INVESTMENT POLICY IN RUSSIA: DEVELOPMENT STRATEGY

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Key words: development strategy, investment policy, investment potential, investment risk, modeling, legal system, investment climate, social variable, reforming, economic growth.

The paper provides conceptual model of investment policy. Decision-making tools for finding integrated innovative and investment solutions are suggested and economic-organizing mechanism for efficient management of innovative-investment processes is developed. Special attention is paid to implementing this mechanism on regional level within intensified state regulation.

Two major problems should be solved to allow proper development of investment policy in this country. Firstly, foreign investment sources have to be formed as well as domestic ones. Secondly, first-priority directions for foreign and domestic investments have to be determined.

Home economists admit that investment policy in Russian Federation currently lacks efficiency. The reason for this can be found in its theoretical and methodological insufficiency. From the other hand the failure to find necessary system principles can be observed. Using structure functional approach for plotting principles to build investment policy allows making research and development of basic structural criteria for different branches of national economy and helps to define function parameters for every constituent of the structure. Results of investment appeal analysis for Russian regions also influence the shaping of investment policy principles. The author defines region (country) investment attractiveness as a qualitative characteristic of the territory. To estimate prospective capital investment volumes the concepts of "investment potential" and "investment risk level" are used. As for production and social sector in general investment potential includes *raw materials, production, infrastructure, labor, institutional, financial and innovative* resources. They can be measured as weight average amount of statistical indices or evaluated by expertise. Potential investment risk in this case is calculated as weight average amount of *economic, political, financial, social, ecological, criminal and legislative* risks resulted from expert estimations.

Information about economic state and investment attractiveness rates of nations and regions are regularly published by foreign and domestic editions and consultancies. For instance, "Expert-region" Russian consultancy has been publishing investment conditions ratings from 1996. Based on these indices the investment climate is built. The results of regional distribution according to investment climate in 2003-2006 show that

♦ investors are interested in labor resources rather than natural ones;

♦ estimating investment climate investors incline to minimal risk (with moderate income) rather than maximal income with high risk.

Russian Federation is still keeping its investment appeal at the moment and priority is given to production sector where the highest scope of investments goes to fuel-energy complex, heavy engineering industry, construction, and transportation sectors.

Within innovative economic development in Russian Federation two sets of principles could be developed and suggested. Firstly, principles to regulate investment activity and secondly, principles to set objectives and strategies of investment policy at all levels of study (unit, structure, sector, region, country).

We suggest developing and formulating the principles within the first and the second group simultaneously by the research development and evidence accumulation.

There is an urgent need in a model for developing methodology and tools to support innovative and investment decision making. The model should provide the basis for experiment and preliminary estimation of all the country's sectors efficient functioning.

This study aims at creating models for innovation processes and attendant investments in production and social sectors subject to system factors influence (e.g. markets, banks etc.).

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Innovation and investment processes in real sector of economy bear specific character. For example, depending on activity category it is possible to distinguish *engineering, managerial, ecological, military, socio-political, state legislative and spiritual* innovations. Within market economy innovation description is based on international standards with regard to technological innovations adopted in Oslo in 1992. The lack of consistent descriptive and evaluative methodology for the rest types of innovations is observed. As for investments, many external and internal factors should be taken into account.

We consider the use of simulation modeling methodology to be the optimum mean for managing innovation-investment process. This model allows us to take into account the whole set of system factors within current conditions. This model makes it possible to take the best decisions, analyse current innovative and investment activity, forecast such macro indicators as GDP volume and others taking into account all processes (including random ones) and follow the situation development the field observation of which is impossible or costly.

Economic growth of every country depends on investment structure and volume, renewal of fixed capital and degree of innovation implementation. Meanwhile the difference can be observed in ways the investment activity supported with.

We consider investment activity stimulation to be the necessary condition for stable economic growth.

In 2006 there was a period of investment activity retention against the background of businesses financial recovery and inflation deceleration. The abovementioned factors influenced the growth of investment volumes favorably (Tables 1, 2).

Compared to 2005 investment gain to fixed assets totaled 13.7% in comparable prices. That exceeded growth rates of several important macro indicators (GDP grew by 6.7%, index of industrial production in categories "Mining Operations", "Manufacturing Activity", and "Production and Distribution of Electrical Energy, Gas and Water" by 3.9%).

