

*Peeter Vahtra*

Expansion or Exodus?

Russian TNCs amidst the global economic crisis

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## Foreword

During the past six years, the Pan-European Institute at the Turku School of Economics has carried out research on the changing role of Russian enterprises on the global business arena and external economic relations of Russian companies in particular. This pioneering research has been made possible by the generous support from the Finnish Ministry of Education and the Academy of Finland.

One of the key areas of this research has been the foreign expansion of Russian companies and outward foreign investments from Russia, a phenomenon that has gained on significant leverage during the past decade. The rise of multinational enterprises from emerging markets is currently one of the key areas of interest in international business discipline, and the Pan-European Institute is proud to be on the forefront of this substantial line of research.

For now, the current report marks the end of the six-year-follow-up of Russian companies' international investments and the Expansion or Exodus? -research report series initiated in 2004 at our institute. This publication series has often been referred to as a benchmark study in research on Russian outward foreign investments. Apart from numerous publications both in the Pan-European Institute's electronic publication series and in international journals and edited volumes, the institute's researchers have provided their expertise for several international organisations, including UNCTAD, the European Commission and the World Bank.

Despite the six years of successful research efforts, the field is far from being saturated. The Pan-European Institute looks forward for future opportunities in carrying out further studies on internationalisation of the Russian companies and economy – a continuously evolving research topic that continues to post new opportunities and challenges for the international academic and policy researchers alike.

Turku, September 2009

Kari Liuhto  
Professor, Director

**To the Reader,**

At the time of writing of this report, two years have passed since the previous volume in the Expansion or Exodus? -research report series. During these two years, the global economic boom has turned into an economic gloom bringing about its immediate and adverse consequences on multinational corporations. After nearly a decade of steady growth, the global FDI has entered a period of recession and not only have many of the new international investment projects been put on hold, but multinational corporations have also sought to eradicate themselves from existing investment projects and international subsidiaries in order to adjust to the changing business environment.

Amidst the general fall in global FDI, a handful of countries stand out as growing FDI sources. Most notably, Russia has recorded growth in outward FDI over 2008 and still in early 2009, a notable division from the current global FDI trend. The world's multinationals have seen the values of their international assets contracting in 2008 and Russian companies are no different in this respect. However, annual FDI outflows and the amount of new transactions from Russia have increased despite the global economic gloom, indicating growing push of its multinational companies towards further internationalisation.

This report summarises some recent trends in Russian OFDI and investments of its leading transnational corporations (TNCs) in particular. In addition, the report marks the conclusion of a six-year research project on the external economic relations of Russian companies and their OFDI in particular. During these years, we have identified new trends and phenomena related to Russian OFDI in an attempt to keep both ourselves and the readers updated with the most recent developments in this increasingly notable field of research. Adapting to the changing global economic environment, the investment practices of Russian companies have changed notably and the country's leading investors have emerged as worthy competitors at international business arena. It is our firm belief that the developments in Russian OFDI will continue strong and only time will show to what extent the balance in global OFDI will shift towards the emerging economies.

Turku, September 2009

Peeter Vahtra

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## Introduction

Over the past ten years, international scholars have found increasing interest in outward foreign direct investments (OFDI) from emerging economies in general and in OFDI from Russia in particular. The key question to be answered by the scholars, however, remains relatively unchanged since the very first scholarly contributions to the field: Can and should the Russian OFDI be treated similarly with those from other (developed market) economies, and, if not, what are the main distinctive features of the Russian OFDI?

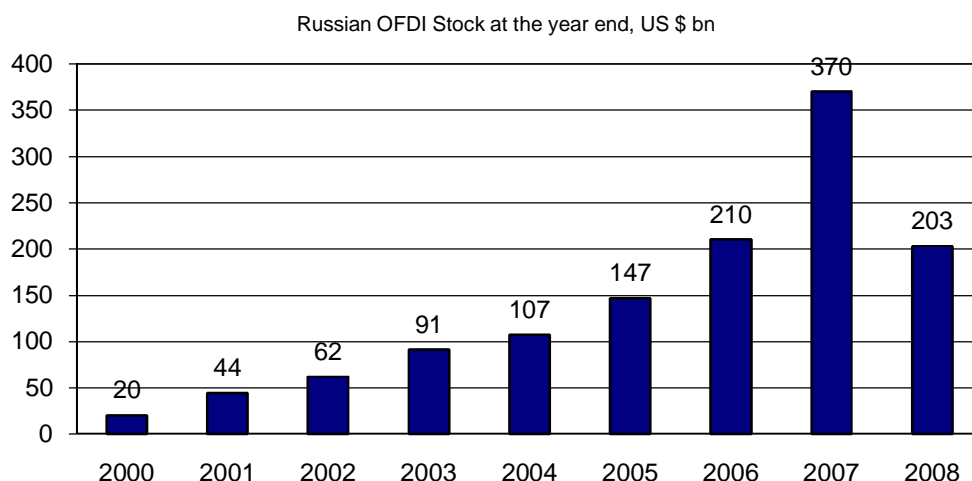
Since the beginning of the economic transition, Russia has stood out among transition economies as a net capital exporting country and the economy with the highest outward/ inward FDI ratio. After a steady yet relatively modest average annual growth of some 10% throughout the 1990s, the Russian OFDI flows took off in 2000s, growing more than tenfold during 2000-2007. Despite a slowdown during 2008, Russia remained among the few economies in the world still posting growing figures in OFDI amidst the global economic crisis. While the global FDI fell by some 20% in 2008, Russian outward direct investment flows grew by more than 10% to amount \$ 53 billion in 2008 and the most recent statistics indicate hardly any drop during the first half of 2009. In addition to officially registered OFDI, there are numerous estimations on the magnitude of capital flight from Russia that by far exceed the official figures on OFDI. In fact, 2006 was the first year that Russia became a net capital importer, indicating a notably large amount of capital outflows by Russian commercial entities and residents.

