

How State Supports Investments: Case of Russian Federation

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Abstract

This article addresses the range of measures that has been developed by Russian Government in order to attract investments in the economy. The analyses of effectiveness of investment protection and promotion agreements, special investment contracts, state program "Project finance factory", various tax benefits and preferences for participants in investment activities is presented.

This study mainly uses such methods of research as analysis, synthesis, comparison, deduction, induction, methods of formal and dialectical logic, method of analogy, methods of expert assessments.

The results show that certain improvements to the implemented support measures should be made for better stimulation of investments.

Key-words: Investment Protection and Promotion Agreements, State Program "Project Finance Factory", Special Investment Contracts, Tax Preferences.

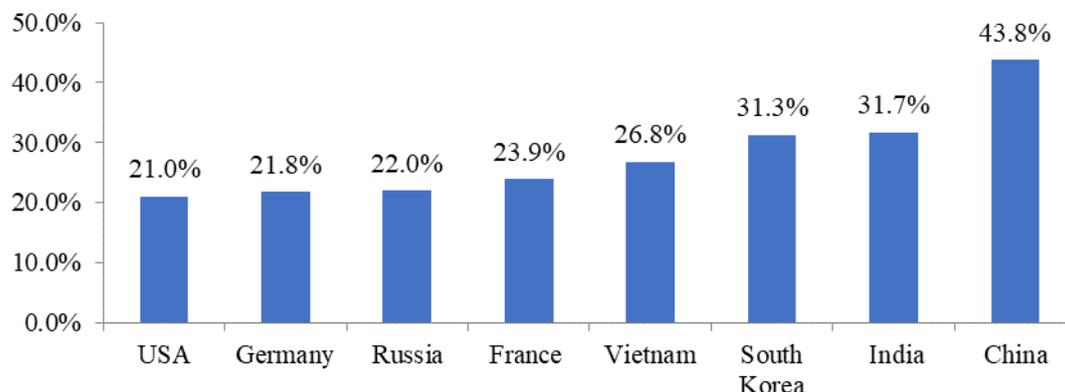
1. Introduction

High level of investments in economy is usually considered as a main economic driver. In the past decade the investment rate in Russia has reached levels comparable to those in developed countries (Germany, The USA, The UK), but yet it is not enough for reduction the technological gap and rapid modernization of the economy.

Despite of the fact that the level of depreciation of fixed capital at the Russian enterprises gradually decreases, this process is still very slow.

The countries with high level of economic growth such as China, South Korea, Vietnam have a much greater rate of investments (Fig. 1).

Figure 1 - Capital Investment as Percent of GDP, 2018



The Entrepreneurs are reluctant to invest in projects with a long pay-back period and that is mainly attributed to poor perception of investment climate in Russia. The main reasons that seriously hinder inflow of capital in Russian economy are frequent changes in legislation and potential volatility of the economic situation in a long-term perspective.

To overcome these barriers the Russian Government has to apply different measures of support in those areas which are considered a priority of state policy.

The Russian Government has developed such instruments for encouraging of investment activity as special investment contracts, state program “Project finance factory”, investment protection and promotion agreements which are aimed to start a new investment cycle in Russia.

Besides, a significant liberalization of tax treatment is designated for those who invest in regional investment projects. The provided tax benefits are aimed at improving the regulatory function of taxes. The proposals on improving the mechanisms of formation of scientific and technical competitive advantages of the Russian industry that also affect the stimulating instruments of investment activity are made in the paper of Russian scientists (Abdikeev et al., 2020)

Most of the measures presented in this paper are relatively new in Russian practice, some are just being introduced, that is why the analysis of applicability and effectiveness of the mentioned state stimulating instruments is especially relevant.

Nowadays in Russia there are not many publications devoted to the complex analysis of state promotion measures for investment activity. Mainly, this is due to the fact that most of the considered mechanisms are relatively new, and they are just being implemented. More common are publications

that deal with the feasibility of public involvement in investment activities in general or those that consider the effectiveness of one or another state stimulation measure in isolation, without taking in consideration their complex character (Kudelich, 2018; Belov, 2019; Sapir & Karachev, 2020).

Foreign publications focus on the determining the borders of economic freedom and the appropriate degree of state participation in investment process and its influence on the effectiveness of investments (Ma, C. 2020; Al-Amarneh, 2017).

