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THE IMPACT OF CONFLICT ON FOREIGN DIRECT INVESTMENT

CASE STUDY: THE 2014 RUSSIAN ANNEXATION OF CRIMEA

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ABSTRACT

This thesis investigates the impact of conflict on Foreign Direct Investment (FDI), specifically focusing on the case study of the 2014 Russian Annexation of Crimea. Academic articles and other resources are used to gain an understanding of Foreign Direct Investment (FDI), showcasing the various ways in which it can manifest itself, and providing context on its importance to nations. The literature review also examines the relationship between conflict and FDI, revealing that conflict often creates a highly unstable and uncertain environment which can deter investors from committing their capital to a conflict-affected region. The case study begins by exploring the geopolitical and economic reasons which ultimately motivated Vladimir Putin to give the green light for the Crimean Annexation in the early Spring of 2014. Quantitative data analysis was conducted to analyse Russia and Ukraine's FDI inflows and outflows in the years surrounding the 2014 annexation, providing empirical evidence for the case study. The analysis reveals that both Russia and Ukraine experienced declines in FDI inflows and outflows after the annexation, thus validating a number of the claims made in the literature review which detailed the negative effects of conflict on FDI. The study is concluded with a discussion, linking findings from the two previous parts, and discussing potential future implications along with recommended actions to be taken.

The findings of the research highlight that the impact of conflict on FDI is contingent upon various factors, including a country's business environment, the type and duration of the conflict, and other related variables. It is evident that the effects of conflict on FDI are not uniform and vary on a case-by-case basis. This research contributes to the existing body of literature by emphasizing the need to consider context-specific factors when assessing the relationship between conflict and FDI.

Key Words: Foreign Direct Investment (FDI), Crimea, Annexation, NATO, Russia, Ukraine, Conflict

RESUMEN

Esta tesis investiga el impacto de los conflictos en la Inversión Extranjera Directa (IED), centrándose específicamente en el caso práctico de la anexión rusa de Crimea en 2014. Se utilizan artículos académicos y otros recursos para comprender la Inversión Extranjera Directa (IED), mostrando las diversas formas en que puede manifestarse y proporcionando contexto sobre su importancia para las naciones. La revisión de la literatura también examina la relación entre conflicto e IED, revelando que el conflicto a menudo crea un entorno altamente inestable e incierto que puede disuadir a los inversores de comprometer su capital en una región afectada por el conflicto. El estudio de caso comienza explorando las razones geopolíticas y económicas que en última instancia motivaron a Vladimir Putin a dar luz verde a la anexión de Crimea a principios de la primavera de 2014. Se realizó un análisis cuantitativo de los datos para analizar las entradas y salidas de IED de Rusia y Ucrania en los años que rodearon a la anexión de 2014, proporcionando pruebas empíricas para el estudio de caso. El análisis revela que tanto Rusia como Ucrania experimentaron descensos en las entradas y salidas de IED tras la anexión, validando así varias de las afirmaciones realizadas en la revisión bibliográfica que detallaba los efectos negativos del conflicto sobre la IED. El estudio concluye con un debate en el que se relacionan las conclusiones de las dos partes anteriores y se discuten las posibles implicaciones futuras junto con las medidas que se recomienda adoptar.

Las conclusiones de la investigación ponen de relieve que el impacto de los conflictos en la IED depende de diversos factores, como el entorno empresarial de un país, el tipo y la duración del conflicto y otras variables relacionadas. Es evidente que los efectos de los conflictos en la IED no son uniformes y varían en función de cada caso. Esta investigación contribuye al corpus bibliográfico existente subrayando la necesidad de tener en cuenta factores específicos del contexto al evaluar la relación entre conflicto e IED.

Palabras Clave: Inversión Extranjera Directa (IED), Crimea, Anexión, OTAN, Rusia, Ucrania, Conflicto

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CBR	Central Bank of the Russian Federation
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
IED	Inversión Extranjera Directa
MNC	Multinational Corporation
MNE	Multinational Enterprise
NATO	North Atlantic Treaty Organization
OECD	Organisation for Economic Co-operation and Development
UNCTAD	United Nations Conference on Trade and Development
SSCU	State Statistics Committee of Ukraine
WB	World Bank

1. INTRODUCTION

The importance of Foreign Direct Investment (FDI) as a catalyst for growth and development in the economy, particularly in developing nations, has long been acknowledged. It entails foreign companies investing in the economy of a host nation, resulting in the creation of new employment opportunities, the transfer of technologies, and economic expansion across sectors (Hayes, 2023). Conflict involves a disagreement between two or more parties on the grounds of differing beliefs. It can range from low-level disputes to international warfare (HIIK, 2021). The decision to initiate, react to, or abstain from conflict can often be the most important decision the leader of a country can make. Since the beginning of the 20th century, it is estimated that at least 187 million people have died because of warfare (Imperial War Museum, 2023), an average of 1.52 million people per year, equivalent to the population of Murcia (Statista, 2022).

There has been extensive discussion over the relationship between conflict and FDI, with research offering varied and sometimes conflicting hypotheses. While certain research investigations (Averchuk, s. f.; Barry, 2018; Biglaiser & DeRouen, 2007; Cáceres, 2021; Duasa, 2007; Groww, 2023; Haita-Falah, 2017; Hayes, 2022; Merwe, 2020; Mihalache-O'Keef, 2018; Oetzel & Getz, 2022; Oh & Oetzel, 2011; OECD, 2002; Pettinger, 2021; Skovoroda et al., 2019; Witte et al., 2017) have linked conflict to FDI declines, other (Donais, 2005; Foreign Affairs Committee, s. f.; Le Billon, 2008; Mitchell, 2023; Skovoroda et al., 2019) hold the view that conflict can present an investment opportunity. Moreover, investment decisions are influenced by a wide range of incalculable variables such as investor prejudice, mistakes, and sub-conscious biases that decision-makers are unaware of. Thus, it is challenging to establish a cause-and-effect connection between the two factors. This emphasises how crucial it is to investigate the connection between conflict and FDI in greater detail to comprehend the underlying variables that affect the direction and

magnitude of the impact. The theoretical underpinnings of the connection between conflict and foreign direct investment will be examined in the literature review. The influence of conflict on FDI inflows and outflows is examined, considering several variables, including political unrest, economic instability, and investment incentives. The thesis will use a case study methodology to examine how the Russian annexation of Crimea has affected foreign direct investment in both Russia and Ukraine. Quantitative data analysis is employed on the FDI inflows and outflows of Ukraine in the years leading up to the annexation, and the four years post-annexation. This analysis tracks changes in capital entering and leaving the countries as a result of the annexation. It will examine how the conflict changed the financial environment, including how investors saw the perceived risks involved in making investments in both Russia and Ukraine. The final part of my research involves a discussion, which ties the theories discussed in the literature review with the quantitative data analysis findings of the case study together.

2. OBJECTIVES

The primary aim of this thesis is to analyse the impact of conflict on foreign direct investment. To do this I will first analyse the existing literature surrounding each topic both individually and in relation to each other. Moreover, I will employ the use of secondary research, placing a notable emphasis on the case study of the Russian annexation of Crimea in 2014. The case study acts as a suitable comparison as it allows me to test the views held by academics and analyse whether the issues explained in the literature review held true in the 2014 annexation. While the main goal of my dissertation is clear, it is necessary to complete two secondary objectives, which in doing so will enable the achievement of the primary objective:

1. Provide an analysis of foreign direct investment, its qualities, intricacies, how it has developed in recent years and how that has shaped many of the decisions made by global players.

2. Inform through research the ways in which we see conflict manifest itself in the 21st century, where the main affected regions are, the motivating factors, and the impacts.

Throughout this project, I also aim to build on the existing body of literature present surrounding these two themes, while also identifying possible gaps, contradictions, and inconsistencies in current literature. I believe that this is an important and relevant task to undertake, as the world we live in becomes ever more interconnected through the process of globalization, with the stakes of conflict at an all-time high.

3. METHODOLOGY

To fully understand the impact of conflict on multinational enterprise operations and foreign direct investment, I have decided to employ a mixed-methods approach, combining both qualitative and quantitative research to collect and analyse data, thus providing a comprehensive understanding of the topic. The first theoretical part will focus on several topics pertaining to Conflict and Foreign Direct Investment. Furthermore, I will analyse the connection between both issues, while additionally delving into the variable factors that affect their correlation and causation. This will include analysing statistical data such as foreign direct investment inflows and outflows as well as their fluctuation intensity. This quantitative data will be used to identify trends and patterns related to the impact of conflict on foreign direct investment globally discussed in the literature review section of this project.

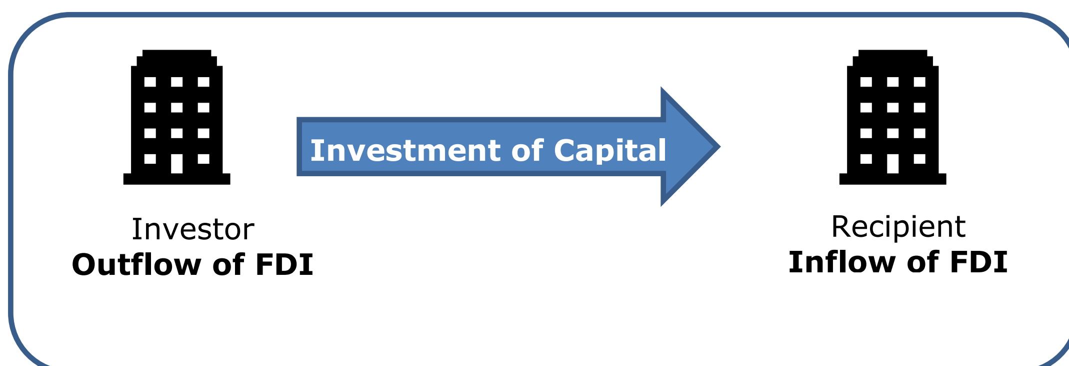
Both parts required the use of secondary sources. To gain an intricate understanding of the concepts, I accessed numerous academic articles from websites such as Science Direct and JSTOR, as well as online resources including Newspapers such as The Economist, and The Financial Times, along with financial content pages, namely Investopedia. As for the execution of the data analysis regarding FDI flows, The World Bank (WB), State Statistics Committee of Ukraine (SSCU), Central Bank of the Russian Federation (CBR) and Global Trade Provider were used as key databases from which to extract information.

One key component of this thesis will be a case study of the Russian annexation of Crimea which occurred over the course of fewer than 6 weeks in the Spring of 2014 but whose impacts were still felt for years after. The case study will utilize both qualitative and quantitative research methods to analyse the effects present in FDI inflows and Outflows resulting from the Kremlin’s 2014 decision to annex the Crimea peninsula located on the Black Sea.

4. KEY CONCEPTS AND CONTEXT

Foreign Direct Investment (FDI) has a number of definitions, such as “the purchase of an interest in a company made by an investor located in a different country” or “an ownership stake in a foreign company or project made by an investor, company, or government from another country”(Hayes, 2023). Typically, the phrase refers to a corporate decision to buy a sizeable portion of a foreign company or to buy it all together to expand operations to a new area. FDI can also be seen through corporations establishing subsidiary companies overseas and starting operations from scratch, known as *Greenfield Investment* (ResearchFDI, 2022). When money is invested from country A to country B, it is counted as an FDI outflow from country A (the investor) and an FDI inflow on the balance sheet of country B (the recipient of the investment). **In its most basic form, FDI describes the transfer of capital from one country to another via investment**. The goal of the direct investor is to establish a strategic, long-term partnership by means of direct investment. When the direct investor controls at least 10% of the voting power of the direct investment firm, that is when the "lasting interest" is proven (OECD, 2023). Additionally, FDI provides the investor with access to the enterprise's economy that it would not otherwise have. Unlike portfolio investments where investors typically do not intend to influence the management of the company, direct investments have distinct goals (OECD, 2023; Hayes, 2023). Aside from boosting economic growth, foreign direct investments also bring fresh ideas, management skills, stronger infrastructure, and job possibilities (FDIINDIA, 2019).

