, even the best-prepared firms can run out of money. As for firms investing in Russia, sanctions creating obstacles to accessing finance may be the most severe disincentives.

In the Russian case, the minimum effect was a drop in GDP in 2022 (materialised at 2.1%), which further accentuated the effect of falling behind other leading countries in the world. The IMF estimated that the Russian GDP in 2021 was about $1.7 trillion, which was 14 times less than the GDP of the United States and 10 times less than the Chinese one. The Russian Federation was a nuclear superpower, but with a middle-sized economy, it was 11th in the world ranking, behind the Republic of Korea. And if the slowdown continues beyond 2023, it will soon fall behind that of other nations, namely Brazil, Australia, Spain, and Mexico, in that order. In other terms, the war accentuates the gulf between the political and military aspirations of the Russian leadership and the economic means to achieve them. As for inward and outward FDI, which is a powerful tool for augmenting a country's productive capacities, as discovered by politicians in various emerging powers, such as China, they risked drying up for the Russian leadership in the worst moment.

Types of sanctions and their potential impact on FDI: the hypothesis

This study has only one hypothesis: that sanctions have a negative impact on both inward and outward FDI in Russia. Within that single hypothesis, we can formulate subsidiary hypotheses related to the different types of sanctions, knowing that the attribution of effects to individual sanctions is not necessarily available.

Prohibition of trade and establishment of new investment links with the Donbas region (announced by the United States). At first sight, this measure has a limited impact, as it applies to American firms only, not if they do business in Russia but in the separatist Ukrainian zones only. However, past experience shows that "American firm" may mean any company with a substantial presence in the United States independently of its ownership structure, to prevent the discrimination of corporations that are domiciled in the country and to preclude the temptation for re-domiciliation to escape the constraints. It is also unclear in the rules if only direct trade and investment relations count or also indirect links via value chains. If the rules are extended to both, non-negligible parts of the global economy are to be affected. It may, for example, be a major issue for firms from "neutral" countries (such as China) that do not wish to lose their access to the large United States market. To be kept in mind, too, is that the exposure of Russian or other international business to the Donbas region may be larger than one would think at first sight. The Donbas is a major producer of coal, iron and steel, machinery, and equipment, which can be inputs for production in Russia and in the value chains of other countries. These sanctions may hurt these business links when the region probably needs an increase in economic activities to satisfy the local population after the evaporation of the initial euphoria of recognition by Russia. Subsidiary Hypothesis 1: For all these reasons, the prohibition to do business with the Donbas is expected to have a negative impact on both Russian FDI inflows and outflows.

Stopping or rolling back business projects in and/or with the Russian Federation by governments applying the sanctions. The first and best-known case is that of the Nord Stream 2 gas pipeline, which was suspended by the German authorities.[2] Although in each case, the economies of the partner countries may be hurt as much as those of Russia, other projects may suffer the same fate. Subsidiary Hypothesis 2: Stopping or rolling back projects in Russia has a major negative impact on inward FDI flows.

Export ban on or control of strategic inputs. Such measures are currently under consideration. The United States wishes to negotiate such measures with the Asian exporters of semiconductors/microchips. It is unclear at this stage if they would be accepted by the partners and what the real impact on the Russian economy would be. It should be noted that Ukraine is a key supplier of semiconductor-grade neon. If the Russian Armed Forces occupy the country and manage to control the Ukrainian suppliers, Russia can try to use them to develop its own semiconductor industry (Russia produces another raw material, palladium). The problem is that such capacity building requires lots of time and know-how. In the meantime, stopping supplies from Asia may affect the business links of those Russian firms that use those

[2] "Nord Stream 2 pipeline firm gets 6-month stay of bankruptcy", *AP*, 12/28/2022.

semiconductors/microchips. It should be noted that such a measure would prompt the Russian authorities to seek local solutions (import substitution) to replace them. Subsidiary Hypothesis 3: The impact of the export ban is negative on both inflows and outflows; its extent is uncertain.

Sanctions against Russian (and Belarusian) individuals linked with the recognition of the breakaway "republics" and the war, mostly in the form of freezing their assets possessed in their personal capacity or in their firms. This is more than a symbolic list. Its effect naturally depends on how long the list is and how many people with business interests figure on it. Already, the first lists included persons linked with Promsvyazbank, VTB Bank, and the VKontakte media group. As the list lengthens, the effect of the measure may increase. Subsidiary Hypothesis 3: The impact of sanctions against Russian individuals has a negative impact on outward FDI.

