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THE WAR IN UKRAINE DEALS A BLOW TO RUSSIA'S  
FOREIGN DIRECT INVESTMENT LINKS

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Centre for Economic and Regional Studies

Institute of World Economics

Eötvös Loránd Research Network

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## The war in Ukraine deals a blow to Russia's foreign direct investment links

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## The war in Ukraine deals a blow to Russia's foreign direct investment links

Kálmán Kalotay<sup>1</sup>

### Abstract

The war in Ukraine started in February 2022 adds major uncertainties to foreign direct investment (FDI) to and from the Russian Federation and affects it negatively in the short, medium and long run. The degree of the hit will depend on the exact contents of sanctions and counter-sanctions, not fully known yet. However, the severe consequences of some of them are already visible, adding to the financial strain caused by the war. FDI to and from Russia is expected to fall drastically in 2022 and, depending on the length and depth of the conflict, in the subsequent years if no exit strategy is developed fast to stop the conflict and its eventual escalation. This study concludes that the fall in FDI will at the end hurt the economic capacities of the Russian Federation already affected by a previous round of sanctions imposed in 2014. Decoupling of the Russian economy from FDI partners works, if it works, only partially, and at a relatively high cost. That in turn could thwart the very economic fundamentals of the war effort.

### Background

On the night of 21 to 22 February 2022, President Putin announced that the Russian Federation would recognize the independence of the self-declared Donetsk and Luhansk “People’s Republics” and would deploy troops there as “peacekeepers”. Then on the

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morning of 24 February 2022, the Russian Armed Forces launched a large-scale invasion of Ukraine, with the apparent aim of removing the Ukrainian Government and replacing it with another one more friendly towards the policies of President Putin. With these steps, hostilities in Eastern Ukraine originated in March 2014 reached a new level. Indeed, between August 2014 and February 2022, they remained of relatively low-intensity, though still deadly and devastating. Since 24 February 2022, death and devastation reached unprecedented levels not just for Ukraine but for the whole European continent since 1945. At the moment of writing these lines, it is unclear how the conflict would evolve, how long would it last, how would it end. We do not even know if it will spill over to other countries or not.

On the first days of the conflict, the initial response of the international community was relatively limited, mostly a continuation of the counter-measures adopted in 2014, when the Russian Federation had annexed the Crimea. After the large-scale invasion, the reaction became more muscled. At this point of time, every day new sanctions are adopted against the Russian Federation and Russian interests and more and more countries join them. The list includes mostly the countries that are linked to the North Atlantic Treaty Organization (NATO) and the European Union (EU) covering the whole European continent except Belarus, a close ally of the Russian Federation that let the Russian troops pass, and Serbia, North America, parts of Latin America, Australia and New Zealand. African and Asian countries and territories are less involved so far, with some exceptions (e.g., the Republic of Korea, Singapore, Taiwan Province of China). The list of countries applying sanctions includes surprises such as traditionally neutral Switzerland that aligned itself to the EU policy minus the one on supplying arms to Ukraine.

At the Security Council of the United Nations, binding action was blocked by a Russian veto. As a result, the case was referred to the Eleventh emergency special session of the United Nations General Assembly convened for 28 February 2022 as requested in a joint letter by more than 87 countries. On 2 March 2022, the General Assembly adopted a new Resolution on the 'Aggression against Ukraine' that reinforced Resolution 68/262 on the 'Territorial Integrity of Ukraine' (March 2014) and went further by demanding an

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immediate halt to Russia's use of force and the immediate, complete and unconditional withdrawal of all Russian forces from Ukraine's internationally recognized borders. With no Russian veto power available at the General Assembly, the new Resolution was adopted by a large majority – the vote of 141 of the 181 countries present, reinforcing the Russian Federation's isolation on the scene of world politics (the 2014 Resolution had been adopted by 100 votes in favour). Of the 35 countries that abstained, there were some emerging powers such as China, India and South Africa that did so as a 'matter of principle' (not to position themselves in a dispute opposing the United States to Russia), although these countries, too, agreed with the need to respect the territorial integrity of Ukraine. The 'no' vote of the Russian Federation was supported by only four more countries: Belarus, the Democratic People's Republic of Korea, Eritrea, and Syria.