For six consecutive years, we have followed the rise of Russia's transnational corporations (TNCs) among the world's leading multinationals. In the current report, recent trends in Russia's outward investments are laid out and some key findings from a six year-follow-up of Russian OFDI are summarised in order to contribute to the debate on emerging market OFDI.

## Russian OFDI rises amidst the global fall

By the end of 2008, the Russian OFDI stock amounted to \$ 203 billion, up from mere \$ 20 billion in the end of 2000 (Figure 1). One should further note that the economic crisis has brought about severe contraction of the asset values of all the world's multinational companies – by the end of 2007, the value of Russia's OFDI stock had already climbed to impressive \$ 370 billion, from which it dropped to the 2008 level mainly due to the valuation changes (- \$ 220 billion over 2008). In fact, the value of new OFDI transactions from Russia increased to \$ 53 billion in 2008. Hence, Russia stands out as one of the few economies posting actual growth in OFDI amidst the global economic crisis.

**Figure 1 Russia's OFDI stock, 2000-2008.**



Source: Central Bank of Russia 2009.

Among its international emerging economies' peer group, the BRICs<sup>1</sup>, Russia has maintained its pole position in outward FDI<sup>2</sup>. Moreover, during the peak year of 2007, Russian OFDI stock came to amount nearly 13% of that of the world's leading foreign investor, the USA. Only in 2000, the respective share was merely 1.5% (Table 1).

<sup>1</sup> Brazil, Russia, India, China.

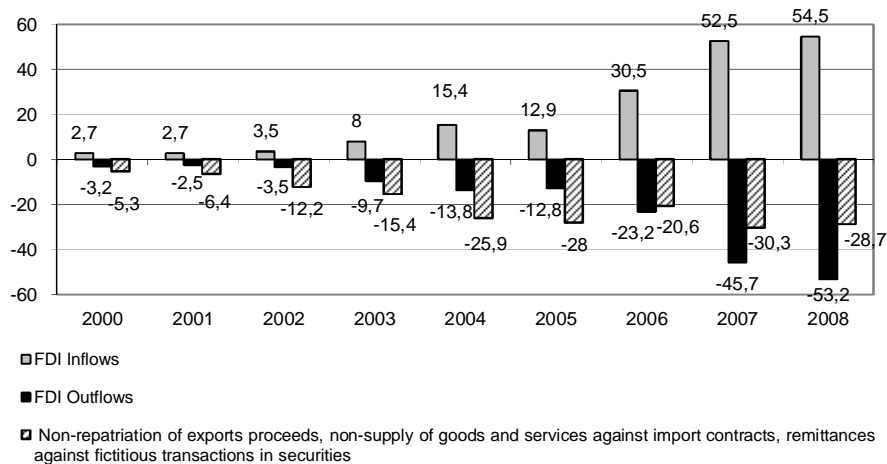
<sup>2</sup> Among the emerging economies of the world, only the international financial centre of Hong Kong, China, has larger OFDI stock than Russia.

**Table 1 OFDI stocks of selected economies, 1995–2008, \$ billion.**

	1995	2000	2005	2007	2008
United States	699.0	1,316.2	2,241.7	2,916.9	3,162.0
Hong Kong, China	78.8	388.4	471.3	1,011.2	775.9
<b>Russian Federation</b>	<b>3.3</b>	<b>20.1</b>	<b>146.7</b>	<b>370.2</b>	<b>202.8</b>
Brazil	44.5	51.9	79.3	136.1	162.2
China	17.8	27.8	57.2	95.8	147.9
India	0.5	1.9	10.0	44.1	61.8

Sources: UNCTAD 2009, Panibratov and Kalotay 2009.

Besides FDI, the Central Bank of Russia includes on the balance of payments an item “non-repatriation of export proceedings...”, which represents the estimated the unregistered capital outflows (or illicit capital exports) from the country. Since the beginning of transition in 1991, the unregistered and illegal capital exports have formed a sizeable share of the total capital outflows from Russia. Until 2006, the value of these “grey” capital exports has surpassed that of outward FDI from Russia, at worst being more than twice as large as the legal OFDI (Figure 2).

**Figure 2 Russian FDI inflows/ outflows and illicit capital outflows**

Source: Central Bank of Russia 2009.

The sheer size of the unregistered capital outflows suggests that they originate not merely from the transactions by the resident individuals but also from the hidden transactions of the Russian companies operating abroad. Hence, we argue that when discussing the amount of Russian capital abroad, one should not limit the analysis to official (although substantial) FDI only, but



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take into account the vast amount of Russian capital abroad accumulated through “grey” transactions by the Russian resident individuals and enterprises. Although capital flight can be considered as a global phenomenon and not only typical for Russia, the enormous value of unregistered capital outflows is what makes Russia to stand out in the global comparison. In the light of the recent data from the Central Bank of Russia, even earlier estimations on capital flight from Russia by the European Commission (\$ 200 – 300 billion between 1992 and 2002) and World Bank (\$ 300 billion by the end of 2003), seem rather underestimated.

Without doubt, the record-high energy and raw material prices and their strong impact on Russian economy can be identified as the single most influential factor behind the surge in Russia’s OFDI over the past decade. Besides the surging revenues from energy exports, however, several other factors have contributed to the rise of (official) Russian OFDI, namely:

- 1) **The improved data collection methods** of the Russian fiscal authorities and the Central Bank of Russia in particular have on their part contributed to the increase in recorded FDI from Russia, bulk of which used to leave the country unregistered during the 1990s. Especially the improved tracking of valuation changes of the existing foreign assets has contributed to compilation of more realistic datasets on Russian investments abroad.
- 2) **The essential lack of domestic investment targets and discouraging industrial policy** has been a major driver for many leading Russian industrial conglomerates seeking to accommodate the accumulated export revenues. As many Russia’s leading industrial enterprises have been forced to supply the domestic market at artificially low prices, the incentives to develop domestic operations has subsequently been lower than these to develop more profitable production infrastructure abroad.
- 3) **Creation of safe deposits abroad** has been a key driver for capital exports especially in the 1990s as the controlling owners of the leading Russian business groups sought safeguards against governmental intervention and potential expropriation. The recently strengthened role of the state in Russian economy may yield resurgence of investments of this type.
- 4) **The re-emerged political ambitions particularly in Russia’s near abroad** have in some occasions guided the foreign investments of the Russian state-owned energy conglomerates, through which Russia has actively sought to establish economic and political leverage in its neighbouring regions.