Freezing of Russian banking assets abroad. This is a very severe measure, affecting both inward and outward FDI. It should be noted that the group of the largest Russian banks includes various state-owned entities (such as Sberbank, VTB Bank, Gazprombank, Promsvyazbank, the State Development Corporation Vneshekonombank or VEB, the Otkritie Financial Corporation, the Russian Agricultural Bank, and Novikombank, to mention the largest), so sanctions are straightforward to justify due to their direct links with the power centre. There are also entities that are on paper privately owned but are so close to the government that, already in 2014, they were put on the sanctions list, such as the Rossiya Bank. The freezing of the assets of these financial institutions (it has already happened to most of the listed; others may be added later on) has a double negative effect on FDI. On the one hand, it results in the stopping or bankruptcy of the affiliates of these banks operating abroad, as it happened very early on with the Vienna-based Sberbank Europe AG, with affiliates also in seven other markets (Bosnia and Herzegovina, Croatia, Czechia, Germany, Hungary, Slovenia, and Serbia).[3] It should be noted that already in November 2021, the bank had initiated the sale of its affiliates in other countries except in Czechia and Germany. With that transaction not yet fully completed, the bankruptcy of the Vienna-based parent may affect the whole network. Other Russian banks may face the same fate if sanctions last for a long time. On the other hand, this freezing of assets means the impossibility of financing the transactions of Russian multinationals abroad. It also has an impact on access to finance for foreign investors located in Russia. The country may be prompted to apply restrictive measures to stop the outflow of resources, including an obligation to surrender export receipts or a prohibition on the repatriation of profits. These circumstances could make the lives of foreign investors close to

[3] Tom Sims, Alexandra Schwarz-Goerlich & Daria Sito-Sucic, "Russia's Sberbank in Europe faces closure after savers demand money", *Reuters*, 02/28/2022.

impossible. Subsidiary Hypothesis 4: The freezing of Russian banking assets abroad has a major negative effect on both inward and outward FDI.

The *exclusion of Russian (state-owned) banks from the SWIFT payment system*. The decision has been taken by the EU to exclude seven large Russian banks, with the exception of Sberbank and Gazprombank, so far. This measure makes all business transactions involving the Russian and foreign clients of these banks costlier and more cumbersome. Alternatives do exist on paper, such as using China's Cross-Border Interbank Payment System (CIPS). However, developing this alternative may not be so easy and would not prevent the problem of increasing the cost of doing business. Moreover, the use of that system may result in "side effects" such as the need to rely heavily on the Chinese yuan as the currency of payment/clearing, which may not be desirable for some businesses. As another alternative, within Russia, the Financial Message Transfer System of the Bank of Russia (SPFS) has been launched with about 400 users, which may be a solution for purely domestic payments. However, this system is not yet linked with other systems abroad; therefore, it does not attenuate the obstacles to international payments, which is a major problem for both foreign investors in Russia and Russian firms abroad. Subsidiary Hypothesis 5: The exclusion from SWIFT creates major inconveniences, hurting both inward and outward FDI significantly.

Sectoral sanctions. Sanctions affecting different sectors of economic and social activities may have very different impacts on FDI. Two of them, banning Russian vessels from foreign ports and Russian aircraft from foreign airspace, can seriously hamper business transactions between Russia and the rest of the world and can act as a major disincentive to FDI. It should be noted that these sanctions are not fully "waterproof". Trade with the outside world can be switched to foreign carriers, but naturally at the expense of an increase in shipping costs and a decline in the Russian freight and shipping sector. Measures affecting cooperation on the Space Station can also have some negative consequences for supplying firms. While the limitations imposed on scientific cooperation may seem more symbolic, so could the measures affecting arts, culture, and sports. In those areas, it is mostly the international reputation of Russia that is hit, though one should not underestimate the business side of these activities either. Subsidiary Hypothesis 6: Sectoral sanctions can have a major impact on FDI in the target activities.

In sum, certain measures may have a major impact on FDI; others would be more limited (Table 3).