### **General considerations on the effects of war and sanctions**

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

Due to the status of the Russian Federation as a nuclear superpower, the sending of troops to Ukraine is excluded for third countries. Their reaction is limited to financial assistance, the sending of military assistance and sanctions against Russian interests. From the point of view of the economic consequences of the war, sanctions deserve particular attention. It is to be stressed that the ones that would bind all United Nations members are excluded as the Russian Federation holds veto power in the Security Council where they should be adopted. As a 'second-best' choice, the 'Western powers' mentioned above started their own systems, trying to coordinate between themselves

and convincing others to adhere on their own free will. However, no third country would be obliged to join them, and the Russian Federation is surely adopting its own counter-measures to counterbalance them (e.g., exchange controls on export proceeds).

This analysis attempts to ask what the potential impact of sanctions and counter-sanctions on foreign direct investment (FDI) inflows to, and outflows from, the Russian Federation would be. Though these measures suffer from many limitations and inconveniences, there are no real alternatives. The most serious limitation is that sanctions do not fully stop economic links, rather they result in higher costs for, and less ease in, doing business. It is also evident from the lessons of the ones imposed after the annexation of the Crimea in 2014 that they have hurt not only the Russian Federation but also the issuing countries. Paradoxically, the winners have been the 'free rider' countries. When Western firms abstain from doing business with the Russian Federation, companies from third countries not applying the sanctions (e.g., China or India) move in and benefit from the departure of competitors. It is also to be noted that the Russian Federation has managed to increase somewhat its economic independence and diversification since 2014. As a result, the new wave of sanctions had to be much more severe to bite.

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

**Table 1. Annual average growth rate of the real gross domestic product in the Russian Federation and in the world, 2009–2018 (in per cent)**

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

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

**Table 2. Share of the Russian Federation in global FDI inflows and outflows, 2009–2018 (in per cent)**

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

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

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

In the Russian case, the minimum expectation is a drop in GDP at least in 2022, which would further accentuate the effect of falling behind other leading countries of the world. IMF estimated that the Russian GDP in 2021 was about \$1.7 trillion, which was 14 times less than the GDP of the United States and 10 times less than the Chinese one. The Russian Federation was a nuclear superpower but with a middle-sized economy, 11<sup>th</sup> in world ranking, behind the Republic of Korea. The IMF also forecasted before the war that Brazil's GDP would exceed that of the Russian Federation in 2022, making the latter the smallest of the BRIC economies again. Moreover, if we assume that the Russian GDP falls 'only' 10 to 20 per cent in 2022 under a very optimistic scenario, it would still fall behind that of other nations, namely Australia, Spain and Mexico, in that order. In

other terms, the war is to accentuate the gulf between the political and military aspirations of the Russian leadership and the economic means to achieve them. As for inward and outward FDI, which is a powerful tool for augmenting a country's productive capacities as discovered by politicians in various emerging powers, such as China, they risk of drying up for the Russian leadership in the worst moment.

### **Types of sanctions and their potential impact on FDI**

At this stage, some sanctions are already announced, others are still under consideration. This section offers a non-comprehensive overview of the main types with the potential impact on Russian inward and outward FDI.

- *Prohibition to trade and establish new investment links with the Donbas region* (announced by the United States). At first sight, this measure has a limited impact, as it applies to American firms only, and not if they do business in the Russian Federation but in the separatist Ukrainian zones only. However, past experience shows that 'American firm' may mean any company with substantial presence in the United States independently of its ownership structure, to prevent a discrimination of corporations that are domiciliated in the country, and to preclude the temptation for re-domiciliation to escape the constraints. Nor is it clear in the rules if only direct trade and investment relations count, or also indirect links via value chains. If the rules are extended to both, non-negligible parts of the global economy are to be affected. It may for example be a major issue for firms from 'neutral' countries (such as China) that do not wish to lose their access to the large United States market. To be kept in mind, too, that the exposure of Russian or other international business to the Donbas region may be larger than one would think at first sight. The Donbas is a major producer of coal, iron and steel, machinery and equipment, which can be inputs for production in the Russian Federation and in the value chains of other countries. These sanctions may hurt these business links when the region probably needs an increase in economic activities to satisfy the local population after the evaporation of the initial euphoria of recognition by the Russian Federation. It may also create a dilemma for Russian firms. On the one hand, they may be prompted by the Russian Government to invest in, and trade with, the region to contribute to prosperity there. On the other hand, they may be hit by U.S. sanctions for doing so. The same dilemma applies to firms wishing to invest in Russia: how to avoid being sanctioned in the U.S. when some of the supplies are best available from Donetsk and Luhansk? For all these reasons, prohibition to do business with the Donbas is expected to have a major negative impact on both Russian FDI inflows and outflows.



