THE ATTRACTIVENESS OF THE RUSSIAN FEDERATION FOR CHINESE INVESTMENTS UNDER THE CURRENT GEOPOLITICAL TENSIONS

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Abstract: As the West has sanctioned the Russian Federation as a form of protest to the Russian policy towards Ukraine, Moscow has turned to its closest partner in terms of political visions and strategic objectives, i.e., to China, to support its economy and pave the way for resource development and exploration energy with the help of Chinese capital. Although China declares itself neutral regarding the invasion of Ukraine by the Russian Federation, stating that it wants peace talks leading to a political agreement between Ukraine and the Russian state, the communication between these two countries with close political views is at an all-time high level so far. China has managed to absorb Russian exports boycotted by Western states and to fill the gap left by the largest withdrawal of foreign investors from the Russian Federation. The investment cooperation between the Russian Federation and China remained quite stable in comparison to the great retreat of the Western companies after the outbreak of the Ukrainian war and the imposition of international sanctions. Against his background, the research has the objective to analyse the current patterns of the investment relations between the Russian Federation and China, by presenting the current changes of the Russian investment framework under the Ukrainian war and identifying the Russian sectors that attracted the major part of Chinese investments.

Key-Words: foreign direct investment (FDI), Russian Federation, China, Russian-Ukrainian war

JEL Classification: F00, F21, F30

1. Introduction

In the wake of the Russian-Ukrainian war and the subsequent sanctions imposed by Western powers on Russian Federation, studying the dynamics of foreign direct investment (FDI) flows between the Russian Federation and China assumes heightened significance. Against the backdrop of escalating geopolitical tensions and economic uncertainties, analyzing this aspect provides valuable insights into the evolving global economic landscape and the strategic choices of major powers.

The war in Ukraine has significantly altered the geopolitical environment, prompting widespread repercussions on global economies and trade relations. As Western states applied sanctions on Russian Federation in response to its military actions, including restrictions on access to financial markets and technology transfers, this state has turned increasingly towards alternative economic partners, particularly China.

China's role as a major economic power and its growing influence in global affairs make it a crucial player in shaping the current economic landscape. Understanding the patterns and trends in FDI flows between Russia and China provides key insights into the extent to which these two nations are deepening economic ties amid geopolitical shifts.

Moreover, analyzing FDI flows between Russia and China offers valuable implications for the broader global economy. As traditional economic alliances are reshaped and new partnerships emerge, the strategic choices made by Russia and China have ramifications beyond their bilateral relations, impacting regional and global economic dynamics.

Furthermore, studying FDI flows in the context of the Russian-Ukrainian war and Western sanctions sheds light on the resilience and adaptability of nations in navigating geopolitical challenges. It offers lessons on how countries maneuver through economic constraints and geopolitical pressures to maintain economic stability and growth.

In this complex geopolitical environment, understanding the motivations, patterns, and implications of FDI flows between Russia and China becomes imperative for policymakers, economists, and businesses worldwide. It provides critical insights into the shifting power dynamics, economic interdependencies, and potential pathways for international cooperation and competition amidst global uncertainty.

2. The „no-limits" partnership between the Russian Federation and China

The Russian Federation and China share a complex, multifaceted relationship dating back to the 17th century, when Peter I ceded the territory north of the Amur River as far as the Stanovoy Range and kept the territory between the Argun River and Lake Baikal. Over the history, these two countries have been both allies and enemies, growing closer in recent decades because of the complementarity of their economies, close political visions, geographical proximity, and shared strategic goals. When considering the chronological evolution of the Chinese-Russian partnership, several key cornerstones must be noted.

Firstly, after the WWII and in the Cold War Early Period China and the Russian Federation (back then the Soviet Union) were close allies under communist ideologies, collaborating extensively until the late 1950s. Secondly, the Ideological Split[1] and the border conflict occurred. The Sino-Soviet split in the 1960s led to ideological divergence and a brief but intense border conflict in 1969[2], straining relations severely. After the Soviet Union's collapse in 1991, China and Russian Federation gradually rebuilt their partnership, focusing on mutual interests and strategic cooperation. During 1991 and 2014 (in the Pre-Crimean crisis era) economic cooperation thrived, with significant energy deals and trade agreements reinforcing their partnership, culminating in strengthened ties before the Crimean crisis. After the USSR collapse the economic cooperation played a crucial role in maintaining and rebuilding ties, providing a pragmatic basis for partnership despite ideological splits and historical conflicts.