Source: the author's collection of information

Table 3. Potential impact of sanctions on inward and outward FDI of Russia, 2022 and beyond

Measure	Expected impact on FDI
Trade and investment ban on Donbas	Major
Stopping/rolling back business projects with Russia	Depends on the size of the project stopped
Export ban on or control of strategic inputs	Uncertain extent
Sanctions against Russian individuals linked with the recognition of the breakaway "republics" and the movement /deployment of Russian troops	Major at the level of the firms that they are linked with
Freezing of Russian banking assets and exclusion from SWIFT	Very major
Sectoral sanctions	The ban on Russian vessels and aircraft may have major impact

The situation at the war and the Western sanctions all indicate that Russia is probably heading towards one of the most severe crises in its history, destabilising the war effort itself. Such a crisis could also hamper the attempts by Russian businesses to build local capacities to counteract the sanctions. It is also to be noted that relying on foreign partners such as China and India to mitigate or avoid the effects of the sanctions can also have side effects. These countries cooperate with the Russian Federation under sanctions out of self-interest. Their governments made it clear that cooperating with Russia does not mean recognising the separatist republics of the Donbas or accepting the Russian invasion. There may also be points in the chain of events when the Chinese and Indian governments and the firms of these countries have to choose between keeping Western and Russian business links, and they choose the former. Moreover, with the loss of Western partners, the dependence of the Russian economy on these partners may increase. It is also to be taken into consideration that this type of cooperation with China and India can also have geopolitical consequences. If Russian firms fall into deep crisis, they may be replaced by Chinese and/or Indian companies in countries that Russia perceived as its zone of influence in the past (e.g., in Central Asia).

The "haemorrhage" started almost instantly. FDI was reacting immediately. As mentioned above, Sberbank Europe was the early bird in a potentially long flow of Russian bankruptcies abroad.[4] Another case of instant bankruptcy was that of the Switzerland-based Nord Stream 2 holding

[4] "Russia's Sberbank in Europe faces closure after savers demand money".

company, which was expected to manage the construction of the gas pipeline but was stopped by the German authorities.[5]

Selected lessons from past sanctions applied against Russia6

As a consequence of the 2022 war in Ukraine, Russia has become the target of the largest number of sanctions in the world: nearly 12,000 measures were in place in early August 2022.[7] Many of these measures directly restrict the scope for reciprocal direct investment, particularly in the financial and technology sectors. The Russian authorities have responded to these sanctions with countermeasures. For firms that carry out activities on both sides of the division line, it has become arduous to comply with the contradictory requirements of the two parties. Many of them have responded by reducing, suspending, or eliminating their business deals on the other side.[8]

The sanctions applied against Russia in 2022 are partly the continuation of the measures applied against Russian firms and individuals after the annexation of Crimea in 2014. This way, lessons can be drawn from the past, too.

In the most recent study prepared before the outbreak of the 2022 war, an analysis of the impact of political factors on Russian MNEs' strategic choices to divest their foreign operations found that firms operating in countries that did not join the economic sanctions against Russia were less inclined to divest their subsidiaries than those in countries that supported sanctions.[9] The article emphasised the political dimension of the foreign market exit, a factor largely confirmed by the events after February 24, 2022.

The first studies on the post-February-2022 situation indicate that Russian businesses react to this new situation by using defensive strategies to minimise their losses, mostly through reverse internationalisation.[10] They are in line with the most recent international business literature on sanctions.[11]

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[5] "Nord Stream 2 pipeline firm gets 6-month stay of bankruptcy".

[6] This section sums up the main findings of Kálmán Kalotay & Csaba Weiner, "The Impact of Sanctions on Russian Business Abroad and Hungarian Business in Russia: Parallel Stories of Adjustment", In: Lourdes Casanova & Anne Miroux (eds), *Emerging Market Multinationals Report 2022: Reinventing Global Value Chains*, Cornell SC Johnson College of Business, Ithaca, NY, 2022, 92–100, on past experience with sanctions in Russia.

[7] "Russia sanctions dashboard", Castellum.AI, https://www.castellum.ai/russia-sanctions-dashboard, 08/09/2023.

[8] Kalman Kalotay, "The War in Ukraine Deals a Blow to Russia's Foreign Direct Investment Links", *Challenges*, No. 238, 2022, 1–17.

[9] Andrey Panibratov & Ajai Gaur, "Political drivers of international divestments of Russian MNEs", *BRICS Journal of Economics*, Vol. 3, No. 1, 2022, 5–25

[10] Kálmán Kalotay & Csaba Weiner, "The Impact of Sanctions on Russian Business Abroad and Hungarian Business in Russia: Parallel Stories of Adjustment".