## The largest Russian transnational corporations

Since 2003, we have compiled and published the listing of largest Russian TNCs, based on our extensive database on their foreign acquisitions. During the past six years, the value of the foreign assets of Russia's 10 leading TNCs has grown more than tenfold<sup>3</sup>, amounting to nearly \$ 70 billion in late 2008 (Table 2).

**Table 2 Russia's leading TNCs by foreign assets in 2008.**

Company	Foreign assets, \$ <i>bln</i>	Principal host countries
Lukoil	23 512	Baltic States, CIS, Finland, USA, Venezuela
Gazprom	12 132 <sup>4</sup>	The majority of the EU and CIS countries, Turkey
Norilsk Nickel	8 965	Botswana, South Africa, USA
Severstal	4 546	Italy, USA
Evrz Holding	4 450	USA
RusAl	3 925	Armenia, Australia, Guinea, Kazakhstan, Nigeria
Altimo	3 825	Armenia, Georgia, Kazakhstan, Tajikistan, Turkey, Ukraine, Uzbekistan
Mobile TeleSystems (MTS)	2 000	Belarus, Ukraine, Uzbekistan
VimpelCom	1 350	Armenia, Georgia, Kazakhstan, Ukraine, Uzbekistan
Novolipetsk Metal	1 050	Belgium, France, Italy, USA

Sources: Company information, authors' calculations.

As indicated by the rapid growth, the leading Russian TNCs have in recent years pursued aggressive acquisition strategies. Besides the increased number of foreign acquisitions, the value of asset purchases by Russian companies abroad has soared. The Russian outward investments, however, are in large part carried out by only a handful of industrial conglomerates, oil, gas and metal companies in particular. As a result, very few companies are responsible for the bulk of foreign investments from Russia (the three leading companies account for more than 60% of the total foreign assets of the top-10 companies). Further, the combined value of foreign investments of the two leading Russian oil and gas companies, Lukoil and Gazprom, amounts to USD 35 billion, which well exceeds the combined value of the foreign assets of the remaining companies on the top-10 list. In addition, the two companies are

<sup>3</sup> During the last months of 2008 and beginning of 2009, the value of assets of global (and Russian) multinationals has decreased notably, which is not indicated by the above figures.

<sup>4</sup> The figure includes the combined value of the assets of some 20 subsidiaries of Gazprom, on which the information has been found. The authors estimate the actual value of all Gazprom's foreign assets to be roughly USD 15 billion after strong devaluation during the past year.

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responsible for more than 90% of OFDI from the oil and gas sector. Although no substantial re-nationalisation has yet appeared on the top-10 list of Russia's TNC, we do expect increasing consolidation of state ownership amidst the global economic crisis, which hardly brings any new substantial actors on the Russian outward investment arena in the near future.

Since the beginning of 2005, there has been a considerable breakthrough on the Russian equity capital markets as the Russian companies initiated a wave of initial public offerings (IPOs) both on domestic and foreign stock exchanges. In 2007, Russia was the fifth-largest source economy for IPOs in global comparison. Altogether, Russian companies raised some USD 40 billion in 2006-2008 through domestic and foreign IPOs. Although the public listings have been dramatically reduced amidst the global economic downturn, the Global 2000 list of international publicly traded companies, published by Forbes in April 2009, included 28 companies from Russia (Table 3).

**Table 3 Russian companies on Forbes Global 2000 list in 2009.<sup>5</sup>**

Rank	Company	Country	Industry	Sales USD bln	Profits USD bln	Assets USD bln	Market value <sup>6</sup> USD bln
13	Gazprom	Russia	Oil and gas	97,29	26,78	276,8	74,55
64	Rosneft	Russia	Oil and gas	46,99	11,12	77,4	34,07
76	Lukoil	Russia	Oil and gas	66,86	9,51	59,1	26,62
168	Surgutneftega	Russia	Oil and gas	24,25	3,61	40,3	19,65
	z						
172	Sberbank	Russia	Banking	21,63	4,33	200,9	8,56
211	TNK-BP	Russia	Oil and gas	36,25	5,94	27,9	9,45
241	Norilsk Nickel	Russia	Non-ferrous metals	17,73	5,52	35,7	8,86
450	Severstal	Russia	Ferrous metals	22,39	2,03	22,5	3,68
505	VTB Bank	Russia	Banking	7,15	1,53	92,5	3,50
548	Tatneft	Russia	Oil and gas	11,03	1,76	15,1	4,42
566	Transneft	Russia	Oil and gas	28,68	2,35	30,1	1,29
570	Novolipetsk Metal	Russia	Ferrous metals	8,00	2,33	13,1	5,69
679	Sistema	Russia	Telecommunications	14,19	1,63	28,3	1,22
682	VimpelCom	Russia	Telecommunications	7,43	1,52	10,6	5,13
899	Magnitogorsk Metal	Russia	Ferrous metals	8,49	1,84	9,4	2,01
1077	Mechel	Russia	Ferrous metals	6,96	0,95	9,2	1,50
1177	Novatek	Russia	Oil and gas	2,52	0,76	4,2	6,61
1297	Moscow Municipal Bank	Russia	Banking	2,00	0,36	21,5	2,21
1349	RusHydro	Russia	Electricity	1,94	0,27	11,3	4,19
1676	TMK	Russia	Materials	4,33	0,50	4,7	0,78
1708	Bashneft	Russia	Oil and gas	4,12	0,53	3,4	0,78
1731	Slavneft Megioneft	Russia	Oil and gas	3,93	0,56	3,4	0,30
1802	AvtoVaz	Russia	Machinery	7,63	0,14	7,4	0,21
1832	PIK Group	Russia	Financial services	2,81	0,73	5,2	0,27
1856	GAZ	Russia	Machinery	6,22	0,27	3,0	0,08
1866	Polyus Gold	Russia	Gold mining	0,90	0,04	3,7	6,05
1921	Rostelecom	Russia	Telecommunications	2,63	0,11	3,0	5,47
1927	Uralkaly	Russia	Chemicals	1,20	0,33	1,6	2,65

Source: Forbes 2009.