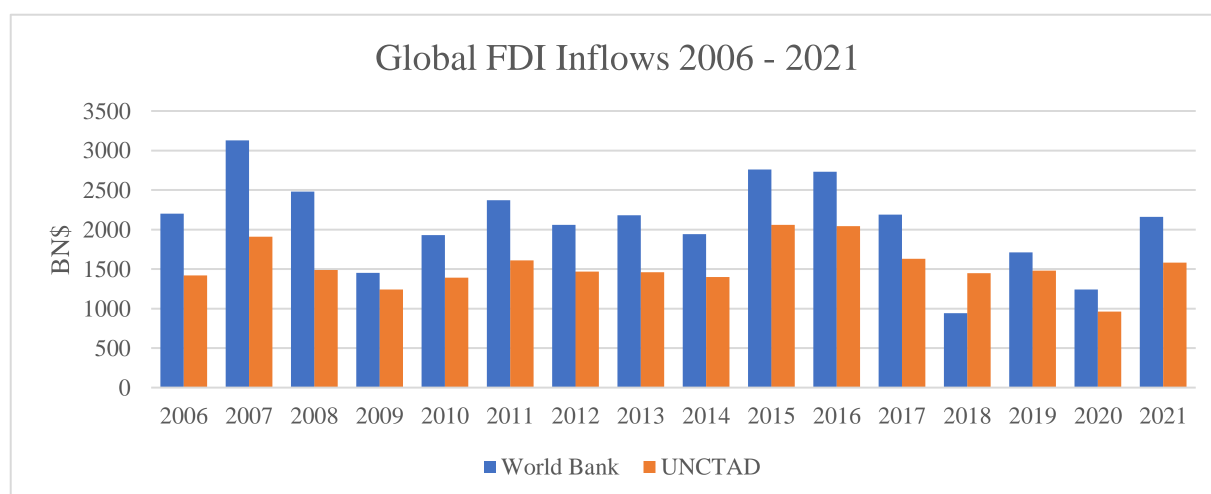
Figure 1: Investment Inflows and Outflows



Source: Own production using information from Hayes (2022)

According to the World Bank, the total value of Foreign Direct Investment Inflows in 2021 was between $1,58 - $2,16 trillion worldwide (UNCTAD, 2022; World Bank, 2023). Global FDI outflows in the same year totalled between $1,7 – $2,2 trillion (Banco Mundial, 2023; UNCTAD, 2022). There are a few factors in the data processing and reporting procedure that inherently lead to variation in Foreign Direct Investment (FDI) estimates, depending on the data source. Various institutions and organisations use different definitions, methodologies, and standards for measuring FDI (Otriz-Ospina & Beltekian, 2018). These variations encompass things like the method used to treat reinvested earnings, along with the inclusion or omission of particular types of investment.

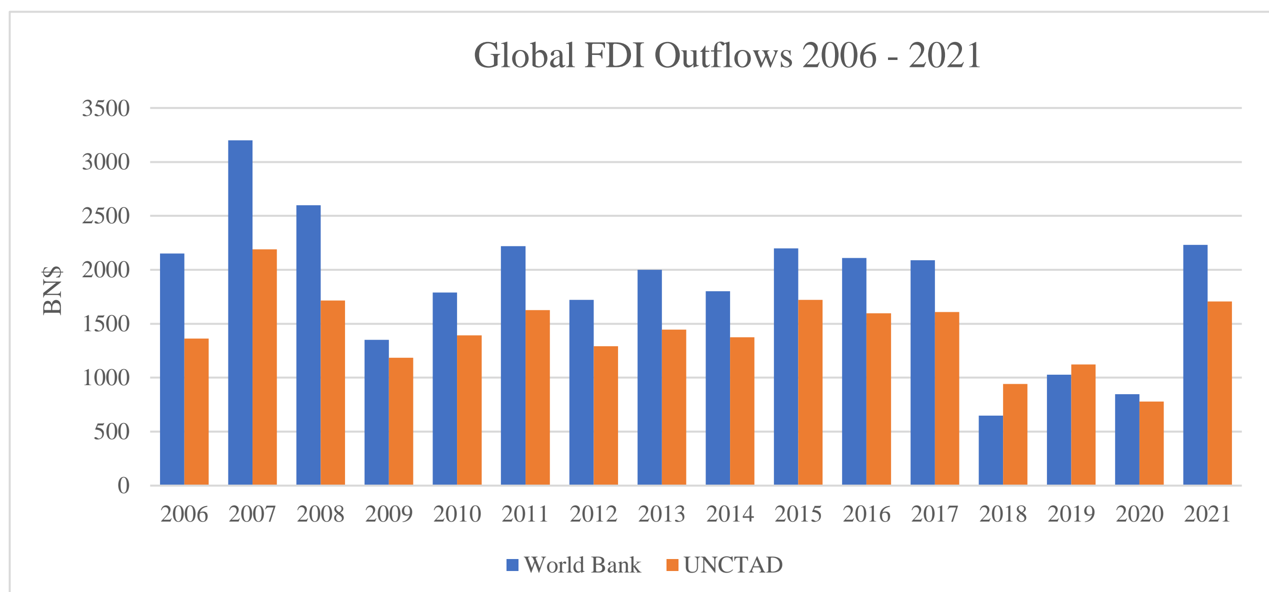
Figure 2: Global FDI Inflows 2006 – 2021 (Billions of US Dollars)



Source: Own production using data from World Bank (2023) & UNCTAD (2022)

FDI inflows and outflows peaked in 2007, the end of the 2000s speculation period just before the global housing bubble burst. The years 2008 and 2009 saw consecutive FDI inflow and outflow declines as financial markets crumbled. The year of FDI inflow and outflow growth between 2014 – 2015 is evident in WB and UNCTAD graphs and will be a relevant point of comparison in the case study in which the FDI flows for the same year in Russia and Ukraine experienced a sharp decline.

Figure 3: FDI Outflows 2006 - 2021 (Billions of US Dollars)



Source: Own production using data from World Bank (2023) & UNCTAD (2022)

The two major players in terms of global foreign direct investment in recent years have been the United States and China, given that they are at the epicentre of global production and trade. While some hold the view that a negative net flow of FDI -where a country's FDI outflows are greater than its inflows- is something that should be avoided, certain countries such as Canada, Germany and the United Kingdom have proven that it can be successful over the long term (Calimanu, 2021). There is some evidence supporting the idea that when these native companies invest overseas, the company itself grows and becomes more valuable, as does shareholder value as a

result of this FDI, which in turn, strengthens the native economy. Moreover, many smaller economies. adapt and adjust their models of growth, capitalizing on their strengths, and putting in place measures to ensure that their weaker areas do not stand in the way of their achievement of economic prosperity (ResearchFDI, s. f.). Ireland, for example, has used its highly educated, English-speaking population and EU membership to compensate for infrastructural shortcomings and the obstacles associated with being an island economy (Department of Enterprise Trade and Employment, 2023).

FDI is one of the most important components of global economic unity. Direct, lasting, and stable connections between countries are made possible by FDI (Hayes, 2022). In addition, it fosters the exchange of knowledge and technology between nations and enables the host country to sell its products more widely abroad (OECD FDI Factbook, s. f.). Finally, FDI is a different source of investment finance and, in the right policy climate, can be a crucial tool for business growth (ResearchFDI, 2021).

5. LITERATURE REVIEW

5.1. INTRODUCTION

The relationship between Conflict and Foreign Direct Investment (FDI) has been a subject of considerable scholarly debate. Within academic circles, there is a divergence of opinions regarding the impact that conflict has on both the inflows and outflows of a nation's FDI. Conceptually, many academics concur that the heightened risks and uncertainties associated with conflict have a negative impact on expected returns, thus reducing the inclination to invest, both on a national and international scale (Averchuk, s. f.; Barry, 2018; Biglaiser & DeRouen, 2007; Cáceres, 2021; Duasa, 2007; Groww, 2023; Haita-Falah, 2017; Hayes, 2022; Merwe, 2020; Oetzel & Getz, 2022; Oh & Oetzel, 2011; OECD, 2002; Pettinger, 2021; Skovoroda et al., 2019; Witte et al., 2017). Conversely, there is a belief held that that conflict may present investment prospects in select sectors or regions (Donais, 2005; Foreign Affairs Committee, s. f.; Le Billon, 2008; Mitchell, 2023; Skovoroda et al., 2019). Scholars (Barry, 2018; Witte et al., 2017) illustrate that when we focus on objective statistical data, the findings are still ambiguous. The reason for a lack of consensus is the complex nature of Conflict and FDI, not only individually, but also concerning the effect that they have on each other.

This review serves multiple purposes, including the identification of existing research gaps and unanswered inquiries, thereby establishing a foundation for future scholarly investigations. By conducting a systematic assessment of relevant academic sources, the present literature review aims to critically analyse and evaluate these contrasting viewpoints, with the ultimate objective of providing an all-encompassing comprehension of the impact of Conflict on FDI. To comprehensively examine and synthesize these divergent perspectives, a thorough literature review is indispensable.

The first step of the literature review will involve exploring the concepts of Foreign Direct

Investment and the various forms in which it appears across the world. A similar in-depth explanation of conflict and its multiple manifestations will be undertaken. To truly comprehend how these issues intertwine and why many academics (Carril-Caccia et al., 2019; Oetzel & Getz, 2022; Hayes, 2023) believe the issues are connected, it is paramount that we grasp the complexities of each topic independently. After defining the concepts of conflict and foreign direct investment, the view that FDI can act as a deterrent to conflict will be explored. Following that will be an examination of the importance of stability to investors at the time of decision-making with regard to deciding whether to invest overseas or not. As the literature review progresses, topics that will be dealt with include The variance in the impact of conflict on FDI depending on variables such as Industry Characteristics, Conflict Intensity and Duration of Conflict. As detailed above, conflict is an intricate and multi-layered concept that can manifest itself in numerous forms, from a casual verbal dispute on one end of the spectrum to international warfare on the other.

5.1.1. FDI and the Prevention of Conflict

One of the outcomes of greater economic interconnectedness among nations has been the significant development in how conflict has manifested itself (Hegre et al., s. f.; Li & Reuveny, 2011). New types of conflict have emerged while established patterns of conflict have been altered as a result of the emergence of globalisation and the expansion of international commerce and investment (Czinkota et al., 2010). Furthermore, competitive trade policies such as protectionism and the imposing of economic sanctions have quickly become popular tools employed by nations to engage in economic conflict (Hegre et al., s. f.). In recent history, both technology and weaponry have evolved exponentially, as one can see with examples dating as far back as the bombing of Hiroshima and Nagasaki which both had disastrous consequences. Nine countries currently possess nuclear weapons, which could irreversibly alter our existence as we know it

(Harrison et al., 2022). Currently, there are 12,700 nuclear warheads, with the United States and Russia owning a combined 90% of them (ICAN, 2023). It is the economic interdependence among nations that in many ways acts as a safety net in wartimes as the "nuclear option" is no longer a viable course of action for a nation that trades on a global scale and wishes to uphold its national reputation (Hegre et al., s. f.; Li & Reuveny, 2011). The stakes of war have grown due to economic interconnectedness as nations and non-state entities compete for control of lucrative markets and resources. This is not a new school of thought, in fact, Adam Smith (1776) makes the claim that:

"It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest".