As non-military coercive measures (coined as "jus ad vim", i.e., the right to use force short of war), they have the potential to disrupt the international business environment, especially the institutional environment, and change the rules of the game.[12] From the point of view of internationalisation theories, sanctions challenge the assumptions about international business, including the institution-, resource-, and knowledge-based view, the resource dependency theory, and the behavioural theories of the firm.

Literature on the choices of Russian businesses facing sanctions from Western governments usually highlights four main options: (1) withdraw, which means losing a strategic market, probably without having a chance to return but retaining strong ties at home; (2) distancing from Russian government policy, which may reduce exposure to sanctions but risks retaliation from the home government; (3) maintaining course while retaining strong ties to Russia, which likely results in challenges to the legitimacy of the firm; and (4) transferring the business to a friendly partner not targeted by sanctions, which creates opportunities to reduce the cost of exit.[13] In the case of Russian business abroad, they have attempted, with varying success, most of these options.

The impact of sanctions on large Russian MNEs and their adjustment[14]

The bulk of Russia's outward FDI is carried out by a handful of large MNEs. Almost all of these firms and/or their executives and owners fell under sanctions, with an immediate negative impact not only on MNEs' operations but also on Russia's foreign economic links. The total foreign assets of the 20 largest MNEs were valued at US$ 108 billion at the end of 2019 (Table 4), compared with a total outward FDI stock of US$ 407 billion in the same year.[15] The majority of these MNEs are natural-resource-based firms, with oil and gas companies occupying the top three posts. Their strategies are related

[11] Klaus E. Meyer, Tony Fang, Andrei Y. Panibratov, Mike W. Peng & Ajai Gaur, "International business under sanctions", *Journal of World Business*, Vol. 58, No. 2, 2023, 101426.

[12] "Jus ad vim" is to be contrasted with two basic concepts of just wars: "jus ad bellum" (the right to wage a war) and "jus in bello" (regulating) the conduct of parties engaged in an armed conflict. Michael Walzer, *Just and Unjust Wars*, Basic Books, New York, 1977: Klaus E. Meyer, Tony Fang, Andrei Y. Panibratov, Mike W. Peng & Ajai Gaur, "International business under sanctions".

[13] Ibid.

[14] This section is adapted partly from: Kálmán Kalotay & Csaba Weiner, "The Impact of Sanctions on Russian Business Abroad and Hungarian Business in Russia: Parallel Stories of Adjustment".

[15] "Balance of payments of the Russian Federation (standard components)", Central Bank of Russia (CBR), https://www.cbr.ru/vfs/eng/statistics/credit_statistics/bop/bal_of_payments_standart_e.xlsx, 10/07/2023. Year 2019 is the latest year for which the list of the largest

to the control of their value chains, typically upstream at home and in developing countries and downstream in developed countries. Certain firms are actively involved in FDI transiting through other countries or leaving the country and coming back (called "round-tripping"). Some (e.g., VEON, NLMK, and Evraz) have undertaken "corporate inversion", and now have their official headquarters registered abroad, while Russian individuals remain the main shareholders. State-owned MNEs make up more than one-third of the list.[16] Together, these firms account for almost half of the assets of the top 20 group. However, the impact of the Russian government does not stop there. The privately owned MNEs are also under state influence; the government has an informal say in their major strategic decisions.[17]

Table 4. Most of the 20 largest Russian non-financial MNEs are affected by sanctions (Firms ranked by foreign assets at the end of 2019, US$ billion and percent)

Note: Firms shown in bold are under sanctions.

Rank	Company	Industry	Long-term foreign assets (US$ billion)		Total foreign assets (US$ billion)		Share of foreign assets in total assets (%)	
			2018	2019	2018	2019	2018	2019
1	Lukoil	Oil and gas	18.4	21.3	24.8	28.8	30	30
2	**Gazprom**	Oil and gas	14.8	15.6	18.5	18.9	6	5
3	**Rosneft**	Oil and gas	8.3	11.1	10.8	13.6	6	7
4	**VEON**	Telecom	6.2	6.8	8.0	8.0	56	50
5	Rusal	Metallurgy	3.7	4.2	5.4	6.5	34	36
6	**Sovcomflot**	Transport	5.6	5.5	6.0	6.1	84	83
7	**Atomenergoprom**	Nuclear energy	3.8	4.1	5.7	5.5	12	10
8	**Russian Railways**	Transport	1.7	2.0	3.1	3.3	4	4

MNEs is available. In principle, it would have been desirable to get data for a more recent year. However, data collection during the war is close to impossible. Nevertheless, as this is information about assets, it shows stability over time.