<sup>5</sup> Forbes Global 2000 companies (the world's 2000 largest corporations) have the top composite scores based on sales, profits, assets and market value.<sup>6</sup> The market value is based on the rating of April 9<sup>th</sup> 2009.

Along with the growth in OFDI, the value of individual investment projects of Russian companies has soared. Between 2006 and 2008, the combined value of the 10 largest foreign acquisitions by the Russian companies amounted to more than \$ 25 billion (Table 4).

**Table 4 Some of the largest foreign acquisitions by Russian companies, 2006-2008.**

<b>Buyer</b>	<b>Target company</b>	<b>Target country</b>	<b>Sector</b>	<b>Share, %</b>	<b>Value, \$ mln</b>
<b>Norilsk Nickel</b>	LionOre Mining	Canada	Metals & mining	100	5 234
<b>Evrax Holding</b>	IPSCO Canada	Canada	Metals & mining	100	4 200
<b>Altimo</b>	Turkcell	Turkey	Telecommunication	13	3 200
<b>Gazprom</b>	Beltransgaz	Belarus	Oil & gas	50	2 500
<b>Evrax Holding</b>	Oregon Steel	USA	Metals & mining	100	2 300
<b>Lukoil</b>	Nelson Resources	Kazakhstan/ Canada	Oil & gas	100	2 000
<b>Mechel</b>	Oriel Resources	UK	Metals & mining	47	1 500
<b>Norilsk Nickel</b>	Gold Fields Ltd	South Africa	Metals & mining	20	1 200
<b>Gazprom</b>	NIS	Serbia	Oil & gas	51	900
<b>Evrax Holding</b>	Highveld Steel	South Africa	Metals & mining	79	678
<b>Evrax Holding</b>	Palini & Partoli	Italy	Metals & mining	75	620
<b>Severstal</b>	WCI Steel Inc.	USA	Metals & mining	100	443

Sources: Vahtra 2007, company information, author's calculations.

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## Key drivers of Russia's OFDI

Over the past ten years, the internationalisation and foreign investment strategies of the Russian companies have evolved significantly. The country's leading multinationals have moved from being mere raw material exporters to strategic international investors whose asset portfolios cover the whole globe. Below, some of the key drivers behind the internationalisation of Russia's TNCs are laid out.

(1) Through OFDI, the Russian companies further seek to establish overseas control over natural resources in order to complement their home resource basins. The Russian natural resource-based multinationals generally seek upstream investment targets that can be developed more readily and cost-effectively than the home-based, often geographically isolated, untapped resources that require vast investments and demand years to develop. Altogether, however, these resource-seeking investments form a relatively modest share in Russia's total OFDI, compared to that of China, for instance.

(2) The Russian multinationals increasingly seek downstream assets in order to build up their value chains internationally and reach the end customers. In particular, this is true for the natural resource-based companies that are still responsible for the lion's share of Russia's OFDI.

(3) The leading Russian providers of telecommunication and financial services, among others, seek targets for market- and strategic acquisitions in order to establish control over markets near abroad. In the strategic acquisitions, one may also include purchases of assets granting easier access to certain protected markets, such as the acquisitions by Russian companies in the US steel and automotive industries.

(4) In some instances, the Russian companies engage in OFDI in order to escape the institutional shortcomings, lack of investment targets at home, or to escape the overwhelming bureaucracy often accompanied with international investments. This motive also partially explains the popularity of offshore locations among Russia's OFDI target countries.

(5) The most speculative yet allegedly remarkable share of Russian OFDI is obtained by investments of Russia's state-owned enterprises that are not always guided by commercial logic but rather seen to serve the purposes of Russia's foreign policy.

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## **Sectoral and geographical overview on the Russian OFDI**

In international comparison, the geographical and sectoral data on Russian OFDI are notably scarce. Along with several earlier case and country studies provided by the author<sup>7</sup>, UNCTAD M&A database, however, provides a relatively extensive dataset on sectoral division of Russia's outward investments. Between 2005 and 2008, the M&As by the Russian companies increased by more than ten times compared with 2001–2004, from \$ 5.5 billion to USD 55.9 billion (Table 5). Most of the cross-border acquisitions were in the primary sector, which accounted for 60% of investments between 1997 and 2008. Manufacturing accounted for 23%, led by machinery, metals and motor vehicles. The share of services was 18%, of which telecommunications was by far the most important sector.

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<sup>7</sup> See e.g. Vahtra & Liuhto (2004), Vahtra & Lorentz (2004), Vahtra (2006, 2007).