Investment volume in fixed capital accounted for 182.4% in 2006 from the level of 2000 and 154.4% from the level of 1995. The percentage of investment into fixed capital in GDP was 17.1% in 2006 (15.9% in 2000 and 18.7% in 1995).

The main purpose of investment in fixed capital during previous years is the replacement of obsolete equipment and machinery. According to sample observation data 72% of respondents in 2006 opposite to 56% in 2000 indicate that fact. In organizations examined the portion of equipment under 10 years old is 29%, from 10 to 20 years - 42% and from 20 to 30 years -18%.

At the beginning of 2006 the degree of capital stock ageing in large and middle-sized

Table 1

Indices for shaping fixed asset investment, %

Indices	Years						
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Portion of Capital Accumulation in gross savings	46,6	58,1	61,2	63,9	59,5	57,6	58,3
Portion of Profitable Organizations in total number of organizations*	60,2	62,1	56,5	57,0	61,9	63,6	70,3
Refinancing Rate (at the end of year)	25	25	21	16	13	12	11
Monetization Coefficient	12,2	14,5	16,1	19,0	21,1	22,6	26,1
Consumer Price Index (December to December of the previous year)	120,2	118,6	115,1	112,0	111,7	110,9	109,0
Machinery and Equipment Production Index (to previous year)	105,7	106,4	91,2	119,0	121,1	99,9	103,3
Electrical and Optical equipment Production Index (to previous year)	125,0	108,4	92,3	143,2	134,5	120,7	94,5
Hoisting and Conveyer Equipment Production Index (to previous year)	110,7	73,6	99,0	114,0	111,5	106,0	103,3
Volume of Physical Work Index in "Construction" (to previous year in comparable prices)	113,5	110,4	102,9	112,8	110,1	110,5	115,7

* 2000-2005 - accounting and reporting data.

Table 2

Indices for characterising fixed asset investment, %

Indices	Years						
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Investment Portion in Fixed Assets in GDP	15,9	**16,8**	**16,3**	**16,5**	**16,8**	**16,7**	**17,1**
Investment Portion in Fixed Assets nonfinancial assets	98,4	99,1	98,6	98,9	99,1	98,2	98,7
Physical Volume of Fixed Asset Investment Index to previous year in comparable prices	1 17,4	110,0	102,8	112,5	113,7	110,9	113,7
Portion of Organizations in Russian Ownership	86,3	85,5	85,7	84,1	83,4	80,6	82,6
of them **Private Organizations**	29,9	36,7	42,0	41,2	46,5	44,9	49,1
Portion of Investments in Transport, Machinery and Equipment	36,6	35,0	37,7	37,1	40,4	41,1	37,7
Portion of Obtained Funds	52,5	50,6	55,0	54,8	54,6	55,5	55,7
of them **Budgetary Funds**	22,0	20,4	19,9	19,6	17,9	20,4	19,8
Portion of Internal Funds	47,5	49,4	45,0	45,2	45,4	44,5	44,3
Portion of Investments in Environmental Protection	2,1	2,1	1,7	1,9	1,9	2,0	1,9

commercial organizations accounts for 44.1% including equipment and machinery - 52.5%.

According to Rosstat data 44-51% of organizations saw the growth of economic efficiency as their purpose. Among strategies to achieve this purpose there are automation or mechanization of existing production process, implementation of new manufacturing technologies, cutting of production costs and energy saving.

Despite intended positive trends for investment growth, investment activity is still unable to become an important factor of economic growth and cannot improve quality of life substantially. It also restrains the scales of population welfare growth. We can define differentiation of pace, random nature and disparity of investment activity in regions as the major problem.

At this stage our task is to create auspicious conditions and climate for investment growth and to provide a qualitative breakthrough of investments to increase competitiveness of the country and provide life improvement.

The task of legislation has to create conditions not only for investment volume growth but also for their stable employment, anticipating and organizing transformation of investment activity towards innovative developments.

The most difficult task in stimulating regional investments is still providing regulatory measures that could take into account regional conditions, investment priorities in the territory, possibility of investments flow handling. Those measures should favor to solve regional problems and not contradict federal legislation.

