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76, av. Vernadsky, Moscow, Russia, 119454
School of International Business

OFFICIAL WEBSITE

ibj.mgimo.ru

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Dmitry V. Breytenbikher

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DEPUTY CHIEF EDITOR'S REMARKS

Artem I. Krivtsov

MGIMO University

Each year coming to an end leaves behind completed projects, new collaborations, and pleasant moments.

Everyone of us will remember this year for personal achievements and hopes that have come true. Everything that we have not achieved this year will contribute to our future achievements and victories. Therefore, the main thing is to stay in high spirits, keep faith in our own strengths and the desire to work and create. You can still say that this year has been far from easy, even challenging in some respects, but if everything in our life were simple, we would not make any progress and strive for better.

The guest author of this issue is Dmitry Breitenbicher, Senior Vice President, Head of Private Banking and Privilege of VTB, sharing several banking sector trends based on the current agenda. An analysis of the current world economic agenda is provided by professors N. Konina and A. Bakulina who focus in their research on the risk factors and key development trends for multinational companies in the context of global changes. We also asked our foreign colleagues to share their opinion on the transformation of the world economy.

For us, members of the editorial board of the International Business magazine, this year has been difficult, but very exciting in terms of information sharing, creative collaborations, new ideas and areas of focus, team building.

I can say with confidence that it is you, dear readers, who make up the large international team of the International Business magazine. Outstanding, creative, flamboyant. It is you who shape the development strategy of international business, adopt innovations, inconspicuously changing the world of the professional community.

On behalf of all the members of the editorial board, I wish you a Merry Christmas and a Happy New Year!

We wish you an abundance of happiness, joy, peace, kindness, health, success, and prosperity in the new year 2023!

Sincerely,
Deputy Chief Editor,
Artem Krivtsov

RISKS OF INVOLVEMENT OF THE ANNEXED TERRITORIES IN SCHEMES OF ECONOMIC OFFENSES AND WAYS TO MINIMIZE THEM

Anna A. Bakulina

MGIMO UNIVERSITY

Ilya A. Bakulin

The Southern Federal University (SFU)

Abstract

This article focuses on assessing the current economic status of the new regions annexed to the Russian Federation: the Luhansk People's Republic, the Donetsk People's Republic, as well as the Zaporozhye and Kherson regions. The annexed territories have an area of 108,844 km² and a total population of 6.2 million people. New regions offer extensive economic potential for Russia, and a correct choice of priority areas of development is one of the most important tasks of the state. However, the special military operation has seriously destabilized the economy of most of the regions and undermined the small and medium-sized business sector. In the long term, this situation may lead to an increase in various economic crimes. The article deals with such economic crimes as money laundering and premeditated bankruptcy.

Keywords

Economic crimes, economic state of business, methodology of expertise, assessment of financial and economic state.

THE CURRENT SOCIAL AND ECONOMIC SITUATION OF THE NEW REGIONS

At the ceremony of signing treaties on accession of the new territories to Russia on September 30, 2022, Vladimir Putin stated that «the accession of the new territories to Russia is economically justified and will not have a negative impact on the Russian budget».

At the moment, experts are trying to calculate the expenditure of the Russian budget required for the reconstruction of cities and return to peaceful life in the new territories. Some experts and media, in turn, conduct a research to determine the economic potential of the DPR and LPR, as well as that of the Kherson and Zaporozhye regions. Thus, The Washington Post estimated the value of mineral resources in the new regions at around 12.4 trillion dollars [2]. According to an analysis by the Vedomosti newspaper, the economic potential of the DPR, LPR, the Zaporozhye and Kherson regions will amount to around \$130 billion as at 2021, which is equivalent to 20% of the Ukrainian economy, adding 2.9% to the Russian economy.

In fact, Russia will receive more than 5 thousand industrial, agricultural, processing, energy, and other enterprises. It is safe to say that all of them have extensive economic potential and their restoration is a rational investment in the future of the Russian economy.

The total area of the four territories is 109 thousand km². 4.1 million people live in the Donetsk region alone. Until 2014, it was the most advanced industrial region of Ukraine accounting for 20% of the country's industrial output (coal, non-ferrous metals, by-product coke industry). It is also worth noting that the Donetsk coal basin is the largest coalfield in Europe. The area of deposits is about 617.8 thousand hectares. At the moment, the following thermal power plants are in normal operation:

- Vuhlehirska TPP
- Starobeshevskaya TPP
- Sloviansk TPP
- Kurakhivska TPP
- Zuivska TPP

The population of the LPR is 1.4 million people. The region has several high-output metallurgical industry enterprises, a chemical and pharmaceutical plant, and a number of important traffic arteries.

Companies based in the Zaporozhye region include the following.

- The Zaporizhstal integrated iron and steel works
- The Dneprospetsstal steelworks
- The Ukrainsky Grafit graphite electrode plant
- The Zaporozhye alumina and aluminum plant (ZALK)
- The Zaporozhye Titanium and Magnesium Plant (ZTMC)
- The Motor Sich aircraft engine plant

- The Zaporozhye Automobile Building Plant (ZAZ)

The Dnieper hydroelectric power plant, the Zaporizhzhia Nuclear Power Plant, which is the largest nuclear power plant in Europe, the Zaporizhzhia thermal power plant, as well as the Berdiansk seaport on the northern coast of the Sea of Azov are also located in the Zaporozhye region, thus emphasizing the economic potential of this region.

The Kherson region has a population of more than 1 million people and about 200 enterprises in the following industries:

- engineering
- food and beverage
- processing industry
- chemical industry
- pulp and paper industry
- light industry
- electric power industry

Shipbuilding is traditionally considered a priority in this region. Industries related to mineral resources and agricultural land are key to stimulating the economy in the coming years. The region has the potential to produce at least 2 million tons of food grains annually, which is an extremely important indicator at present.

Let's take a look at the opportunities the Sea of Azov can provide, which, with the accession of the four new territories, has become an inland sea for Russia: additional seaports, agriculture, tourism, foreign trade, logistics in the south of the country, health resorts and recreation centers.

MAIN RISKS OF INVOLVEMENT OF THE ANNEXED TERRITORIES IN ECONOMIC CRIME SCHEMES

Today, integration into the Russian economy and its legal framework is an especially relevant issue for the new territories.

Despite the immense potential of the annexed regions and a large number of major industrial facilities, it is worth noting that Russia received these territories in an unstable economic state in the long term. This is due to the fact that for many years Kyiv failed to provide such enterprises with sufficient investments.

The special military operation has seriously affected the majority of small and medium-sized businesses. The period of hostilities is also characterized by a large outflow of the population.

There is a trend suggesting that the worse the economic situation in a region, the greater the risk of various economic crimes. In this case, this issue is especially relevant as Russia has not yet managed to fully integrate its system of control and suppression of economic crimes.

Economic crime endangers basic interpersonal relationships, economic development and in some cases the political stability of the

state.

Due to the lack of proper economic supervision in the annexed regions, the risks associated with money laundering are increasing. If the trend of the lack of financial and economic control continues, the DNR, LNR, as well as the Zaporozhye and Kherson regions, in theory, could become a haven for money laundering, which, according to FATF estimates, will negatively affect Russia's reputation after the end of the special military operation.

The risks of money laundering in the annexed territories are also increasing due to the start of reconstruction of the infrastructure destroyed during the special military operation. It's well known that civilian engineering accounts for a large share of money laundering cases. Since there are a number of contractors in this industry, criminals can engage in money laundering schemes involving concealed works which cannot be audited after the fact. Materials hard to account for and illegal workers paid under-the-table also make the construction industry attractive for both money laundering and tax evasion.

Therefore, the Federal Service for Financial Monitoring (Rosfinmonitoring) should keep a close eye on the DPR, LPR, Zaporozhye and Kherson regions. Integrating various Russian financial intelligence agencies into the new territories should be a priority task for the state for stabilizing the social and economic situation to prevent the new territories from becoming a center of economic crime in Russia in the aftermath of the special military operation.

It is also worth noting that the current economic situation in the new regions (a crisis of the regional economy, curfews, small and medium-sized businesses operating at a loss) leads to an increase in business costs and, as a result, to higher indebtedness. At present, Russian banks are still not operating in full in the annexed territories. According to the State Duma of the Russian Federation, the leading Russian banks will be integrated into the new regions as late as next year [4]. The first stage of integration is opening offices of banks that have successfully adapted their operations in the territory of Crimea. Thus, PJSC Promsvyazbank opened new branches in the DPR and LPR, however, at present these are insufficient to financially support the local population and businesses. In the meantime, the lack of proper funding leads to a deterioration in the economic standing of business. Under these circumstances, there is a higher risk of premeditated bankruptcy.

According to Article 196 of the Criminal Code of the Russian Federation, deliberate bankruptcy is the commission by an entrepreneur of actions aimed at worsening their financial situation, as a result of which the organization becomes insolvent. Thus, companies that have debt and are in an unstable financial situation can initiate bankruptcy proceedings in order to relieve themselves of the liabilities to creditors. These circumstances may adversely affect the operations of Russian

banks.

MINIMIZATION OF IDENTIFIED RISKS

A rational way to mitigate the risks described above can be the creation of state-owned think tanks for financial and economic audit of enterprises.

The creation of such think tanks can also help small and medium-sized businesses in assessing their financial situation and credit risks, as well as developing a business strategy.

Financial and economic audit relies on source accounting documents and financial statements of a company, while research methods are based on the existing theory of financial analysis. The information reflected in corporate financial statements is a comprehensive set of various indicators characterizing the financial and property status of a company.

The primary task of financial and economic audit is the study of financial statements through vertical and horizontal analysis. This study provides insights into the trends of a company's performance indicators, its structure, and the definition of the so-called red flags, i.e. items in accounting statements that have a noticeable spike.

At the next stage of the methodology an expert examines source accounting documents to determine the causes of structural changes. At this stage, it is possible to determine the main counterparties of the company, as well as to assess whether its current activities are real by matching source accounting documents with bank statements for the periods examined.

The final stage is to check the company's counterparties. This study is aimed at identifying signs of shell companies in their operations, i.e. inconsistencies between registered address and business address, mass character, lack of utility bills, inconsistencies in the number of personnel and scope of activities, etc. The transactions with such companies may be indicative of wash transactions and, consequently, falsification of financial statements in order to overestimate the company's debts.

Such an analysis will help to identify enterprises that are most susceptible to involvement in economic crime schemes or already involved in them, as well as to determine areas of development of the new regions and the most vulnerable industries that require enhanced control and additional financial support.

CONCLUSION

Russia annexed territories with extensive agricultural and industrial potential, but with severely degraded infrastructure due to underinvestment from Kyiv over the past 30 years. The main task of

the government is to integrate these territories and provide support by bridging the gap in economic development, eliminating the consequences of destruction caused and reducing the risks of involvement of the new territories in economic crime schemes. At the initial stage, Moscow will finance the budgets of the four regions. In the future, as the integration continues and the economy restarts, the amount of transfers from the federal budget will decrease. The activity of state-owned think tanks relying on methods of financial and economic audit in their research contributes to defining the main areas of government support for small and medium-sized businesses, as well as the territories as a whole.

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About the authors:

Anna A. Bakulina - PhD in Economics, Associate Professor, Department of Public Governance, MGIMO University. 76, av. Vernadsky, Moscow, Russia, 119454.

ORCID ID: 0000-0003-2110-4194

Scopus Author ID: 57203781801

Ilya A. Bakulin – Master's Degree Student, Southern Federal University (SFU). 105/4,2 B. Sadovaya str., Rostov-on-Don, Russia, 344006.

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MAIN TRENDS OF DEVELOPMENT OF INTERNATIONAL COMPANIES IN THE CONTEXT OF GLOBAL CHANGES

Natalia Y. Konina

MGIMO UNIVERSITY

Annotation

The article deals with the nature of changes in the external environment of modern international business. It is observed that the external environment is becoming increasingly volatile, uncertain, complex and ambiguous. As shown, one of the ways of optimizing the operations of international companies is fragmentation of business operations, outsourcing and offshoring of various activities, transition to a geographically distributed network model of value chains known as global value chains, GVCs. The article provides insights into modern methods of GVC management, highlighting the importance of intangible assets of MNCs.

Keywords

International companies, globalization, multinational corporations, MNCs, global value chains, GVCs, intangible assets.

INTRODUCTION

The global economy has undergone dramatic changes over the past few decades, resulting in a rapid, constant, and unpredictable transformation of the external business environment. The development of the world economy is currently affected by a number of significant problems, including inflation and volatility in financial markets, growth of global debt, depreciation of currencies and goods, restructuring of global supply chains, decline in the tourism industry and international remittances, lower credit ratings, lack of food and potable water in poor countries, the emergence of structural unemployment, climate change, etc.

