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Geography of FDI from Visegrad Countries in Russia

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Abstract. The article investigates the Russian place in outward FDI geography of the Visegrad countries. The role of the neighborhood effect is shown. With the help of the authors' special methodology for FDI calculations which overcomes deficiencies in the Bank of Russia's statistics, the distribution of the Visegrad group's FDI between Russian regions is studied. The authors demonstrate the presence of a hierarchical-wave model of spatial diffusion of FDI by investors in retail and banking. At the same time, it is found that Moscow and its surrounding dominate the recipient regions. It is also shown that Visegrad group investments in Russia are mostly made by enterprises which remove any political component. As a result, their FDI expansion to the Russian market is likely to continue as soon as the Russian economy returns to growth.

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1. Introduction

Visegrad countries (Poland, Czech Republic, Slovak Republic and Hungary) have been traditionally viewed as major foreign direct investment (FDI) recipients in Central and Eastern Europe. As Rossitsa Rangelova puts it, FDI from the West-European countries has been a major driver for CEE transformation since the beginning of the 1990s, including technological and structural renewal as well as new management methods and organizational rules (Rangelova, 1999). Some recent studies emphasize the changing character of inward FDI in these countries, outlining the growth of service and knowledge-oriented FDI (Sass, Fifekova, 2011).

Being the most developed countries in Central and Eastern Europe and the leaders of post-communist transition, the Visegrad countries have also become notable FDI exporters in the recent years (e.g. Kalotay, 2004; Gorynia et al., 2012; Kaliszuk, Wancio, 2013; Sass, Kovács, 2015). The case has not received much attention partially due to the fact that many national companies with foreign assets had been bought by foreign multinationals in previous years. This made these enterprises' outward FDI originate statistically from other countries. Among the reasons for the internationalization of the enterprises from the Visegrad group are the small size of their domestic markets (Kuznetsov, Chetverikova, 2007), resource shortages and tax optimization (Radlo, Sass, 2012).

Despite several interesting articles on comparison of outward FDI patterns from various Visegrad and some other Central European countries (e.g. Andreff, 2003; Rugraff, 2010; Cantner et al., 2013), Visegrad group investments in Russia have not been studied in detail. However, it is a case of special interest as Russia could receive significant FDI from the Visegrad group due to geographical proximity and historical ties. In fact, according to the Bank of Russia, inward FDI stock in Russia from the Visegrad group was USD 1029 million at the beginning of 2016 (Bank of Russia, 2016a). For example, this was five times less than Austrian FDI stock in Russia, although total Austrian FDI stocks exceed direct investments abroad from Visegrad group by 2.4 times (UNCTAD, 2016). At the same time, outward FDI stock from Russia to the Visegrad group was USD 2839 million (Bank of Russia, 2016b).

Research into Russian-Visegrad group economic ties has always been difficult due to an intense political component (Csaba, 2006). In this study we argue that Visegrad group direct investments in Russia are mostly made by enterprises which remove the political component. It enables the researcher to investigate opportunities for pragmatic cooperation between these countries.

2. Methods for comparison of statistical sources

National statistics on FDI, especially in transition economies, are extremely unreliable due to using 'offshore' facilities (Kalotay et al., 2014), a lack of accounting on small investment projects, as well as reinvested profits and some other points leading to the distortions (Kuznetsov et al., 2013). Most of these are found for the Visegrad group. For example, official statistics put offshore jurisdictions and financial centers among the main recipients of the Visegrad group's FDI. In fact, investments via these destinations are usually trans-shipping or even round-tripping FDI. Some of the Visegrad group's FDI outflows to offshore centers finally reach Russia.