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- *Stopping business projects in and/or with the Russian Federation by governments applying the sanctions.* The first and best known case is that of the Nord Stream 2 gas pipeline suspended by German authorities. Although in each case, the economies of the partner countries may be hurt as much as that of the Russian Federation, other projects may suffer the same fate. And the impact on both types of FDI flows is negative.
- *Export ban on, or control of, strategic inputs.* Such measures are currently under consideration. The United States wishes to negotiate such measures with the Asian exporters of semiconductors/microchips. It is unclear at this stage if they will be accepted by the partners, and what the real impact on the Russian economy would be. To be noted that Ukraine is a key supplier of semiconductor-grade neon. If the Russian Armed Forces occupy the country and manage to control the Ukrainian suppliers, the Russian Federation can try to use them to develop its own semiconductor industry (the Russian Federation produces another raw material, palladium). The problem is that such capacity building requires lots of time and know how. In the meantime, stopping supplies from Asia may affect the business links of those Russian firms that use those semiconductors/microchips. To be noted that such a measure would prompt Russian authorities seek local solutions (import substitution) to replace them. The measure is very uncertain; so is its impact.
- *Sanctions against Russian (and Belarusian) individuals linked with the recognition of the breakaway "republics" and the war,* mostly in the form of freezing their assets possessed in their personal capacity or in their firms. This is more than a symbolic list. Its effect naturally depends on how long the list is and how many people with business interests figure on them. Already the first lists included persons linked with Promsvyazbank, VTB Bank and the VKontakte media group. As the list lengthens, the effect of the measure may increase.
- *Freezing of Russian banking assets abroad.* This is a very severe measure affecting both inward and outward FDI. To be noted that the group of the largest Russian banks includes various State-owned entities (such as Sberbank, VTB Bank, Gazprombank, Promsvyazbank, the State Development Corporation Vneshekonombank or VEB, the Otkritie Financial Corporation, the Russian Agricultural Bank and Novikombank, to mention the largest), therefore sanctions are straightforward to justify due to their direct links with the power centre. There are also entities that are on paper privately owned but are so close to the Government that already on 2014 they were put on the sanctions list, such as the Rossiya Bank. The freezing of the assets of these financial institutions (it has already happened to most of the ones listed, others may be added later on) has a double negative effect on FDI. On the one hand, it results in the stopping or bankruptcy of the affiliates of these banks operating abroad, as it happened very early on with the Vienna-based Sberbank Europe AG, with affiliates also in seven other markets (Bosnia and Herzegovina, Croatia, Czechia, Germany, Hungary,

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Slovenia and Serbia). To be noted that already in November 2021 the bank had initiated the selling of its affiliates in other countries except in Czechia and Germany. With that transaction not yet fully completed, the bankruptcy of the Vienna-based parent may affect all this network. Other Russian banks may face the same fate if sanctions last for a long time. On the other hand, this freezing assets means and impossibility of financing the transactions of Russian multinationals abroad. It also has an impact on access to finance by foreign investors located in the Russian Federation. The country may be prompted to apply restrictive measures to stop the outflow of resources, including an obligation to surrender export receipts or prohibition of the repatriation of profits. These circumstances could make the life of foreign investors close to impossible. These measures may become inevitable considering that the part of the foreign assets of the Central Bank of Russia has been frozen, meaning that the institution cannot access those reserves that is piled up before the war but located abroad. Because of this measures, foreign exchange controls have to be instituted earlier and in a more drastic manner.