International companies determine the interconnectedness of different economies through their business operations. This is due to their capacity to shape and use complex network models and value chains on a global scale. Changes in technology, as well as the liberalization of world trade and the economic policies implemented, along with the active role of a large number of market players, have led to an even greater openness of the global market, increased competition and dynamic development of the entire world economy over the past 20 years. Multinational corporations (MNCs) are the main players and beneficiaries of the economic globalization process, they actively operate in various promising markets, which is confirmed by the volume of investments, cross-border mergers, and acquisitions, as well as strategic alliances. The largest corporations experience both positive and negative effects of globalization, mainly determined by differences in the nature of business operations, the characteristics of country-specific and industry-specific markets.

Thanks to rapid scientific and technological progress, a new business environment has been established in which, on the one hand, digital technologies determine the main vector for the development of economic sectors and all aspects of public life, and, on the other hand, such global events as the 2008 financial crisis, the COVID pandemic, and geoeconomic conflicts increase the sense of danger and unpredictability of all global processes.

A state of greater turbulence has replaced the sense of stability and predictability so important to international business. The external environment of international companies is becoming increasingly complex and ambiguous, characterized by constant, uncertain changes that are the norm in most industries and management and leadership that emerged in the pre-digital era. New, more flexible and pragmatic approaches to modern management technologies are based on advanced digital technologies and assume that the top management of companies in its practical decisions relies on a clear vision, foresight, flexibility and a

good understanding of the company's development strategy.

Globalization, having a huge impact on the development trends of the world economy over the past 20-25 years, has led to significant changes in global markets. New environmental conditions associated with technological, demographic, social and economic changes have led to significant shifts in the production and economic activities of international companies, MNCs.

RESEARCH RESULTS

MNCs account for a significant share of the world industrial output and trade in most sectors of the economy. According to the AMNE database of the Organization for Economic Co-operation and Development (OECD), in 2016 the share of multinational corporations and their subsidiaries accounted for 36% of the global industrial output, which is about 2/3 of world exports and more than 1/2 of imports. This share is especially noticeable in the sector of knowledge-intensive goods and services, where MNCs generate up to 90% of exports. Digital transformation and globalization have allowed most MNCs to optimize production and marketing.

Over the past decades, global economy can be characterized by two new phenomena:

1. Emergence of a large group of high-tech companies.
2. Almost all MNCs have made a transition to a geographically distributed model of international production and management based on global value chains, GVCs.

Significant reduction in transport and communication costs, accelerated technological progress, and the removal of political and economic barriers to trade have increased the potential for international production fragmentation. Due to the growth of specialization and fragmentation of business, MNCs structure their global operations through outsourcing and offshore activities.

Many of them have become «network constellations», huge global value chains with blurred boundaries. For example, Microsoft's GVCs include more than 300,000 partners around the world. General Electric is introducing new ways to manage its massive supply chain of about 0.5 million suppliers in more than 100 countries with 14 languages spoken. GE's annual procurement spending with this global network is around 55 billion dollars.

Value chains include various activities: research and development, design, marketing, production, transportation and distribution, as well as customer support for the end consumer. If a value chain crosses national borders, i.e. value is added to a product in more than one country, it is referred to as a global value chain. At the same time, participants in

GVCs are not only subsidiaries, but also a large number of independent companies. If they follow the vertical integration model when creating foreign subsidiaries of MNCs, then different stages of the value chain are covered within the same company. For example, the share of intra-firm trade in the total exports of foreign subsidiaries of American MNCs in 2012 was about 50%; Swedish, more than 70%; German, about 50%; Japanese, more than 20%. Such integration is achieved through mergers and acquisitions (M&A) or investments in new projects. All this allows MNCs to gain control over most of respective GVCs.

Production decisions of MNCs are dominated by three main motives: reducing production costs, mitigating risks and increasing market power. The business strategies that MNCs use to achieve each of their goals are intertwined with the structural characteristics of the specific GVCs within which they operate. MNCs organize their production networks using three main methods: foreign direct investment (FDI), non-equity methods and market trade.

Research and development, product design and branding, marketing, and retail are key elements in global value chains for MNCs, as completing these tasks adds more value to products manufactured and marketed along the value chain. The strategy of MNCs in managing global value chains is to maintain control over the top level of value chains: final assembly, distribution and marketing of finished products, which, as a rule, are highly profitable. Proving this strategy to be effective is the largest American MNC, Apple Inc., which has established and manages the iPhone value chain, enabling Apple to receive the largest share of the iPhone's added value of 59%.

Global value chains serve as an important tool for exports of services associated with intangible assets of MNCs, an effective way to use their trademarks, patents and other intellectual property. The use of intellectual property in GVCs is a key element of their architecture, which greatly increases the incentives for MNCs to conduct R&D and introduce innovations in brands, unique designs, patented technologies, and supply chain management know-how. 90% of the value of the largest US MNCs in the S&P 500 international rating is intellectual property, which contributes twice as much to the volume of trade as tangible assets.

Most often, GVCs are found in industries where it is easier to distinguish between the stages of value creation, for example, in the electronics, automotive, or clothing industries. However, GVCs also exist in other sectors of the economy, including the service sector. GVCs cover many relationships between companies through investment, trade, people, technology, and information flows.

All this has a significant impact on world trade. Today, GVCs cover about 60% of world trade in intermediate goods or services, in particular more than one half of the goods imported by OECD countries and almost three quarters of the imports of large developing countries such as China

and Brazil. 30% to 60% of G20 exports are intermediate goods traded under GVCs. GVCs coordinated by MNCs account for approximately 80% of world trade. From the point of view of the countries involved, trade between developing and industrialized countries primarily means an exchange of production services for services provided with intangible assets.

It should be noted that GVCs are usually considered as part of exports. Domestic sales of multinational corporations through their local subsidiaries and affiliates are defined as non-GVC activities, with sales of MNC subsidiaries and affiliates exceeding 32.9 trillion dollars per year in 2019.

At the same time, it is worth noting that local companies have an indispensable role in international production networks.

For example, in the United States of America, a typical MNC purchases 25% of its resources from more than 6,000 small and medium-sized enterprises (SMEs). Similarly, Japanese MNCs based in Southeast Asia get more than half of their resources from local companies. Local national companies participate in GVCs in four main areas: relations with suppliers in the GVC network, strategic alliances with MNCs, direct exports and outward FDI. These paths are not mutually exclusive and may build on each other. Local national companies can be more integrated into GVCs by expanding their interaction with MNCs and continuing to learn from them. Therefore, national domestic companies can obtain the necessary production capacities and knowledge of international markets in order to compete directly in them.

RCEP in the Asia-Pacific region. Since GVCs are managed primarily on the basis of intellectual property, MNCs greatly value regional and meta-regional complex, integrated trade agreements, which, along with trade, regulate issues of investment, services, intellectual property, etc. A new fundamentally important aspect of strategies as they make a transition to sustainable development and the current activities of the leading MNCs was the change in their strategies as they make a transition to sustainable development and global warming issues.

CONCLUSION

Expanding interaction with multinational corporations increases the probability of companies to become exporters. This process also strengthens the capacity of companies to produce better or more complex products and improve the company's overall performance. There are many examples of this.

According to a study of MNC suppliers in Costa Rica, four years after they had become MNC suppliers, local companies showed a 20% increase in sales, a 26% increase in staff count and a 9% increase in productivity. A study in India showed that local companies that are part of joint ventures with MNCs are 30% more likely to export directly than local companies

that do not interact with each other.

The Russian company Askona, as part of cooperation with the Swedish MNC IKEA, started exporting its products in 2010 reaching more than 1 million mattresses exported in 2021. Global value chains have stimulated productivity growth and structural transformation in many developing countries, allowing them to specialize in certain activities and stages of production rather than waiting for entire industries to develop.

In order to succeed in their activities, MNCs largely rely on the established international division of labor and the specifics of modern international trade and other forms of international economic relations. Against the backdrop of the stalled multilateral negotiations within the WTO, MNCs are lobbying in every way for a revision of existing regional agreements, for example, USCMA in North America, as well as for the creation of meta-regional trade and economic groups, for example, RCEP in the Asia-Pacific region. Since GVCs are managed primarily on the basis of intellectual property, MNCs greatly value regional and meta-regional complex, integrated trade agreements, in which, along with trade, issues of investment, services, intellectual property, etc. are regulated.

MNCs are becoming less unwieldy, more flexible and maneuverable. The spread of globalization has ensured that the activities of the largest industrial MNCs are associated with the successful application of the distributed production model through the creation and skillful management of global value chains, as well as the formation of a positive image based on close interaction with global consumers.

The success of MNCs in the modern economy is increasingly dependent on accumulated intellectual capital, intangible assets, digital platforms and intellectual property, so MNCs are concentrating the activities of their divisions on R&D, technology, business analytics and investment decision making.

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About the author:

Natalia Y. Konina - PhD in Economics, Professor, Head of the Department of Management, Marketing and Foreign Economic Activity named after I. Gerchikova, MGIMO University. 76, av. Vernadsky, Moscow, Russia, 119454.

RSCI Author ID: 349514

ORCID ID: 0000-0002-1186-7596

Scopus Author ID: 57202468228

Researcher ID (WoS): AAN-9588-2020

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ENSURING TECHNOLOGICAL SOVEREIGNTY AND INDEPENDENCE OF THE FINANCIAL INFRASTRUCTURE, THE CASE OF CHINA

Vladimir V. Shapovalov

MGIMO UNIVERSITY

Abstract

For many years, the dollar has been considered the major currency for international settlements. However, nowadays, we observe the opposite trend of a gradual de-dollarization virtually all over the world. As the share of China's economy in world GDP grows and its national currency becomes more significant in world trade, the need to adapt the world monetary system to new realities has become especially relevant. Transactions in national currencies in foreign trade reduce the dependence of countries on the situation on international monetary and financial markets, especially in a tense geopolitical environment. For Russia, it is fundamentally important to ensure the development of its own financial infrastructure and its technological sovereignty. The article provides a fundamental analysis of the current state of Russia's scientific and technological potential, outlines the prospects for increasing the share of foreign trade settlements in rubles and achieving national technological sovereignty, and also presents the experience of promoting the RMB on international financial markets.

Keywords

Foreign companies, technological sovereignty, internationalization of the RMB, financial infrastructure, world monetary system, the People's Bank of China, settlement and clearing centers, de-dollarization.

According to the Skolkovo Foundation and Skoltech, from the spring of 2022 on they started losing foreign clients. Skoltech lost a dozen commercial contracts with Philips, Bosch and other American and European companies for which the university developed various technologies and products. The loss of cross-border contracts will have an impact on both the university's revenue and its ability to build competencies. According to Skoltech management, in medicine the United States and Europe are on a completely different level compared to Eastern or Russian companies. Apart from that, several members of academic and professor staff quit their jobs at the university, in particular due to the fact that the professional community of the Massachusetts Institute of Technology received a circular prohibiting any cooperation with Russian researchers.

In March some of the foreign industrial partners refused to work with the Skolkovo Foundation. The status of foreign industrial partners implies financing of research activities at Skolkovo, the use of technologies, start-ups, etc.

At the same time, in the second quarter of 2022 the number of applicants for the resident status at Skolkovo turned out to be close to record-breaking. The total revenue of resident companies, along with the volume of investment, grew by about 15% in the first half of the year. 80% of Skolkovo residents operate only on the Russian market; the others, on the markets of friendly countries, which is connected, among other things, with Russia's goal to gain technological sovereignty, develop 5G and 6G mobile telecommunications equipment.

To support technological sovereignty, it is also important to ensure the independence of the financial infrastructure so that foreign investment can freely flow into the innovation sphere.

From this perspective, China's experience in promoting the RMB for international settlements and investments presents some interest.

Today, China is the world's leading economic power. According to IMF data, China accounts for 15% of world GDP. Over the past decade, China has made notable progress in internationalization of the RMB. Today, the RMB is among the reserve currencies of the IMF.

China is the world's largest manufacturer and exporter of goods and services with impressive results in technology.

Few countries have managed to achieve a full-fledged international status for their currencies. The degree of currency internationalization is determined by the size of the economy, the degree of confidence of international counterparties and the maturity of the financial market. Today, the only alternative to the US dollar as an international currency is the euro, which has taken some of the dollar's share in international settlements, central bank reserves and international borrowings.

The process of strengthening China's economic position is accompanied by calls for the need of reforming the existing world

monetary system (WMS). The global financial crisis of 2007–2008 highlighted the shortcomings of the modern WMS and revealed the need for its adaptation to the new aspects of the world economy, taking into account the balance of power between leading economies.

China's best practices may be of interest in terms of ensuring the independence of Russian players in the international high-tech market from the financial infrastructure and currencies of third countries. By the way, the share of settlements in national currencies (RUB- and RMB-denominated) between Russia and China for goods and services is steadily growing.

The process of internationalization of the RMB required a number of administrative and regulatory reforms to be implemented. They were expected to bring political and economic benefits to China, as well as to its foreign counterparts.

