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**DEVELOPMENT DIRECTIONS AND PROSPECTS FOR  
INTERNATIONAL PRODUCTION COOPERATIVE RELATIONS  
UNDER SANCTIONS RESTRICTIONS**

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***Abstract***

This article is devoted to the issue of development directions and prospects for international production cooperative relations of enterprises in the conditions of sanctions restrictions. It is emphasized that in comparison with the end of the XX century, when Russian budget deficit reached 30%, and state bonds were used to build financial pyramids, nowadays, the Russian economy has become much more stable due to the high key rate and compressed money supply, high taxes and lower real incomes of citizens. There is an undeniable fact that foreign investors are interested in investing in Russian projects (because they allow them to get a good profit from investments), but they do not voice this interest publicly, because it can negatively affect the reputation of foreign companies and the personal reputation of their management in the home country. There is a point of view that in order to activate the process of investment capital inflow to our country, it is necessary to be aware of next sanctions steps against Russia. We can quite surely predict that if the sanctions are lifted, the obstacles to investment in key sectors of the Russian economy will disappear. This situation will allow getting cheap loans abroad, and this will lead to a significant increase in investment by the Western investors. Unfortunately, such a scenario is unlikely in the nearest future: there are dozens of developing countries in the world whose GDP is growing by 3-5% per year, and Russia's GDP has a near-zero growth.

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**Keywords:** International cooperation, business climate, foreign investment, joint ventures.



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## 1. Introduction

The Russian economy is an organic part of the world economy. It is constantly striving to take its rightful place in the international labor division. The state of innovative development institutions and the foreign economic activity, the Russian geo-economic status are constantly improving. At the same time there are changes in methods and techniques of the successful entrepreneurial activity at the micro level, the latest achievements of the digital economy are being embedded in everyday practices of public and business structures. All this increases the favorable investment and business climate of the country. The purposeful efforts of the government and the business community of the Russian Federation have brought a significant success: at the end of 2019, Russia secured its 28th position in the authoritative world ranking Doing Business (this rating is regularly published by the World Bank to assess the level of favorability of the business climate in various countries), in 2012, it has only the 124th position (The World Bank Group, 2018). The Russian ranking place in creating a successful business environment is between France and Spain and began to correspond to the level of some EU countries; although there is a slight gap from the major world economies – the ranking leaders. And all this positive dynamics became possible in spite of the policy of total containment implemented by the Western countries. One of the most important reasons that led to such a remarkable result is the wide spread of international cooperation on the territory of the Russian Federation.

International cooperation is the industrial cooperation of international organizations in the production sphere, which allows to increase by 90% the level of the product quality in case of industrial cooperation with a foreign partner, while the development of production with using a foreign technology on their own may achieve growth in a much smaller size (about 70-80%). The main advantage of the international cooperation is that it not only provides additional jobs and working places, but is also one of the fundamental reasons for attracting foreign direct investment to the Russian Federation, which, in turn, allows our country to receive and further distribute advanced production and management technologies. The effect of attracting foreign direct investments in Russia is extremely high, so the issue of developing international production cooperation relations is currently relevant and problematic.

## 2. Problem Statement

According to Forbes, the net flow of foreign direct investment into the capital of Russian companies at the end of 2018 amounted to more than \$6 billion – a record result in the entire history of observations (since 1997). However, the total investment volume in the non-financial sector of the economy amounted to only \$5.938 billion (it is the minimum since 2002). This is only the fourth negative year result for the whole history: previously it was observed in 2003 (minus \$2.1 billion), in 2012 (minus \$866 million) and 2015 (minus \$445 million). In 2017 the inflow of foreign investments into the capital of Russian companies amounted to \$9.705 billion, in 2016 – \$18.238 billion (Forbes, 2019).