**Table 5 Cross-border acquisitions by Russian multinationals, by sector/industry, 01/1992–06/2008, \$ million**

Sector / industry	1992–1996	1997–2000	2001–2004	2005–2008
<b>All sectors / industries</b>	511	1,700	5,498	55,850
<b>Primary</b>	45	1,098	2,980	33,485
Agriculture, forestry, and fishing	-	-	5	-
Mining, quarrying and petroleum	45	1,098	2,976	33,485
Mining and quarrying	-	-	1,546	15,742
Petroleum	45	1,098	1,430	17,743
<b>Secondary</b>	451	146	661	13,430
Food, beverages and tobacco	-	90	9	2
Wood and wood products	3	-	-	34
Oil and gas; petroleum refining	-	7	161	589
Chemicals and chemical products	-	-	164	113
Metal and metal products	-	31	306	2,914
Machinery	6	-	17	7,575
Electrical and electronic equipment	-	2	-	453
Electronic equipment	-	2	-	217
Communications equipment	-	-	-	143
Transportation equipment	442	15	-	1,537
Motor vehicles	200	15	-	1,537
<b>Services</b>	15	456	1,857	8,935
Electricity, gas, and water	-	177	60	1,042
Construction firms	-	-	100	1,637
Hotels and casinos	-	-	2	468
Trade	-	235	536	350
Transport, storage and communications	15	13	1,106	3,880
Telecommunications	-	10	1,021	3,637
Finance	-	23	30	1,773
Business activities	-	2	23	116
Business services	-	2	19	250
Community, social and personal services	-	7	-	888

**Source:** UNCTAD 2009.

While historically the Russian OFDI has focused on the nearby CIS region, the recent years have marked a clear turn in this respect. On a current estimation, more than three quarters of Russia's OFDI goes to the developed markets and the share is continuously rising. As the Russian multinationals have gained on experience in international business, they tend to look further than near abroad for new acquisition targets. Beyond Europe, Russian companies are increasingly active in the USA with several strategic investments in metal and machinery sectors, as well as in Africa with large-scale resource-seeking investments. Regarding the



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geographical division of Russian OFDI, one should, however, note that the statistics are often somewhat biased due to large share of offshore investments and investment round-tripping. The continuously high rankings of countries such as Cyprus, Netherlands, and British Virgin Islands among the most popular destinations of the Russian OFDI serve as an indicator of these common practices.

The recent focus of Russian multinationals on developed markets is also indicated by the UNCTAD M&A database, showing that the overwhelming majority of Russia's OFDI has gone to the European Union and the USA (Table 6). The domination of developed markets in the UNCTAD database is further due to the fact that the value of the deals in developed economies tends to be manifold compared to that in the CIS, for instance. As indicated by Table 6, however, also the value of the M&A deals in the CIS has grown notably since 2000.

**Table 6 Cross-border M&A purchases by Russian multinationals, by host country/region, 1992–2008, \$ million**

Country / region	1992–1996	1997–2000	2001–2004	2005–2008
<b>World</b>	511	2,211	5,498	56,794
<b>Developed economies</b>	511	2,151	3,962	44,287
Europe	311	1,749	2,766	30,575
European Union	311	1,749	2,566	30,160
Austria	-	-	4	1,662
Belgium	-	90	-	-
Bulgaria	-	816	37	-
Cyprus	-	-	-	511
Finland	45	45	-	276
Greece	-	-	-	806
Hungary	6	6	-	177
Italy	-	-	-	1,280
Luxembourg	-	-	-	1,660
Netherlands	245	245	-	-
Romania	-	300	121	-
Slovakia	-	-	72	-
Slovenia	-	-	-	50
Sweden	-	-	-	4,652
United Kingdom	-	211	2,273	19,016
North America	-	170	1,195	13,247
Canada	-	-	68	7,937
United States	-	170	1,127	5,310
Other developed countries	200	232	-	465
Australia	-	2	-	461
Japan	200	200	-	-
<b>Developing economies</b>	-	-	-	3,210
<b>Africa</b>	-	-	-	250
Nigeria	-	-	-	250
<b>Asia and Oceania</b>	-	-	-	2,945
Turkey	-	-	-	2,006
China	-	-	-	786
Malaysia	-	-	-	92
<b>South-East Europe and the CIS</b>	-	61	1,536	9,297
Southeast Europe	-	-	303	257
Bosnia and Herzegovina	-	-	-	157
Croatia	-	-	76	-
Serbia and Montenegro	-	-	225	59
Commonwealth of Independent States (CIS)	-	61	1,233	9,039
Armenia	-	-	27	423
Kyrgyzstan	-	-	-	150
Russian Federation	-	47	990	5,614
Ukraine	-	13	199	2,769

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*OFDI for global economic policy leverage – The African conquest*

Perhaps the most notable geographical reorientation of Russia's overseas investments during the past year has been that towards African countries, which have resurfaced not only in Russia's economic interest but also on its foreign policy agenda. The most notable expression of Russia's recent turn to Africa was the visit by the Russian President Medvedev and more than a hundred of Russian businessmen to Egypt, Nigeria, Namibia, and Angola. The high-profile tour marks the increasing interest among Russia's large multinationals towards Africa's natural resources – oil, gas, diamonds and uranium in particular. In each country, intergovernmental co-operation agreements were signed, covering both economic and policy aspects of co-operation.

Some of the most significant deals covered by the recent agreements of Russian investments in Africa include:

- 1) Involvement of Russia's state-owned **RosAtom** in building the first nuclear power plant in Egypt. If realised, the multibillion deal would put the Russian nuclear giant ahead of the US, France, and Japanese companies that have long sought access to the region's nuclear markets.
- 2) The \$ 2.5 billion joint project between **Gazprom** and the Nigerian state oil company to develop the country's oil and gas fields and to build a gas pipeline from Nigeria to Europe. While such projects are still far from being realised and face mounting practical challenges, the projected gas pipeline would significantly strengthen Gazprom's position against its European customers.
- 3) Access of the Russian oil company, **Zarubezhneft**, to Angolan oil and gas fields and planned joint ventures with the state oil company Sonangol.

The planned economic-co-operation and investment projects unanimously seek to reinforce Russia's foothold in Africa and, most importantly, to counteract the Western and Chinese influence in the region. In an attempt to shift the geopolitical (and –economical) balance away from the West, the leading Russian energy and metal companies are currently targeting the very same resources and subsequent influence on the continent that has been sought by the US and European energy giants during the past years. In Africa, the Russian economic power is currently fought hardest by the Chinese multinationals that seek to

leverage their financial strength to establish control over the abundant mineral resources of the continent.