16 Atomenergoprom, Gazprom, Rosneft, Russian Railways, Sovcomflot, VSMPO-Avisma (with only a minority blocking share of the state), and Zarubezhneft.

17 Andrei Panibratov, "The influence of the state on expanding Russian MNEs: Advantage or handicap?", Russia/NIS Center, https://www.ifri.org/sites/default/files/atoms/files/ifriandreypanibratovrussiancompagniesengdecember2013.pdf, 03/22/2023.

Rank	Company	Industry	Long-term foreign assets (US$ billion)		Total foreign assets (US$ billion)		Share of foreign assets in total assets (%)	
			2018	2019	2018	2019	2018	2019
9	**Evraz**	Metallurgy	2.1	1.9	3.7	3.2	40	32
10	NLMK	Metallurgy	1.4	1.3	2.9	2.5	29	24
11	**EuroChem**	Chemicals	1.4	1.4	1.7	1.8	18	15
12	NordGold	Metallurgy	1.3	1.3	1.6	1.7	64	61
13	Russneft	Oil and gas	1.2	1.6	1.4	1.7	37	36
14	**VSMPO-Avisma**	Metallurgy	0.1	0.2	1.2	1.4	25	25
15	**Zarubezhneft**	Oil and gas	0.5	0.6	1.0	1.2	37	35
16	**MegaFon**	Telecom.	0.2	0.5	0.2	1.0	3	9
17	TMK	Metallurgy	0.9	0.3	1.9	0.8	38	15
18	**Norilsk Nickel**	Mining	0.5	0.4	0.7	0. 7	4	3
19	**MMK**	Metallurgy	0.3	0.3	0.5	0.5	7	6
20	AFK Sistema	Holding	0.9	0.3	1.6	0.5	8	2
Total of the top 20			73.1	80.7	100.8	107.6		

Source: the authors' compilation.[18]

At the level of individual firms, the haemorrhage started early. As mentioned above, Sberbank Europe was the first in a potentially long flow of Russian bankruptcies abroad. Another case of instant bankruptcy was that of the Switzerland-based Nord Stream 2 holding company, which was in charge of a trans-Baltic Sea gas pipeline between Russia and Germany, mentioned above.

Some Russian MNEs also face difficulties in financing their overseas operations. In the first half of 2022, Severstal and Evraz, two large Russian integrated iron and steel producers, defaulted on their international bond payments, despite the availability of sufficient funds to pay them. The reason for this paradox was that these MNEs' foreign bankers refused to process the payments on the grounds that the principal owners were oligarchs put

[18] Based on: Alexey V. Kuznetsov, "Direct Investment from Russia Abroad: Changes since 2018", *Herald of the Russian Academy of Sciences*, Vol. 91, 700–707.

on the sanctions list. In March 2022, Severstal, owned by the Russian oligarch Alexei Mordashov's Severgroup, failed to make a US$ 12.6 million interest disbursement to holders of bonds worth US$ 800 million after its banker, Citigroup, froze those payments.[19] Also in March 2022, Evraz, partly owned by another Russian oligarch, Roman Abramovich, was blocked by its banker, the New York affiliate of Société Générale, from paying the US$ 18.9 million coupons on its US$ 700 million bond, partly due to UK sanctions against the oligarch.[20] The UK justified its sanctions by the fact that Evraz produces 28% of all Russian railway wheels and 97% of the country's rail tracks, which were "of vital significance as Russia uses rail to move key military supplies and troops to the frontline in Ukraine".[21] As a side effect, the financial difficulties of Evraz affected its North American operations. The first layoffs were reported in Canada in May and June 2022, though this scaling back did not apparently affect the firm's large plant in Pueblo, Colorado.[22]