According to statistics from the Central Bank of the Russian Federation, in 2018, \$15.994 billion was invested in the capital of Russian companies from abroad, while foreign investors withdrew \$22.407 billion (the largest amount since 2015, when foreign investors withdrew investments of \$32.326 billion) (Forbes, 2019). Also in 2017, the net volume of direct foreign investments in non-financial sector exceeded

30 billion dollars, which represented the most significant result of the last four years, in spite of a relatively low investment ranking (BB+ by S&P), according to the Russian direct investment fund – RFDI (Russian direct investment fund, 2018). This success was absolutely incomparable with the scale of Russia, its significance in the world, especially in comparison with the United States (\$380 billion dollars), Hong Kong (\$160 billion), China (\$130 billion) – and these countries are the modern world factories for the production of high-tech products; they have balanced conditions for investment and capitalization of funds, provided protection of the interests of industrialists-investors and the private property in general, which is an example for the Russian Federation. In addition, it is necessary to take into account the role of innovation activities of other enterprises in related industries and industrial relations.

The empirical strategy is aimed at determining the role of the innovative intensity in four different areas (technology, organization, personnel training and information and communication technologies) and the role of corporate industrial relations at the enterprise level in the working environment (Antonioni, Mazzanti, & Pini, 2009). On the one hand, cooperative industrial relations are always positively and firmly linked to the welfare of workers. On the other hand, innovations generally have a positive effect on working conditions, but this effect is weak, and for specific organizational aspects it may be even negative. Therefore, it is necessary to study development directions of international production cooperation relations in the Russian market, to find out problems associated with this aspect. This study is devoted to solving this problem.

### **3. Research Questions**

Technological changes have an undeniable impact on international relations and changing nature of the world politics. They also affect the pace of technological changes. Any technological change is a process of an economic redistribution and a change in the society that creates new winners and losers, as well as allows building strategically new norms and organizations. The nature of the technology itself and the extent to which the public sector encourages innovations have different effects on international cooperative relations (Drezner, 2019).

International production cooperative relations include the involvement of practitioners, as well as the application of a variety of knowledge and experience to generate new knowledge (at least theoretically) that is socially sustainable and accountable to the society (Hinchliffe, Levidow, & Oreszczyn, 2014). The use of knowledge for development is a major challenge in developing or newly industrialized countries; at the same time, knowledge and its components are considered in the context of increasing the competitiveness in the global production of new goods and services, maintaining sustainable growth in the international arena, providing new growth sources and increasing the productivity (Mohaghegh, 2016).

The defining features of modern business organizations are supply chains, as well as production and other complex inter-organizational relations (Wright & Kaine, 2015). The instability of the Russian economy in terms of the domestic demand reduction has an impact on foreign business which is focused on the domestic market. Obviously, foreign retailers have been and are still under pressure of the decrease in real incomes of the population over the past 5 years. That is why they are leaving Russia. Large companies maintain their presence in our country, because they understand that after the recession there will be growth; however, they reduce the volume of their development (investment activity).

There are different views on foreign investments. Some economists generally believe that their role for the economic growth is overestimated. Many countries (including the Russian Federation) limit the volume of foreign investment depending on various conditions (and this is quite justified). In the framework of this study, directions and prospects for the development of international production cooperation relations of the Russian enterprises in the conditions of sanctions restrictions are considered as the primary basis for attracting foreign direct investments in order to increase the pace of the innovative development of the Russian Federation, and to strengthen the country's economy.

#### **4. Purpose of the Study**

By itself, the company's participation in industrial cooperation of international organizations requires a high level of organization of its technical and economic development. Therefore, the main purpose of this study is to analyze problems associated with the development of international production cooperative relations under sanctions, and to study trends in the development of Russian industry as a whole, investment and reproduction aspects (as a movement of fixed capital).

#### **5. Research Methods**

In the course of this study, the authors took into account the fact that statistical information about the participation of industrial enterprises in international cooperative relations often relates to internal information that is a commercial secret. However, using indirect indicators that are available in open statistical information sources, it is quite possible to get a fairly complete picture of how foreign economic activity of Russian enterprises is carried out, what is the degree of their participation in the international labor division, and how effective is the participation of Russian enterprises in the development of international production cooperation. Therefore, empirical, diagnostic, retrospective, predictive, and stochastic methods, as well as methods of system and factor analysis, can be used to achieve the research goals.