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## **The economic crisis and the Russian OFDI**

The prolonged global economic crisis has, in many respects, hit Russia even harder than most of the developed markets and the rivaling emerging economies, and China in particular.

During 2008, the Russian stock market showed signs of volatility and then collapsed, the rouble underwent a gradual devaluation against the dollar and euro and the real economy began to experience first a slowdown and then a preserving decline. A modest rise of 1-2% in the country's GDP is again expected only in 2010–2011.

The reactions of the Russian governmental administration to the crisis have been largely ambiguous. While at the earlier stages of the crisis, the country's leadership tried to portray Russia as a economical and financial safe haven, and stressed the diversion of Russia's economy from those of the USA and the EU. The leadership at first focused on blaming the USA for the crisis on. Simultaneously, however, the government took active measures to support the banking system and to introduce a package of anti-crisis measures mostly to enterprises identified as significant from the economic (policy) perspective.

The slow but steady rise in the world oil price has additionally had a stabilising effect on Russia's economy and the value of the rouble began to appreciate early 2009 followed by gradual recovery of the stock markets. Despite the relatively modest improvements, however, the economic situation in Russia has remained problematic, and the government has come to admit the serious consequences of the crisis for Russia's real economy. Currently, much of the debate is surrounded around the issue of a possible second wave of the crisis in late 2009 or in the beginning of 2010. At the moment, the "W" shape of economic recovery does look more probable than the "V" shape, hoped for by the government.

Some of the immediate economic effects of the crisis in Russia are listed below:

- A steep decline of 10-11% in GDP with modest growth forecasts of 1-2% for 2010–2011
- A collapse in industrial output of some 15% in 1H 2009 compared to 1H 2008 and a 9-10% drop forecast for entire 2009

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- Natural gas production in 1H fell by nearly 20% and crude steel production by more than 30% compared to 1H 2008
  - Output of most consumer and investment goods is falling, in particular those related to the collapsing sectors of construction and machinery
  - Imports and exports have contracted to approximately half of the levels of 2008. The official forecasts of Russia suggest that 2007 levels will be reached again only in 2012–2013
  - Inflation forecasts reach 14–15% for 2009
  - The budget has gone from a surplus of the last 9 years to a deficit towards the end of 2008 as the spending on anti-crisis measures have grown. Despite the falling budget revenues, the government has thus far been largely a reluctance to cut spending on social programmes and military
  - The original but unrealistic budget of November 2008 for 2009 was amended in April 2009, from a surplus of 3.7% to a deficit of 7.3% of GDP, to be funded mainly from the Reserve Fund
  - Despite of Russia's large financial reserves, the country's Finance Minister Aleksei Kudrin has warned that the Reserve Fund will be exhausted in early 2010 at latest, and the government may have to rely on National Welfare Fund, given the projected preserving budget deficit for 2010
  - The Russian banking sector has undergone further concentration and is heavily dominated by the state-owned banks
  - By mid-2009, some 20% of the credit portfolios of Russia's largest banks consisted of problematic or dubious loans, according to the Central Bank of Russia
  - Companies and households have experienced immense troubles in obtaining credit, and in many instances, the interest rates have reached 20-25%, having caused massive cutbacks in investment plans
  - The widespread difficulties of companies in repaying loans has led to a serious danger of a second wave of the crisis and re-strengthened credit crunch resulting in collapse of numerous smaller banks and another round of government refinancing and bailouts

The response of the Russian government to the crisis and its anti-crisis measures have had modest success at best. As pointed out by Elvira Nabiullina, Minister of Economic Development and Trade, the scale of the crisis is not only the result of external shocks, but also a result of

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domestic weaknesses of our economy and, most importantly, a crisis of trust. Thus far, the industry has in practice received only a fraction of the designated governmental funding. Moreover, the funding has mostly been granted to large enterprises only with small and medium enterprises not benefiting much from the anti-crisis measures. The crisis has therefore led to renewed tensions between the state and the SMEs. Additionally, despite the Government's attempt to preserve jobs, the unemployment forecast for 2009 exceeds 10% while the employment preservation schemes themselves inhibit industrial reforms at the same time.

The effects of crisis depicted above have understandably served to tighten the position of Russia's multinationals. The pace of growth in Russia's OFDI witnessed during 2004-2007 has weakened, however, the country still posts positive OFDI growth figures. While the Russian OFDI flows nearly doubled annually between 2004 and 2007, from 2007 to 2008 the growth was more modest – slightly more than 15%, from \$ 45 billion to \$ 53 billion. Following the downward trend in world FDI flows, the Russian OFDI fell by 15% during 1Q of 2009 (from \$ 16 billion to \$ 13 billion), compared to the same period in 2008.

From the perspective of Russian TNCs, the domestic (and international) credit market has virtually collapsed and the global demand for industrial products is showing little signs of recovery. In addition, the prices of commodity exports, driving the OFDI by most of Russia's leading TNCs, have declined and the market capitalisation of leading Russian companies has shrunk notably. It is therefore without doubt that the economic crisis has hit hard on Russia's economy and some of its leading multinationals. Not only does the global credit crunch cause increasing troubles for the already overleveraged Russian enterprise sector, but the collapse in global demand for energy and raw materials, the key source of Russia's export and federal budget incomes, has had dire consequences on the export-oriented companies. For instance, the Forbes 2009 list of world's billionaires indicates a 70%-drop in combined net worth of Russia's wealthiest industrial owners (Appendix 1). In other words, many of Russia's leading businessmen, or oligarchs, that created their wealth during the economic privatisation in 1990s have seen the value of their assets contracting amidst the global economic downturn. In addition, several of the leading Russian businessmen have been forced to seek state loans and subsequent bailout of their assets.