The use of the national currency in the innovation sphere and foreign investments raises the status and strengthens the country's role on the world stage. The use of the national currency facilitates the international economic expansion of MNCs. A state that supports innovative projects and provides financing in the national currency is now able to influence trade partners and borrowers.

With transactions available in the local currency, foreign innovative companies get easier access to the market. At the same time, the interest of international innovative investors in the domestic market is growing. Under the dominance of the US dollar, international innovation activities and related investments are directly dependent on companies' access to dollar liquidity and the international financial infrastructure. National currencies provide innovative companies with alternative methods of payment, reducing their dependence on third countries.

The United States has repeatedly used the international financial infrastructure for political purposes, imposing restrictions on China, Russia and other countries.

The use of the national currency eliminates foreign exchange exposure associated with exchange rate fluctuations. With no need to hedge foreign exchange risks, investors incur lower costs.

China started taking the first steps to expand the circulation of the RMB in international payments more than 15 years ago.

Under a program launched in 2002, qualified foreign institutional investors were admitted to the Chinese stock market. A year later, the People's Bank of China (PBC) assigned the first clearing bank for RMB settlements abroad. Hong Kong then allowed RMB deposits, foreign exchange transactions, RMB debit and credit cards for individuals.

In 2005 the Chinese authorities adopted a managed floating exchange rate regime for the RMB, moving away from a fixed exchange rate against the US dollar. PBC started to determine the official exchange rate of the RMB against major currencies based on trading on the

inter bank market.

This was followed by the announcement of a quota program for qualified Chinese institutional investors, allowing investments in RMB-denominated bonds and money market instruments of foreign issuers.

2007 saw the first foreign issue of RMB-denominated bonds. The People's Bank of China then entered into a currency swap agreement with the Republic of Korea.

In 2009 a pilot project was launched to use the RMB for cross-border settlements in Shanghai, a number of regions, as well as in Hong Kong and Macau.

In 2010 under the Chiang Mai Initiative China entered into currency swap agreements with a number of Asian countries, including Japan, the Republic of Korea and 10 ASEAN countries.

In the same year, the Moscow Exchange and the China Foreign Exchange Trade System (CFETS) began trading the RMB-RUB currency pair. A year later, the People's Bank of China allowed Chinese companies to engage in foreign direct investment in RMB.

In 2012 the RMB exchange rate fluctuation limits were expanded and the total volume of currency swap agreements doubled. Trading started in the RMB/JPY and RMB/AUD currency pairs.

In 2014 Shanghai Free-Trade Zone was launched and the RMB exchange rate fluctuation limits were expanded. Trading started in the RMB/GBP and RMB/EUR currency pairs.

The following year, foreign central banks, sovereign wealth funds and international financial institutions were admitted to China's domestic bond and currency markets. The first stage of the Cross-Border Interbank Payment System (CIPS) was implemented in Shanghai.

London began to develop as an overseas RMB clearing house along with Hong Kong. England issued the first RMB-denominated bonds.

In 2016 China expanded the access to its bond market for investors. In October 2016 the RMB entered the IMF Special Drawing Rights basket (IMF SDR).

In 2017 a settlement and clearing bank for RMB-denominated transactions was opened in Moscow and New York. The People's Bank of China unfroze the quota program for Chinese institutional qualified investors to invest in RMB-denominated securities of foreign issuers.

In the process of internationalization of the RMB China started creating so-called settlement and clearing centers. The first of these were opened in Hong Kong and Macau, followed by more than 20 similar centers.

Settlement and clearing centers provide market players with RMB liquidity. Hong Kong maintains its position as the main overseas RMB settlement center with a share of about 70%.

Since 2008 the People's Bank of China has entered into currency swap agreements with financial regulators in a number of countries.

Agreements were concluded with the European Central Bank, Great Britain, Australia, Canada, Brazil, Switzerland, Russia, Thailand, Mongolia, Pakistan, Sri Lanka, Ukraine, Kazakhstan, Tajikistan, Uzbekistan, Qatar, UAE, South Africa, New Zealand, Turkey, Chile, Hungary and other countries.

For a currency to be considered international, certain criteria must be met. SWIFT distinguishes the following phases of currency internationalization: its use in trade financing, in foreign investments and as a reserve currency.

The IMF characterizes a freely usable currency as follows: it is widely used to make payments for international transactions and widely traded on the principal exchange markets.

Today, the RMB meets all of the above criteria: it is used in trade financing, foreign direct and portfolio investment and also as a reserve currency.

In 2013 the RMB became the world's 8th most used currency.

In 2018 the share of the RMB in the total settlements of Chinese counterparties with foreign countries increased to 16.8%, reaching 5.11 trillion RMB (761 billion dollars).

According to the IMF, the central banks of 60 countries have included the RMB in their foreign reserves.

The euro currently accounts for about 21% of central banks' foreign reserves. In 2018 its share in the foreign reserves of central banks of other countries grew due to a decrease in the share of the US dollar down to 61.7%. In particular, in 2018 the Bank of Russia sold assets worth of more than 100 billion dollars. In the same year, the People's Bank of China reduced dollar investment by 60 billion dollars.

At the same time, the RMB is not actively traded on the main foreign exchange markets, significantly lagging behind the dollar and euro by transaction turnover.

There's hardly any widespread use of the RMB for international transactions. In April 2020 its share in international settlements was only 1.66%. At the same time, about 36% of international contracts were EUR-denominated.

In order for a national currency to be widely used by external counterparties, it is necessary to have a large domestic market and manufacturing capabilities, a developed financial market, the country must secure a significant share in global trade and there must be no restrictions on the movement of capital and currency exchange. The national currency exchange rate should be stable and inflation should remain at a low level.

China does not fully meet the conditions listed above. China is the leader in world trade, has strong manufacturing capabilities and a large domestic market. Despite its size, access for international investors to China's financial market is restricted.

The Chinese stock market is huge and continues to grow. It has a

number of high-tech companies. At the same time, the share of foreign investors in this market is only a couple percent.

Building relations with states that are interested in reducing the dependence on third-country currencies can provide a stronger position, in particular, in terms of ensuring technological sovereignty.

The development of fintech, digital banking, digital platforms, and ecosystems (in the case of China, based on Alipay and WeChat Pay) will also contribute to the implementation of the above task.

According to a 2018 survey by the Asian Banker, most of the respondents, banks and companies, increased the share of RMB settlements and planned to continue doing so in the future. The main driver in this process was the reduction of transaction costs, as well as a possibility to negotiate more favorable conditions with counterparties.

At the same time, there was an increase in the volume of RMB-denominated foreign financing, in particular, by issuing bonds, as well as some growth in the volume of RMB deposits opened outside of China. The inclusion in the SDR basket has given new impetus to the use of the RMB. Increasing the openness of financial markets through the use of quotas for foreign investors has also had a positive impact. According to the survey, more than one half of foreign and about a third of Chinese companies plan to increase the amount of RMB-denominated foreign assets in the future. More than a third of Chinese companies have plans to issue RMB-denominated bonds in foreign markets.

An increased share of the national currency in international transactions also has a number of negative consequences, in particular, lower competitiveness of domestic producers, higher volatility in the foreign exchange and financial markets and changing conditions for financing.

A higher demand for the national currency from international investors may put pressure on its exchange rate, making domestic products less competitive on the global market. As a result, production facilities may be transferred to other countries, increasing the unemployment rate. The influx of foreign capital from outside and its outflow when the economic situation changes increase volatility on the domestic stock and currency markets, which poses a threat to the financial stability of the country's economy.

Raising funds in traditional currencies can take place on more competitive market conditions, both in terms of cost and maturity dates of borrowings, however, in some areas that enjoy state support and special economic privileges, the opposite effect is also possible.

The internationalization of the national currency requires the authorities to liberalize the national economy, remove trade and foreign exchange restrictions.

An increased use of the national currency in international investment in innovation not only leads to technological sovereignty, but also enhances

the country's international prestige among investment partners, reducing the vulnerability to countries that use their financial infrastructure for political purposes.

In August 2022 Russia became the third most active country by RMB use in international payments. Given the increased risks associated with transactions in USD and EUR, the importance of the RMB in Russian financial transactions and investments will grow.

The Russian financial authorities struggled with the dollarization of the national economy for many years. Various measures were introduced to reduce the share of foreign currency on the balance sheets of credit institutions and companies.

Today, additional incentives are not required. Russian importers and exporters, financial organizations and investors are independently moving away from using currencies of unfriendly countries. Keeping account balances in such currencies has become too risky. At the moment, the only serious alternative to RUB-denominated investments is the RMB.

On the Russian exchange market of «soft» currencies of friendly countries the RMB is the undisputed leader. The RMB liquidity is at an acceptable level. According to the Central Bank, in recent months RMB trading accounts for up to 26% of foreign exchange transactions. The RMB/RUB currency pair at the Moscow Exchange has more than once exceeded the dollar and the euro by daily turnover.

Additionally, there are financial instruments for local investments in RMB. Companies such as Polyus, Metalloinvest, and Rosneft have already issued RMB-denominated bonds. The Russian Ministry of Finance has repeatedly announced plans to place RMB-denominated OFZ government bonds on the Moscow Exchange.

According to SWIFT, in August 2022 Russia accounted for 4.27% of foreign RMB transactions. For comparison, the UK for 5.75%. Hong Kong is traditionally the undisputed leader (with a share of more than 70%). This means that Russia has become an important offshore RMB hub. It is worth reminding that since 2003 China has opened more than 20 such centers. Moscow became a RMB center only in 2017.

For many years China has been promoting international payments in its national currency and has achieved notable success in this area. However, the RMB's share in the world is relatively small and does not correspond to the country's place in the world economy. It accounts for only 2.31% of world settlements. For comparison: the US dollar accounts for 43%; the euro for 35.5%.

For Russian importers and exporters and the high-tech goods market, RMB settlements are expensive, inconvenient and unusual. China has a multi-level currency control system. The RMB is present on two markets: the onshore CNY, circulated in China, and the offshore CNH, used in international transactions. The onshore RMB can be converted into foreign currencies only under export-import contracts. Russian

companies can receive CNY from their Chinese counterparties in payment for goods and services or make settlements in CNH through offshore centers. Today, China is calling upon its major trading partners to create a RMB cross-border settlement area as an alternative to the international monetary system based on the US dollar.

Using the RMB is certainly a more acceptable option compared to the risk of transfers block or suspension by banks of unfriendly countries. Despite Russia's significant place in the use of the offshore RMB in the world, the «yuanization» of foreign trade and financial relations is not that significant and does not have major consequences. At the same time, faced with the risks associated with foreign financial infrastructure, the priority task for Russian importers and exporters is to undertake continuous efforts to persuade foreign counterparties to switch to direct settlements and investments in RUB. This is the way China uses the RMB.

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About the author:

Vladimir V. Shapovalov - PhD in Economics, Associate Professor, Department of Applied International Analysis, Dean, School of International Business, MGIMO University. 76, av. Vernadsky, Moscow, Russia, 119454.

RSCI Author ID: 835711

ORCID ID: 0000-0001-5776-2274

Scopus Author ID: 57223027459

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POSITION OF RUSSIA IN THE CONTEXT OF ECONOMIC SANCTIONS

Bendreff Desilus Augustin

UNIVERSIDAD TECNOLÓGICA DE MÉXICO

Abstract

The article provides an analysis of the global consequences that followed after the introduction of anti-Russian sanctions by a number of countries. It can be noted that over the past decades economic sanctions against other countries have not led to the desired results: countries faced with sanctions tend to reject the requirements of the state imposing these restrictions. This article is based on official macroeconomic data published by international organizations, which enabled collecting up-to-date information indispensable to fully comprehend current global situation. The purpose of this paper is to define whether economic sanctions retain their efficiency in putting pressure on a country in order to maintain the established world order.

Keywords

BRICS, economic costs, inflation, international community, energy.

INTRODUCTION

A few months after the onset of the Russian-Ukrainian conflict we can claim that the current performance of the world economy is not in line with the forecasts of experts. It is obvious that the major objective of economic sanctions is to achieve political goals at the international level, however, it turned out to be impossible to weaken the Russian economy: in 2022, the ruble appreciated by 16% which contributed to the shift to settlements for energy supplies in the corresponding currency.

POSITION OF RUSSIA IN THE CONTEXT OF ECONOMIC SANCTIONS

Today the energy sector plays an increasingly crucial role in the production of goods and services, so there is a strong correlation between economic growth of a country and its energy sector. Therefore, stable energy prices underly the growth and sustainable economic development of both heterodox (alternative) and orthodox (conventional) economies.

According to the World Bank report, energy prices in the post-pandemic world are still rising which increases global inflationary pressure and ensures accelerated economic growth of energy exporting countries at the expense of importing countries.

Russia is considered one of the world's leading oil producers and exporters, and a leader on the natural gas markets. Europe until recently remained the main market for Russian oil products. For instance, in 2021 Russia exported about 4.7 million barrels of crude oil a day with a significant amount exported to European buyers, 2.4 million barrels a day to be precise. Russian natural gas accounted for about 45% of all European imports (International Energy Agency, 2022).