- *The exclusion of Russian (State-owned) banks from the SWIFT payment system.* The decision has been taken by the EU to exclude seven large Russian banks, with the exception of Sberbank and Gazprombank so far. This measure makes all business transactions involving the Russian and foreign clients of these banks more costly and more cumbersome. Alternatives do exist on paper, such as using China's Cross-border Interbank Payment System (CIPS). However, developing this alternative may be not so easy and would not prevent the problem of increasing the cost of doing business. Moreover, the use of that system may result in 'side effects' such as the need to rely heavily on the Chinese yuan as the currency of payment/clearing, which may not be desirable for some businesses. As another alternative, within the Russian Federation, the Financial Message Transfer System of the Bank of Russia (SPFS) has been launched with about 400 users, which may be a solution for purely domestic payments. However, this system is not yet linked with other systems abroad; therefore, it does not attenuate the obstacles to international payments, which is a major problem for both foreign investors in Russia and Russian firms abroad. In sum, the exclusions from SWIFT creates major inconveniences, hurting both inward and outward FDI significantly.
- *Restricting the financing of the Russian sovereign debt from Western (U.S.) capital markets.* If implemented, this measure would make the refinancing of the debt more costly and more difficult. It would however have only an indirect impact on the operations of State-owned Russian multinationals, financed by the Russian State.
- *Sectoral sanctions.* Sanctions affecting different sectors of economic and social activities may have very different impacts on FDI. Two of them, banning Russian vessels from foreign ports and Russian aircraft from foreign airspace can

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seriously hamper business transactions between the Russian Federation and the rest of the world, and can act as a major disincentive to FDI. To be noted that these sanctions are not fully 'water proof'. Trade with the outside world can be switched to foreign carriers, but naturally at the expense of an increase in shipping costs and a decline in the Russian freight and shipping sector. Measures affecting cooperation on the Space Station can also have some negative consequences for supplying firms. Limitations imposed on science cooperation may seem to be more symbolic, so could the measures affecting arts, culture and sports. In those areas, it is mostly the international reputation of the Russian Federation that is hit, though one should not underestimate the business side of these activities either.

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

**Table 3. Potential impact of sanctions on inward and outward FDI  
of the Russian Federation, 2022 and beyond**

Measure	Expected impact on FDI
Trade and investment ban on Donbas	Major
Stopping business projects with Russia	Depends on the size of the project stopped
Export ban on, or control of, strategic inputs	Uncertain
Sanctions against Russian individuals linked with the recognition of the breakaway "republics" and movement/deployment of Russian troops	At the level of the firms that they are linked with
Freezing of Russian banking assets and exclusion from SWIFT	Very major
Restricting the financing of the Russian sovereign debt from Western capital markets	Limited
Sectoral sanctions	Ban on Russian vessels and aircraft may be major

*Source:* the author's collection of information

The situation at the war and the Western sanctions all indicate that probably the Russian Federation is heading towards the deepest and most severe crisis in its history, destabilizing the war effort itself. Such a crisis could also hamper the attempts of Russian business to build local capacities to counteract the sanctions. It is also to be noted that relying on foreign partners such as China and India in mitigating or avoiding the effects of the sanctions can also have side effects. These countries cooperate with the Russian Federation under sanctions because of self-interest. Their Governments made it clear that cooperating with the Russian Federation does not mean a recognition of the separatist republics of the Donbas or accepting the Russian invasion. There may be also points in the chain of events when the Chinese and Indian Governments and the firms of

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these countries have to choose between keeping Western and Russian business links and they choose the former. Moreover, with the loss of Western partners, the dependence of the Russian economy on these partners may increase. It is also to be taken into consideration that this type of cooperation with China and India can also have geopolitical consequences. If Russian firms fall into deep crisis, they may be replaced by Chinese and/or Indian companies in countries that in the past the Russian Federation perceived as its zone of influence (e.g., in Central Asia).

The 'haemorrhage' has already started. FDI is reacting immediately. As mentioned above, Sberbank Europe is the early bird in a potentially long flow of Russian bankruptcies abroad. Another case of instant bankruptcy is that of the Switzerland-based Nord Stream 2 holding company, which was expected to manage the construction of the gas pipeline stopped by German authorities.

