Investing in Russia – Crimea Fallout Part 3

This is the third in a series of articles about investing in Russia in light of the annexation of part of neighboring Ukraine by the Russian Federation. Our first article looked at the annexation of the Crimea from the perspective of Russian history. The second article considered the shorter term consequences of investing in Russia and effects on the European and Russian economies. Our third and last article considers long term investing in Russia and what factors to consider in **foreign direct investment** in Russia and other investments directly affected by this matter.

Events

It is unlikely that East and West will go to war over the annexation of Crimea. It is also unlikely that the Russian troops massed on the eastern border of Ukraine will invade. However, tensions between the USA and Europe on the one hand and Russia on the other are at their highest since the end of the Cold War. The major economic powers have expelled Russia from the Group of 7 which had previously expanded to be the Group of 8. Selective economic sanctions have affected a number of high ranking Russians thought to have been involved in deciding on the annexation of Crimea. Now the Russian president has called the American president and foreign ministers are meeting in Paris to seek a solution. Russia wants to avoid having a democratic and western influenced nation right on its border and the West would like to have just that as well as assurances that Russia will not decide to repeatedly threaten its neighbors with annexation.

Consequences

If you are considering foreign direct investment in Russia you do not want to be doing so as a new Cold War starts up. Certainly companies that plan in the billions of dollars and plan over decades want to avoid having their investments damaged by a Russian president who is playing tough to appeal for support at home and sow fear in the hearts of his neighbors. Last week we mentioned that the US oil and natural gas boom now coincides with a desire of Europeans to reduce dependence of oil and gas from Russia that transits Ukraine via pipeline. Much of the boom in Russian oil production came from the use of Western technologies applied at the end of the Cold War. It is unlikely that Western companies will want to risk their capital at a time when Russia may decide to annex Latvia, Estonia and Lithuania next. The investment consequences of this are not just limited to investing in Russia but also to selected investments in Europe. As we noted last week Russia and the EU are major trading partners and the EU has been the leader in foreign direct investment in Russia. That situation is likely to change for a long time if Mr. Putin does not take steps to make things right.

Pulling North America and Europe Closer

Negotiations for the **North American European free trade agreement** are still going on. It is distinctly possible that concerns regarding investing in Russia and the Crimea fallout may lessen concerns that have held these negotiations back. If a free trade agreement links the North American and European economies that will be the largest free trade zone in the world encompassing an area with GDPs as follows:

- North America $18 trillion
- European Union $16.6 trillion
- Total $34.6 trillion

Add Japan to this and you get $ 6 trillion more to make $40.6 trillion!
As a point of reference the combined economies of the BRICS nations, Russia, China, Brazil, South Africa and India are as follows:

- China $8.2 trillion
- Russia $1.0 trillion
- India $1.8 trillion
- South Africa $ 0.4 trillion
- Brazil $2.3 trillion
- Total BRICS GDP = $14.7

The point is that Mr. Putin's play for local support by annexing the Crimea has not only excluded him from the G7 but may exclude his economy from the most massive free trade zone ever imaged when North America and Europe (and possibly Japan) are pulled together by the threat of another Cold War with Russia.

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