The dynamism of this relationship has intensified in 2014, when the international sanctions imposed as a response to the annexation of Crimea by the Russian Federation determined it to strengthen political, military, and economic links with China (Radin et al., 2021). As these sanctions have limited Russian trade and restricted the access to international markets, Russian authorities embarked on a so-called „pivot to the East" strategy, emphasizing „friendly" relations with China, and increased investment between the two emerging markets.

Following the invasion of Ukraine in 2022, Russian dependence on China's economic and political support increased, rising China's advantage in this relationship. Moreover, in February 2022, in the context of the opening of the Beijing Winter Olympics, Xi Jinping and Vladimir Putin emphasized that both countries aim to promote a „no-limits" partnership that „goes beyond an alliance" (China Power Team, 2022; Jarmon, 2023). The joint statement issued later stated that this bilateral relationship has been more resilient than any post-Cold War alliance and that the partners want to overturn the current U.S.-led liberal international order.

The invasion of Ukraine tested the „no-limits" partnership between the Russian Federation and China. Although China declares itself neutral regarding the invasion of Ukraine by the Russian Federation, stating that it wants peace talks leading to a political agreement between Ukraine and the Russian state, the communication between these two countries with close political views is at an all-time high level so far. Contacts between Chinese

[1] The ideological split between China and the Soviet Union, known as the Sino-Soviet split, occurred in the late 1950s and early 1960s due to leadership and ideological differences. Mao Zedong's China and Nikita Khrushchev's Soviet Union diverged on the direction and implementation of communist ideology. Mao criticized Khrushchev's de-Stalinization policies and perceived them as a betrayal of true Marxist-Leninist principles. Moreover, both countries prioritized their national interests, leading to conflicting foreign policies. China opposed Soviet policies towards the West and its approach to coexistence with capitalist countries.

[2] The Sino-Soviet border war of 1969 was a brief but intense military conflict over territorial disputes along the Ussuri River, highlighting the deep ideological and geopolitical rift between China and the Soviet Union.

President Xi Jinping and his Russian counterpart, Vladimir Putin, have intensified since the outbreak of the war (CRS, 2023).

At the same time, although China has given assurances to the West that its support for the Russian Federation will not cross certain lines, it seems that there is a difference between what the Chinese state says and what it does. China has managed to absorb Russian exports boycotted by Western states and to fill the gap left by the largest withdrawal of foreign investors from the Russian Federation.

Although the ties between these two countries significantly increased, there are doubts regarding the strength of this relationship (Radin et al., 2021; Fong and Maizland, 2024). Some experts underline that Russian pivot to east is more rhetorical and political than economically substantial (CNBC, 2016), being based on similar perceptions of US hegemony and a common fear of NATO expansion in Europe (Simpson, 2023; Jochheim, 2023). According to Andrieu (2024), this alliance is not a solid and a long-term one, but rather a temporary rapprochement that has been strengthened by the Ukrainian war, being characterized by a fragility based on structural imbalances and mutual mistrust. Moreover, it is hindered by important divergence of interests between these two countries, but also by the economic weakness of the Russian Federation, which slows the existing projects, mainly in the field of energy and military technologies (Alexeeva and Lasserre, 2018).

3. Literature review

The existing literature approaching the Russian-Chinese economic relations is focused mainly on their bilateral energy cooperation, given that energy has laid at the heart of their relations since the fall of the USSR. Moreover, the major role of the energy sector for the Russian economy, but also the aim of China to gain access to energy resources led to an increased number of studies in this field (Jakobson, 2011; Poussenkova, 2013; Six, 2015; Chow, 2015; Kaczmarski and Kardaś, 2016). At the same time, the research in investment cooperation remains quite limited, being focused on two aspects, firstly, on the challenges regarding the Russian-Chinese investment cooperation, and, secondly, on the patterns of Chinese investment in the Russian Federation under the „Belt and Road Initiative" (BRI). For instance, Gao (2012) analysed the choice of Chinese foreign direct investment (FDI) in the Russian Federation from the perspective of the industry, and put forward the corresponding benchmark of industrial choice. Li (2013) investigated the problems and reasons for Chinese investment in the Far East of the Russian Federation. The investment strategy of China under the BRI is presented also by Li (2015) and Kravchenko et al. (2020), while Yin (2018) identified the risks for Chinese investments in the Russian Federation from the legal perspective. Moreover, recent papers argue that the Russian Federation needs China to realize many of its goals for infrastructure development and resource extraction, while China is eager to access the Arctic's economic potential and enhance its technological prowess (Stronski and Ng, 2018). However, Chinese investment is not materializing as broadly as Russian authorities would like, while Beijing often uses its economic leverage to extract favorable commercial terms. These developments could be a reason for conflict between Russia and China for the control and influence of the Far East (Bifolchi, 2024). However, from our knowledge, there are almost no studies that address the Russian-Chinese investment cooperation in the context of the war in Ukraine.