#### **6. Findings**

According to estimates of the Ministry of economic development, direct investments in the Russian Federation in 2018 decreased significantly. At the same time, for example, in the third quarter of 2018, an outflow of a record \$ 6 billion was recorded (RBK, 2018). In the first quarter of 2019, the volume of foreign direct investments increased slightly to \$ 11.5 billion. Foreign investors are again showing interest in investing in the Russian economy and are ready to increase investments as it stabilizes. For example, the Canadian company Kinross Gold reported on investment plans for the development of gold deposits on Chukotka (the volume of foreign direct investment attracted to this project, according to preliminary estimates, may amount to \$ 1.2 billion by 2041, and the number of new working places – more than 61 thousand). Korean Hyundai Motor in the summer of 2018 informed about its intention to invest about 27 billion rubles in the Russian market and build a plant for the production of engines (150 thousand units per year); to do this, the company submitted documents for the conclusion of a special investment contract, which gives it the opportunity to receive some the support in exchange for investments. We should take

into account an undeniable fact: in any volatility period, new investors (who are not working in the Russian market yet) will not rush to make strategic decisions, they will always take a pause to assess the development of a current situation. But, in spite of this fact, a strong increase in foreign direct investments on the background of sanctions seems unlikely in the nearest future. Foreign investors say they want to invest in the Russian economy. But such statements are made non-publicly, in "closed formats". In fact, statistics record the withdrawal of money and closing business. This is primarily determined by the sanctions effect.

Sanctions are measures that are applied before beginning to implement military force or a war. The broadest and most recent application of sanctions is currently taking place between the West and Russia in the Ukrainian crisis. In this crisis, the USA and the European Union are trying to change the behavior of the Russian Federation by imposing a large amount of trade and financial embargoes and sanctions against individuals. Russia is trying to fight against Western sanctions by imposing retaliatory sanctions against European countries and European officials (Bagheri & Akbarpour, 2016). Thus, the reasons for the decrease in foreign direct investments in the Russian economy are mainly political. It's worth noting that under President Donald Trump, the timing of US anti-Russian sanctions is unpredictable and often depends on internal events in the USA; the framework and motivation are blurred, and there is no viable exit strategy (Kluge, 2019).

Traditional investors in Russia (Cyprus, Luxembourg, and similar offshore jurisdictions) are formally foreign companies and in practice Russian subsidiaries and affiliates. Significant US pressure led to banking problems, for example, in Cyprus (either Russian business funds began to return back to the Russian Federation, or they were reoriented to projects in other countries). In addition, the Russian business was affected (though, to a lesser extent) by negative trends that existed before in the business climate of the Russian Federation (legal insecurity, administrative barriers, and other weaknesses of the Russian investment climate).

Although Western financial sanctions are not a decisive factor, nevertheless, they significantly affect the deterioration of the economic situation in Russia. They significantly undermined the ability of Russian companies to attract foreign capital, thereby contributing to the deterioration of their financial conditions (which is especially noticeable in the case of energy companies those became subjects to sanctions). In this regard, Russian business needs more support from the state. At the same time, it is necessary to take into account the undeniable fact that oil export revenues are the main source for the Russian budget, so this support is becoming increasingly difficult because of the sharp drop in oil prices (Domańska & Kardaś, 2016). The fact that Russian enterprises participate in global value chains (especially in cooperation with companies from developed countries) requires from them a high level of technical and organizational development. In conditions where the largest share in the exports of industrialized countries is made up of machinery and equipment, in order to ensure the international cooperation of domestic industrial enterprises on an equal basis, the corresponding priority development of manufacturing industries is necessary.