Regional investment climate is created depending on regulatory legislation content. Federal legislation provides level playing field for all participants of investment process and it also determines regional legislation. You can create uniform rules but it is impossible to pursue a uniform policy in relation to regions due to their different problems and objectives.

The situation with resources and labor force is better known in the regions themselves. The importance of regions in investment policy formation can scarcely be overestimated. Let us dwell on the question of conditions for regional legislation shaping and give a detailed account of different tasks and directions of regulations that are left to regions within the reforms and distribution of authority on levels.

Within administrative reforms regions are authorized to stimulate and support investment activity and create favorable investment climate. They are enabled to influence on the following factors:

♦ state administration quality, regional policy and administrative, technical and informational barriers;

♦ sufficiency and quality of acting regional legislation;

♦ investment processes coordination within the territory;

♦ rationalization of public expenses in regional budget;

♦ tax system quality and tax level burden in part of taxes-and-duties;

♦ level of development and availability of infrastructure;

♦ work force quality;

♦ availability of institutional sector.

Still their major task is to support investment activity within the lack of sufficient power and budgetary funds.

Social and economic potential of the region can be characterized by objective prerequisites for assimilation of capital investments. It has some several components: level of economic development, points of increase, living standard, level of market transformations in the real sector of economy.

Level of economic development includes two components. The first one is productive potential describing the level and competitiveness of production. It has the following markers: working efficiency in the region, the regional share in GDP, level of capacity utilization, indices of physical production volume and capital investments, the percentage of export-oriented sectors in the region. The second constituent is the manpower resources. It is evaluated by employment rate, percentage of young people among unemployed population, educational level of labor force and age structure of economically active population.

A point of increase presence demonstrates the availability of prospective sectors for investing in the region. To estimate this characteristic we suggest to use the following indicators: profitability runup of 1 ruble in additional resources; natural resources potential; demand for resources from subsurface users; the availability of innovation complex and regional sectors susceptibility to innovations.

Living standards indicators are represented by money income *per capita*, level of housing and other social services and fiscal capacity of population.

Self investment potential is composed of financial potential of enterprises, population and regional budget. Among financial indicators the following ones can be named: their gross profit per unit of gross receipt, share of net income in gross profit, balance of accounts receivable and accounts payable, amortised deduction and the share of financial -production capital in gross investments in the region.

The investment potential can be measured by accumulation share per capita, average bank deposit of population and the share of population capital in non-production capital investments.

Investment potential indicators are represented by budget investments with respect to regional budget revenue and investments from regional budget per capita.

Increase in investment volume towards municipal economy modernization at the expense of private investors indicates high pace of housing and communal services reform implementation in Russian Federation. However, to intensify investment activity the representatives of Russian Federation subjects were recommended to promote activity on development and adoption of regulatory legal acts that define insurance arrangements scheme for private investors.

There is a necessity to develop methodological documentation on organizing investment process in housing and communal services on the territory of Russian Federation subjects. Moreover there is an urgent need in training for supervisory personnel of regional managing companies. The representatives of Russian Federation subjects should stimulate the initiative from housing owners if they want to determine the way to manage their apartment building. It could be done by interpretation of laws and regulations and by establishing feedback mechanism. Despite serious difficulties caused by delays in financing and by non payments there are positive tendencies of construction complex development in regions. The structural renovation of construction complex has been almost completed and its reorganization and demonopolization are finished. Joint-stock companies and partnerships are organized instead of construction industry administrations and they have to perform all activities connected with increasing volumes of capital construction. One of the most acute problems is insufficient demand for facility of contractors and construction enterprises. Involvement of private and banking capital would help to solve this problem.

It is obvious that federal level substantially limits regional legislation directed to investment climate improvement. There is no way to create jural society in a separately taken region. Investment process involves all members of economic activity and all sectors and branches of economy. This implies that “dotted” legislation cannot solve the problem of investment activity stimulation. The whole legislation needs to be improved and inefficient law enforcement system needs to be reformed. Thus the problem has to be solved on federal, regional and municipal levels. As regional authorities do not have any power to influence upon finance and credit system, law enforcement bodies and corporate law it is impossible to improve investment climate strongly, to provide maintenance of law and order, to decrease crime and corruption, to defend property rights and to make economy transparent.

