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Why Foreign Investment in Russia's Regions is Falling

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A view of Kazan, Tatarstan.

Ninety-five percent of Russian regions are unattractive to foreign investors, a study released last week in Moscow found, in a sign that investment is likely to remain sluggish after Russia emerges from a deep recession.

Only a few regions are managing to create favorable investment conditions for foreigners, according to an investment attractiveness index presented by Russian ratings agency Expert RA last week.

The key reason for the poor investment climate was a lack of support from local authorities, the agency said.

"Investment has already fallen in 70 percent of regions," Dmitry Kabalinsky, head of the corporate ratings department at Expert RA, said at the "Regions of Russia: perspectives

of development and new opportunities" conference, where the index was revealed.

According to state statistics agency Rosstat, investment fell 6.3 percent in the first three months of 2015.

The weak figures come as Russia's economy is expected to shrink by up to 5 percent this year. The price of oil — the mainstay of Russia's government finances — has fallen by over 40 percent since a peak last summer, while sanctions imposed by the United States and European Union last year over Moscow's actions in Ukraine have curbed the flow of Western cash to Russia.

Cash transfers from Moscow to the regions — a key source of local income — have fallen over the past five years by 25 percent, said Kabalinsky.

The World Bank warned earlier this month that Russia faces an "era of small potential growth" due in part to weak investment.

But the crisis also has its advantages for foreign investors, according to Kabalinsky. Before last year, production costs in Russia were higher than in the United States and Europe, but a sharp devaluation of the ruble has reversed this, swelling the buying power of foreign currency investors.

The ruble has fallen by 35 percent to the U.S. dollar since the start of 2014.

According to a regional investment climate rating conducted last year by the Agency for Strategic Initiatives, a government-sponsored organization meant to provide support for Russian and foreign investors, the most successful regions at luring investors and implementing investment projects over the past five years are the Kaluga and Lipetsk regions in central Russia, the republic of Tatarstan, the Sverdlovsk region in the Urals and the Kostroma region to the north of Moscow.

Of these regions, only Tatarstan has a well-developed oil industry.

"The regions that have showed great success in attracting investment do not have the resources that the oil regions do," Svetlana Chupsheva, the agency's corporate director, said at the conference.

The best-performing regions achieved their results through well-developed organizational and informational investor support mechanisms, development of transportation systems and efficient processing of documents, the Agency for Strategic Initiatives said.

Any region could implement these measures, but they don't, Chupsheva said.

Many regions still see the arrival of foreign companies as something dangerous.

"When we go to towns with populations under one million, we often still have to explain to the heads of the regions that we will not ruin local business, but will contribute to its development," said Galina Panina, communications manager at French construction goods retailer Leroy Merlin.

Regional administrations have only begun to understand that foreign investment can boost the local business in recent years, Panina said.

Expert RA surveyed investors in seven Russian regions and named the biggest challenges facing investors in Russia as inefficient support from the local administration, poor protection against corruption, difficulties in connecting to electricity and running water and obtaining licenses and permits.

National legislation provides equal regulations for working with entrepreneurs, but there is a dramatic gap between the regions at the top of the index and those at the bottom.

In Tatarstan, obtaining a construction permit requires 40 days, while the worst rate among the regions is 530 days, according to Chupsheva, who did not name the region in question.

Expert RA's index singled out the Tuva republic and the republic of Ingushetia as regions with extremely high investment risks and low potential.

The index put Moscow came first for investment potential, followed by the Moscow region, St. Petersburg and the Krasnodar region.

Yet, despite the constraints, some investors still see opportunities.

Thomas Kerhuel, commercial director at Franco-Russian Chamber of Commerce, said that "Russian regions have a huge potential due to the increasing purchasing power caused by the rising standard of living."

Household wealth in Russia raced upward in the 2000s, but began to fall last year as the economic crisis deepened.

The Kaluga region has been creative about luring foreigners, building 10 huge industrial parks and allowing investors direct contact with the governor, according to Alexei Laptev, the first deputy governor.

Laptev said that since 2006 the Kaluga region has attracted about 2.5 billion dollars of investment each year, or a total of more than 14 billion dollars, half of which is foreign direct investment.

Direct access to the governor has also been introduced by the governor of the Ulyanovsk region, and has gone down a treat with investors.

Development in the Russian regions always starts with meeting local authorities, because companies are dependent at every stage on regional governments, said Kryshtof Tkachik, director of regional expansion of Leroy Merlin Russia.

"It's much easy to go to a region where the authorities are open for a dialogue," said Leroy Merlin's Panina.

"If direct contact with every mayor or governor was possible, a lot more could be done to improve the investment climate in the regions," she said.

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