Applied to this context, governments do not just avoid initiating conflict because it is morally abhorrent, it also reduces national stability, is a deterrent to FDI, and damages international relationships. Not only does every country represent a potential supplier of goods, but more importantly, a new potential customer base. This statement was echoed 19 years later by Immanuel Kant, who states in his 1795 book *Perpetual Peace* that the spirit of trade was the key factor in maintaining harmony and provided a solid foundation for future unity (Kant & Campbell Smith, 2016). There is a feeling (Hegre et al., s. f.; Mihalache-O'Keef, 2018) that the benefits associated with trade, FDI and economic openness, most notably increased political stability have the power to indirectly quell tensions and promote peace in both democratic and autocratic systems alike.

5.1.2. Importance of Stability to Investors

Conflict has an immense amount of related negative effects. One of the most notable for investors, however, is instability. Stability is paramount to investors and FDI in countries such as Venezuela and Syria has plummeted as a result of political instability and inflation in Venezuela, while war

has decimated the physical, political, and economic landscape of Syria (Global Conflict Tracker, 2023; UNHCR, 2023). According to a survey by the Multilateral Investment Guarantee Agency (2016), the concerns of investors in conflict-affected countries are more focused on unexpected and arbitrary changes in government policies in relation to their investments than on security issues, 62% naming “regulatory changes” as their top political risk concern, while only 15% and 4% responded that war and terrorism were the main threats to their investments (Averchuk, s. f.). The survey goes on to say that state intervention has provoked more investor losses than military conflict in developing countries.

Scholars (Duasa, 2007; Groww, 2023; Hayes, 2022; Pettinger, 2021) believe that stability has a variety of benefits for investors. Firstly, stability fosters investment-friendly conditions by reducing risks and uncertainties. Additionally, stability fosters investor trust. Foreign investors are more prepared to commit large sums of money, as well as labour on long-term projects when they have faith in the political and economic stability of the recipient country. This guarantee is essential for attracting foreign investment and promoting a consistent inflow of FDI. Thirdly, stability encourages sustained economic growth. Investors are more ready put down roots in a country when they sense stability there. Such is its’ importance that in a World Bank (2019) “*Global Competitiveness Survey”* Political Stability was deemed *‘Critically important’* by 49% of investors and ‘*Important’* by another 34.9%, ranking higher than other criteria such as Legal and Regulatory Environment, Low Taxes and Market Size.

The connection between conflict and FDI is not always clear-cut. Some nations have managed to maintain FDI inflows despite prolonged hostilities. In Colombia, FDI inflows remained steady despite persistent internal hostilities as a result of a mix of economic stability, a solid legal system, and government initiatives to encourage investment (International Trade Administration, 2022). The country also ranked 67th globally in the World Banks’ 2020 *“Ease of Doing Business Index”*

(World Bank, 2021). Similarly, despite the region's political unrest and sporadic conflicts, Lebanon has been able to draw sizeable FDI inflows (Macrotrends, 2023b).

Figure 4: Importance of Political Stability to investors

Source: World Bank (GIC Survey 2019)

5.1.3. Supply Chains

When a nation engages in conflict, major supply chain disruptions tend to follow closely behind . Supply chains are crucial for the functioning of a business, from sole trader to multinational corporation, allowing us to obtain different elements of production to make our final product (Hayes et al., 2023). Supply chain disruptions in a country will reduce the likelihood of new overseas investment entering a country, while also leading established investors to part with their capital elsewhere. This can largely be attributed to the fact that given that reduced competitiveness and financial losses are often symptoms of these interruptions. Investment in countries becomes less lucrative once their supply chains are damaged as it impacts all areas of the business. Delays in the supply chain prevent a business from fulfilling orders efficiently. In some cases, orders are unable to be fulfilled in the case of severe supply chain disruptions. Failing to meet orders not only damages a company's reputation but also fractures relationships they have with existing customers. Similarly, the enterprise's ability to attract new buyers and expand its customer base is notably weakened. Having established the resulting effect that conflict has on FDI, it is important to examine the causes of these disruptions: **Why does conflict negatively impact supply chains?**

Transport infrastructure such as roads, ports, and railways are at risk of being damaged, or in some cases destroyed. Damage to any of these three transport routes not only delays the transport of goods but also has the potential to bring certain supply chain operations to a complete standstill (Jagtap et al., 2022). Inflation and capital flight are commonplace during periods of conflict, increasing the likelihood of bad debts and the inability to pay suppliers and source the necessary elements of production. Thus, suppliers become reluctant to provide extended credit periods to companies in conflict-stricken areas. The risk of selling goods on credit increases exponentially as warfare can escalate overnight.

Conflict reduces our marginal propensity to consume and overall demand in the economy as people face the uncertainty of not knowing when their workplace will close, whether or not they will join the army and the sad reality of losing one or both income providers for the family. Companies often need to look to neighbouring countries (or further afar depending on the scope of conflict) as a market to sell their goods as the viability of their supply chains is threatened (Oh & Oetzel, 2011).

5.1.4. Length of Conflict

One theory that has been put forward is that the effect of conflict on FDI varies depending on the stage of the life cycle at which the FDI project is at. The case is made (Barry, 2018) *"that the costs and risks associated with conflict are a function of both intensity and duration".* In the short term, conflict often creates a highly unstable and uncertain environment, which can deter investors from committing their capital to a conflict-affected region. The risks associated with conflict, such as physical damage to infrastructure, disruptions in supply chains, and increased political and economic uncertainties, can significantly discourage immediate investment decisions. Investors may adopt a cautious approach and postpone or redirect their investments until the conflict subsides or stability is restored.

The longer a conflict persists, the more susceptible national institutions are to corruption, power struggles, and all-around political instability. This is advantageous to only a small minority, generally around the extractive industries, or others in which political stability has shown to have a positive correlation, acknowledged in numerous academic works (Biglaiser & DeRouen, 2007; OECD, 2002; Skovoroda et al., 2019; Witte et al., 2017). Countries tended to recover relatively quickly from short-term conflicts, normally those that lasted under one year, again this tendency being most evident in the resource industry or the extractive industry (Barry, 2018). These countries often experience a slight or notable drop in foreign direct investment as companies delay plans to increase or indeed begin investing in a particular affected region. As we have seen the industries with high sunk costs or with notably high profits do not cease operations, however the conflict and political stability and other downsides which it brings to put a halt to investment inflows for at least a year (Barry, 2018). In the wake of the conflict, governments introduced policies with the objective of attracting foreign investment in order to rebuild a nation's infrastructure or to attain economic levels is boasted prior to the conflict.

The downsides of conflict are exacerbated and sometimes increase exponentially as it continues to rage on. Long term conflicts can result in the damage if not obliteration of local infrastructure, death of local workforce, along with resistance from trained native employees to move to a country that has being engaged or is currently engaged in warfare particularly that of longstanding nature (Oetzel & Getz, 2022; SIPRI, 2022). Oh & Oetzel (2011) outline the tendency for Multinational Enterprises (MNEs) to cut FDI via the closure of foreign subsidiaries in overseas markets when there is little guarantee that these issues can be solved in the present and curtailed in the future.

5.1.5. Stage of FDI Lifecycle

The Sunk Cost Fallacy is a cognitive bias in which our aversion to loss prevents us from *"cutting our losses"* and walking away from a negative situation in the hopes that we can recover that which we have invested (e.g. time, money, effort) (Haita-Falah, 2017). Though these losses are irrecoverable, we continue to *"throw good money after bad"* to remedy the predicament we find ourselves in and can often end up seriously worsening the situation (Cáceres, 2021; Haita-Falah, 2017). So how does this apply in the context of FDI and conflict? The case is made (Barry, 2018) that this bias leads to Multinational Corporations (MNCs) behavior no longer following the same rationale after entering the host country. Before a location is chosen for foreign direct investment & new endeavors, multinationals seek out long-term peace; nevertheless, after entrance costs have been incurred (sunk), they are resilient to all except the most severe and protracted conflicts (Barry, 2018; Merwe, 2020). Companies can show signs of hesitancy to withdraw from the market because they have already invested a large sum of money and time. They could believe that ceasing operations may lead to the loss of all capital invested. This type of thinking causes people to cling to the notion that things will turn around and that their early investments will eventually pay off. The sunk cost fallacy, however, can make a company oblivious to the risks and current reality of doing business in a region that is afflicted by war. They could be unable to evaluate current problems with objectivity, such political unrest, security risks, and economic ambiguity, which can seriously impair their productivity and profitability (Haita-Falah, 2017; Oh & Oetzel, 2017; Witte et al., 2017).

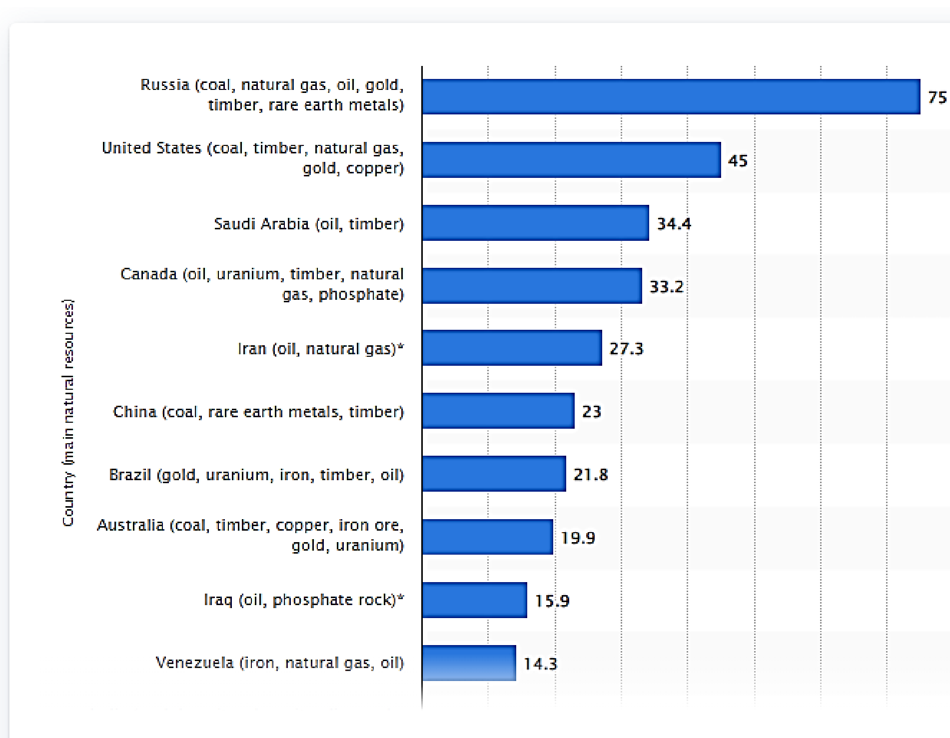
5.1.6. Industry Characteristics

Corporations operating in the extractive industry can often be faced with a moral dilemma or other issues when they undertake operations in troubled countries such as Myanmar, Sudan or a number of Middle East countries. Interestingly, these obstacles do not stand in the way of said corporations producing consistently high incomes and profits year on year. Building on the previous works of other scholars (Biglaiser & DeRouen, 2007; Witte et al., 2017), Skovoroda et al., (2019) make the notable discovery in their research that Multinational Enterprise (MNE) ownership of overseas resource-extractive subsidiaries was greater in host nations experiencing high political risk and violence. In the same Skovoroda (2019) article, the researchers also uncovered that:

"Inward FDI presence in resource-extractive industries is positively associated with (the risk of) Interstate War, Civil War, Terrorism, Battle Deaths,(and) Labour Strikes"

The extractive industry is so lucrative that many companies view conflict and its associated negative aspects as simply one of the costs of doing business and factor it into their price at the point of sale (OECD,2002). The Sunk Cost Fallacy is particularly evident in the case of investors in the extractive industry who have substantial financial incentives to maintain their positions until the conflict is finished. The costs that businesses must incur before they have even filled a barrel of oil in a particular location are significant. There are of course the vast amounts spent on exploration and the highly technical, costly experiments that must be undertaken. Drilling rights can set a company back millions also. Thirdly there is the equipment which will be used to extract the oil, such as the pumpjacks. Finally, the hiring and in many cases, relocation of highly skilled workers.