### **Corporate exodus from Russia?**

In the Russian Federation, one of the mainstays of inward FDI, the oil and gas sector has already experienced the first attempts to leave the country. First, BP announced on 27 February 2022 that it would sell its 20 per cent stake in Russian State-owned oil giant Rosneft, then the next day Shell expressed its wish to exit its joint ventures with also State-owned Gazprom, and the day after Exxon announced its exit from the Sakhalin oil and gas project in the Russian Far East.

Beyond the oil and gas industry, some Western firms started leaving the Russian Federation or stopping sales to the Russian market. To some degree, this is a change in corporate philosophies. In the past, business kept more distance with politics, only complying with the sanctions dictated by public authorities. Examples include:

- the *transportation industry* (Maersk and MSC halting container shipping to and from Russia, Hapag Lloyd and container carrier Ocean Network Express of Japan suspending reservations to Russia, DHL suspending services to and from Russia),
- *major aircraft manufacturers* (Boeing suspending the supply of parts, maintenance and technical support to Russian airlines and the operation of its training centre in Moscow, Airbus stopping the sending of parts to Russia),

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- *vehicle producers* (Ford suspending its participation in its joint venture in Russia, Daimler Truck suspending cooperation with its Russian joint venture partner Kamaz, automotive supplier ZF Friedrichshafen stopping deliveries to Russia, Harley-Davidson stopping sales to Russia, Volvo and General Motors stopping exporting to Russia),
- *the tech industry* (Apple stopping selling its products in Russia),
- *financial services* (HSBC, Société Générale, Raiffeisen Bank Austria and Shinhan Bank of the Republic of Korea severing ties with Russian banks, Visa and Mastercard excluding Russian financial institutions from their networks),
- *consumer goods producers* (Nike stopping sales in Russia), and
- *the entertainment industry* (Spotify with its closure of its Moscow office, Stonemaier Games with its exclusion of Russian partners, Disney, Warner Bros., Sony, Netflix).

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

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

## **Impact on Hungary**

Hungary occupies a partly special position in the Russia–Ukraine conflict. Though it is a member of the EU and NATO, over the past decade, its Government has developed very close links with the Russian Government under the umbrella of a policy called 'Eastern Opening', which covers also China, Turkey, and various Central Asian countries. The Hungarian Government has attempted to implement a political model similar to the one

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already in place in the Russian Federation. At the fora of the EU and NATO, it used its vote to protect the interests of the 'Eastern' partners. It has also initiated joint projects with the Russian Federation built not only on economic and financial considerations, of which the largest is the plan to build phase two of the Paks Nuclear Plant with the help of State-owned Rosatom and financed by a Russian loan. Hungary also became in 2019 the official headquarters of the multilateral development institution International Investment Bank (IIB) whose largest shareholder is the Russian State.

After 24 February 2022, the Hungarian Government decided to align its policy to EU and NATO decisions in a rather radical change of policy line, though it did so with some reluctance. At the moment of writing these lines, it is unclear if it is a deep change in policy directions, or more a reluctant alignment.

An overview of the business interests at stake has to factor in that the policy of 'Eastern Opening' has not brought about a breakthrough in Hungarian-Russian economic relations. The two countries are not major business partners for each other, except in selected sectors such as energy. Indeed, according to official statistics, in 2020, the share of the Russian Federation reached 17.8 per cent in Hungarian imports, composed almost exclusively by fuel. In turn, the share of the Russian Federation in Hungarian exports remained under 1 per cent, composed mostly of processed goods (typically pharmaceuticals, medical equipment, machinery, vehicles, food and agricultural products). The dependency of bilateral cooperation on energy supplies is reflected also by the fact that, just before the outbreak of hostilities, the two countries started negotiating an increase Russian gas supplies to Hungary. In the new situation, it is becoming more and more doubtful if it ever becomes reality.

As for inward FDI of Hungary from the Russian Federation, it remains relatively small. By the ultimate beneficial owner principle, the FDI stock in Hungary originated in Russia accounted in 2019 about €1 billion, or 1.3 per cent of the total, according to the data of the National Bank of Hungary. The same year, the FDI stock of Hungarian investors in Russia by the nationality of the immediate investor (data on ultimate investors are not available on that direction) amounted to €521 million, or 1.7 per cent of the total. These data may not fully reflect the real size of bilateral FDI links, especially

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on the side of Hungarian capital in Russia, due to the presence of roundtripped and transhipped transactions. (Roundtripped deals mean capital leaving a country, transiting another one, to return to the country of origin. Transshipment means capital transiting through a third country between the country of origin and the final destination. Both types of transactions make the accurate counting of FDI difficult.)