Even with a fairly large number of suppliers on the energy market, Russia still plays a decisive role on the international natural gas market.

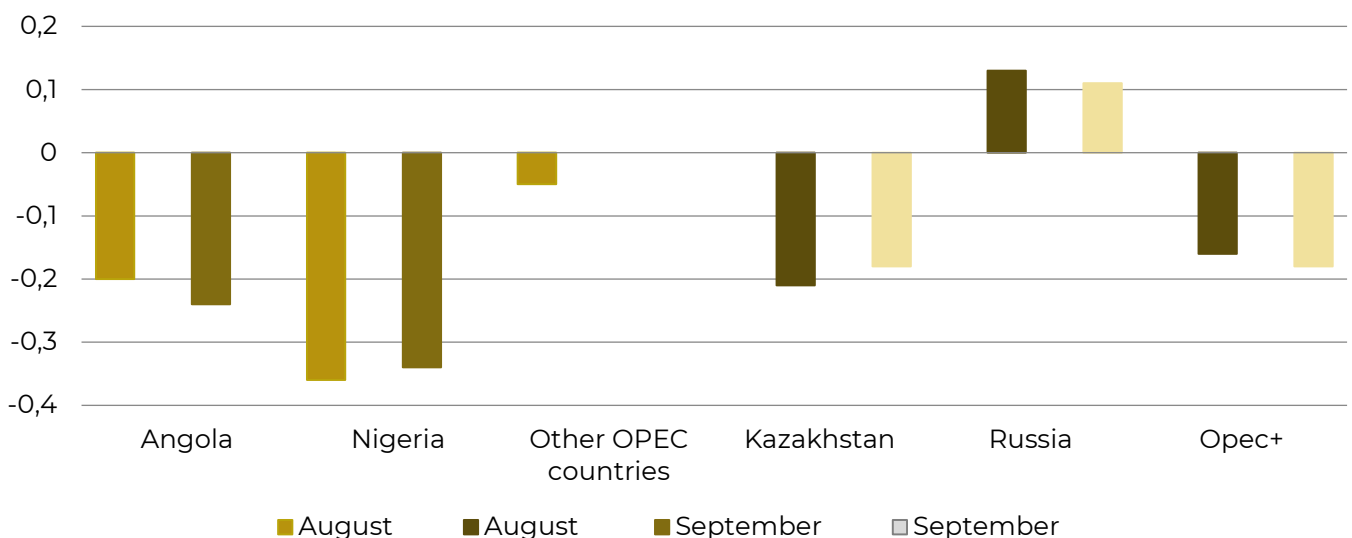


Figure 1. Oil production output in line with OPEC targets in August and

Russia continues to supply commodities to the EU countries. However, the cost of commodities for member states used to be 12 billion euros a month, but with the onset of the special military operation it has reached 22 billion euros. From January to April 2022, Russian oil exports to the EU and Turkey decreased by 30% whereas the prices rose by 33%. As for Russian gas, its exports decreased by 27% while prices rose by more than 80% respectively.

We should bear in mind that Russia is a member of the BRICS. The number of countries that make up this grouping plays a vital role in the world economy. Recently, they have been trying to unconditionally support Russia, strengthening its economic ties and thereby help expand the purchase of Russian oil. The accession to the economic union of such states as Iran and Argentina could even further strengthen the economic power of Russia since they possess the sufficient resources to this end.

It should be added that the current global economic and political environment has a very peculiar nature. Today countries are unprecedentedly interdependent which is reflected in various areas: economy, energy, climate agenda, technology, etc.

In the modern political and economic model, the concept of interdependence is a central element of the methodology for understanding multilateralism in the current environment. The new level of economic interdependence forces all states to reconsider the concept of economic sanctions as a tool of isolation in international relations. Reduced import or complete ban of Russian gas by European states has largely caused the depreciation of the euro and will certainly fuel the rise in prices for goods and services produced in Europe. Moreover, the gas exported, for instance, from the United States will cost Europe far more. The combination of these factors suggests that the economic downturn in Europe is almost inevitable.

The events related to anti-Russian sanctions have shown that their effectiveness is extremely limited. Hegemony and a high degree of countries' interdependence give reason to think about the appropriateness and effectiveness of sanctions in general. The assumption that sanctions will become more effective in the future is false: the imposed sanctions will not be able to suppress the country's will to achieve certain political goals, most states are resistant to external impact and are not ready to submit to the demands from the outside.

CONCLUSION

First, it is worth noting that economic sanctions affect not only the country under sanctions but third countries as well. Even with a sharp

decline in foreign direct investment in Russia, the economic situation was leveled off by rising energy prices and stronger ruble accordingly. Given 62% share of Russian commodities in the EU economy, the inflation in member states surged: its pace reached double digits.

Secondly, in view of Russian gas reduced supplies to the EU gas exports from the United States rose, however, at prices much higher than for Russian gas, which also affected the stability of European prices. According to the publications in *The Scientific American* and *Bloomberg*, in the first four months of 2022 the US supplied almost 3/4 of all LNG to Europe, compared to 1/3 last year. All this suggests that the United States particularly takes most benefits from the imposed sanctions and one of the losers is undoubtedly the EU.

Thirdly, the whole concept of the international community is being questioned, since a number of countries in both Latin America and Africa have opposed to anti-Russian sanctions. Moreover, they have expanded trade turnover and strengthened cooperation with Russia.

About the author:

Bendreff Desilus Augustin – Head of International Postgraduate Programs, Universidad tecnológica de México. 45, av. Benjamin Franklin, Mexico City, 06140.

ORCID ID: 0000-0002-2346-2983

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COMPARATIVE ANALYSIS OF THE INVESTMENT POLICY OF RUSSIA AND CHINA IN CENTRAL ASIA (2009-2020)

Olesya A. Maltseva

MGIMO University

Ninel Y. Senyuk

HSE University

Schreiber Niels Holger

HSE University

Hart Alice Catherine

HSE University

Abstract

This article explores the main drivers and determinants of Russian and Chinese foreign direct investment in Central Asia, aiming to explore potential areas for economic cooperation and possible causes of conflict between the two powers in the region.

Keywords

Foreign direct investment, OLI concept, Russia, China, developing countries.

INTRODUCTION

Further development of economic ties between China and Russia in Central Asia has been troubling experts and scholars in global economics and politics since the beginning of the 21st century. While one group of experts argued that the rise of China as a major economic player in Central Asia was likely to cause conflict with Russia in the region, other experts considered this idea exaggerated due to the complementary interests of both states in the economic development of Central Asia.

This article is aimed at studying the interaction of China and Russia with the states of Central Asia. It offers a comprehensive analysis of the main drivers and factors behind foreign direct investment (FDI) from both countries. In doing so, this article uses an analytical framework based on Dunning's FDI theory to explore the question of which driving forces and determinants explain Russian and Chinese FDI in Central Asia.

The study uses both quantitative data on FDI flows and accumulation from Russia and China and data on export to the five Central Asian republics between 2009 and 2020, as well as a qualitative analysis of the development trajectories of financial regulation, bilateral investment transactions, economic and political initiatives in the region. Thus, the article uses data from such databases as ITC Investment Map, WITS (World Bank) and DOTS (IMF), as well as data provided by regional organizations and national statistical agencies of Central Asian states.

This article consists of two parts, the first of which constitutes an analytical framework on the drivers and determinants of FDI in emerging economies based on the OLI model. The second part of the study is divided into three sub-sections: two of them are case studies providing comprehensive reports on the Russian and Chinese driving forces as well as the determinants of FDI in Central Asia. The third subsection compares Russian and Chinese FDI in the region.

THEORETICAL CONCEPT OF THE DRIVERS AND DETERMINANTS OF FDI

The two main inextricably linked questions related to FDI concern the following aspects:

- why firms engage in FDI (compared to other internationalization options such as export, licensing or activity in the domestic market only)
- why firms choose certain locations for their FDI. The OLI concept assumes that FDI can be explained by three categories of factors: ownership (O), location (L) and internalization (I) advantages.

Given the article focus on the reasons why Russia and China seek to carry out FDI in Central Asia, this study examines the «L» element of the eclectic OLI paradigm. The OLI theory points to three main motives for FDI: FDI to explore markets, FDI to improve efficiency (to cut costs) and

FDI to acquire resources (including strategic assets).

Based on the methodology of UNCTAD (2006) we can distinguish between driving forces and determinants of FDI. The determinants of FDI are predominantly macroeconomic indicators that are largely static and change significantly only in the medium and long term. The most substantial determinants of FDI are represented by such variables as country's GDP, labor productivity, availability of natural resources and macroeconomic stability. On the other hand, drivers of FDI can relate to both macro- and meso-level matters, such as the scope of regulation and policies and micro-level factors, such as stimulus measures and corporate-level priorities. The article also integrates the paradigm from the fields of international political economics and multinational business, associated with the need for interdisciplinary approaches in this area.

Thus, after presenting the main analytical concept of this article, the next part constitutes a detailed account of the research into the driving forces and determinants for FDI in developing countries.

REVIEW OF RELEVANT SCIENTIFIC LITERATURE

One of the earliest and most important tenets of FDI research is the scholars' contention that market imperfections are one of the main factors driving FDI. In particular, market-oriented FDI aims to penetrate the recipient country's domestic market. The ongoing research estimates the size of the market using GDP (the size of the recipient country), GDP per capita (a measure of the purchasing power of population) and GDP growth (market potential in terms of economic growth). And these figures are expected to be positively correlated with FDI inflows.

An analysis of the empirical data of the postwar years enabled Dunning to single out the income as the main determinant, which gave grounds for further generalization within the Investment Development Path (hereinafter IDP) model. The IDP model demonstrates a non-linear wave-like dependence of net investment flows on GNP/GDP per capita, which goes through five stages in its dynamics. By the end of the second stage the flow of FDI reaches its relative high and the peak of FDI can be seen at the end of the fourth stage. At the same time, developing countries seem to «squeeze» this wave-like curve compared to developed countries, reaching their peak reading at lower income levels. However, developing countries, including those in Central Asia, are very different. As for the driving forces of FDI, since institutionally proximate countries or regions, *ceteris paribus*, enjoy the greatest investment attractiveness, the leading role in assessing this proximity is played by the so-called «institutional distance». This is an aggregate figure that depends on many other factors of regulatory and fiscal policy, as well as on the level of macroeconomic stability, which in turn depends on the level of political risks and the openness of the recipient economy.

These determinants and driving forces, external objective and subjective factors, significantly affect the motivation of TNCs in relation to the locations of FDI. Another local advantage component deals with internal corporate factors, as well as the standing and preferences of senior management. According to the analysis of Western private companies, the exploration of new markets is the most vivid motivation, followed by efficiency gains and resource development. State-owned companies may show different trends. The specific set of determinants, driving forces and motives shapes a special investment profile of the country, a comparative analysis of which is the main objective of this study.

FDI IN DEVELOPING COUNTRIES

Given the article focus on Central Asia, the authors review studies of FDI inflow in developing countries. Since the early 1980s, scholars have noticed a sharp increase in the number of developing countries and investment in them is considered profitable.

Since FDI inflows contribute to economic growth, including long term horizon, developing countries seek to attract FDI to accelerate the initial development of their capital-intensive industries.

Scholars distinguish between traditional and non-traditional determinants of FDI in developing countries. As for traditional factors for predicting FDI flows to developed countries, such indicators as the size of domestic market, trade balance, as well as GDP, GDP per capita and GDP growth are the most significant determinants for investment flows. In addition, factors, such as restrictions on access to national markets, administrative barriers and risk factors have been proposed as additional traditional factors affecting the attraction or redirection of FDI flows to developed countries.

Globalization process has caused debates over reduced importance of traditional determinants of FDI, such as GDP per capita. Scholars have marked the emergence of non-traditional determinants of FDI: openness to foreign trade, tariff rates and human capital. It is argued that these changes are related to the broader aspect of the transition from FDI focused on the exploration of new markets and resource development to vertical investments or investments aimed at improving efficiency.

CASE STUDY

To investigate the applicability of Dunning's model of drivers and determinants to Russian and Chinese investment in Central Asia this article carries out both qualitative and quantitative analysis of the investments of the two BRICS members in the region. The applicability of the Dunning model is considered for each country, using qualitative and quantitative data and focusing on the FDI development trajectory

in the region as a whole and in countries individually. Statistics for both countries is given in the Annex to this article.

EXAMPLE 1: RUSSIA

RUSSIAN FDI IN CENTRAL ASIA

Taking into account both geographical proximity and historical and political heritage, it can be noted that Russia maintains close economic ties with the five Central Asian republics, while the intensity and diversity of these ties vary from country to country. In addition, the economic issues are often inextricably intertwined with security issues.

DETERMINANTS OF FDI

When considering the determinants of Russian FDI in Central Asia, we can identify the following key characteristics.