Special attention is devoted to the role of tax benefits and allowances in stimulation of investment activity. (Jinshuai, Jiang & Holmes, 2019). The point is made that a careful choice of subsidies' recipients is especially important because these measures are most successful only if the companies have a lack of financial resources. General issues concerning the influence of investment policy on economic growth at sub-federal level are also considered (Kim & Park, 2020).

It is reported in a series of publications that such measures as accelerated depreciation (Ohrn, 2019; Fan & Liu, 2020) and interest rate subsidies in case of their high volatility have a positive impact on enterprises' investment activity (Correia et al, 2018).

Nowadays it is the analysis of all state measures aimed at investment support that is of high interest. This paper is intended to reduce the lack of research reflecting the complex approach to analysis of state investment promotion measures.

Foreign publications of different years contain various data on tax approaches to investment promotion in industrial countries. They focus primarily on personal income tax, corporate income tax, value added tax and reducing State social insurance contributions. Promotion of investments on the listed taxes usually involves tax deductions, reducing tax rates or shifting the due date of tax payment. The last mentioned benefit, which abroad is called tax holidays, in Russia has its counterpart that is called tax investment credit. The main difference is that the latter is a fee-paying (from 0,5 to 0,75 per cent of the key interest rate of the Russian Central Bank). In 2020 tax holidays were also introduced in Russia. They were aimed at overcoming the economic consequences of coronavirus infection and lockdowns caused by it. Previously tax holidays were not used to promote investment activities in Russia. It is explained by the fact that tax holidays commonly apply to the corporate income tax which is not applicable at initial stages of investing as there is no profit yet, and the legislation does not provide for such a long-term shift of losses to the future through the formation of deferred tax assets.

A European experience of developing tax-free special investment funds may be interesting for such participants of investment activities as state corporations and other major taxpayers.

There exists, for example such fund as “Fund for financing the costs of ensuring the modernization of organizations of the nuclear power Industry and nuclear weapons complexes of the Russian Federation, the development of nuclear science and technology, design and survey work and other investment projects” but the participants which contribute to the fund have no benefits for corporate income tax.

Nevertheless, the financial resources of state corporations are primarily of budgetary origin, which are used in accordance with government programs. The budgetary resources needed for every government program are always limited so the requirements for their effectiveness are very high (Margolin, 2018). Consequently, the proposed benefit will raise the effectiveness of public expenditures in investment activities.

2. Methodology

The main research questions of this paper are as follows:

- Consider the existing state support measures for investment activities in Russia;
- Analyze their potential impact on promotion of investment activities;
- Consider the tax approaches to promotion of investment activities in developed countries and the possibilities to adopt them to Russian tax environment;
- Determine the influence of such measures as accelerated depreciation and depreciation premium on investment promotion;
- Examine the reasonability of application similar practices of investment promotion in developing countries.

In this research, we aim to bring together new approaches to promotion of investment activities in Russia in integrated manner and to assess their potential effectiveness.

In order to reach the aim of the paper the authors have chosen such methods of research as analysis, synthesis, comparison, deduction, induction, methods of formal and dialectical logic, method of analogy, methods of expert assessments.

The exploration of the existing supporting measures of investments and the assessment of their possible impact on the increase in investment activities of economic agents is based on methods of analysis, synthesis, comparison, deduction, induction. Besides, methods of analysis, synthesis, comparison and the analogy method were used to examine the applicability of measures considered in the article to promote the investment activities in developing countries.

Elaboration of proposals on improving of the existing and planning approaches to promotion of investments required the application of methods of formal and dialectical logic and methods of expert assessments.

3. Findings

Investment protection and promotion agreement is an agreement that is aimed at setting up a new project at any industry with the exception of gambling, manufacture of tobacco and alcohol, retail, oil and gas extraction, etc.

Depending on the industry the project should meet the minimum threshold of investments: from 250 million rubles till 5 billion rubles. Investment protection and promotion agreement involves providing stabilization clause which covers some taxes (corporate income tax, property tax, land and transport tax), urban planning and land use conditions (Sapir & Karachev, 2020).

The stabilization clause is valid for a period from 6 to 20 years depending on the amount of investments made. There's a possibility to extend it one-time up to six years. Besides, investment protection and promotion agreements provide an opportunity to recover investor's costs on established infrastructure. If the infrastructure facility is necessary only for implementation of the investment project, then 50% of investor's expenditures will be compensated. In case the infrastructure facility is necessary for other users as well, all investor's costs for establishing infrastructure may be offset.

It is necessary to mention that implementation of investment protection and promotion agreements is very up to date, because according to surveys of business representatives the reform of the existing state supporting measures of investments should aim at stabilization of law and business environment.