Kormnov (1999) revealed the mechanism for launching the economic growth in the technological chain by expanding the participation in international cooperation. The author argues that even in the conditions of the fierce political confrontation, sanctions, and mutual restrictions, the key aspect in the problem of forming a development strategy of foreign economic relations in the Russian Federation is

understanding of the fact that only the participation in international economic processes, the liberalization of foreign economic activity of enterprises, and the attraction of foreign direct investments will allow the formation of the country's international competitiveness. It has been repeatedly proved that the strategy of openness to cooperation and the formation of international production alliances can ensure the economic growth above the global average rates. At the same time, innovations created everywhere in the world and effective technical solutions are applied through hiring competent foreign managers, borrowing ideas into the organization and production management, etc. (Yakovlev, 2016). Today, international production chains and cooperation alliances cover thousands of links (individual firms that cooperate with each other). These links are formed into chains that are called global value chains. At the global level, elements of such chains are industrial enterprises located in different countries and continents, connected through the production process of technology or a finished product.

In the modern world economy, there is a slowdown in the globalization processes. This is particularly evident in the dynamics of the ratio of trade volume to GDP: from 1960 to 2008, it increased by 35 percent points, and over the past 5 years – by only 0.2 p.p. Some experts hypothesize the end of globalization under the influence of some reasons (unprecedented growth of protectionism, higher labor costs in developing countries, reshoring, new industrialization of developing countries, shifts in global costs, the impact of industry 4.0 technologies), others make hypotheses about the creation of a new globalization model which is characterized by a change in all the proportions that have already developed before (Kondrat'ev, 2018). Modern companies need to find new drivers for their growth, since their participation in the previous global value chains is canceled due to the decentralization phenomena and the exclusivity of modern production processes of goods and services. It is necessary to find new segments of increasing the production of goods (services), which can potentially be found, first of all, in those developing countries where the production growth rate has started to exceed the similar indicators in the developed countries. It is also important to place enterprises of various sizes as close as possible to consumers and at the same time minimize costs due to the production scale. Today, digital and additive technologies, robotics and high communication skills allow us to solve these tasks (Keller, 2016).

The degree of participation of industrial enterprises of different countries in foreign economic relations determines the amount of their contribution to the global value chains. At the same time, the contribution of industrial enterprises to the global value chains depends on many factors. One of the most significant ones (at least, for Russia) is the technical level of production and the availability of raw materials and energy resources. The estimation of alternative production costs of high-tech products by options “production entirely on their own” or “with the use of broad international cooperation” shows that the import substitution strategy contains an internal dichotomy for industrial enterprises. Implementation of international scientific and industrial cooperation projects allows their participants from a certain country to understand limits of their competences in time and not to disperse their resources for goals with ambiguous results; decide where they should not initially waste limited resources, but turn to purchasing finished products and components from leading companies in their industrial branch.

It is impossible to survive in the international cooperative relations without the state support. Only the state can force foreign companies that use the mineral wealth of Russia in accordance with production sharing agreements (PSAs) to purchase domestic equipment, raw materials and materials within the

framework of localization programs and special investment contracts (SPIC) (Volsky, 2004). Therefore, it is obvious that the mechanism for ensuring and maintaining the international competitiveness of industrial enterprises should organically combine both corporate and state regulation tools and purely market methods. One of the key directions of ensuring competitiveness in the conditions of rapid development of information technologies, application of achievements of the global scientific and technical progress is the high quality of products and their proximity to consumers. Therefore, not all global companies consider the cheap labor and the unstoppable market growth (like in China and India) to be indisputable advantages. For example, the Japanese company Canon is sure that developing “hi-end” products at home is a more effective way, so it continues to work mainly in Japan. The company decided not to save money due to the cheap labor, but to spend it on innovations in order to maintain its leadership in the segment of high-quality electronics.

Despite the difficult geopolitical background, German, Chinese, Korean, and Japanese companies maintain a high level of their business activity in Russia and are among the leaders in terms of the production localization (Lindt, 2018). Examples of specific industrial sectors of Russia, that are attractive for foreign companies, include oil and gas industry and infrastructure (they are the most attractive for China), agriculture (attractive for Vietnam), cheese making (attractive for Finland), mechanical engineering (for Germany). In fact, these are investment areas that have developed historically in the cooperation with foreign companies.