Figure 5: Value of Natural Resources per Country



Source: (Statista, 2021)

In short, these resource-rich areas are often in a state of conflict or in many cases under the rule of dictators or authoritarian regimes, which hampers the running of a business, in many cases to a large extent. The natural resource curse alludes to the high levels of corruption, lack of general infrastructure and the concentration of investment and power towards those that operate in the extractive industries (Chen, James, 2021; Doroshenko & Shelomentsev, 2014). Natural resources often generate conflict, as we have seen the incomes and possible profits for operating in the extraction of natural oil gas and minerals are so lucrative that companies do not see conflict as enough of a deterrent to put a halt to these operations.

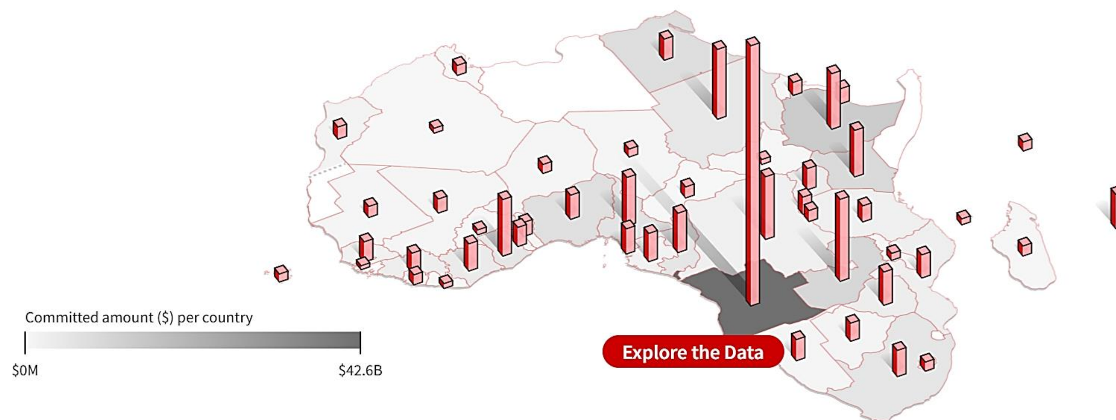
5.1.7. FDI during conflict

For foreign investors prepared to take on greater risk, conflict also presents an opportunity, as was the case with the diamond business in Angola during the civil war in the late 1990s (Le Billon, 2008). Moreover, post-conflict periods can present opportunities for FDI in terms of reconstruction, economic revitalization, and development efforts, as witnessed in Bosnia and Herzegovina shortly after 1992–1995 Bosnian War (Donais, 2005). This presents an investment opportunity for businesses that specialise in these fields. Many investors or financiers can also charge notably elevated interest rates to their debtors due to the necessity of finalisation for a nation in the post-conflict recovery stage. Conflict can also increase demand for specific products and services, such those connected to security and military, drawing investment from businesses in those industries. More than just financial aid, the world of geopolitics can also be linked to foreign direct investment in conflict-stricken areas (Skovoroda et al., 2019). Although it seems counter-intuitive from an economic and operational standpoint to invest in conflict affected areas, it is important to remember that these investments also provide returns in the form of bargaining power (Mitchell, 2023). The high levels of Chinese FDI in Sub Saharan Africa are an interesting case in point. Almost 14% (18/49) of Sub Saharan nations were engaged in conflict in 2021 with 2/3 of the conflicts being classified as high intensity (SIPRI, 2022). Currently, there are over 10,000 Chinese companies operating across Africa and China's FDI stock in the continent rocketed almost a hundred-fold, from $490m in 2003 to $43.4bn in 2020, peaking in 2018 at $46.1bn (Mitchell, 2023).

It is reported (Foreign Affairs Committee, s. f.) that since 2005, Chinese trade there has reached a value of over $2 trillion, with $300 billion in ongoing investments. Not only that, but Africa has also already surpassed Asia as the continent with the greatest market for Chinese construction projects abroad (Foreign Affairs Committee, s. f.). Boston University also reports that Chinese financiers signed almost 1200 loan commitments with African governments and their state-owned

enterprises between 2000 and 2020.

Figure 6: Chinese loan commitments in Africa 2000 – 2020



Source: (Boston University, s. f.; Foreign Affairs Committee, s. f.)

By providing financial investment to a continent in which many nations which have struggled in recent years to source funding from organizations such as the International Monetary Fund (IMF) and the World Bank (WB), Chinese investment is the only funding available for certain nations who wish to develop their infrastructure and production facilities. It's possible that short-term profit is not the end goal for China in the majority of these operations and what they really want is economic diplomacy i.e. strengthening ties with African leaders as well as gaining a foothold in the region. As China and the United States continue their economic battle for global supremacy, China have already set up ports in African countries such as: Angola, Cameroon, Djibouti, Ivory Coast, Mauritania and Mozambique (Bartlett, 2022; Boston University, s. f.; Foreign Affairs Committee, s. f.). This has led many onlookers to proclaim the Chinese Belt and Road Initiative

(BRI) "*as a vehicle for Chinese geopolitical expansion"* (Foreign Affairs Committee, s. f.). Furthermore, Africa is a continent that has almost 1/6 of the world's population (1.4 billion) and represent a long term market, that in many ways is still untapped (Worldometer, 2023). The continent boasts an abundance of natural resources and a winning workforce for the extractive industry. China is the world's largest global producer and is constantly searching for new customers. Therefore, Africa represents a potential future market.

When analysing the Chinese investment in Africa, an important question is raised: Is Chinese foreign direct investment entering Africa ***because*** **of conflict**, or ***in spite of*** **conflict**?

5.2. CONCLUSION

This literature review has explored the impact of conflict on Foreign Direct Investment (FDI) inflows and outflows. Conflict negatively affects FDI, due in large part to the uncertainty it creates.

Throughout the analysis, several key themes have emerged. Firstly, it has been discussed that FDI can potentially act as a preventive measure against conflict, as it promotes economic development and stability. Investors often prioritize stable environments for their investments, and conflict can significantly undermine the desired conditions for FDI.

Secondly, the review has underscored the vital role of stability in attracting and sustaining FDI. Conflict, by its very nature, disrupts stability through increased risks and uncertainties. This instability adversely impacts FDI by creating an unfavourable investment climate. The interplay between conflict and stability serves as a critical factor influencing the decisions of potential investors.

Furthermore, the review has highlighted how conflict can negatively affect global supply chains. Disruptions caused by conflict, such as infrastructure damage and trade restrictions, can impede the flow of goods and services, thus affecting FDI activities. These challenges add another layer of complexity to the impact of conflict on FDI dynamics.

In addition, the duration of conflict has been identified as a significant factor in terms of its impact on FDI. Short-term conflicts may not always have a substantial influence on FDI, particularly in industries like extractive resources, where high sunk costs and lucrative profits account for conflict as an inherent component factored into the final price of natural resources.

Overall, this literature review has provided an examination of the impact of conflict on FDI. It has highlighted the nuanced dynamics at play, emphasizing the importance of stability, negative effects on supply chains, influence of conflict duration, and provided examples of FDI in conflict-affected regions. The review has shown that while conflict can create opportunities for investment

in certain sectors, such as extraction in Angola and reconstruction in Bosnia, the negative impacts on FDI tend to outweigh the positives. It is crucial to note that the impact of conflict on FDI is highly context-specific and can vary depending on the specific circumstances, geographical location, industry sectors involved, and the overall business environment. Understanding these complexities is crucial for policymakers, investors, and researchers in formulating effective strategies to mitigate the adverse effects of conflict on FDI and promote sustainable economic development in conflict-affected regions.

The most notable factor of the impact of conflict on FDI is the lack of consensus among studies. Some studies suggest a negative relationship, re-iterating the above points which claim the instability and damage to supply chains hamper the entry of overseas capital. In contrast, other research finds that the opportunities created by conflict, particularly in sectors like defence and reconstruction can increase FDI inflows. This variance in hypotheses warrants additional investigation.

The case study of Russia's annexation of Crimea will act as an interesting area for us to discover how both Russia and Ukraine were impacted in the wake of the 2014 annexation.

6. CASE STUDY – RUSSIAN ANNEXATION OF CRIMEA 2014

6.1. BACKGROUND TO THE ANNEXATION

Annexation involves the transfer of political sovereignty over a certain territory from one state to another, generally after military occupation of the region (Pretrarca et al., 2022; Rothwell et al., 2014). Throughout history, annexations have often shared two commonalities. Firstly, they are often undertaken by a nation against one of its smaller neighbouring countries, as was the case in 1938 when Nazi Germany annexed Austria, Japan's annexation of Korea in the 20th century, and of course the annexation of Crimea by Russia (Iyenaga, 1912; Wright, 1944). Crimea is a peninsula located in Eastern Europe surrounded by the Black Sea and the smaller Azov Sea (Brittanica, The Editors of Encyclopedia, 2023). On April 26, 1954, The Russian Soviet Socialist Republic transferred ownership of Crimea over to the Ukraine Soviet Socialist Republic (Kramer, s. f.). After the collapse of the Soviet Union in 1991, Crimea became part of the newly independent Ukraine, and would remain as such up until the annexation (Siviş, 2019). It has a population of approximately 2.4 million people and its largest city is Sevastopol (Siviş, 2019) In the spring of 2014 Russia employed military forces to the peninsula of Crimea and annexed the territory on the basis of protecting Russian. Historically Crimea 's main industry was agriculture with wheat and sunflowers being the crop of choice. In fact, there is an 18th century Spanish saying with regards to the production of crops in Ukraine. If Spanish farmers wanted to obtain a favourable price for their wheat, there were three things that would be required: *"Lluvia, Sol, y Guerra en Sebastopol"* (Camarero, 2022).

Figure 7: Collective map of Russia, Ukraine, & Crimea

Source: (Lynch, 2022)

Palmer & Morgan (2011) explain that the two primary concerns of a nation in relation to foreign policy are "**Change"** and **"Maintenance"**. Governments seek to alter elements of the current international climate that do not suit their agenda while simultaneously pursuing a policy of maintenance for aspects that favour the regime. The capacity of a state to do so, is primarily determined by its relative capability. Due to the fact that national capability is limited, a state must compromise between policies intended to bring about change or maintain current conditions (Palmer & Morgan, 2011). This change in the status quo that Russia sought to avoid in Ukraine came in the 2013 elections in which a Pro-European president was elected in the form of Petro Poroshenko. This election was a major blow to the kremlin in the battle against the west in the conquest for allegiance from former Soviet states. The expansion of NATO has also been a major driving force for conflict between Russia and the former Soviet countries. Carpenter (2022) captures the sentiment in his guardian article, explaining that *"Many Russians see NATO as a vestige of the cold war, inherently directed against their country"*. Georgia's bid to enter NATO

in the mid-2000s culminated in the 2008 Russo-Georgian war in which the Kremlin launched attacks on Georgia between the 1st – 12th of August 2008 (Larsen, 2012). The 2007 Security Conference in Munich also saw Russian President Vladimir Putin criticise the expansion of NATOs eastward expansion (Kremlin, 2007).