Researchers from the Primakov Institute of World Economy and International Relations (IMEMO) have elaborated a special methodology for FDI accounting. It was successfully implemented in studies of FDI in post-Soviet countries (our report on mutual FDI in the CIS was named among 50 best analytical publications of global think tanks – McGann, 2015: 122). This methodology includes analysis of both Russian and a partner's 'mirror' central banks statistics, comparing it with the data from other official sources (e.g. data from ministries of the economy or state investment agencies), international organizations (mainly UNCTAD statistics as well as OECD data which usually excludes investment to financial holdings) and – the most important – the data on particular FDI projects which can be found in corporate reports, press and industry overviews specifically collected (see details in Kuznetsov et al., 2013).

Through comparing data from different sources it is possible to assess the real amount of funds invested. The main problems with various statisti-

cal sources are explained not by false estimations of FDI deals but by limited surveys of investors and the specifics of official methodology. It should be stressed that the basis for all statistical sources is formed using information on FDI from corporations directly or indirectly. For example, central bank statistics use questionnaires from companies (e.g. by the official 1-Invest form in Russia). Thus, the unreliability of national statistics can be explained by the incomplete list of investigated companies, low response rates of businessmen and 'mistakes' in determining home and host countries for FDI in case of offshore schemes. As a result, the researchers' task consists of the verification of Russian and 'mirror' statistics by careful comparison of corporation data and detailed official statistics on the industrial and regional structure of FDI.

Corporate statistics also allow the usage of approximate estimates when exact figures are absent. Where a company tries to hide information on FDI its approximate value can be calculated in comparison with similar deals from other firms. Sometimes figures on non-current assets may also be used which are not FDI but can show at least an approximate level of FDI activity (e.g. USD 1 million, USD 10 million or USD 100 million). Omissions in official statistics can be easily found by this method. Another way to count FDI is to analyze news in the media (the best example is Polish FDI in Kaliningrad region which amounts, according to the Bank of Russia, to only USD 2 million). Thanks to such analysis the cause of negative volumes in investment statistics can be identified which does not always mean divestment but may be a consequence of credit return to the parent company by its foreign subsidiaries.

The analysis of the regional distribution of the Visegrad group's FDI in Russia had been a challenge for a long time as there had been no statistical data by region until 2015 when such data was first published by the Bank of Russia. This data still has deficiencies. For Visegrad countries detailed figures are available only for Moscow, the Moscow region and St. Petersburg. In many other cases only figures for 'Eastern Europe not specified' can be found which combines information on the Visegrad group with Belarus, Ukraine, Moldova, Romania and Bulgaria. Nevertheless, such limited statistics can prove the dominance of Moscow.

In order to determine the validity of the quantity and character of regional distribution of the Visegrad group's FDI in Russia, the following studies were conducted:

— comparison of Russian official statistics, including data on the subjects of the Federation, and the 'mirror' statistics of Visegrad countries;
— analysis of the data on specific investment projects and their dynamics, comparison with official statistics;
— interpretation of the results, taking into account theoretical propositions about the 'neighborhood effect' and the hierarchical spatial diffusion of FDI.

3. Theoretical framework

The study attempts to trace the 'neighborhood effect' regarding the Visegrad group's FDI in Russia, which is the situation when investors tend to put money into economies which are geographically and culturally close to their own (Kuznetsov, 2008), and it is argued that this effect is most often seen when smaller countries are investing. We assume that Russia, lying close to Visegrad countries and having common historical ties attracts considerable FDI from the Visegrad group as a result of the cultural closeness enhanced by a gravity effect.

The main theoretical proposition for FDI distribution within a recipient economy is the spatial diffusion of FDI according to Haegerstrand's model of innovation diffusion (Schlunze, 1992). This model means that foreign investors often prefer to start their spatial expansion within a country in its economic capital (i.e. Moscow in Russia). Next they establish subsidiaries in other significant cities, such as St. Petersburg, Kazan or Nizhniy Novgorod, as well as in towns around the capital. Then they open subsidiaries in cities with a lesser hierarchic rank and in the surroundings of several large cities, etc. In the case of Russia, the shift from initial FDI in European part of Russia to additional FDI in the Urals and only then in Siberia can also be seen, especially in the FDI geography of many large US, German and French investors (Kuznetsova et al., 2007).