First, with regard to structural economic indicators, the authors of the article note differences in the correlation between the economic conditions of the five countries in the region and the Russian FDI. While in Kyrgyzstan and Tajikistan, the growth in accumulated Russian FDI shows a moderate positive correlation with the growth in GDP over a given time period, in Kazakhstan and Turkmenistan the trend is reversed with moderately negative correlation coefficients from 2009 to 2020. (Table 1). Uzbekistan doesn't show the same case, with the correlation coefficient being close to 0. As for the correlation between the absolute GDP of Central Asia and the size of the Russian FDI, the authors note that in Kazakhstan there is a moderate positive correlation coefficient, Kyrgyzstan and Tajikistan show high reading and Uzbekistan and Turkmenistan demonstrate moderate and strong negative correlation coefficient respectively. Such results point to the insufficiency of GDP as the only determinant explaining the dynamics of the Russian FDI in the region.

Table 1

Russian FDI: correlation analysis

Correlation (2009-2020)	GDP (USD) and Russian FDI (in absolute terms)	GDP and Russian FDI (annual growth)	GDP and Russian FDI (annual growth)	Labor productivity and Russian FDI (in absolute terms)	Trade openness and Russian FDI (in absolute terms)	Openness and Russian FDI (in absolute terms)
Kazakhstan	0.2875	-0.2626	-0.3681	0.9622	-0.6954	-0.9026
Tajikistan	0.6745	0.2093	0.4288	0.0796	0.0861	-
Kyrgyzstan	0.7125	0.3357	0.2477	0.6484	-0.4994	0.3348
Uzbekistan	-0.8356	0.0052	-0.0070	-0.8275	-0.0702	-
Turkmenistan	-0.7028	-0.2156	-0.2296	-0.7080	0.3415	-

Source: ITC

Second, when approximating a country's economic openness as a share of trade to GDP in %, the correlation with Russian FDI is strongly negative in Kazakhstan and Kyrgyzstan, moderately positive in Turkmenistan and marginally negative and positive in Tajikistan and Uzbekistan respectively. These results imply that a country's openness to foreign trade is not significantly related to Russian FDI in a particular country.

Third, while data on the investment climate, such as the OECD FDI Regulatory Restrictions Index (2021), are available throughout the study period only for Kazakhstan, it can be noted that the gradual increase in Russian FDI in the country is commensurate with the decline in restrictions in the indicated time period, showing a significant negative correlation coefficient. In contrast, in Kyrgyzstan, where these data are available only for 2012, there is a moderately positive correlation between the degree of regulatory restrictions on FDI and the size of Russian FDI, which confirms the assumption that Russian outward investment in the country does not depend on structural and regulatory conditions.

Fourth, with regard to labor productivity, in Kazakhstan and Kyrgyzstan we can observe a high positive correlation with the FDI from Russia, while in Uzbekistan and Turkmenistan the respective correlation coefficients show a significant negative correlation. Finally, in Tajikistan similar figures show a slight positive correlation coefficient equal to 0.08.

Thus, the analyzed macroeconomic indicators show an ambiguous picture in terms of identifying the key factors that determine the size of Russian FDI in Central Asia.

DRIVERS OF FDI

As for the driving forces behind Russian FDI in the CIS, in contrast to Dunning's assertion of firms' effort to reduce costs and gain strategic access to technology through FDI, Russian companies are mainly driven by gaining access to raw materials and local markets for distribution purpose.

Starting to analyze the specific factors affecting flows of Russian FDI in Central Asia, it is worth noting the favorable geographical position of Russia in relation to Central Asia and the high though declining share of Russian speaking population in the region. These factors are «attractive», they reduce the transaction costs of Russian enterprises when investing in the countries of Central Asia. However, the stimulating effect of such “attractive” factors on Russian FDI is offset by administrative barriers, restrictions on foreign investment and high corruption level that potential investors face in the region. As far as market “pushing” factors are concerned, then the relatively large size of the Russian market may offer structural opportunities for Russian investment and joint use of production opportunities in Central Asia. A good example is the recent inflow of FDI in the car making industry in the region.

As for business environment and public policy, the Eurasian Economic Union (hereinafter referred to as the EAEU) has adopted a policy aimed at harmonizing business and investment standards between Russia, Kazakhstan, and Kyrgyzstan in Central Asia, which is an additional driving force for Russian investment in the region. Apart from that, international political conflicts such as the Ukrainian crisis in 2014 have led to a large-scale shift of FDI flows to the CIS region. According to the data released by the Eurasian Development Bank in 2020, Kazakhstan and Uzbekistan ranked first and second among the largest recipients of FDI in the CIS region compared to the second and fifth spots in 2012. The special military operation has also had a serious impact on the dynamics of FDI in the post-Soviet area. Since some of the Central Asian countries are heavily dependent on Russian FDI and have a considerable share of the total FDI of Russia, they face many complications and therefore have significant incentives to reduce their economic dependence on Russia and diversify bilateral economic ties. In particular, according to a recent World Bank report, Russian multinationals, which account for a substantial share of Russian FDI in Central Asia, are expected to face serious challenges in cross-border transactions and logistics due to Western sanctions which will reduce investment opportunities for Russian enterprises in the region. As the problems associated with the economic situation in Russia amid sanctions have caused the depreciation of currencies and rise in inflation in Central Asia, FDI in the region continues to decline which is likely to bring about further investment outflow from these countries.

As for attractive factors related to the business and political environment, developments in Central Asia, such as a change in political leadership, were turning points for Russian FDI. One of the most important examples of political opportunities to attract investment is the transition from rather isolationist foreign policy of Uzbekistan led by Islam Karimov to a multi-vector approach by his successor Shavkat Mirzoev. This political system has led to state support for creating environment for a large-scale partnership and investment between Russia and Uzbekistan. Similar statements on expanding the bilateral investment partnership were made by the presidents of Russia and Kazakhstan after the unrest in Kazakhstan in January 2022.

These political statements on expanding bilateral investment are especially important amid domestic political situation in Kazakhstan since early 2022 and, as a result, the growing caution of foreign investors towards Kazakhstan.

Comparing the relevance of various driving forces behind Russian FDI in Central Asia, it is worth emphasizing the importance of FDI based on access to resources and the lack of substantial FDI focused on efficiency and acquiring strategic assets in the general analysis of investment flows in Central Asia. The priority areas of Russian FDI are closely linked to the energy and hydrocarbon sectors of the region. In particular, Russian

investors seek to benefit from acquiring the rights for transit and export of energy from Central Asia and from the exploration and development of hydrocarbon fields. At the same time, it should be noted that three large Russian energy companies rank among top five investors in the post-Soviet area by investment: LUKOIL, Gazprom and Atomenergoprom. In addition, since companies, such as Gazprom and LUKOIL, operate through subsidiaries or joint ventures with local energy companies in Central Asia, they have gained significant leverage on Central Asian energy markets. In addition to the development of hydrocarbon fields in Tajikistan, where Russian direct investment is second only to China, FDI flows can also be seen in the energy sector. At the same time, Sangtudinskaya HPP-1 is Russia's largest investment project in the region.

Moreover, intergovernmental ties between Russia and the countries of Central Asia are a key factor in stimulating bilateral investment cooperation in the region. Meanwhile, political initiatives and regional security issues appear to be important catalysts for Russian FDI and Russian economic activity in Central Asia in general. Russian politicians often emphasize the large scale of Russian investment in the region as well as the economic concessions to the countries of the region to show Moscow's benevolent relations with the five Central Asian republics. These political factors driving Russian FDI in Central Asia stem from the central role that the region plays as an area of special interest. Consequently, some unprofitable Russian FDI projects in the region, such as the modernization of the gas distribution system of Kyrgyzstan by Kyrgyzgas, a subsidiary of Gazprom, were de facto viewed as economic aid to stimulate the country's accession to the EAEU. Given latent domestic political instability in Central Asia and the detrimental impact of political unrest in the region on Russia's status as a guarantor of security, FDI also serves as a tool for strengthening countries' domestic stability in the region.

ANALYSIS OF RUSSIAN FDI TRAJECTORIES TO CENTRAL ASIAN COUNTRIES IN 2009-2020

Having studied the main driving forces and determinants of Russian FDI in Central Asia, it is possible to get down to the analysis of quantitative time trajectories of flows and accumulation of Russian FDI in the region. Figures 1 and 2 show trajectories of Russian FDI in Central Asia from 2009 to 2020.

It can be noted that in the total Russia's FDI flows Central Asia occupies an important spot: this region accounts for 1.93% average annual share of Russian FDI. Between 2009 and 2020, Russian FDI amounted to \$7.48 billion. Moreover, the importance of this region as a recipient of Russian foreign investment is somewhat higher than that of France. Compared to total Russian FDI to other sub-regions of the post-Soviet area, investment in Central Asia is more than five times higher compared to the countries of the Caucasus (Armenia, Azerbaijan, Georgia). At the same time, this

region accounts for about half of the total Russian investments in the countries of the Baltic and Black Sea regions (Belarus, Ukraine, Moldova).

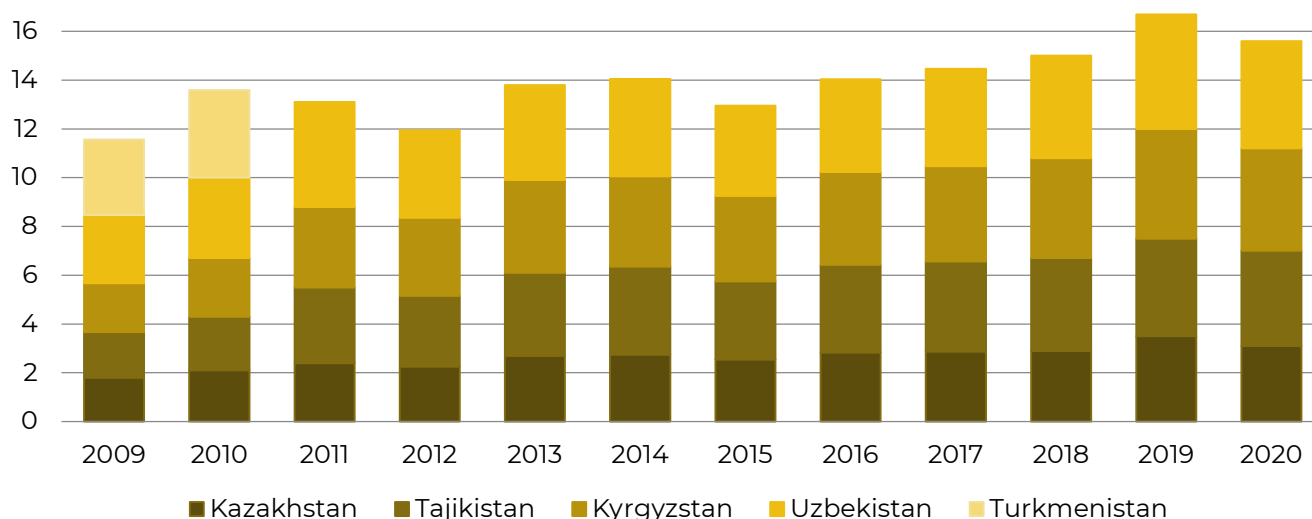


Figure 1. Russian FDI in Central Asia (US\$ bn, 2009-2020)

Source: ITC

When examining the differences in Russian FDI flows to individual countries, it becomes clear that there is a serious asymmetry between the five republics. For instance, Kazakhstan, which attracts 509 million dollars of Russian FDI annually, receives on average about 82% of Russian FDI between 2009 and 2020, while the other four Central Asian countries attract far less investment. While Kyrgyzstan and Uzbekistan, with an average annual Russian FDI inflow of 53.4 billion dollars and 13.6 billion dollars, respectively, ranked second and third among the Central Asian recipients of Russian foreign investment, Tajikistan and Turkmenistan accounted for an average of about 2% and 1.5%. Thus, by the amount of Russian FDI in Central Asia in 2020 Kazakhstan accounts for more than 80% of the accumulated investment to Central Asia, the share of Tajikistan is 8%, Uzbekistan and Kyrgyzstan make up about 5.2% and 4.1% respectively.

Apart from that, the study of individual trajectories of recipient countries of Russian FDI in the region allows us to talk about the stimulating role of political initiatives for attracting FDI. After Kyrgyzstan joined the EAEU, between 2014 and 2015, the country experienced a more than threefold rise in Russian FDI. At the same time, this growth remained fairly stable until 2016 and 2017, but after 2018 it has decreased significantly. However, a similar trajectory was not observed in Kazakhstan, where there was an almost linear decline in the annual flows of Russian FDI since 2013, with the exception of 2017, when large-scale government initiatives were taken to increase the attractiveness of the country for foreign citizens.