The Russian side in these cooperative projects acts in business with its production grounds, skilled labor forces, investments and scientific developments, as well as a capacious solvent market. For example, it was planned that the production of cars in Russia will grow by 10-12% by the end of 2018, while the level of capacity utilization will reach 45%, which is not available in developed countries. In fact, in 2018, the production of passenger cars increased by 16%. In total, 1.56 million cars were produced for 12 months. Production of domestic cars increased by 18% and amounted to 414.9 thousand units. Production of cars of foreign brands increased by 15% for 2018 (to 1.15 million cars). Positive dynamics were recorded at “Avtotor” (+47%), “PSMA Rus” (2.3 times growth), “GAZ” (+15.5%, contract assembly), “Renault Russia” (+3%), “Ford Sollers Elabuga” (+3%), “Mazda Sollers Manufacturing Rus” (+29%), “Volkswagen Group Rus” (+22%), as well as at St. Petersburg plants that produce Hyundai, Kia, Nissan, Toyota (+8.5%). The share of foreign cars in the total volume of the passenger car production in Russia in 2018 was 73.5% (in 2017, the share was equal to 74%).

The authors note the undeniable fact that, despite the sanctions, almost no large German companies have left the Russian market. In Russia, there are 4965 enterprises with the German participation, accounting for more than 270 thousand working places. Moreover, 30% of German companies are planning new investments this year; 63% of them reported an increase in turnover in Russia. Taking into account that the Russian economy grew by only 1.5% last year, German companies managed to grow stronger than the market. The Japanese companies are not far behind: “Mitsubishi” resumed the production of Pajero Sport SUV in Kaluga in November 2019, and also returned the ASX crossover to sale. According to experts, the Russian version of Pajero may be 20% cheaper. Other foreign automakers are also increasing their production in Russia.

In the regional dimension, the Far East is a specific territory in this context. Up to 26% of the total volume of foreign direct investment in the country are directed there, especially investments from China and Japan. These investments are directed into shipbuilding, petrochemicals, agriculture and fertilizer production. Taking into account that about 80% of RFDI investments are in projects that are located outside of Moscow and St. Petersburg, the thesis is confirmed that there are attractive sites available for projects using innovative technologies in the Russian regions. New for Russia formats of special economic zones and priority development areas that are actively used today in the country, are considered as crucial drivers of direct foreign investment inflows, as these areas can offer their residents the most favorable tax conditions and benefits (Streltsov & Yakovlev, 2018). The most successful companies are those that are growing along together with developing industries: manufacturers of clothing, medicines, furniture, textiles, and chemical industry enterprises.

## 7. Conclusion

The authors highlighted the main reasons that prevent the inflow of foreign investment in our country: sanctions aimed at those sectors of the Russian economy that are the most attractive to foreign investors (primarily the oil and gas sector) and the Russian counter-sanctions that restrict the supply of products from some countries that supported sanctions against Russia. However, it is noted that despite the restrictive measures, international cooperation projects of Russian enterprises (primarily in the fields of mechanical engineering, pharmaceutical and food industries) are growing both in scale and in their total number. Special attention is paid to the fact that the positive dynamics of attracting foreign investment and advanced technologies are influenced by the level of risks, as well as a high place in international ratings, support of the authorities, and infrastructure support.

Despite the sanctions policy of Western countries, Russian enterprises are expanding their participation in international cooperative relations. However, the Russian Federation is among the most undervalued emerging markets. Significant factors (oil and gas prices, the Central Bank's key rate, the ruble exchange rate, undervaluation of assets, and the volume of effective demand) ultimately form the inflow of investments from global funds and private investors, whose dynamics can now be regarded in terms of "growing and promising". To ensure the growth of the Russian economy, one of the most priority areas where the authorities of any country around the world intend to invest their funds and efforts is to attract foreign direct investments. It is possible to forecast an increase of up to 10% of foreign direct investments in 2020, despite the sanctions and counter-sanctions regime, as well as the existing macroeconomic policy. Foreign investments and investors are necessary for the economic growth of the Russian Federation. Therefore, business cooperation with foreign companies should continue its development.

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