However, this well-known hierarchical-wave model is not universal for FDI diffusion, for example it can be simplified by economies of scale. It can also be distorted by previous cooperation ties or acquisition deals because the entire logic of hierarchic-wave FDI diffusion is based on learning processes while cooperation or acquisition of existing business networks can support foreign investors with necessary information for FDI in rather 'unexpected' regions of Russia for newcomers. At last, it is difficult to see any model of FDI diffusion in the oil and gas industry and some other resource-based sectors. For example, the geography of FDI in these sectors is determined not only by economic factors but also by state regulation (licenses, etc.).

We investigate spatial diffusion of foreign investments regarding the Visegrad group's FDI within Russia. The effect is best demonstrated by retailers and banks. Indeed, companies establish many subsidiaries in these sectors (as a result, rather complicated models can be tracked), the size of nearby markets is crucial (thus, a hierarchic element can be seen) and the information factor is also important (while wave elements in spatial diffusion usually appear due to learning processes which connected with gradual access to necessary information).

4. Results

4.1. Russia as part of the second 'neighborhood belt' for the Visegrad group's FDI

The geographical structure of FDI from Visegrad countries has been transforming in recent years. Immediately after joining the EU the neighborhood effect in FDI distribution can be traced very clearly (Table 1). This can be explained by the fact that most local TNCs were at an early stage of internationalization, which is traditionally characterized by a focus on the comfortable and friendly environment of neighboring countries. Of course, there is no strict correlation between FDI stocks and spatial or cultural proximity because in some industries it is not an important factor or investors can prefer offshore locations. Moreover, neighbors can have an unfavorable investment climate or are strong competitors for the country's TNCs. Nevertheless, comparison of FDI stocks at the end of 2006 from Austria and Visegrad countries shows that only the rather large Poland had less distinct 'neighborhood effect' in FDI geography (moreover, there was a dominance of Luxembourg and some other trans-shipping destinations in the distribution of Polish outward FDI).

Table 1. Geography of outward FDI stocks from Visegrad countries and Austria, end of 2006 (according to OECD)

Indicator	FDI from Austria		FDI from Poland		FDI from Hungary		FDI from Czech Republic		FDI from Slovak Republic	
	USD million	%	USD million	%	USD million	%	USD million	%	USD million	%
Total outward FDI stock	105,697	100	14,319	100	12,369	100	5,017	100	1,325	100
FDI stock in EU*	61,175	57.9	8,363	58.4	7,812	63.2	4,185	83.4	1,031	77.8
FDI stock in three most attractive neighbors	28,548	27.0	1,862	13.0	4,044	32.7	1,971	39.3	934	70.5
Three most attractive neighbors for FDI of the country	Germany; Czech Republic; Switzerland		Czech Republic; Ukraine; Germany		Slovak Republic; Romania; Ukraine		Slovak Republic; Germany; Poland		Czech Republic; Ukraine; Poland	
FDI stock in Russia	2,377	2.2	281	2.0	184	1.5	198	3.9	43	3.2

Explanation: * Figures for Austria, Poland and the Slovak Republic are approximate because data on some recipients are closed as confidential.

Source: OECD International Direct Investment Statistics 2012. Paris: OECD.

Today the first phase of internationalization has passed and differences in the geographical expansion of TNCs from Visegrad countries are becoming more noticeable. Polish TNCs still demonstrate a

clear focus on intermediary countries (in 2014 Switzerland, Luxembourg, the Netherlands and Cyprus took a total of about 80% of Polish TNCs' foreign investments – Table 2). Polish TNCs also demonstrate the neighborhood effect as a large share of their FDI goes to the Czech Republic, Germany, Russia and Romania. Hungarian TNCs invest in the United Kingdom, the United States, the Republic of Korea and Israel, as well as the trans-shipping centers of FDI attraction – Switzerland, Luxembourg and even Curaçao.