Despite of the attractiveness of the considered measure investment protection and promotion agreements are an instrument of economics management "in the manual mode" that is applicable mainly for medium and large businesses. Meanwhile the promotion of investment activities is necessary for all economic agents. That may be realized only in case of significant improve of investment climate in the country.

The mechanism of special investment contracts (hereinafter – SPIK) was introduced in 2014, and the first contract was awarded in 2016. The core of SPIK is that the government creates favorable conditions for implementation of investment projects which are aimed at development or modernization of new industrial production including ones without equals in Russia.

Under the first variation of SPIK (SPIK 1.0) a total of 45 contracts worth more than 800 billion rubles mainly in the chemical and automotive industries were concluded from 2016 to 2019. The contracts were concluded for a period up to 10 years, the minimum investment threshold was 750 million rubles.

At the moment it is possible to assess the impact of special investment contracts on investment promotion in respect to the contracts concluded in the period of 2016-2018, as a number of large contracts in 2019 have long lead periods and are only at the beginning of the investment phase.

As indicated in the table below (table 01) the significant investment flows provided by SPIK were recorded only in automotive industry (about 70%), but the influence on other manufacturing industries is not so substantial (does not exceed 10% by sector).

Table 1 - Influence of SPIK 1.0 on Capital Investments

Industry	SPIK 1.0 2016-2019, mln.rub.	Capital investments 2016-2019, mln.rub.	Share of SPIK 1.0 in Capital Investments
Automotive industry,	278 959	399 306	69,9%
Ferrous metallurgy, pipe industry and metal structures	18 221	1 580 295	1,2%
Machine engineering	25 528	835 517	3,1%
Chemical industry	159 667	1 748 880	9,1%
Pharmaceutical industry	14 623	155 263	9,4%
Total industries with SPIK	496 998	4 719 261	10,5%
Total. All manufacturing industries		9 711 311	5,1%

Conclusion of SPIK should involve high multiplier effects and promotion of business activity in related industries. But in Russia the implementation of projects in automotive industry, vice versa, led to declining of some related manufacture. In particular, the automotive components industry was almost lost.

Foreign corporations on preferential terms concluded special investment contracts and organized car assembly. Meeting only minimum requirements to production localization they received a control over the automotive industry. At the same time, the transfer of key production technologies was not executed.

Under the first variation of SPIK (SPIK 1.0), investors offered projects which were based on proven technologies that were needed by Russian industry, but they did not contribute to promoting innovative technologies in those industries (Belov, 2020).

To address the weakness of SPIK 1.0 the executive authorities of the Russian Federation are in process of improving it since 2018. The goal of reforming is expansion of SPIK application fields, creating an innovative basis for the Russian economy. It is supposed that as a result of the project investor will implement and possibly develop a modern technology based on which production of internationally competitive goods will be established.

Thus, the focus is shifting from organization of production to creation of new technologies which do not have any analogues in Russia. The main difficulty in implementing SPIK 2.0 is connected with determination and actualization of modern technologies list, which is developed based on proposals of expert organizations and public discussion with stakeholders. It is adopted by Russian Ministry of Industry and Trade and should be periodically updated. At the very beginning the negotiation of this list took too much time. In case the actualization of modern technologies turns out to be so long, the effectiveness of the whole mechanism will come under question.

While meeting all SPIK requirements, investor is entitled to various State measures of support such as tax benefits, accelerated depreciation, facilitated access to public procurement, special conditions of leasing land, building of infrastructure needed for project implementation, the possibility of obtaining the status of sole public procurement supplier.

Fiscal support measures may be provided for corporate income tax, corporate property tax, land and transportation taxes for the period up to 15-20 years depending on the amount of investments.

It is worth noting that the above mentioned taxes are allocated to the regional budget (with the exception of a land tax which is allocated to the local budget and a small piece of corporate income tax which is allocated to the Federal budget). Consequently, concluding SPIK the regional authorities postpone the increase in their tax income for minimum 15 years. It seems that the increase in personal income tax caused by new projects will not be so significant that it can add substantially to the regional budget, because most modern technologies are aimed at robotization of manufacturing processes and do not create many new jobs. Besides during such a long period the new technology may lose its relevance, and the region will be placed in a situation when tax reliefs have been provided, but substantial effect was not received by the regional budget.

In general, provision of tax reliefs is a more accessible measure for donor regions, but the problem of investment stimulation is more urgent in regions with high deficit of budget. Thus, the effective application of investment promotion measures involves the need for deeper structural reforms, in particular the equalization of regional budgets' fiscal capacity.