Nevertheless, although the financial crisis has made it harder for the Russian companies to internationalise, it has not stopped them from seeking to expand internationally. Despite some

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inevitable rationalisation of international asset portfolios, many of the country's leading foreign investing companies are still far from surrendering their international assets.

For instance, the leading Russian steel manufacturers Evraz and Severstal allegedly plan to hold tight on their US assets despite the recent sellout rumours, while the country's number one private oil producer, Lukoil, actively seeks oil refining and retail assets in continental Europe and beyond, as indicated by its notable purchase of a 49 % share in the ISAB refinery in Sicily from the Italian ERG. The deal announced in February 2009 was valued at \$ 1.2 billion. Adding to this, the world's leading natural gas producer, Gazprom, is planning several multi-billion-dollar infrastructure projects in Europe and Eurasia, including the Nord and South Stream gas pipelines. Additionally, the list of the largest Russian M&A transactions in the first quarter of 2009 include the acquisition by the Russian Surgutneftegaz of 21% of the shares of the MOL Hungarian Oil and Gas from the Austrian OMV Group, and the purchase by TNK-BP of 49% of the shares of the US-based manufacturer of steel pipes NS Group Inc.

Moreover, according to the recent data from the Central Bank of Russia, during the first half of 2009 there were no signs of repatriation of Russian financial assets abroad from international financial centers such as Cyprus, the Netherlands, the British Virgin Islands, which are known to serve as tax havens for Russian firms since the beginning of 1990. As such, one may even claim that, in some instances, increasing economic protectionism in the West poses the greatest challenge amidst the current crisis to expansion plans of Russian multinationals.

All in all, the results of the crisis, if yet prolonged, would cause major financing problems for many Russian TNCs, which already struggle with massive international debts. Subsequently, the companies could be forced (and many already have) to turn for the state financial aid with their stocks ending up as collaterals against the state loans. This could easily lead to a deprivatisation spree with ownership and managerial restructuring. Inevitably, the pessimistic scenario would thus also lead to a certain degree of nationalisation of Russia's OFDI as the some of the key industrial companies would fall in the hands of the state. On the other hand, in case the private companies are able to find ways and means of refinancing their debts, the current crisis could eventually lead to managerial shake-up and more efficient and international management practices as well as to increased cost effectiveness.

The long-term effects of the economic crisis are difficult to predict at the current stage. In case the economic downturn will prove relatively short for Russia and new credit opportunities will



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become available, many Russian TNCs can be in a position of acquiring cheap assets on international markets during the next couple of years, causing the Russian FDI and the value of foreign assets of Russia's TNCs to surge again in 2010-2011. Some of the Russian companies have already managed to take advantage of the falling prices of international assets – for instance, Severstal saved \$ 300 million, compared to the original asking price of \$ 1 billion, as it acquired purchasing the Canadian coal-mining firm PBS Coals in late 2008. Similarly, another Russian metals and mining major, NLMK, gained \$ 50 million while purchasing the US steelmaking firm Beta Steel for \$ 350 million (down from the original \$ 400 million) as a result of falling international asset prices.

### ***The economic policy impact of the crisis and the future of Russia's multinationals***

Currently, the Russian government seeks its way out of the economic crisis attempting to maintain a degree and continuity, or, in other words, to somehow keep the economy going. There is a serious threat, however, that this approach further asserts the existing weaknesses of the economy as it is based on supporting the traditional, natural resource-based sectors and giant enterprises. However, appears likely to entrench the weaknesses in the economy. The increasing state involvement in the sectors with already relatively high state interference and control, further establishes the narrow ownership base of the economy and concentration of wealth. In this light, a real economic or industrial reform, albeit necessary in the longer run, appears unlikely. Along with the prolongation of the crisis, the budget pressure increases and the likelihood for serious institutional and industrial reforms further diminishes.

The economic crisis thus inevitably brings into limelight more the economic policy contradictions and choices of the government and the presidential administration. As of recent, the economic success has been one of the main claims to legitimacy among the population, the short-term remedies to the crisis have obtained the key position among the anti-crisis measures. From the position of the Russian multinationals, this brings both troubles and, to some extent, renewed possibilities for international expansion.

As the government support, both on paper and in reality has largely been directed towards major state-owned or otherwise defined as strategic enterprises, the one-sidedness of Russia's OFDI will be further emphasised in the future. Already pre-crisis, only a handful of companies

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were responsible for the bulk of Russia's OFDI and there are few signs that the current policies would alter the situation. Whether it will be through direct government subsidies or bailouts by the state of the large troubled enterprises, the international assets of the Russian TNC universe will be concentrated in yet fewer hands during the next couple of years.

Naturally, the state support will help to maintain, or even increase the international asset portfolios of selected Russian companies, in some instances providing them with competitive advantage over international peers. Simultaneously, however, this would inevitably mean greater penetration of state control in Russia's OFDI, something that we have already witnessed both in the cases of Russia's renewed interest in African assets and the high-profile investment of Magna and Sberbank/ GAZ in Germany's Opel.

At the moment, the prospects of further internationalisation by Russia's SMEs through OFDI therefore look incomparably dim. The prospects are neither brightened by the fact that even until now, the Russian companies (SMEs) outside the traditional natural resource-based industries that have engaged in OFDI have mostly belonged to larger industrial holdings as opposed to being individual, standalone companies. As most of Russia's financial-industrial conglomerates are currently facing dire financial conditions, the assets of these smaller, often non-core companies inside the vast holdings are likely the first to be surrendered.

In a broader sense, the current economic crisis has underscored the widespread lack of trust in the economy in Russia as well as exposed the institutional weaknesses of the economy. In particular, the crisis has emphasised that the Russian economic growth of recent years has been based not on institutional change and economic diversification but on growing raw-material prices and surging export revenues. While this should come as no surprise, there are important post-crisis ramifications of this biased economic structure on Russia's OFDI. As the government has virtually tried to back the economic recovery on traditional, natural resource-based industries, there are little prospects for immediate support to the "new" sectors of economy (apart from telecommunications, to some extent), which will, in turn, inhibit their development and future prospects for internationalisation. Should the government policies change towards supporting the (re)birth of more innovative, high-tech industries, or parts of traditional financial-industrial holdings that could provide diversification of the economy, the next few years of global economic recovery could bear fruitful possibilities for international co-operation and learning for Russian SMEs in "new" economic sectors.