The Czech Republic and the Slovak Republic continue to demonstrate considerable focus on each other in FDI outflows, but this focus has weakened in recent years (e.g. in 2005 Czech and Slovak mutual FDI in each other's economies was more than 25 and 50% respectively (Kuznetsov, 2008) while in 2014 it was 16 and 31%). However, these countries manifest a greater neighborhood effect in the distribution of FDI outflows than the rest of the group: the major recipients of the Slovak Republic's investment are Poland and Hungary; Czech money mostly goes to Croatia, Romania, Bulgaria and Poland.

Table 2. Geography of outward FDI stocks from Visegrad countries, end of 2014 (according to IMF)

FDI destination	Visegrad Four total		Poland		Czech Republic		Slovak Republic		Hungary	
	USD million	%	USD million	%	USD million	%	USD million	%	USD million	%
Total	217,811	100.0	27,154	100.0	17,494	100.0	2,998	100.0	170,165	100.0
Switzerland	55,394	25.4	3,256	12.0	-4	-0.0	-1	-0.0	52,143	30.6
Luxembourg	50,774	23.3	7,316	26.9	0*	0.0	418	13.9	43,040	25.3
United Kingdom	15,485	7.1	981	3.6	542	3.1	6	0.2	13,956	8.2
Cyprus	13,217	6.1	8,610	31.7	16*	0.1	735	24.5	3,856	2.3
Netherlands	11,734	5.4	2,787	10.3	6,966	39.8	101	3.4	1,880	1.1
Curacao	10,671	4.9	35	0.1	0	0.0	0	0.0	10,636	6.3
USA	10,177	4.7	635	2.3	37	0.2	5	0.2	9,500	5.6
Republic of Korea	9,305	4.3	8	0.0	-3*	-0.0	0	0.0	9,300	5.5
Slovak Republic	4,850	2.2	260	1.0	2,872	16.4	X		1,718	1.0
Israel	4,443	2.0	145	0.5	0*	0.0	0	0.0	4,298	2.5
Belgium	3,996	1.8	-111	-0.4	200	1.1	41	1.4	3,866	2.3
Croatia	3,665	1.7	77	0.3	344*	2.0	12	0.4	3,232	1.9
Czech Republic	3,086	1.4	1,736	6.4	X		944	31.5	406	0.2
Romania	2,455	1.1	580	2.1	1,019*	5.8	13	0.4	843	0.5
Germany	2,330	1.1	1,135	4.2	1,064	6.1	35	1.2	96	0.1
…										
Bulgaria	1,644	0.8	48	0.2	552	3.2	6	0.2	1,038	0.6
Russia	1,543	0.7	721	2.7	337*	1.9	14	0.5	471	0.3
Poland	1,413	0.6	X		368	2.1	222	7.4	823	0.5
Hungary	591	0.3	403	1.5	137	0.8	51	1.7	X	

Explanation: * The Czech Republic does not publish such information, so the source is the recipient's official data.

Source: IMF data on Coordinated Direct Investment Survey based on Visegrad countries' central banks – http://data.imf.org: table 6-o, table 6-i

The analysis shows that Visegrad countries themselves, together with nearby Central and Eastern European states, form the first 'neighborhood belt' of the Visegrad group's FDI.

Russia is part of the second 'neighborhood belt' and receives a share of the Visegrad group's FDI which is comparable to that going to Germany. It is the next step in the path of internationaliza-

tion for firms from Visegrad countries. Access to these markets is fraught with numerous difficulties for the investors: increased competition, the need to develop new business models and adapt to the new peculiarities of the markets, etc.

However, Russia is one of the most attractive and significant markets for many major investors from the Visegrad group. For instance, the Hungarian *OTP Bank* has invested more than USD 0.5 billion and become the leading investor from the Visegrad group in Russia. The bank has subsidiaries in eight Balkan and East European countries but its Russian subsidiary is the second largest after Bulgarian *OTP* bank.