Moscow perceived the EU's approach to the Eastern Partnership as a danger to the Kremlin's self-interests, but Brussels paid little attention to Russian concerns, because Russia took little real action in response to earlier and ongoing EU and NATO enlargements (Merry, 2016).

6.1.1. What did Russia stand to gain from annexing Crimea?

One of the key attractions of Crimea for the Russian government what's the fact that it is located on the Black Sea and increases the coastline of Russia by approximately 2500 km (Brittanica, The Editors of Encyclopedia, 2023). This access to the Black Sea is extremely valuable to Russia as prior to the annexation of Crimea they did not have the capabilities to block exports into Eastern Europe or the ability to place troops legally in this maritime zone. It is clear that Russia would face at least some sort of consequence for the annexation of Crimea. Though this could not be calculated prior to the undertaking of the annexation government officials and advisors would have had at least an estimation of the potential range of backlash that the Russian Federation would face after executing such a decision. They undoubtedly would have expected sanctions to come their way almost immediately after the seizing of the Eastern European peninsula and of course then you or would have been certain that their reputation would suffer a great blow. Why do invasions take place? What do countries have to gain from forcefully taking another country's territory? In many cases countries seek to impose their neo imperialistic ideologies upon those countries who they deem weaker. Traditionally we saw armies overpowering their neighbours ransacking the communities and turning a once foreign land into their own land. This required the use of large military force and often resulted in thousands if not millions of armies and of course

civilian casualties.

However, natural resources were the primary motivating factor Russia's actions, something we have come accustomed to. Between 2000 – 2022, oil and gas rents as a percentage of Russian GDP has oscillated between 7 – 21% (*Total natural resources rents (% of GDP) - Russian Federation | Data*, s. f.).

Russia is a nation with an extremely high dependency on the extractive industry, resulting in its power in the international stage, and as a result, its geopolitical relations with other countries, being overwhelmingly determined by natural resources. Oil and gas prices do not just determine whether a nation has sufficient resources to engage in foreign intervention, it also heavily influences the ability of other countries to reprimand the behaviour. We see a prime example of this through the variance in sanctions imposed by NATO countries subject to their dependency on Russian gas.

Before the annexation of the massive untapped oil reserves were discovered in the black sea that would fall into the jurisdiction of Ukraine. As we know, Russia needs oil revenue to aid their financial ambitions and have done so since long before the fall of the Soviet Union. Another key aspect of natural resources is their value as a geopolitical tool. For all the deserved controversy soviet dictators have received, they have always been keenly aware of how both oil and gas can be effectively employed as geopolitical weapons. In this case, the reserves found at the Ukraine would have made it the country with the second largest oil reserves in Europe after Norway, excluding Russia's Eurasian reserves. It is interesting to analyse the areas in the invasion of Ukraine that were initially attacked in the 2022 invasion, it correlates almost exactly to where the most resources rich areas are located.

Before the invasion took place, Vladimir Putin knew certain industries would suffer because of the annexation. However, he made a calculation and deemed the annexation of a key geographical

territory in Eastern Europe worthy of potential enforced exile by Western countries, and the particularly those prominent in NATO such as France, Germany, and most notably, the United States. This exile occurred in the form of Russia being removed from the G8 in the wake of the annexation (Siviş, 2019). While FDI does play a major part in the development of certain countries, it is merely a part of a complex and multifactorial equation, in which the players make decisions on a day-by-day basis as factors vary.

Figure 8: The areas of Ukraine richest in natural resources

Source: (RealLifeLore, 2022)

6.1.2. Importance of Foreign Direct Investment in Russia and Ukraine

FDI plays an influential role in the development of economies globally. Russia and Ukraine recognise its importance for several reasons. First, FDI helps finance the development of the country's manufacturing and construction sectors, both of which are crucial for its long-term economic success (Hayes, 2023). In addition, FDI has been essential to the development of Russia's energy and gas industries, which are significant economic generators for the country. The modernisation of Russia's communication and transportation networks, both of which have

benefited from FDI, is essential for the country's economy to function effectively.

Second, FDI helps create jobs in Russia and Ukraine, tackling the countries' unemployment. Foreign investors offer capital and technology that help launch new businesses and expand existing ones, creating jobs for the local workforce (Blomstrom, 1991). Finally, FDI helps Russia and Ukraine get technology and information that are essential for increasing the country's potential for innovation and competitiveness (Calimanu, 2021). Foreign investors bring in innovations, business plans, and management skills that local firms and industries use. This has the potential to increase the production, effectiveness, and competitiveness of economies, leading to a quicker pace of economic growth.

6.2. QUANTITATIVE ANALYSIS

The annexation of Crimea by Russia in 2014 had a significant impact on Foreign Direct Investment (FDI) to and from Russia. Below showcases statistics from various sources that detail the impact.

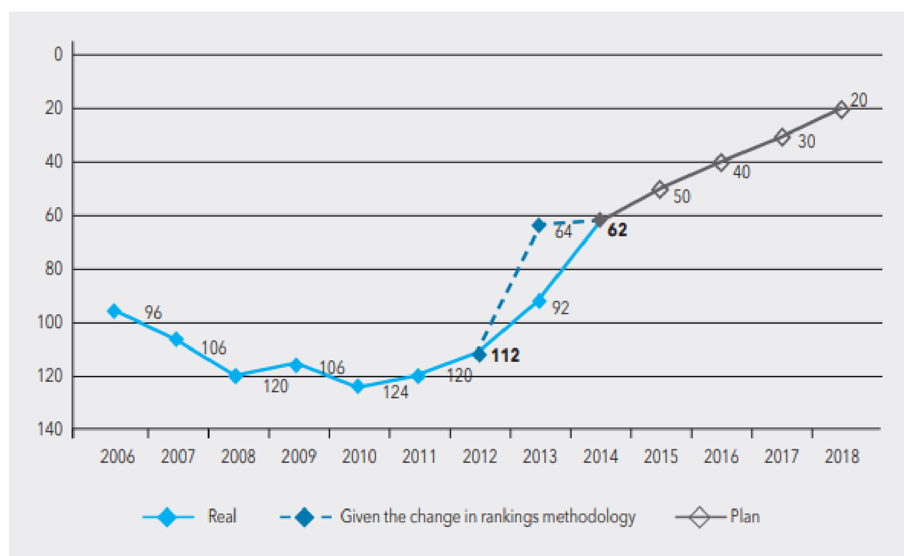
As previously mentioned, the annexation of Crimea was performed under the guise of integrating people of Crimea. In 2014, after an independence referendum 95% of Crimean voters on the day, voted to join the Russian Federation. This referendum was deemed illegitimate by the international community as it wasn't passed through the Ukraine Parliament. However, when the results of the referendum came out, Russia formally annexed Crimea. The annexation was internationally condemned, and Russia faced heavy sanctions, particularly from the United States.

The annexation's effects on FDI in Russia were less clear. In fact, some scholars contend that since it stimulated domestic investment, the acquisition of Crimea had a favourable effect on FDI in Russia. The Russian government used measures to promote domestic investment, such as tax exemptions and subsidies for domestic businesses, in response to the sanctions and dwindling

FDI. As a result, indigenous firms have taken the place of certain foreign ones, notably in the energy industry.

Surprisingly, The World Bank's "Doing Business 2015" ranked Russia 62nd out of 189 countries in terms of ease of doing business in 2015, up 50 places from 112th in 2013 World Bank (2015).

Figure 9: Russia "Ease of Doing Business" Ranking 2006 – 2018

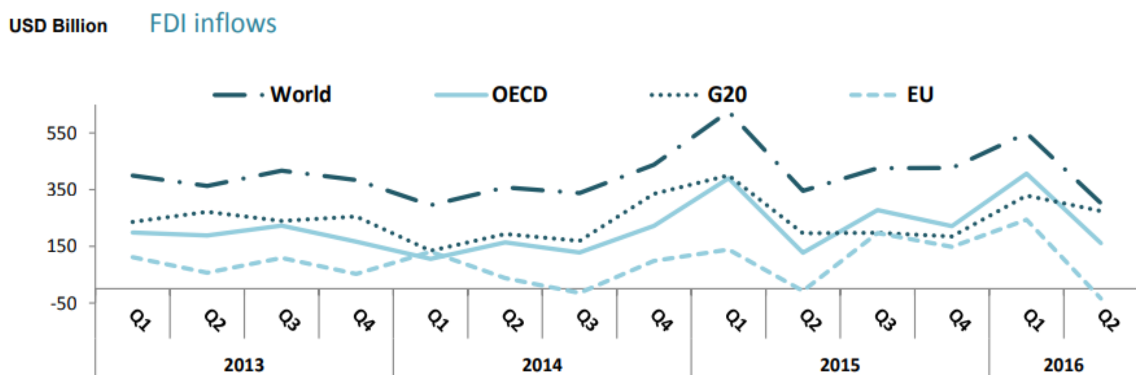


Source: 2015 "Ease of Doing Business Rankings" (World Bank)

6.2.1. Russia FDI Inflows

Russia experienced a sharp decline in FDI inflows during the period of 2013-2015. The graph below documents how incoming foreign direct investments plunged 90% in these two years from $69.2bn in 2013 to a mere $6.9bn in 2015 (Figure 11). Undoubtedly, this decline cannot merely be put down to one sole issue. However, the Annexation undertaken by the Kremlin certainly exacerbated the downturn in FDI inflows, as the decline experienced in Russia surpassed that of the worldwide mean.

Figure 10: FDI Inflows Q1 2013 – Q2 2016 (Billions of US Dollars)

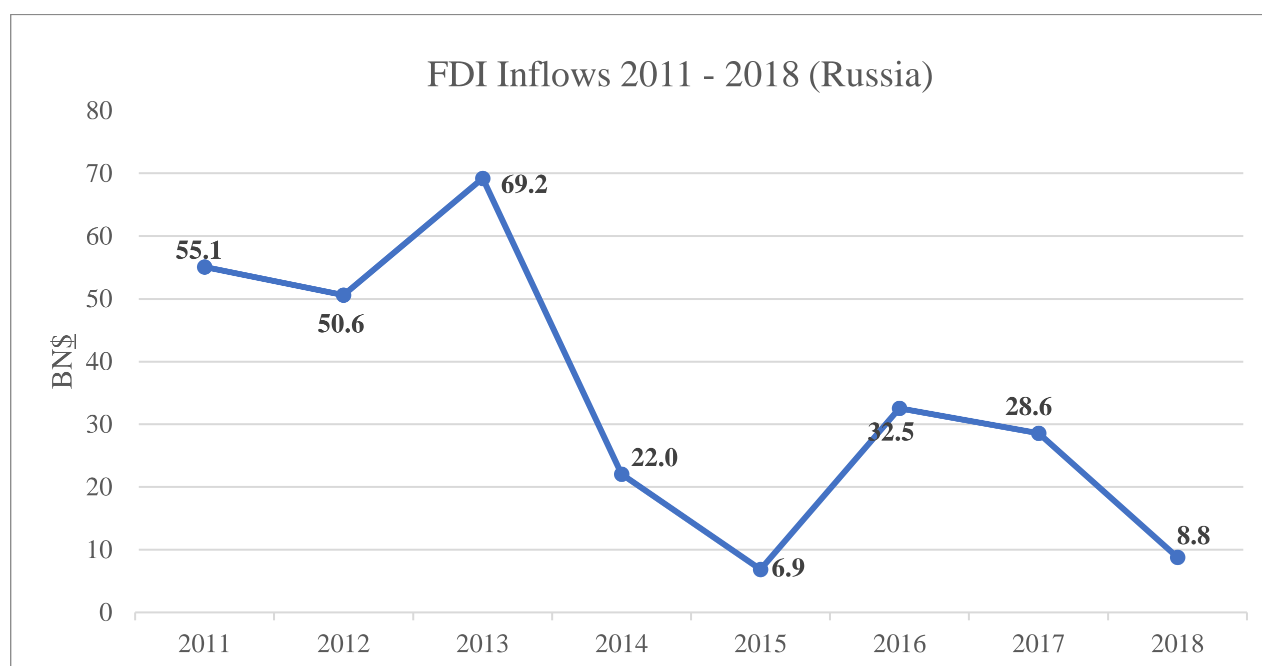


Source: OECD International Direct Investment Statistics database and IMF

In 2013, many countries across the globe witnessed a decline in FDI due to global economic uncertainties arising from the 2008 financial crisis (Figure 11). This trend is visible in the OECD graphs (Figure 10) in which we see all 4 areas having lower FDI inflows in Q1 of 2014 than Q1 of 2013. This decline was partly attributed to reduced investor confidence and risk aversion. However, Russia's FDI inflows experienced a more pronounced drop during this period. More importantly than that is the inflow trends for 2014. In figure 10 FDI entering three out of the four areas (World, OECD, G20) increased over 2014, with the trend continuing into 2015, this time World, EU and OECD all experiencing increases in FDI inflows. Refocusing on figure 11, it can be observed that FDI inflows continued their downward plunge through 2014 falling to just