Investors are uppermost interested in safety guarantees, private property protection supported by efficient legislation, law enforcement system and prosecution. These are the problems of federal level.

Investors will come only if the government shows its readiness to maintain competitive investment climate. That means there is a necessity to change institutions outside the economy. It should be clearly shown to investors that there is definite movement toward independent courts, freedom of the press, coordinated anti - corruption actions of law enforcement bodies. The statements enabling to decrease risks should be amended into federal laws.

We have two problems at regional level. The first one concerns shadow economy and real earnings suppression. The second reveals inefficient mechanisms of investment sales and low level of state management. The problems of investment activity stimulation and legalization of shadow income are closely connected. The decision of those problems is more in competence of federal authorities.

Activization of lawmaking process is connected with adoption of new Tax Code and with substantial changes in budget formation and spending.

Federal laws concerning demarcation, general principles of legislative and law enforcement bodies (№95-FL 4 July 2003) general principles of local government formation (№95-FL 6October 2003) are given effect to.

Under reforms the enhancement of legislative and law enforcement authority's role in investment management is of primary importance.

Regional laws are developed taking into account objective conditions of investment activity: sectoral structure, capital assets characteristics, investment potential of the territory (gross profit in economy, net financial result, population income).

Comparative analysis of federal laws in Ural Federal District and Russia (Moscow region, Yaroslavl region, Leningrad region and Krasnodar territory) enables us to define the following frequently occurring articles and statements:

♦ directed to create and provide conditions for mobilization of investment; tools of state guarantees, tax remissions, budget credits;

♦ directed to efficient utilization of investments, immunity grant ;

♦ directed to getting state authorities to take part in budget funds utilization on social sector's needs;

♦ directed to efficient draft of budgetary funds for development and adoption of investment programmes and determining primary sectors.

Statements containing directions for influence on investment processes and tools of regional influence are partially presented in regional laws but in practice there are trends to their limitations.

We consider some issues as not fully reflected in federal legislation:

1. elaboration of investment activity support by all level of state authorities is not sufficient enough;
2. conditions for providing governmental support on regional level are not clearly defined;
3. there is no clear definitions of criteria, limits and sizes of guarantees, credit, grunts, tax remission and other off-budget support for investors;
4. the set of financial and administrative tools is limited;
5. the system of state support is oriented mainly on investment increase but not on regulation of capital investment spheres.

Thus, measures on governmental regulations are mainly seen by Russian Federation subjects in the light of investment attraction. Analyzing certain laws we isolate two tendencies of governmental support setting: the subjects do not use their capacities in full and they exceed their power.

Potentialities inherent in budget and tax legislation can be defined. They are subsidies, budget credit granting, government contractual work, preferential nature management on primary directions of investment activity (within the Federal Law "On Agreement about Division of Production").

The potential of administrative support is not fully used though it predetermines possibilities and conditions for implementing investment policy. Many bills contain certain directions but do not give detailed outline for their realization and determine authority's power. It was all very nice on paper, as the saying goes.

In this section we examine major trends of economic policy which is the basic tool to influence investment processes.

The core idea of economic policy is providing stable economic growth and transformation budget into an active tool for its implementation. The most evident changes in regional budgets lie in increase of social needs expenditure and in decrease of real sector support. Sectors financing is based on the leftover principle and has lower priority.

The analysis of formation and trends in budget performance indicates that allocation of supply does not provide the necessary support to real sector. Meanwhile, the possibilities to increase supply for real sector are limited that is why it is necessary to increase budget revenue.

The federal level of authority minimized regional potential to influence investment activity through the budget. The budget was eliminated from active interference with regional economy. Thus, the government continue gradually drift apart from its direct influence on real economy. And this stems the tide of economy and breaks reproduction processes. These trends of regional budgets formation and performance give rise to important conclusions that current possibilities and factors of economic growth connected with innovation activity and investment capital strengthening are out of budgetary policy.

Optimal assignment of budgetary resources does not mean their efficient performance. The first problem can be solved at the level of drawing draft budget proper organization. The second one is backed by formation of budget performance mechanism.

Increase in efficiency of budgetary resources utilization requires reformation of the whole financial and administrative mechanism to regulate the activity of regional authority. It also requires the establishment of budget flows control taking into account regional priorities.

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