Conclusion of SPIK aimed at modernization of the existing manufacture should be treated very carefully, because in this case the region may lose a significant piece of already collecting taxes when the existing production will be replaced by a new one based on modern technologies. Therefore, it is advisable to envisage a point in legislation that SPIK may be concluded only in case it doesn't reduce the amount of taxes being already collected in the region.

It seems appropriate to provide a more deep differentiation of tax benefit periods taking as a basis the relevant approach fixed in investment protection and promotion agreements where the stabilization clause period varies from 6 to 20 years depending on amount of investments. Besides, one time extension of stabilization clause is possible.

Certain flexibility in concluding SPIK is more beneficial from the point of financing regional budget. It appears that when the majority of regional budgets have deficits it is not reasonable to impose in SPIK the waiver of future tax revenues.

An important difference between SPIK 2.0 and SPIK 1.0 is that SPIK 2.0 is available to a potentially wide range of investors because of absence of minimum criteria for the amount of invested capital. In doing so, an investor may be an initiator of concluding SPIK, and the project may be rather small and not require much investments. Based on the practice of public private partnership projects there's a reason to believe that private initiative might prevail. It is obvious that conclusion of SPIK requires resources of public authorities for preliminary review and coordination of draft, organizing a competitive bid process. In this context it appears that the absence of minimum initial investment threshold is not fully justified and may lead to dispersion of authorities' resources over consideration of small investment projects, which implementation will not be enough for promotion of investments at the regional level.

State program “Project finance factory” (hereinafter - Project finance factory) is a mechanism of syndicated financing of investment projects when the risk of raising the Central Bank's key rate is hedged by state subsidy for the amount of the rate's possible increase. VEB.RF is a national development bank that acts as an operator of Project finance factory. VEB.RF together with commercial banks provides a syndicated loan. The loan is granted by several tranches. The first tranche, which may be up to 40% of the whole amount, involves a special pricing mechanism: infrastructure bonds guaranteed by government are issued for financing projects under Project finance factory. This aims to reduce the loan interest rate and makes project finance more accessible.

Project finance factory is an instrument that solves major problem of Russian economy – lack of long-term fund-raising. Project finance factory contributes to the diversification of commercial

bank risks that allows them to participate in financing of long-term investment projects (Kudulich, 2018).

During the last two years the first ten projects for the amount more than 800 billion rubles have been approved for funding under Project finance factory and another twelve with potential investments for more than one trillion are under consideration.

It should be mentioned that the scope of Project finance factory is rather narrow, because primarily the instrument was designed especially for development of project finance when project cash flows are the main source for loan repayment. Project finance, as a rule, is applicable for complex high-budget projects, consequently, the mechanism of Project finance factory does not imply large-scale replication, but the problem that is solved by it - key rate increase during the period of investment project implementation – is common for all investment lending market.

Given the long life of loan investors worry that throughout the implementation of an investment project the cost of debt service will become higher than expected. It is quite possible that their concern is not entirely off-base. Funding organizations, in their turn, taking into consideration possible fluctuations of interest rates in the future provide loans at floating rates linked to Central bank's key rate. Thus, the extension of Project finance factory mechanism to the whole investment lending market should have a positive effect on implementing of investment projects in the real economy and contribute to attracting the long-term resources in the economy.

Reduction of the corporate income tax base for the amount of capital investments. It is advisable to extend a so-called “depreciation premium” that is usually used in regards to acquisition of equipment to all other capital investments made by firms. Such a proposal is premised on the fact that no depreciation is charged for capital investments, but tax relief is already relevant at the construction phase of the project. In foreign practice this measure is called accelerated depreciation. In Russia this is a widely used instrument in business accounting, but not in tax accounting. At the same time it is prudent to take into consideration the impact of depreciation on the results of investment projects assessment (Margolina & Spitsyna, 2018). The experience of such countries as Denmark, Portugal, Netherlands, Luxembourg, Austria, Italy shows the effectiveness of such preferential measure.

Investment tax credit provided in Russian legislation envisages shifting the due date of tax payment, but not the reduction of the tax base. That is why it is less attractive for taxpayer companies that are actively investing in the economy.