As for the countries outside the EAEU, after the change of leadership in Uzbekistan, the inflow of Russian FDI surged as the Uzbek-Russian investment agreements were signed. Thus, starting from 2019, Russian investment differed drastically compared to the relatively low figure from 2012 to 2015. Unlike the case with Uzbekistan, the flow of Russian FDI

to Tajikistan is more volatile: FDI reached its first peak in 2011 at 47.64 million dollars, then started to decline, and in 2019 there was a sharp rise to 52.34 million dollars, which coincided with the overall increase in foreign investment inflows into the country after a series of investment deals signed in 2018. The annual size of Russian FDI in Turkmenistan is relatively unstable: investment reached its high in 2009 and 2015 (55.08 and 130.34 million dollars), after which it collapsed owing to the decision of Gazprom to completely cease gas imports from the country.

CONCLUSIONS

Summarizing the results of the analysis of Russian FDI in Central Asia, it is worth noting that government initiatives and political goals play an important role in shaping the dynamics of Russia's trade and investment policy in the region. At the same time, it cannot be denied that the analysis of regional integration projects, such as the EAEU, where Kazakhstan and Kyrgyzstan have full-fledged member status (Uzbekistan has had observer status since 2020), shows different results for these three countries. While Kyrgyzstan's accession to the organization led to a short-term increase in Russian FDI, in Kazakhstan and Kyrgyzstan the effect was less pronounced. Such dynamics confirms the assertions of experts that such projects are implemented primarily for domestic political rather than economic reasons. The above findings support the hypothesis given in this article that growth trends in Russian FDI and exports are often associated with announcements of large state trade and investment agreements, mainly in the energy sector.

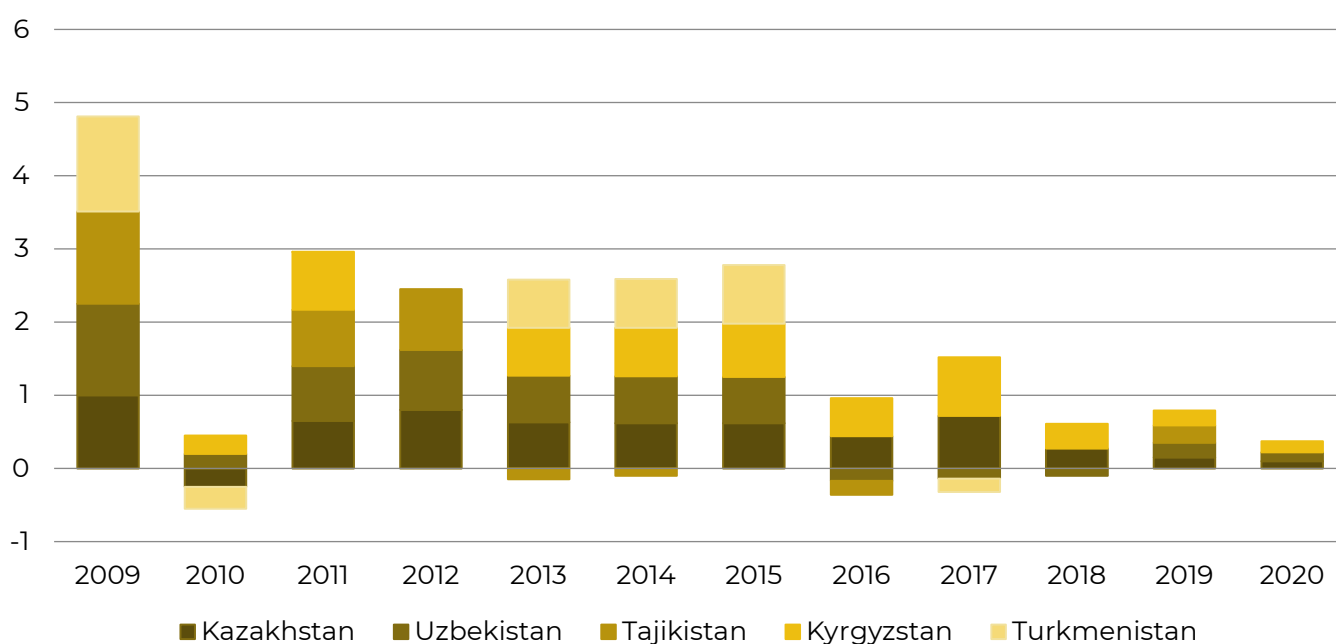


Figure 2. Russian FDI in Central Asia (US\$ bn, 2009-2020)

Source: ITC

EXAMPLE 2: CHINA

DRIVERS AND DETERMINANTS OF CHINESE FDI

KEY DRIVERS OF FDI

As for the domestic market situation, the overcapacity faced by China's manufacturing, construction and emerging industries has been an important "pushing" factor for Chinese FDI. Given that Central Asia is undergoing a period of «great transformation», the emerging nature of the region's economies may allow them to absorb China's excess manufacturing capacity, making them attractive to Chinese FDI. GDP growth can be viewed as an indirect indicator of the prospects for FDI and the sustainable dynamics of economic indicators. Thus, this indicator can be very useful in analyzing the ability of countries to absorb excess production capacity. The average GDP growth of the Central Asian states since independence (3.07%) is much higher than those of Japan (0.75%), the US (2.30%) and the EU (1.46%). Moreover, the important role of transport infrastructure for China's Belt and Road Initiative may constitute the country's willingness to expand its access to world markets. Central Asia geographically bridges Western Asia with Europe, attracting Chinese FDI related to transport and logistics.

However, the relatively small size of some markets in Central Asia limits the number of Chinese firms willing to invest in them. The five Central Asian countries have very different GDP figures. For instance, in 2020 the GDP of Kazakhstan was more than 20 times the GDP of Kyrgyzstan. The correlation between Chinese FDI and GDP growth is either weakly positive (Tajikistan and Turkmenistan) or negative (Kazakhstan, Kyrgyzstan, Uzbekistan), suggesting that there are factors other than market size and market entry opportunities that matter to Chinese FDI in the region (Table 2). In addition, China lacks linguistic advantage and common Soviet heritage that the countries of Central Asia share with Russia. In contrast, the Sino-Soviet border conflicts of the 1960s and 1970s additionally contributed to anti-Chinese sentiment in the region. People of China and Central Asia have little knowledge of each other and lack professional ties and relationships. Thus, it is worth considering other factors that facilitate the inflow of Chinese FDI in the region.

Table 2

Chinese FDI: correlation analysis

Correlation (2009-2020)	GDP (USD) and Russian FDI (in absolute terms)	GDP and Russian FDI (annual growth)	GDP and Russian FDI (annual growth)	Labor productivity and Russian FDI (in absolute terms)	Trade openness and Russian FDI (in absolute terms)	Openness and Russian FDI (in absolute terms)
Kazakhstan	0.4202	0.593	-0.096	0.4949	0.8464	-0.5797
Tajikistan	0.0663	0.5195	0.1957	0.4778	0.9699	-

Kyrgyzstan	0.7057	0.8759	-0.242	0.0976	0.9801	0.8198
Uzbekistan	-0.3171	-0.116	-0.729	0.1178	0.7552	-
Turkmenistan	-0.2069	-0.234	0.2448	-0.085	-0.2407	-

Source: ITC

As for production costs, while low labor costs used to give the country a significant competitive edge in attracting FDI, now China itself is looking for low-cost manufacturing abroad. Central Asia may offer China some advantages given relatively low wages. There is a strong positive correlation (not lower than 0.76) between Chinese FDI in Central Asia and labor productivity for all countries of Central Asia except for Turkmenistan. However, Chinese firms engaged in FDI generally do not employ workers from Central Asia, preferring to offer lending facilities subject to use of Chinese technology and employees. At the same time, capital-intensive mining operations do not require a large amount of labor at all. Indeed, more than 60% of projects within the Belt and Road initiative are allocated among Chinese enterprises.

The guidelines for doing business in Kazakhstan released by the Ministry of Commerce of China highlight the low level of skills and productivity of local workers, thereby demonstrating the reluctance of Chinese firms to use labor from Central Asian countries. However, the Chinese insurance company Sinosure made a similar comment regarding the labor force in Tajikistan. Thus, cheap labor in the countries of Central Asia is not always an «attractive» factor for Chinese FDI, so its use to justify Chinese FDI in the region is limited. The favorable tax regime and the openness of the Central Asian economies represent a factor attracting FDI to the region. China has signed double tax treaties and agreements to prevent tax evasion with five countries in the region.

The Tajik government often provides tax incentives or free land for Chinese investment. For instance, in 2019 the Chinese company Kashgar Xinyu Dadi Mining Investment signed a contract with the Committee on Investments and State Property of Tajikistan to develop the Yakjilva silver deposit and gained tax exemption on any income and equipment imported into the country to service mines for seven years. Two Chinese companies investing in Kyrgyz refineries noted that support from the recipient government (through subsidies) was a critical factor in deciding on investment. At the same time, the challenging business environment and pervasive corruption in Central Asia reduce the effectiveness of the region's business environment as an «attractive» factor for FDI.

MAIN DETERMINANTS OF FDI

There is an assumption that Chinese firms (as well as successive governments) adopted a strategy of seeking new markets to carry out FDI in Central Asia. For instance, a number of scholars indicate a statistically significant correlation (at 1% level) between the size of the recipient economy and Chinese FDI. There is a significant positive correlation between FDI and GDP for Kazakhstan (0.59), Kyrgyzstan (0.88), Tajikistan (0.52) and the region as a whole (0.82), although Turkmenistan and Uzbekistan show a weak negative correlation, which perhaps indicates the heterogeneity of the economic situation in the five countries of the region.

To solve the problem of overcapacity in 1999 the Chinese government started to implement a policy «Exit», and in 2013 – the Belt and Road initiative. These programs are aimed at stimulating domestic demand by using China's capital reserves to invest abroad and expand foreign demand for Chinese goods and services. Chinese companies tend to implement infrastructure projects under the auspices of the Belt and Road initiative, which allows them to gain external benefits through investment. For instance, the main partner in the project for the construction of an alternative north-south road in Kyrgyzstan (financed by \$850 million loan from Chinese Eximbank) is China Road and Bridge Corporation (CRBC). The US State Department notes that Chinese Eximbank loans for infrastructure projects in Kyrgyzstan made it easier for Chinese enterprises to enter the market. This trend demonstrates the progress made by China in achieving its goal of entering new markets.

Given the limited market size of many Central Asian countries, the governmental nature of market expansion measures (particularly through Exit policy and the Belt and Road initiative), the importance of state-owned enterprises in China's FDI and the implementation of the Chinese state capitalism model should be considered as part of the government's priorities in the region. The activity of Chinese companies abroad is primarily aimed at making profit, but the above companies should also be in line with the broad political goals of the Chinese government and promote these goals (or be seen advancing them). Since at least 2015 reduction in overcapacity has been one of the top five objectives of China's economic reform. Thus, the Chinese government's FDI policy can be seen as part of a broader government effort to reduce excess production capacity.

FDI aimed at discovering and exploring resources, such as hydrocarbons, are especially important for China due to the lack of natural resources in the country. For instance, 72% of oil and 43% of gas are imported. There is a strong positive correlation between Chinese FDI and natural resources at 1% level, demonstrating the predominance of the factor related to the search for resources for Chinese FDI. The fact

that the entire production chain (from mining to processing and supply) is controlled by China demonstrates that China's interest in the region is one of the main goals of the government to ensure energy security.

The geographical proximity of Central Asia to China and abundant natural resources and minerals in the region (especially oil in Kazakhstan and gas in Turkmenistan) make Central Asia an attractive destination for Chinese FDI aimed at ensuring the country's resource and energy security. In 2017 two of the largest Chinese investment projects in the energy sector were in Central Asia: an oil pipeline from Kazakhstan and Central Asia-China gas pipeline (with participation of all five countries of Central Asia, currently three lines are in use and the fourth is planned), which clearly shows the investment attractiveness of the region.

Looking at the countries of the region individually, about half of the 55 Chinese FDI projects announced in 2017 as part of the Kazakh-Chinese industrial cooperation initiative account for the oil and gas sector and 22% account for the mining and metallurgical industries. While the data for Turkmenistan is very limited, the available figures suggest that the country is important to China's resource development and energy security goals. For instance, in 2002 CNPC signed a contract with the state concern Turkmenneft to develop the Gumdak oil field and received a 100% stake in the project for five years. In 2021 Turkmenistan was the second largest exporter of natural gas to China (after Australia) and the largest exporter of pipeline gas to China. In the same year, the China Petroleum Engineering and Construction Corporation (CPEEC) and its subsidiary CNPC signed a contract to develop onshore gas facilities in Bagtyyarlyk, demonstrating China's ongoing FDI partnership with Turkmenistan. In 2014 Tajikistan and the Chinese company Heli signed an agreement for the construction of an oil refinery in the Dangara Special Economic Zone which was completed in 2020. In addition to the oil and gas sector a significant amount of Chinese FDI was also directed to the production of metal ores in Tajikistan.

And although a number of experts argue that China is currently diversifying its FDI models in Central Asia, the country's investments remain concentrated in infrastructure, in energy sector particularly. For instance, during the visit of Prime Minister T.A. Sariev to Beijing in 2015.