$6.9bn by the end of the year. While the countries FDI flows do show a resurgence in 2015, by the year end while the world OECD and G20 find their FDI flows in a better position at the year's end, Russia's increase takes their FDI inflow figures to $32.5 billion, less than half of what they attracted just two years prior (see figures 10 and 11). In 2016 and 2017 two further declining years for Russian FDI inflows are observed, meaning that by the start of 2018 Russian FDI flows we're only $8.8 billion (figure 11). In fact, after the annexation of Crimea in 2014 Russian FDI inflows never even reached half of the 2013 levels in the four years post annexation.

Figure 11: Russian FDI Inflows 2011 – 2018 (Billions of US Dollars)



Source: Own production using data from (World Bank, 2023c)

In response to the annexation of Crimea, heavy sanctions were imposed by the United States and the European Union particularly in key Russian sectors such as energy and finance. This greatly hindered Russian ability to attract foreign investment. Furthermore, diplomatic relations are greatly damaged between Moscow both the E.U. and U.S. Russia's international image became tarnished and inspired reluctancy among multinational corporations at the hour of deciding whether to invest in the country, as often happens when nations are engaged in conflict (Merwe,

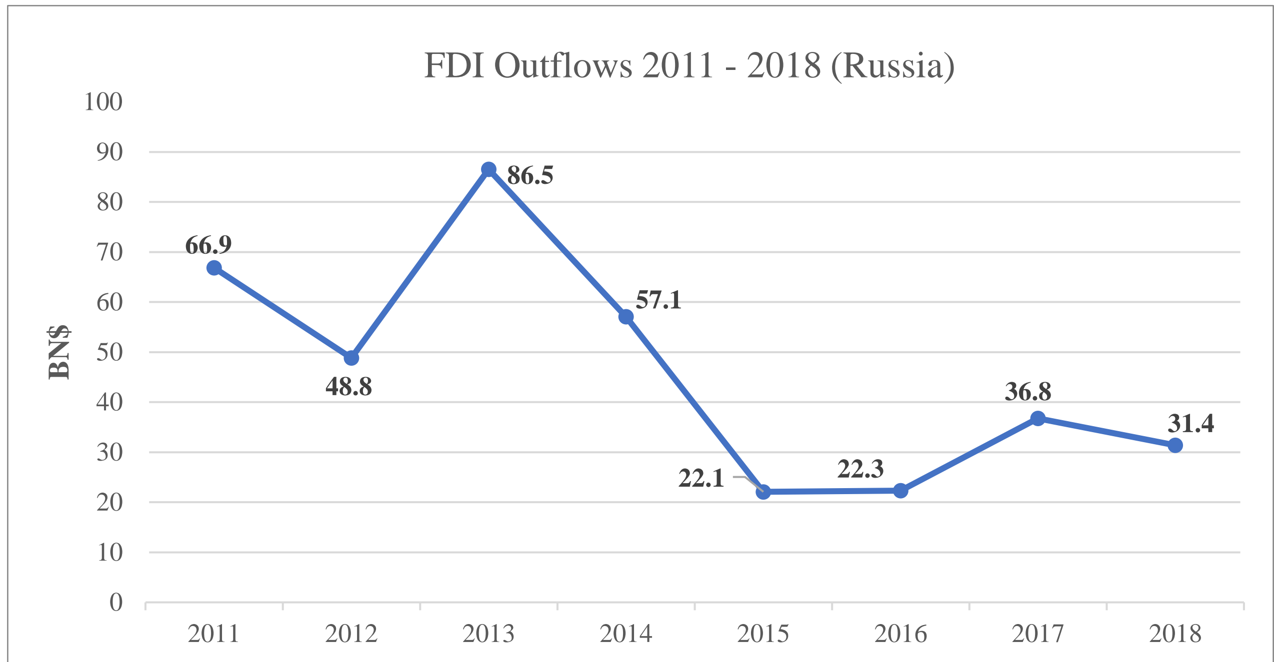
2020).

As we have seen earlier stability uncertainty both in the political and economic sphere are paramount for investors and thus it comes as no surprise that the influx of capital would reduce in the wake of not just the physical warfare between Russia and the Ukraine but also the economic battle that the Kremlin was engaged in with the world's western superpowers.

6.2.2. Russia FDI Outflows

FDI outflows for Russia also experienced major drops between the years 2013 to 2015, While the inflows and outflows share a similarity in the severity of decline of foreign direct investment there is a contrast between the two (Figure 12). The fall in FDI outflows in Russia between the years 2013 and 15 can almost be broken down into two equal drops of 2013 to 14 and that of 2014 to 15. The reduction in FDI outflows during 2014 and indeed in subsequent years can partially be put down to countersanctions issued by Russia in response to sanctions imposed on them and their exports particularly in the energy industry. In a bid to protect national industries, a number of protectionist policies were implemented by the Kremlin (Hanousek & Matěj, 2019).

Figure 12: Russian FDI outflows 2011 – 2018 (Billions of US Dollars)



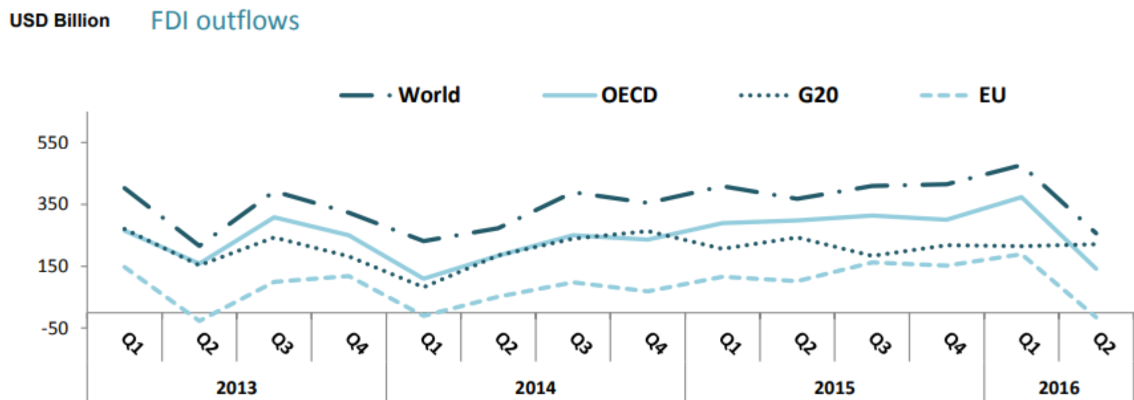
Source: Own production using data from (World Bank, 2023e)

This concentration on promoting whole economic sectors meant funds were diverted from overseas projects, and instead funnelled into developing home industries. The severity of some of the sanctions could have been a wakeup call to Putin and highlighted the fragility of dependence on foreign direct investment, acting as a catalyst for the increase in domestic focus. Counter sanctions were also issued by Moscow in 2014 in retaliation to the economic conflict. In large part these included high tariffs and indeed even bans on the import of agricultural products a new range of other goods (Hanousek & Matěj, 2019).

Comparing the FDI flows with the OECD, G20, world, and the EU Further confirms this assertion. By the end of 2015 all four had all but returned to their 2013 levels, with some even surpassing their figures from two years prior. In contrast, Russia's FDI at the same time was only 26% of their 2013 levels. A report by the Russian Central Bank states that the annexation of Crimea had a significant impact on the country's foreign debt, with external debt declining by

7.5% in 2014 and a further 5.5% in 2015 (Russian Central Bank, 2016).

Figure 13: FDI Outflows: World, OECD, G20 &EU



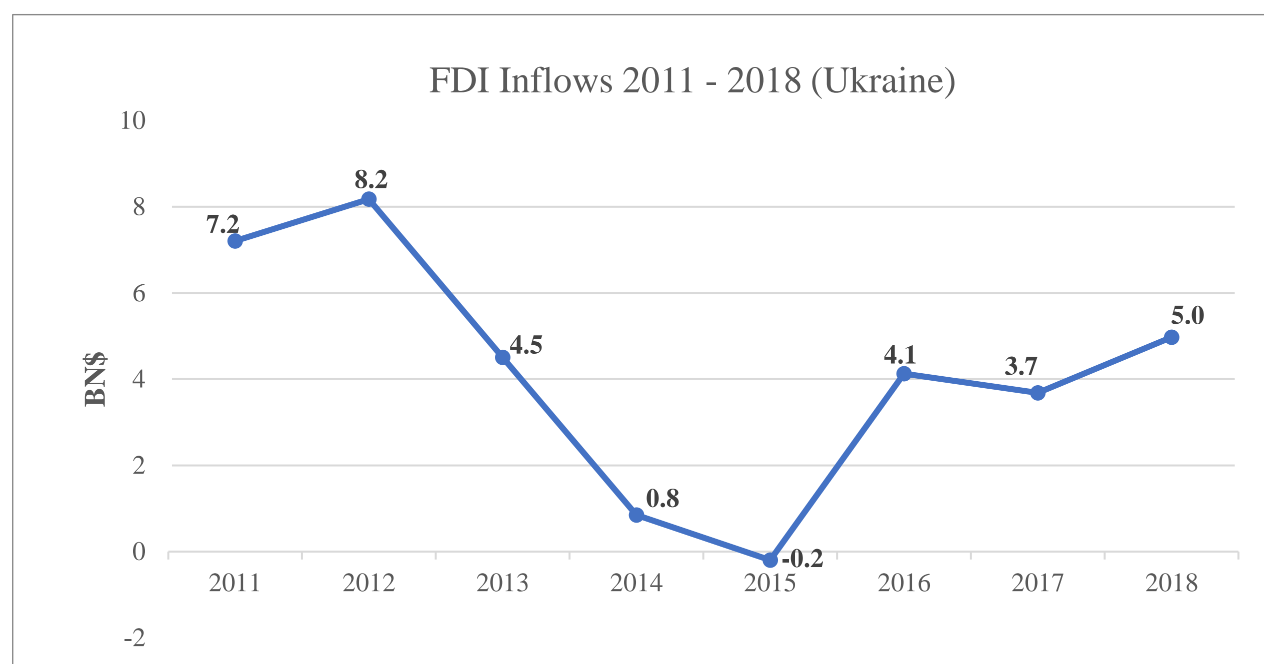
Source: OECD International Direct Investment Statistics database and IMF

Similar to inflows, we see that FDI outflows from Russia do not even reach half of the 2013 levels in the three years post invasion. In fact, average FDI outflows in the three years post annexation ($30.2bn) are less than half of the average outflows recorded in the 3 years prior to the annexation ($64.1bn). **This demonstrates that the conflict between Russia and Ukraine had a negative impact on Russian FDI in terms of inflows and outflows.**

6.2.3. Ukraine FDI Inflows

In recent history, there are 3 periods in which we see a sharp decline with regards to FDI inflows for the Ukraine. The first of these is between 2008-2009 resulting from the *2008 Global Financial Crisis*. The second, which is the focal point of my research appears in the years after the Crimean annexation. The final significant decline in recent history was in 2020, arising due to the *Covid-19 Global Pandemic*, during which there was extreme movement restrictions of 3.9 billion people across 90 countries, along with repeat lockdowns in many nations, and unprecedented supply chain disruptions (Sandford, 2020). Even before the events of 2014, FDI inflows had already begun to decline in the country. Ukrainian FDI declined by 46.4% in 2013 (figure 13)due to a decline in demand for Ukrainian goods, deteriorating political conditions, and economic instability (Averchuk, s. f.). A number of years prior, in 2009, FDI inflows to Ukraine declined by 56% as a result of a sharp decline in global investment flows following the global financial crisis (Kalotay, 2022). As detailed in figures 1 and 2, this drop was certainly not unique to Ukraine. However, the eastern European nation certainly felt the impact stronger than many others, as the average global FDI Inflow drop was 40% between 2008-09, Ukraine's being 16% higher (Kalotay, 2022) (figure 13).