Some Russian firms have designed strategies to bypass sanctions, with varying success. The state-owned shipping company Sovcomflot avoided the seizure of its assets by selling off at least a dozen tankers (of a fleet of 121 vessels). Some transactions took place "through a web of shell companies, shielding the vessels' ultimate owners from the risk of penalties".[23] Another part of the strategy consisted of transferring selected corporate headquarter functions to Dubai in the United Arab Emirates. This partial "corporate inversion", following the footsteps of other firms (see the discussion on Table 4), allowed Sovcomflot to obtain safety certification from India for over 80 vessels managed from its Dubai centre.[24] In another case, in March 2022, the Russian gas giant Gazprom terminated its participation in the Germany-based Gazprom Germania and transferred its shares and company assets held in Europe to a former Gazprom unit controlled, through voting rights, by a hitherto unknown Russian firm – to no avail.[25] In April 2022, Gazprom Germania was brought under the control of the German energy regulator,

[19] Alistair MacDonald, "How a Russian Steel Giant Was Unplugged From the Western Economy", *Wall Street Journal*, 03/25/2022.

[20] "Evraz says bond payment blocked over Abramovich sanctions", *Financial Times*, 03/21/2022.

[21] Jacqueline Holman & Ekaterina Bouckley, "UK sanctions Russian steelmaker Evraz", *Commodity Insights*, 05/05/2022.

[22] Daniella Ponticelli, "170 Regina Evraz steel mill workers laid off since May, company says more expected", *CBC News*, 06/18/2022; Casey Tolan & Audrey Ash, "This Colorado steel mill 'built the American west,' but its ownership has ties to Russia", *CNN*, 04/04/2022.

[23] "Russia's Sovcomflot sells tankers as sanctions loom – WSJ", *The Moscow Times*, 05/13/2022.

[24] "Russia's Oil Tankers Receive Safety Cover From India Via Dubai Firm", *Marine Insight*, 06/24/2022.

[25] Gazprom Germania was renamed SEFE Securing Energy for Europe in June 2022.

Bundesnetzagentur. In retaliation, in May 2022, Russia imposed sanctions against the former Gazprom Germania units.[26]

Another response of Russian firms to sanctions has consisted of the use of the Swiss trading platform, which traditionally manages the bulk of Russian commodity transactions. Though Switzerland decided to apply the same sanctions as the EU, Switzerland-based MNEs continued some deals in Russian coal, and so did some large Russian coal producers maintaining subsidiaries in the country (including SUEK and Evraz; Atkins, 2022). There were also questions raised about the eventual indirect imports of Russian gold via the U.K. and Dubai, though the adoption of the EU's July 2022 ban on both direct and indirect imports of gold closed, in principle, this loophole on sanctions.[27]

Corporate exodus from Russia

In Russia, one of the mainstays of inward FDI, the oil and gas sector already experienced the first attempts to leave the country some days after the outbreak of the war. First, BP announced on February 27, 2022, that it would sell its 20 percent stake in Russian state-owned oil giant Rosneft. The next day, Shell expressed its wish to exit its joint ventures with state-owned Gazprom, and the day after, Exxon announced its exit from the Sakhalin oil and gas project in the Russian Far East.

Beyond the oil and gas industry, some Western firms started leaving Russia or stopping sales to the Russian market. To some degree, this was a change in corporate philosophies. In the past, business kept more distance from politics, only complying with the sanctions dictated by public authorities. Let us highlight some examples drawn from a collection of information by Yale University, confirmed by corporate and press reports:[28]

- the *transportation industry* (Maersk and MSC halting container shipping to and from Russia, Hapag Lloyd and container carrier Ocean Network Express of Japan suspending reservations to Russia, and DHL suspending services to and from Russia),[29]

[26] In September 2022, Germany also placed the local units of Russian state-owned oil firm Rosneft under fiduciary management.

[27] Dominique Soguel, "Swiss gold imports come under scrutiny as G7 targets Russia", *SWI swissinfo.ch*, 06/27/2022.

[28] The usual disclaimer applies to the eventual inaccuracies of corporate and press reports. "Over 1,000 Companies Have Curtailed Operations in Russia—But Some Remain", Chief Executive Leadership Institute, https://som.yale.edu/story/2022/over-1000-companies-have-curtailed-operations-russia-some-remain, 08/17/2023.