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## Policy conclusions

Over the past decade, the Russian overseas investments have undergone dramatic change, both in size and scope. The leading Russian foreign investors have taken a giant leap forward in seek for global foothold and leverage, both economically and politically. What still remains a focal point from many of the host countries' viewpoint is whether the Russian investments should be treated as welcomed capital inflows or as suspicious attempts to build on Russia's economic and political leverage in the target countries. In addressing the question, the following points could be made:

- Russian foreign investments remain heavily concentrated on the energy and mining sectors, with no foreseeable change in this investment pattern. As a major energy power, Russia holds substantial foreign policy interests both near abroad and on the global scale. While it is difficult to separate the state-owned energy giants, Gazprom and Rosneft, from Russia's energy and foreign policy goals (as it is the case with every state-owned energy companies in the world), the private Russian energy companies have proved follow commercial logic in their operations abroad.
- The role of the state has notably increased in the Russian economy over the past years, both with regards to domestic economy and foreign investments. The most visible effects of this development can, however, be seen in increased limitations on inward foreign investments and economic protectionism, whereas the increased state ownership has thus far had limited effects on outward investments from Russia.
- With regards to above, the current economic crisis may bring along increasing state involvement in Russian OFDI, as the troubled enterprises may end up in the hands of state having put parts of their stocks up as collaterals against the state loans. In addition, the intensifying race for geopolitical and –economical power may cause further state intervention and government-negotiated deals between Russia and the host countries (the African example).
- The economic crisis has revealed the vulnerability of Russia's one-sided economy, which is also reflected in the country's OFDI. In case the government succeeds

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introducing new policy measures to support the development of more innovative sectors of the economy, the Russian OFDI is due to be carried out by even fewer industrial conglomerates and/ or state-owned industrial giants.

- There is still more in Russian OFDI than the investments by the state-run companies, however. Pre-crisis, the Russian private enterprise sector had gained on experience from international operations and the leading private TNCs used to be the most active foreign investors from Russia.
- The current economic crisis has the potential of bringing positive outcomes for Russian TNCs through increasing push for improved managerial practices and cost-effectiveness. If succeeding in refinancing their key operations, many of the Russian TNCs may find attractive international acquisition targets at bargain prices. Increasing economic protectionism brought along with the economic crisis may cause a threat for Russian TNCs for upcoming years.
- The fiercest competition faced by Russian TNCs in the upcoming years is likely to rise from the east as the Chinese multinationals gain leverage on the international arena. In any case, the shift in the balance of power in global FDI is visible already now, as the emerging market multinationals fight for ever larger shares of global economy.

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**Appendix 1 Russian citizens on the list of Forbes World's Billionaires in 2009**

Rank	Name	Net worth 2009, USD bln	Net worth 2008, USD bln	Affiliation	Age
40	Mikhail Prokhorov	9,5	19,5	Onexim Group – principal owner	43
51	Roman Abramovich	8,5	23,5	Millhouse Capital – principal owner	42
57	Vagit Alekperov	7,8	13,0	Lukoil – CEO, 10% ownership	58
71	Mikhail Fridman	6,3	20,8	Alfa Group – principal owner	44
93	Vladimir Lisin	5,2	20,3	Novolipetsk Metal – CEO, principal owner	52
119	Alexander Abramov	4,4	11,5	Evrax Group – 20% ownership	50
122	Leonid Fedun	4,3	6,4	Lukoil – Vice president, 5% ownership	52
122	Alexei Mordashov	4,3	21,2	Sevestal – CEO, principal owner	43
132	German Khan	4,0	13,9	Alfa Group – principal owner	47
164	Oleg Deripaska	3,5	28,0	Basic Element – CEO, principal owner	41
183	Iskander Makhmudov	3,3	11,9	UGMK Holding – Chairman, principal owner	45
191	Boris Ivanishvili	3,2	6,4		53
196	Suleiman Kerimov	3,1	17,5	GNK Holding – Chairman, principal owner	43
196	Dmitry Rybolovlev	3,1	12,8	Uralalkaly – Chairman of the Board, principal owner	42
196	Alexei Kuzmichev	3,1	10,8		46
261	Viktor Rashnikov	2,5	10,4	Magnitogorsk Metal – CEO, principal owner	60
285	Leonid Mikhelson	2,4	4,7	Novatek - CEO, 20% ownership	53
285	Sergei Popov	2,4	6,4	MDM Bank, principal owner	37
318	Vladimir Potanin	2,1	19,3	Norilsk Nickel – CEO, majority owner	48
334	Pyotr Aven	2,0	5,5	Alfa Bank, major owner	54
376	Vladimir Bogdanov	1,9	2,6	Surgutneftegas – CEO, principal owner	57
376	Mikhail Gutseriev	1,9	2,6		51
397	Viktor Vekselberg	1,8	11,2	Renova – Chairman of the Board, principal owner	51
397	Nikolai Tsvetkov	1,8	8,0		48
397	Alexander Frolov	1,8	5,5	Evrax Group, 15% ownership	44
450	Alisher Usmanov	1,6	9,3	Metalloinvest – principal owner	55
601	Vladimir Evtushenkov	1,2	10,0	SISTEMA – CEO, 75% ownership	60
647	Roustam Tariko	1,1	3,5		47
701	Igor Zyuzin	1,0	10,0	Mechel – Chairman of the board, 50% ownership	48
701	Lev Kvetnoi	1,0	1,5		43
701	Andrey Melnichenko	1,0	6,2		37
701	Boris Berezovsky	1,0	1,3		63

Source: Forbes 2009.

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