This article adds value to the existing literature by describing the current Russian investment framework under the Ukrainian war and by identifying the changing patterns of the Chinese FDI in the Russian Federation during the 2022-2023 period.

4. Methodology

To achieve the research objectives, we have employed a mixed methodology. Firstly, we have conducted a qualitative analysis of the Russian investment framework under the Ukrainian war, by presenting the data on foreign companies that suspended their operations or left the Russian Federation, between 2022-2023, but also the changes regarding the legislation on FDI adopted by the Russian government during 2022-2023, aiming to stop the retreat of foreign capital and to increase state control over it. In addition, we have carried out a quantitative analysis of the changing patterns of the Chinese FDI in the Russian Federation. The data on the amendments regarding the legislation on FDI were retrieved from the official site of the Russian government. Moreover, the Chinese FDI in the Russian Federation were gathered from the IMF database, while the data for investment projects with Chinese participation carried out in the Far East of the Russian Federation were retrieved from the official sites of the Russian authorities.

5. The Russian investment framework under the Ukrainian war

Two years after the Russian invasion in Ukraine, the Russian economy is facing a significant decrease in the inflow of foreign capital. Thus, FDI inflows to the Russian Federation have seen a dramatic decline (-18.6 billion dollars in 2022, compared to 38.6 billion dollars in 2021), as the geopolitical climate has led various Western companies to stop or limit their activity on the Russian market (UNCTAD, 2023). As a result of unprecedented sanctions, applied by Western states as a form of protest to the Russian policy towards Ukraine, the Russian Federation has faced the so called „Great Business Retreat". Since the beginning of the Ukrainian war, more than 1000 foreign companies have announced that they are either suspending their operations or withdrawing from the Russian Federation (Yale, 2024). In the first stage, many companies suspended their activity while still making wage payments, leaving the Russian market later, e.g., the largest employers as McDonald's, Ikea, Coca Cola, Volkswagen Group, Toyota Motor Corp., Ford Motor Co., BMW AG, Hyundai Motor Co., and Renault SA etc.[3].

As a result of the withdrawal of foreign companies and the economic recession[4], in 2022, the total revenues generated by foreign companies in the Russian Federation decreased by 25% compared to 2021. However, the revenues of companies that chose to remain in the Russian market increased by 6.7% (Table 1), determined most likely by a reduced competition, which allowed the remaining companies to expand their market share and their profit margins.

Table 1: Foreign companies that suspended their operations or left the Russian Federation, during 2022-2023

Status-quo	Number of companies	Gross revenue recorded in the Russian Federation in 2021 (millions of dollars)	Gross revenue recorded in the Russian Federation in 2022 (millions of dollars)
Left the Russian market	359	93.350	-
In the process of leaving the Russian market	1.214	73.571	38.079
On hold	540	55.642	32.451
Decided to stay on the Russian market	1.615	93.058	99.372

Source: Authors' representation based on Kyiv School of Economics (2024).

According to SelfSanctions/LeaveRussia database (Kyiv School of Economics, 2024) the share of companies that have exited the Russian market tends to be correlated with the Russian government political stance towards the military aggression in Ukraine. For example, 20-30% of companies from the European Union (EU) have left the Russian Federation since the first year of the war, and at the opposite end of the spectrum, there can be find „friendly" countries (in official Russian terminology this term indicates countries which did not impose sanctions). For example, not a single company from China, Iran or the United Arab Emirates has left the Russian Federation since the outbreak of the war. Regarding the economic sectors affected by the FDI exodus, the largest share of withdrawals by foreign firms was reported in the field of advertising (25%), tourism (20%) and real estate business (21.7%). In the total number of companies that chose to leave the Russian market for good, German companies hold an important share (they represent 11% of the total number of foreign companies that stopped their operations in the Russian Federation).