Bilateral FDI between the two countries may be both directly and indirectly affected by the sanctions imposed on Russian business. For example, the majority ultimate owner of Dunaferri iron and steel company is the VEB bank, under sanctions in the West, and a minority shareholder seems to be linked with the Industrial Union of Donbas. The FDI components of the Paks 2 could also be in jeopardy, although the first reaction of Hungarian authorities was that sanctions would not affect the project. However, not only the continued participation of the fully State-owned Rosatom may pose problem for both the EU and NATO, but also its financier, the sanction-ridden VEB bank.

Transshipment of FDI also means that it is not straightforward to identify all Russian business interests in Hungary. The number of relatively large companies with Russian equity over HUF 500 million (\$1.5 million) may be around twenty and the list may have changed over time. For example, the company Panrusgas Gas Trading Plc. importing natural gas from Gazprom was closed in 2021 and entered liquidation before the onset of the war as the terms of gas supply from Russia had changed. Sberbank Hungary, affiliated to the now bankrupt Vienna-based Sberbank Europe is also in liquidation.

It also remains to be confirmed how Russian businessman Ruslan Rahimkulov's projects are affected by the war and sanctions. He has his permanent residence in Hungary and thus his investments should be counted as local investment. He is a 50 per cent business partner to a big intermodal logistics centre on the Hungarian–Ukrainian border subsidized by the Hungarian Government. Construction on this container terminal aimed to become a major gateway for Chinese rail freight transported all along the 'New Silk Road' (now officially called Belt and Road Initiative) started in 2021 and it is close to completion. However, the future of the project is now in jeopardy mostly due to the war that tore apart all links passing via Ukraine.

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Another Russian company subsidized by the Hungarian Government in investing in Hungary and potentially subject to a halt is Arnest Group, which in January 2022 announced the construction of a new aerosol filling and metal packaging plant in Hungary. It is unclear if the company retains enough capital to carry out the project or it has to cancel it.

In principle, all investment involving Russian business interests can fall directly or indirectly under the EU sanctions, though individual exceptions can be made. For instance, the construction of a vaccine factory expected to produce the anti-COVID Russian vaccine Sputnik among others, could claim an exception on health care grounds. To be noted also that IIB was not an immediate target of the first sanctions, although Czechia and Romania indicated their withdrawal from the institution claiming that IIB was connected to Russian spy operations.

As for Hungarian businesses having relatively large-scale operations in the Russian Federation, their number is limited. Without attempting to be fully exhaustive, the bank OTP, the oil and gas company MOL Group, the pharmaceutical firm Gedeon Richter are mentioned as prime examples. One can also mention the medical implant and prosthesis producer Sanatmetal, the animal and feed supplement producer Agrofeed. Some of these firms are also present in Ukraine but not in the two breakaway counties, thus not subject to the ban of doing business there. In turn, doing business in the Russian Federation may soon become very difficult for all these firms, making their future more uncertain there.

## **Conclusion**

In sum, the war in Ukraine adds major uncertainties to FDI to and from the Russian Federation and will affect it negatively in the short, medium and long run. The degree of hit will depend on the exact contents of sanctions and counter-sanctions, not fully known yet. The paradox of this war is that, if the intention of the planners was to make the Russian Federation more powerful, the effect is already opposite, and can worsen over time. Observers may wonder what went wrong with the planning of the economic consequences. One hypothesis is that the inputs did not reflect the realities of the outside world correctly. Perhaps realities have been replaced by a wishful image of a



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weak, divided and paralyzed international community. Sadly enough, one cannot avoid a feeling of déjà vu as the lessons of European history more than eight decades ago seem to be by and large forgotten or ignored by today's planners of the economic consequences of war.

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

*Information closed at 9 a.m. CET on 3 March 2022*

*Disclaimer:* This study has been prepared exclusively on the basis of publicly available information. While all care has been taken to verify each piece of information, unintended errors in the facts are not fully excluded in a situation where information and disinformation are arms used by the warring parties

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