[29] Gregor Gowans, "Daimler ends Kamaz cooperation as Volvo Trucks halts production in Russia", *Trans.Info*, 02/28/2022; "Msc Temporarily Halts Bookings to/from Russia", MSC, https://www.msc.com/en/newsroom/customer-advisories/2022/march/msc-

– *major aircraft manufacturers* (Boeing suspending the supply of parts, maintenance, and technical support to Russian airlines and the operation of its training centre in Moscow; Airbus stopping the sending of parts to Russia),[30]
– *vehicle producers* (Ford suspending its participation in its joint venture in Russia, Daimler Truck suspending cooperation with its Russian joint venture partner Kamaz, automotive supplier ZF Friedrichshafen stopping deliveries to Russia, Harley-Davidson stopping sales to Russia, Volvo and General Motors stopping exporting to Russia),[31]
– *financial services* (HSBC, Société Générale, and Shinhan Bank of the Republic of Korea severing ties with Russian banks; Visa and Mastercard excluding Russian financial institutions from their networks),[32]
– *the entertainment industry* (Spotify with its closure of its Moscow office, Stonemaier Games with its exclusion of Russian partners, Disney, Warner Bros., Sony Music, Netflix).[33]

In most cases, the severing of these links affects trade, with the possibility of a reversal of decisions if the situation changes. However, the suspension of participation in joint ventures can also lead to divestments. Moreover, the exit of transportation services and the suspension of supplies are hurting the participation of Russian units in global value chains, and the decisions of financial institutions further exacerbate the financial obstacles to doing business in and with Russia.

In response to the exodus, the Russian authorities attempted to declare a ban on departures. The problem was the effectiveness of such measures if companies prefer leaving behind their assets while still stopping operations. Moreover, such a ban could risk prompting a series of investor–state disputes by foreign companies. The Russian authorities, if condemned, may risk being ordered extremely high amounts of damages, further reducing the country's financial resources.

temporarily-halts-bookings-tofrom-russia, 06/18/2023; "Ocean Network Express halts Russia bookings; Maersk may follow", Ship Technology, https://www.ship-technology.com/news/ocean-network-express-russia-bookings/, 08/18/2023.

[30] Sarah Butler, "Disney suspends Russian operations in response to Ukraine invasion", *The Guardian*, 03/10/2022.

[31] "Ford Issues Statement On Suspension of Russian Joint Venture and Assistance for Ukrainian Refugees", Ford, https://media.ford.com/content/fordmedia/fna/us/en/news/2022/03/01/ford-russia-ukraine-statement.html, 08/19/2023; Gabrielle Coppola & David Welch, "GM, Harley-Davidson Halt Shipments to Russia as Sanctions Bite", *Bloomberg*, 03/01/2022.

[32] "MasterCard statement on suspension of Russian operations", MasterCard, https://www.mastercard.com/news/press/2022/march/mastercard-statement-on-suspension-of-russian-operations, 08/20/2023.

[33] "Spotify closes its office in Russia in response to attack on Ukraine", *Reuters*, 03/02/2022.

It is also to be stressed that announcements about departure from Russia do not necessarily mean abandoning that market. For example, in the case of Apple, it was reported that, despite its official announcement of stopping selling its products there, the parallel imports of iPhones (via intermediaries) jumped to 1.1 million devices (+15 percent) in the first half of 2023 year-on-year. Parallel imports are also common in the case of consumer goods, such as Zara dresses and Nike sneakers, though they do not re-establish the FDI links that were broken with the abandonment of direct selling.[34]

As for Raiffeisen Bank Austria, in 2023 it successfully delayed quitting Russia despite pressures. There may be other corporate players who try to postpone their departure for as long as possible.[35]

A plunge in Russia's FDI inflows and outflows as a consequence

As a result of the above-mentioned trends, the 2022 war in Ukraine increased uncertainties about FDI to and from Russia and was expected to affect it negatively in the short, medium, and long run. In 2022, both inflows and outflows declined sharply and turned largely negative due to divestments (Figure 1). Both dropped more than in the year of the COVID-19 pandemic (2020), though in that year, during weeks, the country came to a complete halt. It should be noted that, via the above-mentioned phenomenon of round-tripping, outflows usually move together with inflows and vice versa. It should be highlighted here, too, that inflows reacted more sharply than outflows, with Russian MNEs attempting to keep some operations at least in "neutral" countries without applying sanctions against them (such as China and India).