4. Discussion

Currently it is the potential effect of state stimulation measures that causes the greatest interest. Many researchers including the foreign ones suppose that such an excessive government intervention in the economy is counter to competition principals when business conditions are the same for all participants (Ma, 2018; Belov, 2019). However, taking into consideration the present situation (sanctions and accumulated domestic issues) it is obvious that government support is especially indispensable. That's why the effectiveness of measures taken by government is of high importance. Particularly, given that at the moment business community considers state support insufficient and not fully effective (Sitnikov & Grigoriev, 2019).

The researchers are usually unanimous that application of such measures as investment protection and promotion agreements and various tax benefits motivate economic agents to increase long-term investments in real economy, and the discussion boils down to determination of specific parameters of these supporting measures (Ohrn, 2019; Fan & Liu, 2020). It is important to mention that the representatives of business community consider financial measures as a key advantage of state support for business. The reason is that tax promotion and other financial measures are more transparent in terms of administration and achieving desired business result (Sitnikov & Grigoriev, 2019).

While analyzing the perspectives of SPIK 2.0 the experts are quite reserved and pay attention that a new version of SPIK will require greater expenses for project preparation at an early stage. Thus, SPIK 2.0 will be attractive mainly for those investors, which are highly interested in Russian market and may offer disruptive technologies in exchange for guarantees and support of Russian Government. The number of such investors is subject to debate. For example, analyzing the relationship with German business community, it is supposed that a number of applicants may significantly decrease over the coming years (Belov, 2020). As opposed to this view it should be noted the approved list of modern technologies contains more than 600 items, which suggests a high potential of SPIK 2.0.

Considering Project finance factory scientists note its potential positive impact on development of project finance in Russia, but as a shortcoming they highlight that according to legislation this mechanism includes only basic requirements to projects for financing but the procedure for selection, assessment and structuring investment projects as well as the procedure for monitoring the implementation of these projects is carried out in accordance with the internal document of the Project finance factory operator VEB.RF. As a result the government may lose

control over projects being financed (Kudelich, 2018). It should be noted that VEB.RF is a state corporation that was created to facilitate the implementation priority of government policy, and the projects realized under Project finance factory are selected in compliance with this criteria. So, it seems that there's no need to indicate the criteria and selection procedure of projects in the federal law.

Another stated shortcoming of Project finance factory is that it creates an additional strain and risks on the budget (Kudelich, 2018). It should be argued that the problem of interest rate volatility is so considerable that it deters long-term investors. It is shown in this paper that the rapid recovery of Russian economy is impossible without private capital flows. Of course, Project finance factory is to some extent a method of managing economy in a "hand mode", but the problem that is solved with the help of it is so significant that the government has to take these risks.

It should be noticed that all the measures considered in this paper address specific problems of Russian economy. That is why it is their integrated application that should contribute to promotion of investment activities.

5. Conclusion

The paper proves that in order to promote investment activities it seems appropriate to extend the successful mechanism of Project finance factory to other investment lending projects.

SPIK 1.0 should be recognized insufficiently effective, because despite the creation of new jobs and increase of investment inflows in automotive and chemical industry the expected multiplier effect in related industries was not reached, in particular such industries as production of automotive components, automotive electronics have failed to develop. The transfer of modern technologies was not executed owing to poor requirements for production localization in Russia and their superficial meeting by foreign investors while the latter received rather significant tax benefits for a period up to 10 years.

The updated mechanism SPIK 2.0 stakes on technological efficiency and this is its main advantage over SPIK 1.0. To further improve the application of SPIK 2.0 it seems appropriate to envisage a deeper differentiation of tax benefit periods depending on the investments made and also impose a minimum threshold for receiving state supporting measures by analogy with investment protection and promotion agreements. At the same time it is necessary that there won't be any reduction in existing tax revenues of the region as a result of tax benefits provision.

One of the main achievements of Russian fiscal policy regarding promotion of investment activities is creation of predictable conditions that fix main parameters of tax system for the nearest six years, in particular, that is introduction of the "budget rule", introduction of "quasi-tax" payments to the Tax Code and adoption of systematic measures to reduce property taxation. It appears that further development of tax benefits should be aimed at the participants of investment activities that invest in less developed regions. To sum it up further measures of tax promotion of investment activities require "more fine tuning".

The considered measures of state promotion of investment activities in their entirety should contribute to launching a new investment cycle in Russia. In general the set of measures is aimed at elimination and mitigation of negative effects that are common to many developing countries, namely: instability of legislation and business conditions, volatility of interest rates in the long run. Consequently, the application of such measures as Project finance factory, special investment contracts, investment protection and promotion agreements should become an efficient way for revival of investment activity in developing countries.

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