

Foreign Private Investment in Russia? “Nyet!” In Ukraine? “Da!”

March 20, 2014

[Polski]

The recent developments in Ukraine and Russia’s annexation of Crimea are not only politically significant, but have a real potential to alter global trading relationships for years to come. As events continue to unfold in Ukraine, it is worth stepping back and reviewing historical precedents and patterns to understand the potential implications. Private companies which have already invested or are planning to invest in Ukraine or Russia should closely monitor the situation, as it will present both dangers as well as opportunities.

How will the conflict affect foreign investors in Russia?

Foreign companies already doing business in Russia are likely to face very difficult challenges in the short- and medium-term future. The U.S. and E.U. continue to assess imposing more extensive sanctions on Russia. Even if greater sanctions are not imminently imposed, the political and economic situation in Russia is bound to get worse before changing for the better, as Russia will become more isolated economically.

Vladimir Putin’s continued defiance of world opinion and diplomatic efforts to de-escalate the conflict, while playing to populist sentiments at home, would ultimately inflame the situation even further. Based on past practice, he’ll likely further agitate and foment unrest in eastern Ukraine, in order to destabilize Ukraine’s new government and bring Ukraine back into Russia’s fold. This could include deployment of economic pressures such as withholding natural gas deliveries and demanding immediate payment of past debts.

So how will the U.S. and the E.U. respond? Initially, a set of preliminary sanctions banning travel on certain officials have been imposed, but these are likely to be followed by more broad-reaching sanctions. But as Putin’s agitation efforts become more and more aggressive, Russia’s economy will begin to suffer. In addition, as is already the case, Russia’s government will clamp down even further on domestic dissent. All this does not bode well for foreign companies in Russia.

What about foreign investment in Ukraine?

At the same time, the U.S. and E.U., joined by other countries and multi-lateral agencies such as the IMF, will need to provide significant support to Ukraine’s economy. In the short-term, this support will be in the form of loan guarantees and credit facilities to stave off default. But in the longer term, the U.S. and E.U. know that the keys to keeping Ukraine from economic and political collapse are private investment and energy independence.

Accordingly, the U.S. and E.U. will be encouraging private companies to invest in Ukraine with new technologies, plants, factories, businesses and joint ventures, much like they did in the 1990’s with respect to the newly democratic countries in Eastern Europe. Such governmental encouragement will include OPIC insurance, IFC guarantees, direct grants and loan guarantees from U.S. and E.U. governmental agencies.

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Of special interest will be the agri-business sector, given that Ukraine is considered one of the major “bread baskets” of the world. Ukraine is also an important manufacturing center in Eastern Europe, especially in the automotive, steel and chemical industries. Also, because Ukraine is completely dependent on Russia for natural gas, starting shale gas production from Ukraine’s vast shale gas reserves will be an important priority.

Nevertheless, even with governmental support, North American companies (more so than European companies) may find the prospect of directly investing in Ukraine intimidating, especially given the lack of a Western business culture and ethical standards. But this “catch-22” dilemma – Western company investment and businesses are needed to help overcome and reform Ukraine’s past business practices, but they are reluctant to invest because of these same past business practices – is precisely what needs to be overcome.

One promising option for North American companies to consider, especially for the agri-business, manufacturing and energy sectors, is to joint venture their investments with Polish companies. Poland has been an avid supporter of Ukrainian democracy and greater independence from Russia and is keen to encourage this kind of facilitation and involvement of Polish companies, especially because Polish companies have been doing business in Ukraine and with Ukrainian company for many years.

North American companies can overcome these hurdles by utilizing governmental support and by mitigating business risks through joint ventures or other structures to take advantage of the business and investment opportunities that present themselves in Ukraine.

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