Figure 14: Ukraine FDI Inflows 2011 – 2018 (Billions of US Dollars)



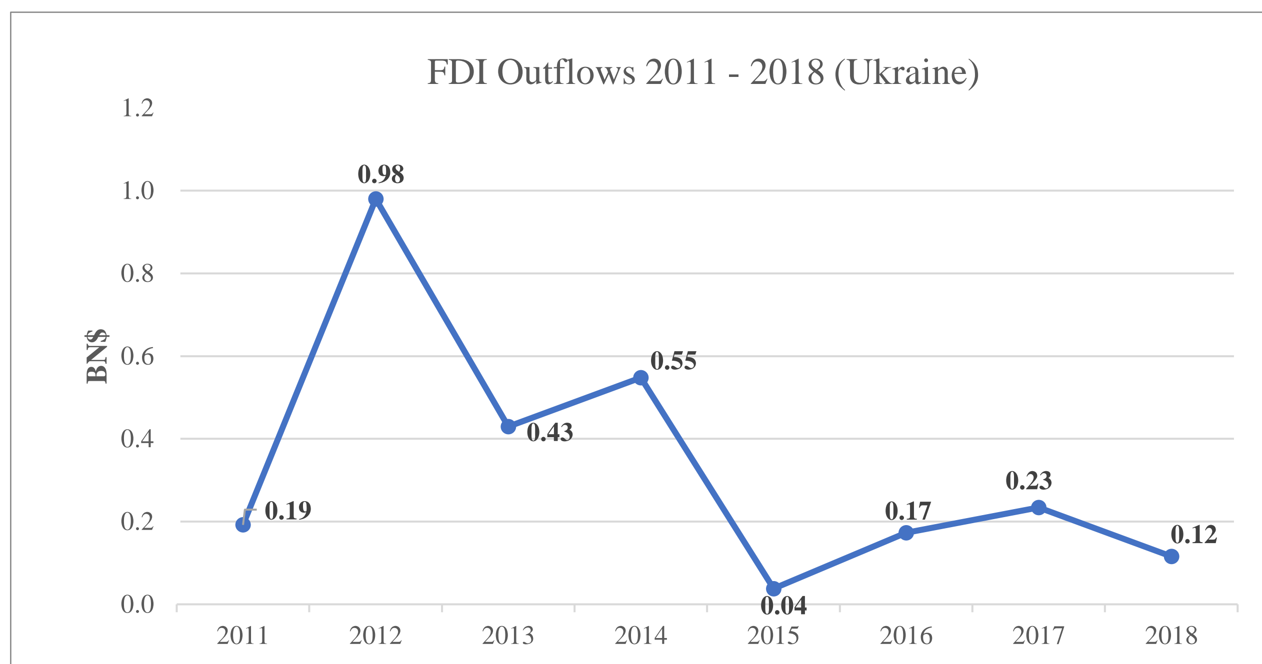
Source: Own production using data from (World Bank, 2023d)

Additionally, because Ukraine's energy sector is a significant recipient of FDI, the annexation of Crimea had a significant impact on it. After the takeover, Russia stopped supplying natural gas to Ukraine, which resulted in energy shortages and higher expenses for enterprises. Russia had previously provided Ukraine with gas (Hanousek & Matěj, 2019). This served to discourage more foreign capital from entering Ukraine.

Outflows

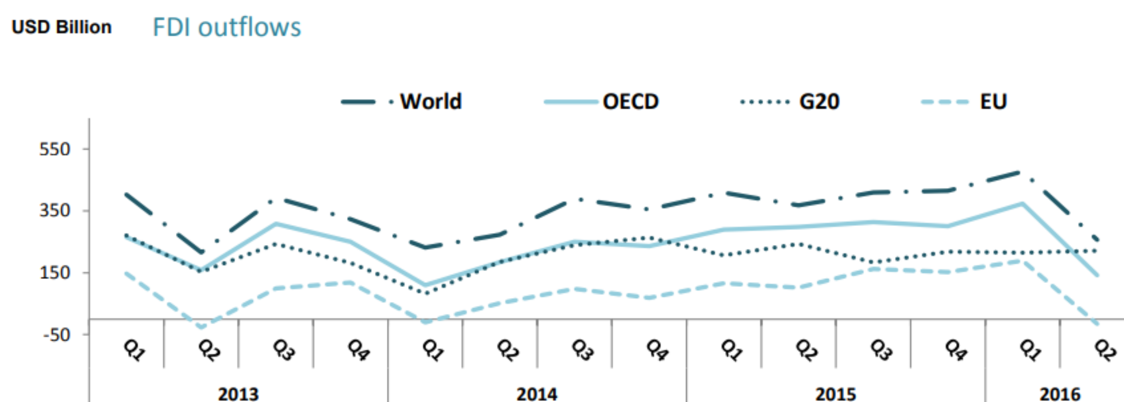
If we analyse Ukraine's FDI outflows throughout the period 2011-2018 (figure 14); we can see that there is a significant drop in FDI of $550m between 2012-2013, increasing from $400m to $500m before plummeting to just $40m in 2015. Studies (Averchuk, s. f.) show that conflict can affect the number of new investments by 34%, while also causing a 90% reduction in the value of invested capital. Between 2004 – 2021 Ukraine experienced it's highest levels of unemployment during 2014 – 2018 with levels between 9.14% – 9.50% in each of the years (Macrotrends, 2023a).

Figure 15: Ukraine FDI Outflows 2011 – 2018 (Billions of US Dollars)



Source: Own production using data from (World Bank, 2023f)

Figure 16: FDI Outflows: World, OECD, G20 &EU



Source: OECD International Direct Investment Statistics database and IMF

6.2.4. Variance Graphs

Trying to represent the development figures of the European Union, Russian Federation, and Ukraine on the same graph was challenging due to the major difference in figures between the three areas. As a result, I felt that variance would be the best way to document their development over the course of the graph. I used 2010 as the base year and so all figures and variance percentages are compared to each respective nation's 2010 figure. Employing a base year provides a standard reference point for the figures shown. The 2010 FDI figures act as a benchmark for the subsequent years, both pre-and post-annexation, to be assessed against. This provided more stability in the graph, and I feel provides a more informative insight into the entrance and departure of capital from each nation's shores in said timeframe. Having a base year also served as beneficial in terms of trend identification.

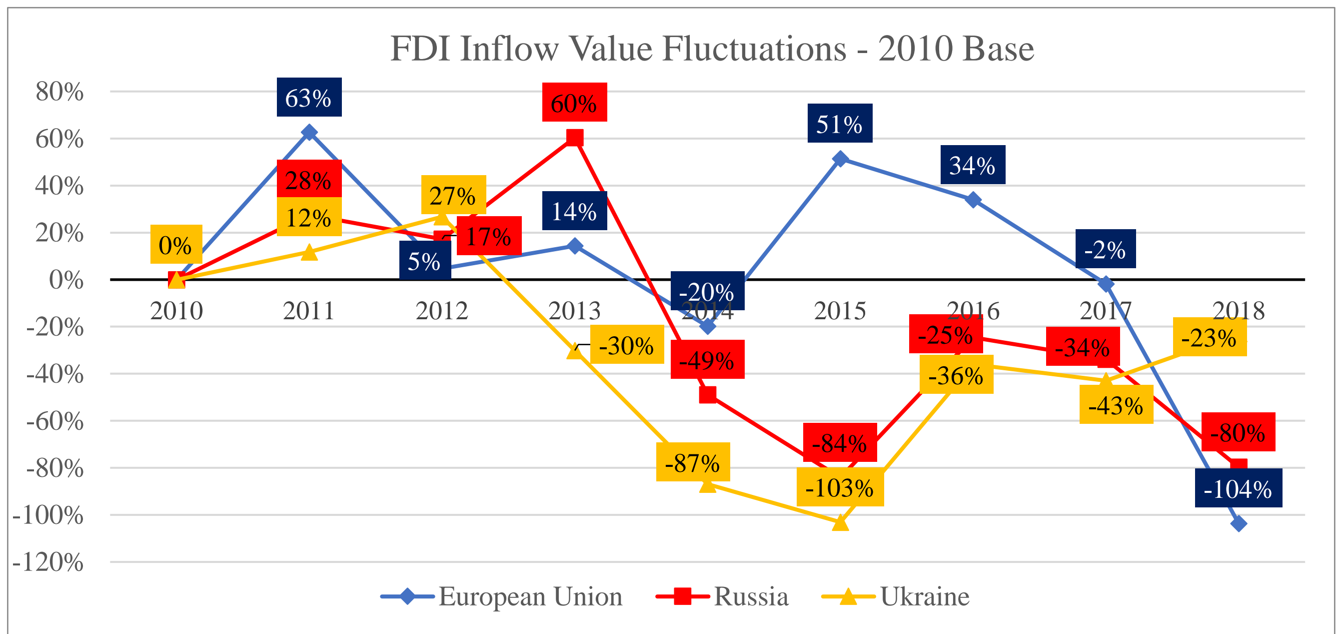
To establish the base year as 0%
The Fluctuation figures were calculated as follows: Fluctuation % = (((Value Outflows 2011-Value Outflows 2010) / 2010 outflows) x 100)
Russian flows 2011 = 27.05%
Calcualtion ((66.9 – 52.6) / 52.6)) x 100 = 27.05%

Figure 17: Russian FDI Inflow and Outflow fluctuation 2010 - 2018

Country	Year	$	Type	Value	% Difference 2010 Base
Russia	2010	MM	FDI outflows	52.6	0.00%
Russia	2011	MM	FDI outflows	66.9	27.05%
Russia	2012	MM	FDI outflows	48.8	-7.21%
Russia	2013	MM	FDI outflows	86.5	64.41%
Russia	2014	MM	FDI outflows	57.1	8.49%
Russia	2015	MM	FDI outflows	22.1	-58.03%
Russia	2016	MM	FDI outflows	22.3	-57.59%
Russia	2017	MM	FDI outflows	36.8	-30.14%
Russia	2018	MM	FDI outflows	31.4	-40.37%
Russia	2010	MM	FDI Inflows	43.2	0.00%
Russia	2011	MM	FDI Inflows	55.1	27.60%
Russia	2012	MM	FDI Inflows	50.6	17.19%
Russia	2013	MM	FDI Inflows	69.2	60.35%
Russia	2014	MM	FDI Inflows	22.0	-48.96%
Russia	2015	MM	FDI Inflows	6.9	-84.12%
Russia	2016	MM	FDI Inflows	32.5	-24.62%
Russia	2017	MM	FDI Inflows	28.6	-33.85%
Russia	2018	MM	FDI Inflows	8.8	-79.65%

If we focus on the variance graphs with 2010 as a base, we can see that **in the 4 years post-annexation (2015 – 2018) neither Russia nor Ukraine experienced levels of FDI inflow or outflow greater than that of 2010.** Conversely, the European Union experienced FDI inflow levels in 2015 that were 51% higher than in 2010, with the 2016 figures being 34% higher.