According to official statistics the Russian share is about 0.5-3%, but the percentage may increase by several times if funds invested through third countries are also included. For example, *Home Credit and Finance Bank* is one of the largest Czech investors in the Russian economy (in 2011 the bank was one of the four largest Russian banks in terms of loan portfolio). However, it belongs to the Dutch *HomeCreditGroup*, which is included in the Czech *PPF Group*. Technically it makes the bank's FDI in Russia as Dutch.

4.2. Spatial diffusion of the Visegrad group's FDI in Russia

According to official statistics, Russian 'capital' regions (Moscow and St. Petersburg) dominate in terms of Visegrad group FDI stocks. The share of Moscow in Visegrad group FDI stocks in Russia is much higher than in general in Russia. St. Petersburg is also more popular among Visegrad investors than among other foreign companies (Table 3). On the one hand, it can be explained by the hierarchical diffusion of FDI. Several significant manufacturing companies from Visegrad countries established their first plants in the Moscow region or other regions of Central Russia. For example, the Hungarian *Gedeon Richter* and Polish *Bella* (a subsidiary of *Zakład materiałów opatrunkowych w Toruniu*) were among the investment pioneers from the Visegrad Group when they opened plants in Egorievsk near Moscow. On the other hand, some service companies account all their FDI to Moscow although the headquarters in the Russian capital receive only a part of investment flows.

Table 3. Role of some Russian regions in FDI stocks from Visegrad countries (according to the Bank of Russia)

Country	FDI stock, USD million							
	Russia, total		Moscow city		St. Petersburg		Other regions**	
	1.1.2015	1.1.2016	1.1.2015	1.1.2016	1.1.2015	1.1.2016	1.1.2015	1.1.2016
Hungary	606	434	473	335*	76	49	57	50
Poland	323	323	177	184	9	8	54	42
Czech Republic	393	253	269	146	14	16	110	91
Slovak Republic	22	19	2	2	0	0	20	17
Visegrad Four total	1,344	1,029	921 *(68.5%)*	667 *(64.8%)*	99 *(7.4%)*	73 *(7.1%)*	324 *(24.1%)*	289 *(28.0%)*
All countries	365,439	342,943	184,722 *(50.5%)*	173,582 *(50.6%)*	22,845 *(6.3%)*	16,583 *(4.8%)*	157,872 *(43.2%)*	152,778 *(44.5%)*

Explanation: **Since October 2015 some Hungarian FDI are registered as FDI from Eastern Europe without strict attribution to any country. ** The Bank of Russia presents information for many regions in format 'Eastern Europe not specified' which includes not only Visegrad Four but also Belarus, Ukraine, Moldova, Romania and Bulgaria. As a result, it is possible to find exact figures only for Moscow and St. Petersburg.*

Source: The Bank of Russia data on inward FDI stocks – http://www.cbr.ru

The neighborhood effect can also be seen in the regional distribution of the Visegrad group's FDI in Russia. It is not evident from the Bank of Russia's statistics but analysis of other official sources and corporate information demonstrates the dominance of the European regions of the Russian Federation, with an especially important role for the Kaliningrad region by Polish investors. According to the Polish Consulate-General in Kaliningrad, Polish FDI stock in the region amounted to USD

70 million. At the end of 2015, there were about 40 Polish investors in the Kaliningrad region (Milota, 2015). This fact means that the Bank of Russia underestimates Polish FDI stocks and such a hypothesis is confirmed by Polish 'mirror' statistics (e.g. USD 323 million versus USD 721 million for the whole Russian Federation at the beginning of 2015). The gap can be explained by the formal registration of some Polish firms with Kaliningrad subsidiaries in Moscow, trans-shipping FDI via offshore locations or ignorance of small and medium-sized investment projects in Russian statistics (indeed, the average FDI stock by Polish companies is less than USD 2 million in Kaliningrad region and none of them have received a status of resident in the Kaliningrad Special Economic Zone).