[3] According to Yale (2022), which used a sample of 1,589 foreign firms active in the Russian Federation in the period before the outbreak of the war in Ukraine, 538 foreign companies had completely withdrawn from on the Russian market, while another 504 companies suspended their activities, keeping their options open for a possible resumption of economic operations.

[4] According to the current data revised by the IMF, in 2022, the GDP growth rate decreased in the Russian Federation by 1.2% (Source: https://www.imf.org/en/Countries/RUS).

Against this background, the Russian Federation tried to stop this retreat and to increase state control over foreign capital, by adopting important changes regarding its legislation on FDI (Ostapets, 2024). Thus, through the amendments adopted in 2023[5], foreign investors are prohibited from obtaining control over strategic entities or acquiring more than 25% of the ownership of a strategic entity. Foreign investors must also obtain the consent of the relevant authorities for the acquisition of smaller stakes in strategic entities or for the acquisition of blocking rights in respect of the activities carried out by such entities. In addition, the new legal framework limits the possibility of foreign companies to sell their assets on the Russian market (by imposing a temporary administration by the Russian authorities of the assets of these companies, taking place in fact a disguised nationalization).

Although some restrictions on FDI were in place before the outbreak of the war in Ukraine, the Russian economy was perceived quite attractive. Prior to the sanctions, some economic sectors – such as the automotive industry and mining – attracted a high level of FDI, especially from Western companies, e.g., Volkswagen Group, Toyota Motor Corp., Ford Motor Co., BMW AG, Hyundai Motor Co., and Renault SA etc., but also, BP, Shell, Exxon and TotalEnergies etc. Investment in automobile production has been favoured by the prohibitive car import tax and the accelerated growth in demand from Russian consumers, while in the case of resource-intensive industries, the FDI were driven by the imperative to develop production in regions with climatic challenges, e.g., the Far East, but also by the need for high technologies and know-how.

It should be noted that this tendency of the state to control foreign capital existed even before the current tense climate between the Russian Federation and the West, given that, as early as 2008, the Russian federal government adopted a law limiting the contribution of FDI in the economic sectors considered strategic. This legislative act[6] stipulated that the sectors of strategic importance for the national economy target aviation, the mining sector, nuclear development, outer space missions, weapons production, telecommunications, but also activities related to television and mass media. Consequently, the Russian authorities have managed to slow down, starting from 2023, the exodus of foreign capital by continuously changing bureaucratic procedures. A recent analysis (IMF, 2023) shows that the number of transactions involving sales of assets by foreign companies decreased in 2023 to 97 (from 109 in 2022), and the total value declined to 11.14 billion dollars (compared to 16.31 billion dollars in 2022).

Considering the great retreat of Western companies, the Russian Federation started to face major challenges related to the survival and the durability of its main industries dependent on the Western technologies, but also regarding the development of its regions with climatic challenges. Consequently, the Russian authorities turned their attention to more „friendly partners", e.g., to China.

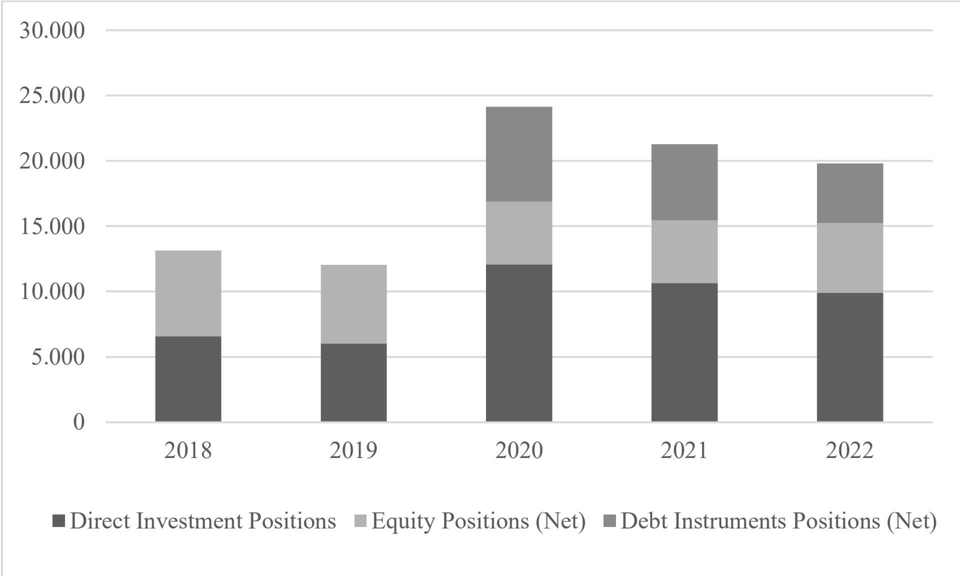
6 China strengthens investment links with the Far East of the Russian Federation