A projection for 2023 is based on data available for January, while June indicates that FDI inflows are foreseen to remain largely negative over the year and outflows could become slightly positive, though of this value (around US$ 8 billion). These data confirm largely our hypothesis about the decline of inward FDI, at least in the short and medium run, due to the war and the sanctions. It seems that the replacement of the lost FDI links with the "West" by FDI links with neutral countries, such as other BRICs, especially China and India, would be an arduous and very time-consuming process, if it works at all. One should not lose sight of the fact that the sectoral composition and technology content of these new links are very different from those registered in FDI with the EU or the United States. In this respect, the efforts of the Russian government in those frameworks that are still

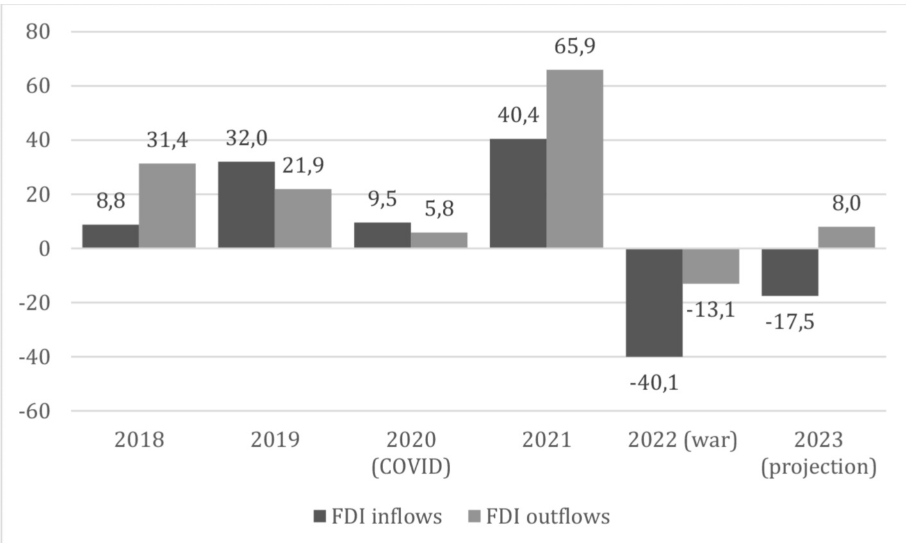
[34] Nicolas Camut, "Russians Can Buy Zara Dresses and Nike Sneakers Again", *Politico*, 11/29/2022.

[35] John O'Donnell & Alexandra Schwarz-Goerlich, "Exclusive: Raiffeisen delays quitting Russia as Austria defends ties", *Reuters*, 08/13/2023.

available may not suffice to cover the losses in FDI, a phenomenon in which there is much less room for domestic alternatives than in measures towards self-sufficiency.

As highlighted at the outset, there is a need now to attribute the effects to different types of sanctions that this article could not fully address. Such an exercise could help us solidify the subsidiary hypotheses that we have raised, which can, for the moment, be confirmed only indirectly. That may be the task of additional studies that will pick up the analysis from this article.

Figure 1. The drop of Russia's FDI inflows and outflows in 2022 (2018–2023 flows in US$ billion)



Note: Projections for 2023 are based on data available for January till June.
Source: Authors' compilation based on data from CBR (2023).[36]

Conclusion

In conclusion, the war in Ukraine adds major uncertainties to FDI to and from Russia and affects it negatively in the short, medium, and long run. The degree of hit depends on the exact contents of sanctions and countersanctions, which are in constant evolution and not fixed yet. The paradox of this war is that, if the intention of the planners was to make Russia more powerful, the effect was already opposite and was (and is) worsening over time. Observers may wonder what went wrong with the planning of

[36] "Balance of payments of the Russian Federation (standard components)".

the economic consequences. The inputs used did not reflect the realities of the outside world correctly. Perhaps realities had been replaced by a wishful image of a weak, divided, and paralysed international community. Sadly enough, one cannot avoid a feeling of déjà vu, as the lessons of European history more than eight decades ago seemed to be by and large forgotten or ignored by today's planners of the economic consequences of war.

Right now, the biggest question for the Russian authorities would be how to get out of an impasse that hurts all people in the world, in Ukraine, Russia, and other countries alike. It would require extreme courage to apply the right solution, namely the implementation of the United Nations Resolution on the immediate cessation of hostilities and the unconditional withdrawal of troops from Ukraine.

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