General Secretary of the State Council of the People's Republic of China Li Keqiang stressed China's readiness to discuss production capacity and investment cooperation with Kyrgyzstan. At the same time T. A. Sariev welcomed China's investments in energy, transport and social infrastructure.

In addition to ensuring the security of energy supplies the Chinese government has other priority political interests in investing in Central Asia. Policymakers hope that the Belt and Road initiative and other investment projects will help create new markets to stimulate trade and catalyze the development of the country's western regions, in particular the Xinjiang Uygur Autonomous Region, which borders three Central Asian countries

and has oil and gas pipelines from Central Asia in its territory.

And economic development is seen as a way to resolve the problem of economic development and political discontent in Xinjiang. For instance, in 2010 China ratified a document on creating a new free economic zone (FEZ) in Xinjiang to turn the nearest frontier port of Khorgos into a center of trade relations with Kazakhstan.

The issue of prestige may also be important for Chinese FDI in the region. Indeed, the Belt and Road initiative is largely based on the historical legacy of the Great Silk Road, when China represented the civilizational and economic center of the world. At present, China intends to once again take on leading global political and economic role. By fighting poverty and supporting education and science the country is able to «gain diplomatic points» and «strengthen its political influence». The role of Beijing as an indispensable player in the region is growing thanks to a wide network of trade and transport links, as well as the development of multilateral institutions for cooperation with China at the center of these initiatives. On the other hand, given that a positive correlation between Chinese FDI and trade openness is observed only in Uzbekistan and Turkmenistan, it can be noted that China does not consider openness of the Central Asian economies as a factor that determines investment in these economies. This trend supports the hypothesis that political rather than economic motivation drives Chinese FDI.

ANALYSIS OF CHINESE FDI TO CENTRAL ASIA IN 2009-2020

There was a significant positive trend between 2009 and 2020 with the accumulation of Chinese FDI in Central Asia, with investment more than quintupling from \$2.26 billion to \$12 billion in 2020. Since the launch of the Belt and Road Initiative in 2013 Chinese FDI in the region has almost doubled. However, the average annual FDI growth was higher before (43.8%) than after its launch (10.11%). It can be probably explained by the fact that China's political goals and the «Belt and Road» concept precede the implementation of this initiative. Comparing Chinese FDI in Central Asia with other regions of the world we can see that Central Asia (79.4 billion dollars) ranks between Russia, which is a neighboring country of China (85 billion dollars), and Canada, which has a high income level (71.7 billion dollars). The share of Central Asian FDI in China's investment portfolio may seem insignificant (0.89% on average). However, among the 146 countries participating in the Belt and Road Initiative Central Asia ranks third (following Singapore, a tax haven, Luxembourg, a high-income country, and Russia, whose official participation in the initiative is still being discussed). These figures reflect the important role of Central Asia in the Belt and Road Initiative given the region's strategic position and abundance of natural resources.

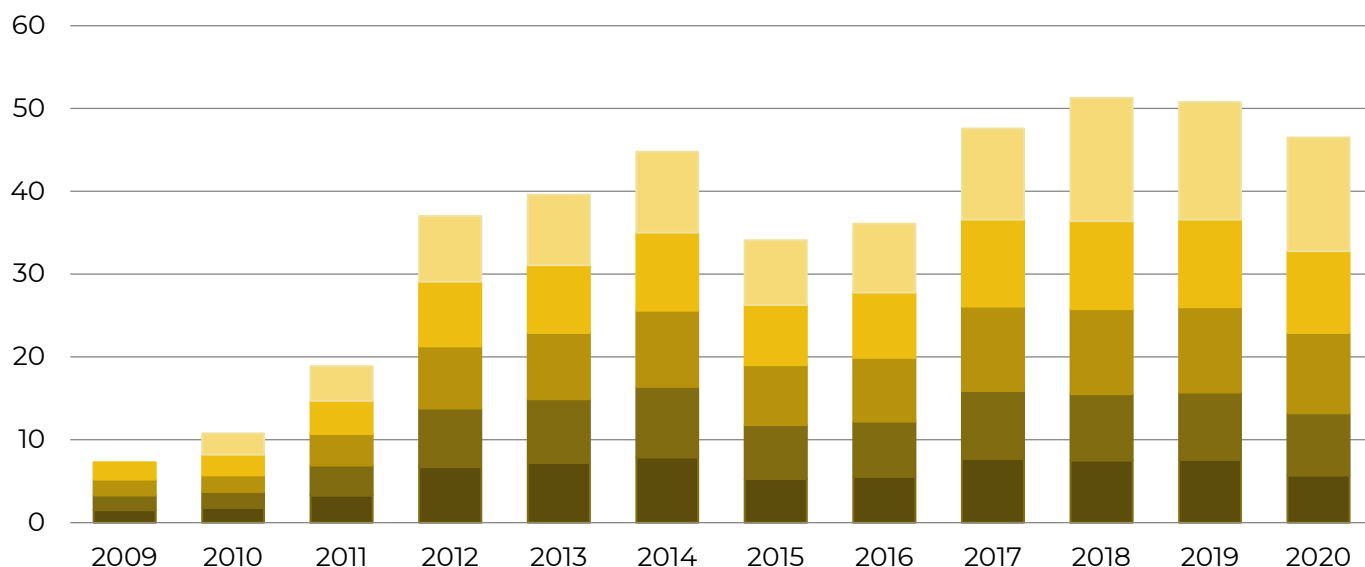


Figure 3: Chinese FDI in Central Asia (US\$ bn, 2009–2020)

Source: ITC and China Statistical Yearbook

Chinese FDI flows to Central Asia are much more volatile than outward investment. Although in annual terms FDI in the region accounts for a similar share of China's total FDI relative to outward FDI, it does not show an overall positive trend. FDI flows to Central Asia peaked in 2012 (the year before the launch of the Belt and Road initiative) and reached its low in 2015 (amid an outflow of investment, coinciding with the fall in oil prices). Like Russian investment in Central Asia, a significant share of accumulated Chinese FDI (at least 50%) and FDI flow over the period was in Kazakhstan. Indeed, in 2009-2018 Kazakhstan was the fifth largest recipient of Chinese FDI within the Belt and Road initiative (following Indonesia, Singapore, Luxembourg, and Russia). These figures reflect China's goals of exploring new markets and developing resources, given that Kazakhstan has the largest GDP in the region, ranks first in the Human Development Index (HDI) and possesses substantial natural resources. However, immediately after the financial crisis Turkmenistan received more FDI from China possibly due to its participation in the development of the Galkynysh oil field. Moreover, since 2012 there has been a marked decline in the amount of Chinese investment in Kazakhstan possibly reflecting risk diversification by Chinese banks, a desire to move beyond simply finding and exploring resources in the region and the impact of anti-Chinese protests in the country caused by Chinese FDI and land reforms. This decline occurred regardless of a joint declaration by China and Kazakhstan on a new stage of comprehensive strategic partnership in August 2015, a joint plan to ensure synergy in the development strategies of two countries (the Belt and Road initiative and Nurlı Zhol) in September 2016 and a new Kazakhstan status of «permanent comprehensive strategic partner» of China in 2019.

Over the specified period Chinese FDI in Uzbekistan surged

compared to total Chinese investment in the region, rising from less than 4% in 2009 (when the country received the least amount of Chinese FDI in the region) to more than 25% in 2020 (the country ranked second in FDI in the region). A noticeable rise occurred in 2018 which coincided with the beginning of the presidential term of S.M. Mirziyoyev (in 2016) and indicates the importance of political factors for FDI.

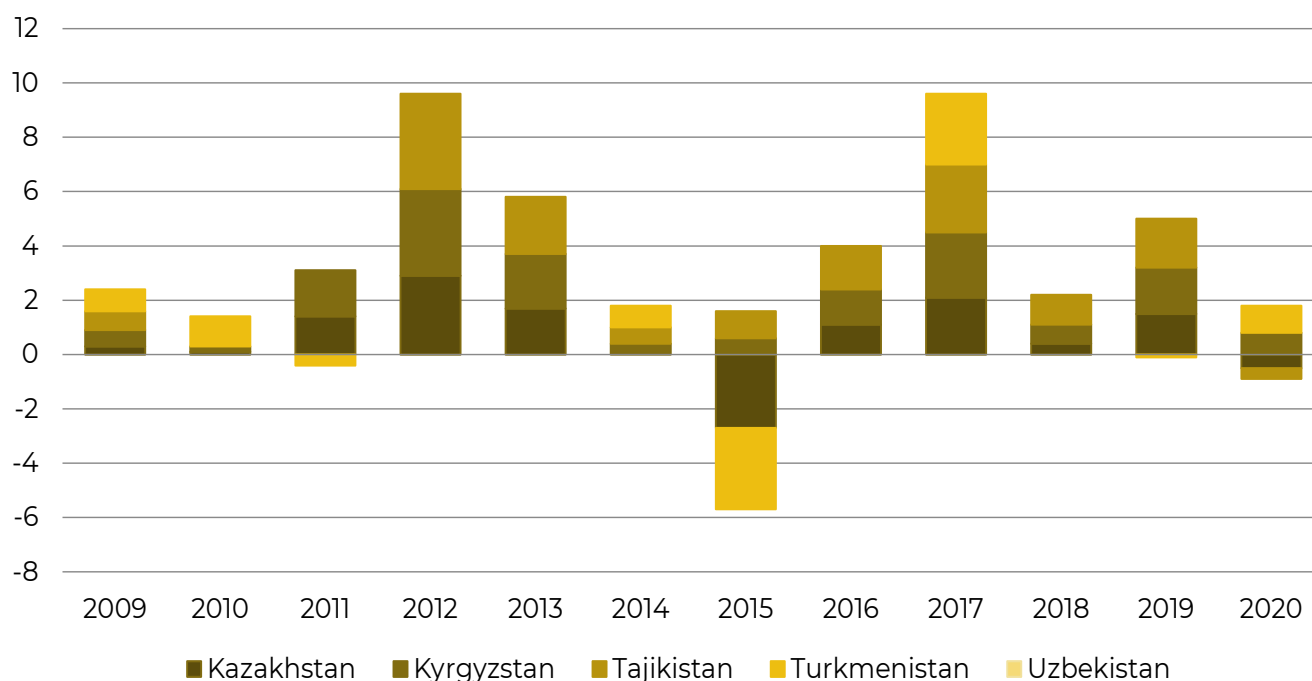


Figure 4. Russian FDI flow to Central Asian countries (US\$ bn, 2009-2020)
Source: ITC and China Statistical Yearbook

FINDINGS

An analysis of the drivers and determinants of Chinese FDI in Central Asia shows the importance of search for new markets and development of resources for FDI. These factors are largely related to general geo-economic and political priorities. Although there is a positive trend in the accumulation of Chinese FDI in Central Asia, there are significant fluctuations and discrepancies in the breakdown of data by country in this region. Kazakhstan is important for Chinese FDI in the region, which is consistent with the hypothesis of the impact of such factors as the exploration of new markets and the development of resources. At the same time, the importance of this country is waning, while other countries of Central Asia, especially Uzbekistan, are becoming more important for Chinese FDI.

COMPARISON OF RUSSIAN AND CHINESE FDI AND EXPORTS TO CENTRAL ASIA IN 2009-2020

Analyzing the absolute value of FDI from Russia and China to Central Asia there is no clear pattern as to which country invests more in the region: both countries generate approximately the same average FDI flow of 623.6 million dollars (Russia) and 721.8 million dollars (China).