The investment cooperation between the Russian Federation and China continue to remain quite stable in comparison to the great retreat of the Western companies, with the outbreak of the Ukrainian war and the imposition of international sanctions. The inward Chinese FDI in the Russian Federation rose by 50.5% in 2022 compared to the 2018 level, direct investment positions mostly contributing to this increase (Figure 1).

[5] The Federal Law on Foreign Direct Investment, enacted in 1999 and recently amended in 2023. The law is available at: https://www.mid.ru/ru/foreign_policy/economic_diplomacy/1726314/

[6] The Federal Law on Foreign Investments in Companies in Strategically Important Sectors, adopted in 2008 and available at: https://www.consultant.ru/document/cons_doc_LAW_76660/

Figure 1: Inward Chinese FDI as reported by the Russian Federation, during 2018 - 2022 (in millions of dollars)



Source: Authors' representation based on IMF data (2023).

To benefit from the isolation of the Russian Federation, but also from the abundance of natural resources located on the common border, China aims to strengthen the transport links with the Far East of the Russian state at an accelerated pace. Through joint infrastructure investment projects, but also through investments in the mining industry, Beijing hopes to secure its access to natural resources and facilitate imports of oil, natural gas, and agricultural products.

According to Russian Deputy Prime Minister Yuri Trutnev, more than 90% of the FDI value attracted to the Far East to date has been financed by Chinese state-owned companies. Under these conditions, the Far East registered an annual increase of 150% in investments made by China, being the most attractive region of the Russian state for Chinese investments. In the period 2022-2023, the Chinese state has carried out a series of investment projects in this region in the transport and mining sectors, totalling a value of 2.2 billion dollars (Table 1).

Table 1: Investment projects with Chinese participation carried out in the Far East of the Russian Federation, during 2022 - 2023

Sector	Project	Investor Partner	Investment value (millions of dollars)	Year
Transport	Tongjiang - Nizhneleninskoye international railway bridge	China Railway Major Bridge Engineering Group, China Railway Harbin Group	315	2022
Transport	Heihe Blagoveshchensk cross-border road bridge	-	358	2022
Mining	Pizhemskoye titanium and quartz deposit (Komi Republic)	China Communications Construction Company	838	2022
Transport	Indiga Arctic Deep Port/ Sosnogorsk-Indiga Railway	China Communications Construction/ Company China Railway Construction Corporation	713	2023

Source: Authors' representation based on data published by the Government of the Russian Federation (2023).

One of the most recent projects is the construction of the first cross-border railway bridge, Tongjiang – Nizhneleninskoye (BRICS PORTAL, 2022) over the Amur River, worth 315 million dollars, which was completed in August 2022 (Table 1). The construction was financed in the amount of 25% by the Far East and

Baikal Region Development Fund and in the amount of 75% by the Russian-Chinese Fund. It is 2.2 km long, while the railway infrastructure is 19.9 km long. In addition to being one of the longest railway bridges, it is an important infrastructure element on the new Silk Road, as it connects the North-Eastern part of China with the Trans-Siberian Railway (Observer Research Foundation, 2023).

Another 358 million dollars transportation infrastructure project is the construction of the Heihe-Blagoveshchensk cross-border road bridge over the Amur River, which has separated modern China from the Russian Federation for decades. It was inaugurated in June 2022, with a daily transport capacity of 630 cargo trucks, 164 buses and 68 cars, further boosting trade between China and the Russian state.