When analyzing the development dynamics of the largest service networks from the Visegrad group in the Russian market (examples are the Czech *Eldorado* and the Hungarian *OTP Bank*), we have ascertained that there is a neighborhood effect together with the hierarchical diffusion of FDI. Striving to get as close as possible to the client these companies made market-seeking FDI in the largest agglomerations and then gradually shifted to smaller towns. Thus, in 2006 *OTP Bank* acquired the Russian *Investsberbank* and its network of branches situated mainly in the European part of Russia. After a few years it began expanding to the Urals, Siberia and the Far East (for example, in 2011 in Khabarovsk and in 2012 in Vladivostok). At the same time, as it was stressed in the theoretical part of our article, it is difficult to trace hierarchical-wave diffusion in some branches of manufacturing.

The sectoral structure of the Visegrad group's FDI in Russia is also demonstrative. There are no official statistics on sectoral structure of FDI stocks in Russia by separate countries but we have made our own rough estimates on the basis of corporate information and news in media. In contrast to investors from some other EU countries, companies from the Visegrad group pay the most attention to non-primary sectors of the Russian economy: they invest in the financial sector (Hungarian *OTP Bank* and Czech *Home Credit and Finance Bank*), pharmaceuticals (Hungarian *Gedeon Richter* and Polish *Polpharma*), wood production (Polish *Videman Polska, Pfleiderer Grajewo* and *Barlinek*) and others (e.g. Czech *Brano Group* with automotive components production in the Nizhny Novgorod region or Polish *Cersanit* with ceramics production in the Samara region).

Only Hungarian companies are more focused on the primary sector (in particular, *MOL* is involved in the development of oil fields, although it sold its largest Russian asset in Khanty-Mansiysk Autonomous District in 2013). Companies from the Czech Republic invest more in service sector projects while Polish ones choose industrial projects. Companies from Slovakia did not initiate many high-profile projects in Russia. An exception is a joint venture of *Continental Matador Rubber* and Russian *Sibur – Russian Tyres*, which has existed since 1995.

According to media and corporate reports (there is no official statistical data on the matter), companies from the Visegrad group choose diverse forms of FDI projects in Russia. They invest both in greenfield projects and in existing Russian enterprises meaning to modernize them. New examples of cooperation can be found even in the period of the current political crisis in relations between the EU and Russia. For instance, in October 2015 the Polish *Barlinek* wood processing company signed an agreement on the resumption of a previous project which had been frozen due to the 2009 financial crisis in Vologda region.

An unfavorable investment climate in Russia is one of the constraints on investment interactions which have a considerable development potential. According to the Doing Business rating (World Bank, 2016), at the end of 2015 Russia was ranked 51 and had progressed only slightly in a year (ranked 54 in 2014), while the Russian government plans to achieve rank 20 as early as 2018 (Ministry of Economic Development …, 2013). According to the majority of Russian experts, economic factors are more crucial than political tensions for the further development of the Visegrad group's FDI expansion in Russia. As a result, their FDI expansion to the Russian market is likely to continue as soon as the Russian economy returns to growth.

5. Conclusions

The analysis shows that Russia and the Visegrad countries maintain significant investment ties, the true scope and real forms of which cannot be ful-

ly described by the official statistics. Indeed, dozens of companies have invested less than USD 10 million in manufacturing enterprises but information on these FDI's can be found only from media or corporate sources.

The dominance of European regions of the Russian Federation is typical for the Visegrad group's FDI which can be explained by several factors including the neighborhood effect. Nevertheless, hierarchical diffusion is also an important feature of Visegrad group FDI geography in Russia, especially in service industries where the leading investors are concentrated (above all the Czech *Eldorado* and the Hungarian *OTP Bank*).

Russia is part of the second 'neighborhood belt' and receives a modest share of the Visegrad group FDI. Russian investment crisis, political tensions between Russia and the EU, further development of the Visegrad group corporate integration within the EU and general tendencies of geographical diversification of the Visegrad group's FDI prevent a significant increase in the Visegrad group's FDI stocks in Russia. Moreover, there was a decrease in this indicator during 2015. However, some companies from the region continue their investment expansion in Russia.

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