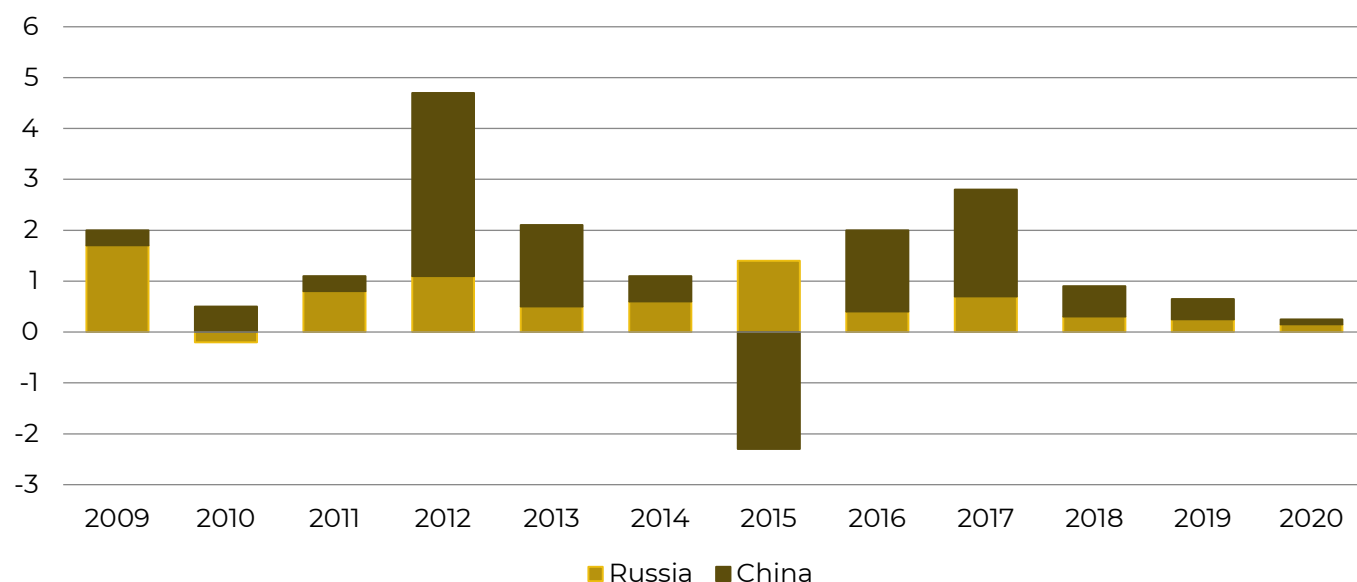


Figure 5. Russian and Chinese FDI in Central Asia (US\$ bn, 2009-2020)

Source: ITC and China Statistical Yearbook

Less volatile FDI statistics shows a clearer picture of the differences between Russian and Chinese FDI. Thus, over the period accumulated Chinese FDI in the region considerably exceeded that of Russia. It should be noted that before 2011 Russian FDI in the region was higher than FDI of China. The shift from Russian FDI to Chinese FDI is observed in the gas industry of Turkmenistan, where the China-Central Asia gas pipeline construction at the end of 2009 led China to increase gas purchase from 5 billion cubic meters in 2010 to more than 33 billion cubic meters surpassing Russia, which until 2020 was the largest buyer of gas in Turkmenistan.

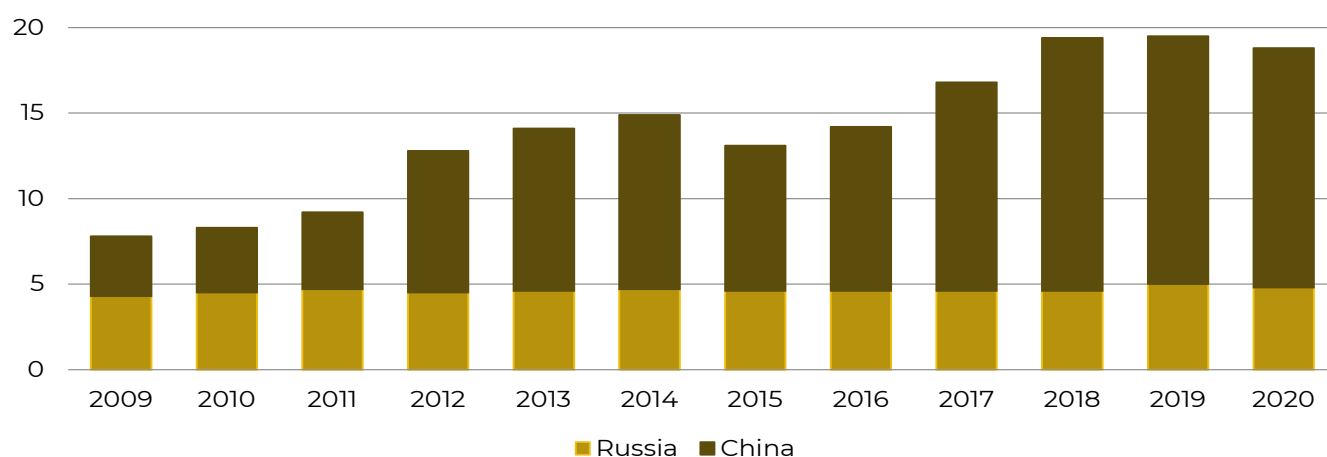


Figure 6. Russian and Chinese FDI in Central Asia (US\$ bn, 2009-2020)

Source: ITC and China Statistical Yearbook

Although in absolute terms China has invested in Central Asia more than Russia, for Russia, in some respects, this region is more important than any other country, perhaps due to mutual historical and cultural ties. In particular, over this period Central Asia received 0.89% of China's total FDI compared to 0.94% of Russia's total FDI, while 1.84% of Russian FDI was allocated in Central Asia against 0.72% of China's FDI. China's higher economic growth and larger economy is the reason why China is economically active in Central Asia notwithstanding the fact that the region accounts for a small share of the country's total FDI.

CONCLUSION

The analysis shows that Central Asia as a destination for FDI is slightly more important for Russia than for China, while the regional projects of two BRICS countries, the EAEU and the Belt and Road initiative, seem to have had a mixed impact on FDI and exports in the region. The determinant for Russian and Chinese FDI in Central Asia is access to natural resources and their transportation. Kazakhstan's large oil resources represent an FDI «attractive» factor for both Russia and China, therefore Kazakhstan receives the largest FDI (and the largest exports) from two BRICS countries among all Central Asian states. The countries of Central Asia, which are not rich in hydrocarbons, receive a significant amount of investment in the development of energy transportation routes.

Analyzing the respective FDI patterns of two countries, it is clear that political and security considerations often outweigh the economic risks. Russia does not want to give up control over its former «sphere of influence» to ensure stability in neighboring countries. As for natural resources, the country seeks to obtain the rights to transit and explore hydrocarbon fields outside its territory. The huge size of China's economy requires significant investment in energy, while FDI in the region is seen as a way to combat problems in Xinjiang and revive the Silk Road era. Moreover, such political factors as the presidency of S.M. Mirziyoyev in Uzbekistan influenced FDI and the structure of exports in the region.

By contrast, Russian and Chinese FDI is not driven by factors such as efficiency gains and the acquisition of strategic assets. Although some Chinese and Russian FDI may be aimed at exploring markets (China additionally uses the region to access the markets of other Western countries), difficult business environment, corruption and the limited size of some countries' economies put a strain on FDI flow to the region. At the same time there is a significant positive correlation in Kazakhstan between the investment climate and Chinese FDI for the specified period (0.82), for Kyrgyzstan this correlation is inverse (-0.57).

It is also worth noting that wider macro-regional and multilateral cooperation in Central Asia, for instance, through the BRICS platform, could be a significant benefit for China and Russia. It can help China

overcome the backlash that the country faces in response to investments in the region and address the problem of energy security, while helping to maintain Russia's influence in the region, as well as strengthening the institutionalization of the two countries' corresponding regional projects.

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About the authors:

Olesya A. Maltseva - PhD in Economics, Associate Professor, Department of Indo-Iranian and African Languages, MGIMO University. 76, av. Vernadsky, Moscow, Russia, 119454.

Ninel Y. Senyuk - PhD in Economics, Associate Professor, Department of International Relations, Higher School of Economics (HSE University). 17, Malaya Ordynka str., Russia, Moscow, 119017.

ORCID ID: 0000-0002-7425-9029

Scopus Author ID: 57192182420

Researcher ID (WoS): U-4560-2018

Niels Holger Schreiber - Master's Degree Student, Higher School of Economics (HSE University). 17, Malaya Ordynka str., Russia, Moscow, 119017.

Catherine Hart Alice - Master's Degree Student, Higher School of Economics (HSE University). 17, Malaya Ordynka str., Russia, Moscow, 119017.

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ROAD OF CHANGE

Dmitry V. Breytenbikher

VTB Private Banking

Abstract

The consequences of the events of 2022 continue to impact the development of the country's economy as a whole and the banking business in particular. And although the most significant negative consequences managed to eliminate, the financial sector continues on the transformation path. We will discuss how one of the largest market player manages to do this together with Dmitry Breytenbikher, Senior Vice President, Head of Private Banking and Privilege VTB.

Keywords

Digitalization, automation, technology leadership, bank.

- **Dmitry, last year turned out one of the most difficult for the Russian economy. It was possible to ensure stability and offset the negative effects of sanctions largely thanks to the banking sector. How did the situation develop, what measures were taken at VTB?**

- Yes, we were the first to face sanctions and it was quite understandable. VTB is a systemically important bank with public stake and this capital stake is substantial. Moreover, our business heavily relied on foreign infrastructure: we have always been a bank for foreign trade and had a developed corporate and investment block with a wide network of foreign partners, counterparties and assets.

After February 24 and the first round of restrictions we faced an outflow of foreign exchange liquidity and at first we managed to cope thanks to the created foreign exchange reserves. At that time, the Central Bank was not yet under sanctions and the market was functioning.

But on February 27 part of the Central Bank's gold and foreign exchange reserves was frozen. The response to this situation was the decision to allow clients to withdraw money. The outflow stopped only after two restrictions were introduced by the Central Bank and the decree of the President: on transfers over 10 thousand dollars and the transfer of dollar denominated liabilities to corporate clients converted at the exchange rate.

Further, we saw the outflow of clients provoked by the bank cut off from SWIFT for the simple reason that there still were SDN banks with an access to SWIFT system.

We started to feel implications of secondary sanctions which eventually led to the situation when counterparties refused to fulfill their obligations to us while maintaining a stable financial standing. The situation was really harsh. But at the moment I can confidently claim that the implications of the first shock have been tackled. As a bank and as a team we have demonstrated resilience and adaptability. There is still a long path ahead which we have managed to comprehend but it is yet to be travelled. It is important that we already witness the prospects, for instance, more active yuan denominated allocation, there will also be ruble-denominated, alternative investments, operation with "soft" currencies, deposit products and substitute solutions.



The only thing that remains
valuable and useful at all times
- knowledge transferred to
practical experience.

- **Yes, as far as I know, you managed to find new products and strategies quite fast, which, as the last year demonstrated, have aroused a lot of interest from wealthy clients. How did you manage to regroup so fast?**

- Having gone through a period of high volatility and a rally on the markets during the first wave of the pandemic (Covid-19) we have learned to quickly respond and even capitalize on changes. In the situation of 2023, we were forced to act much faster. I remember how the solutions generated in the morning were already blocked by the evening. We started looking for other solutions. This added up to the craze and required continuous communication with clients. On the one hand, we faced rapidly changing realities, on the other, acute request for information and capital preservation. We did our utmost to offer regular expertise, conduct transactions, process client orders and propose new tools. One of the most striking trends in 2022 was gold bullion. Since March VTB Private Banking and Privilege of VTB have sold more than 30 tons breaking the record on the Russian market. The popularity of this asset class surged particularly after the cancellation of 20% VAT.



As a bank and a team, we have demonstrated resistance and adaptability. We have a long way to go, which we managed to realise and now it's time to overcome that way.

It should also be noted that the average transaction was 10 kg and if you consider the period after September last year, we have seen a 20% rise in demand from month to month. It is well known that historically gold has proven itself as a reliable defensive asset, profitable in the long term, especially amid high inflation and growing geopolitical risks. But there are extra factors that could make 2023 a good year for gold as an investment asset. Its value will be driven by the growing demand from the Central Banks and the limited supply by gold mining companies.

In the second half of 2022 the 20% VAT on the purchase of diamonds was also cancelled. Given the market changes, amendments to the law and limited investment opportunities in general, diamonds will be a good asset to diversify portfolios with a long term horizon.

We also note the reversed interest in deposit products. After a hike in the key rate to retain capital and attract new customers we began to offer deposits with double-digit return. Tellingly, after the expiration of these deposits and the reduction in the key rate we managed to retain 92% of the funds.

In July we introduced VTB investment products in yuan giving an opportunity to obtain additional return on yuan exchange rate fluctuations against other currencies (ruble, dollar). Based on the dynamics of changes in currency preferences we predict an increased interest in the yuan among retail investors. There is also good demand for securitized VTB bonds. In 2021 they were backed by mortgage loans and in 2022 by consumer loans. And in 2023 we foresee a fairly stable interest in these securities.

These are just a few examples of the replacement solutions we offer to our bank's clients. This year we plan to continue developing them as well as expanding the range of tools for investors adjusted for the global and market agendas.



This year we are going to enlarge the toolbox for investors adjusted for global and market agenda.

- But we can see changes beyond financial products, what new services do you offer to your clients?

Of course, with major foreign partners such as Mastercard and VISA leaving the market, many familiar options have been lost. And we focused on implementing similar solutions to maintain the usual level of comfort. On December 5, VTB was the first on the market to launch a joint project with the MIR payment system - Mir Pass, the only alternative to Priority Pass that left our market. Our loyalty program provided access to many business lounges both in Russia and abroad.

- **And as for the constant trends in investment, are there any niches that remain attractive regardless of the global situation?**

- The situation in the world can really change overnight, we have witnessed it several times in real life. I believe the only thing that remains valuable and useful at all times is knowledge turned into practical experience. That is an investment in yourself. If rated honestly, I believe in human capital, i.e. today and in the future we should prioritize investment in education, science, and healthcare, all those longstanding areas underlying the real values and intellectual capital of the nation.

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