Moreover, China's interests in the natural resources of the Russian Federation continue to materialize through important investment projects, such as the development of the largest titanium deposit in the Russian Federation (Komi Republic), initiated in 2022. Thus, Russian Titanium Resources and China Communications and Construction Company signed an agreement for the development of the Pizhemskoye mining field in the Komi Republic, worth 838 million dollars. This mining field holds the largest deposit of titanium and quartz in the world and more than 80% of the titanium ore reserves of the Russian Federation. The mining project was identified as a potential component of the official Strategy for the development of the Russian Federation's Arctic region and ensuring national security until 2035, approved by Russian President Vladimir Putin in October 2020. The involvement of the Chinese company in the project could give Beijing the opportunity to play an important role in developing Russian strategic assets. Also, this project is in Moscow's interests too. First, the Russian state aims to increase investments in the Arctic area and build a viable North Sea route and a functioning year-round passage through the Arctic, connecting Europe to Asia. Second, thanks to Chinese capital, Moscow hopes to gain long-term access to titanium reserves, which are particularly important for the aerospace, defence, marine, chemical processing, and automotive industries.

Another project aiming to contribute to the development of the Arctic region of the Russian Federation is the bilateral agreement signed in 2023 between the China Railway Construction company and the Russian authorities, worth 713 million dollars, which started the construction of the Indiga deep sea port and the Sosnogorsk-Indiga railway. These projects are expected to facilitate bilateral exports through the Ural region and Siberia, but also on the North Sea route.

7. Recent intergovernmental initiatives in the field of investment cooperation

In addition to mentioned above important bilateral projects, in November 2022, the Russian Federation and China signed a Memorandum on Strengthening Investment Cooperation and agreed to invest further 1.3 billion dollars in joint projects (TV BRICS, 2022). The role of Chinese investment for the Russian economy was confirmed in March 2023, when the Russian Prime Minister Mikhail Mishustin stated that the portfolio of Russian-Chinese investment projects concluded over time exceeded 165 billion of dollars (RSPP, 2022).

Bilateral investment relations were strengthened on November 20, 2023, during the 10th meeting of the Russian-Chinese Intergovernmental Commission for Investment Cooperation (RCBC, 2023), which resulted in the launch of new ambitious investment projects in priority sectors, such as the automotive, mining, natural gas, agriculture, logistics and IT. Particular attention was paid to the cooperation in the nuclear sector and in the field of renewable energy sources, the also being discussed the construction of fast neutron reactors and the use of the unique technologies of the Russian company ROSATOM. In addition, the countries addressed the implementation of joint projects in the field of aircraft construction and increasing cooperation in the car sector, but also strengthening cooperation in the field of artificial intelligence. At the meeting, the countries agreed to continue to expand the use of the rubble and yuan in bilateral trade and to support the establishment of the Russian and Chinese banks on their financial markets. Moreover, they stated the readiness to implement agreements on the coordinated development of the Greater Eurasian Partnership and the BRI[7].

[7] The President Vladimir Putin announced the Russian government's objective to develop a Greater Eurasian Partnership at the St. Petersburg Economic Forum in June 2016. In his opening speech, Putin proposed „to consider the prospects of a broader Eurasian partnership that would involves the Eurasian Economic Union", in which countries such as China, Pakistan, Iran and India would be included (Source: https://www.wilsoncenter.org/publication/kennan-cable-no-40-russias-search-for-greater-eurasia-origins-promises-and-prospects).

8. Conclusions

Our first finding is that although the invasion of Ukraine by the Russian Federation in 2022 led to an exodus of foreign capital from the Russian market in the first year after the outbreak of the conflict, however, because of the new legal barriers imposed by the Russian authorities the exodus slowed down in the second year of the war. As the West has sanctioned the Russian Federation, Moscow has turned to its closest partner in terms of political visions and strategic objectives, i.e., to China, to support its economy and pave the way for resource development and exploration energy with the help of Chinese capital. Consequently, the investment cooperation between the Russian Federation and China remained quite stable in comparison to the great retreat of the Western companies, helping to mitigate the adverse effects of the sanctions and providing the necessary financial support to support the Russian economy.

However, Moscow's dependence on China's investments has the potential to generate several challenges and risks for the Russian Federation. On the one hand, the long-term risks of growing dependence relate to Moscow's loss of sovereignty and control over key sectors of the economy. On the other hand, Chinese investments directed to the Far East support an economic model based on the extraction and export of natural resources, and the volume of Chinese capital is not large enough to cover the low level of public investment in the region.

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