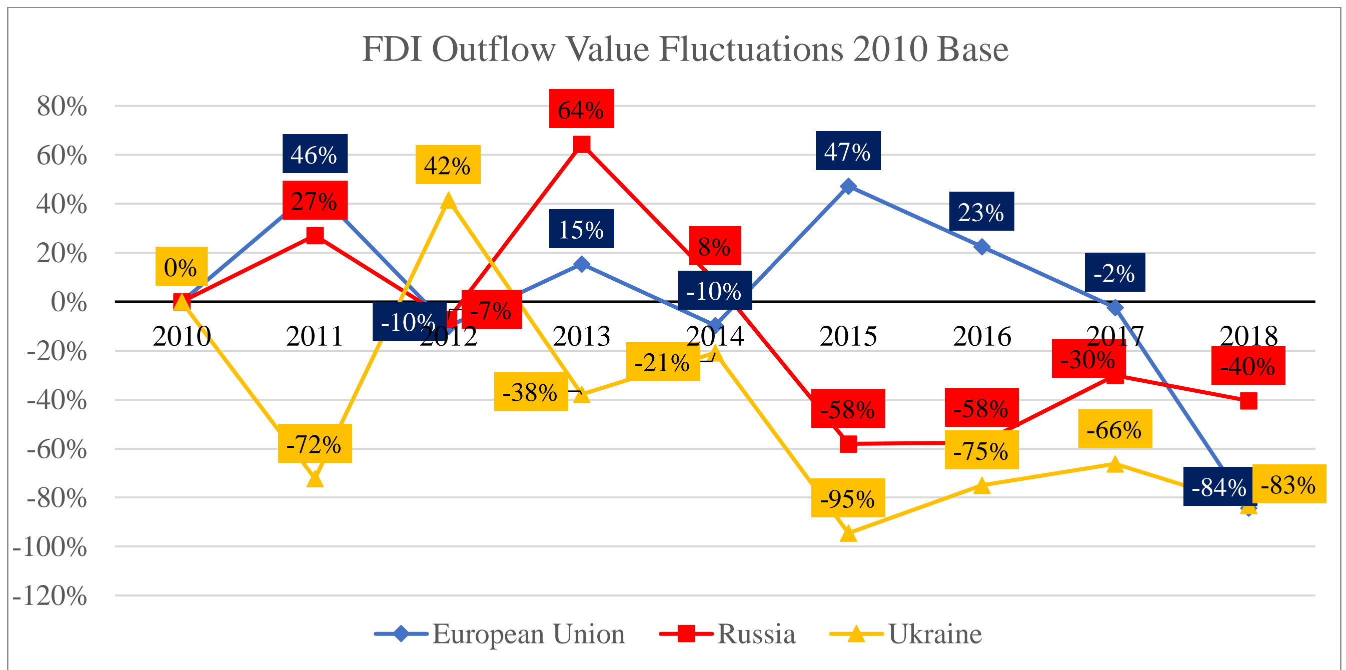
Figure 18: FDI Inflow Value Fluctuations comparison - 2010 base year



Source: Own production using data from (World Bank, 2023a)

Both Russia and Ukraine experienced increased economic and political uncertainty because of the annexation of Crimea. Foreign investors were hesitant to commit their cash due to the unstable climate produced by the geopolitical tensions and violence that followed the annexation. Many potential investors were discouraged from choosing Ukraine as an investment destination due to uncertainty surrounding the future of ties between Ukraine and Russia as well as the general geopolitical situation (Jagtap et al., 2022).

Figure 19: FDI Outflow Value Fluctuations comparison - 2010 base year



Source: Own production using data from (World Bank, 2023b)

The annexation of Crimea exacerbated the volatility of FDI inflows and outflows for both Russia and Ukraine (Figures 17 and 18). Political unrest and economic sanctions imposed by the international community led to an unstable investment environment. The FDI numbers for Russia showed this volatility, with changes in confidence among investors and risk perceptions influencing investment flows (Figures 17 and 18). Ukraine's Foreign direct investment (FDI) inflows decreased due to the political unrest and economic turbulence that followed the annexation. Similar difficulties were encountered by Ukrainian businesses while trying to grow and enter foreign markets, which limited the amount of FDI leaving the country.

6.3. CASE STUDY CONCLUSION

The FDI inflows into Ukraine and Russia were heavily affected in the immediate years after the invasion. Although global FDI flows decreased in 2013-2014, they increased year on year in 14-15 and 15-16, an upsurge which was not experienced in either Russia or Crimea.

The case study confirms several assertions made in the literature review. As mentioned in the

literature review (Averchuk, s. f.; Barry, 2018; Biglaiser & DeRouen, 2007; Cáceres, 2021; Duasa, 2007; Groww, 2023; Haita-Falah, 2017; Hayes, 2022; Merwe, 2020; Oetzel & Getz, 2022; Oh & Oetzel, 2011; OECD, 2002; Pettinger, 2021; Skovoroda et al., 2019; Witte et al., 2017), conflict causes instability in the host country and is a major deterrent to FDI. Both Russia and Ukraine experienced an immediate drop in FDI inflows and outflows in the wake of the annexation (figures 11-14). This instability also plays a role in the volatility we see in both Russia's and Ukraine's FDI flows. If we look at figures 11 and 16 which analyse the FDI inflows and outflows of: G20, EU, OECD, and World, we see that the four areas follow a similar pattern. FDI flows dropped from the end of 2013 leading to 2014, before increasing figures over the next two years. In contrast, the FDI flows of Russia and Ukraine experienced no such resurgence in inbound or outbound foreign investment (figures 11-14). This further emphasizes the point that the annexation of Crimea had a negative impact on the FDI in both Russia and Ukraine. Russian countersanctions and the decision by the Kremlin to increase investment in domestic markets and decrease reliance on foreign direct investment contributed to the sharp decline in Russian FDI outflows in the wake of the annexation. In terms of Inflows, the annexation of Crimea damaged Russia´s reputation on the international stage, evident through its removal from the G8, and thus acted as a deterrent for companies to invest in the country (Hanousek & Matěj, 2019). Figures 17 and 18 which use the 2010 base as their focal point present an interesting point: FDI Flows, both inwards and outwards, never reached 2010 levels after the annexation. The value of flows becomes highly volatile due to conflict, sanctions affected the business environment (Siviş, 2019).

Neither Russia nor Ukraine reached 2013 levels of FDI inflows or outflows in the 4 years post-annexation, highlighting the fact that the unstable environment acted as a deterrent for investors. Heavy sanctions placed on Russia, particularly by the EU and US, further exacerbated the downfall in FDI for Russia and counter-sanctions reduced Moscow's FDI outflows. There was an

upsurge in political tensions and economic penalties against Russia were brought about by the widespread worldwide condemnation of the annexation. The financial, energy, and defence sectors of the Russian economy were among the major targets of these sanctions. Ukraine suffered heavy impacts in both aspects of FDI as a result of the annexation. The quantitative analysis carried out on the FDI inflows and outflows of Russia and Ukraine clearly demonstrate that the years following the annexation greatly reduced the capital entering and leaving the nations. Figures 17 and 18 which analyse World, G20. EU and OECD show that the declines experienced in 2014 and 2015 by Russia were not a global issue, thus highlighting the negative impacts that the annexation had on the Russian and Ukranian business environment as well as their ability to appeal to investors.

7. Discussion

My research was undertaken to investigate "**The Impact of Conflict on Foreign Direct Investment"**. My research has shown that the relationship between conflict and FDI is nuanced and varies on a case-by-case basis. We have seen examples of conflict attracting investors to areas engaged in or recovering from conflict, such as Angola and Bosnia in the 1990s, and the current Chinese investment in Africa. However, it is evident that war and violence create a highly uncertain and dangerous environment for foreign investors, as mentioned in the literature review and seen in the quantitative analysis of Russia and Ukraine (see figures 12-15). Generally, investors tend to avoid investing in countries at war due to the economic and political uncertainties associated with conflict. Moreover, infrastructure damage, supply chain disruptions, and logistical challenges further hinder foreign investors from conducting business effectively. Consequently, FDI typically experiences a significant decline during times of war and strife.

Although FDI is not always a primary concern for leaders when deciding to engage in conflict, there are various reasons why conflict negatively affects FDI. Power struggles and the fragility, corruption, unpredictability, and instability of political institutions are common outcomes of conflict. The impact of war on FDI depends on several variables, including the nature and duration of the conflict, the level of political unpredictability, and the economic conditions of the involved countries. The case study of Russia's annexation of Crimea shows that the FDI inflows and outflows of both sides in the conflict were negatively affected for a number of years.

Fluctuation graphs of Russia and Ukraine illustrate highly variable FDI flows that never reached pre-annexation levels. Although certain countries may experience a temporary spike in FDI during conflict, in the long term, conflict-affected regions become less attractive to investors. Opportunistic investors may enter during times of instability, seeking to take advantage of the situation, but their presence does not represent quality FDI.

This research project has shown that conflict can provide certain opportunities for FDI, although it demonstrates that conflict has an overwhelmingly negative effect both on Inflows and Outflows of FDI. Therefore, if a country wishes to increase quality and lasting foreign direct investment, it must strive to establish stability within its borders. Avoiding engagement in domestic and international conflicts is crucial to pursue in order to achieve this goal.

7.1. Limitations

In terms of the limitations of the study, I think the main issue is centred around the lack of scope for primary research. While I certainly was able to access a wide range of datasets, I was still limited to the parameters which were available in existing datasets. In some cases, for example with the World Bank dataset on provincial fund allocation, there were incomplete sections of data for certain periods.

Another notable impediment in this project was the variance of figures depending on the database chosen to access data. In many cases the data were identical, or there were marginal differences, some as low as a rounding error which did not inhibit the ability to analyse and represent the connection. However, there were occasions where the difference in figures between sources was over 30% (Figure 1 & Figure 2). As a result, I had to select one source that I would use for the rest of the project. A common limitation in relation to data analysis is the accessing of meaningful data. In the FDI section I accessed several databases when obtaining figures. To maximize the efficacy and efficiency of the data analysis sections in which I interpreted statistical information surrounding FDI flows followed by the creation of graphs, I made the decision to use one source: The World Bank. This decision was made on the basis that it had relevant data for all of the criteria I needed.

An element of data analysis that, to be frank, left me somewhat dismayed at times was the issue of

“correlation vs causation”. As the topics being dealt with are global issues there are an almost incalculable number of events, both significant and seemingly insignificant that can have profound impacts on data of a country. In 2014 for example, the Winter Olympics took place in Sochi, Russia just one month before the Formal annexation of Crimea was signed by Vladimir Putin on the 21st of March. If the research title was to examine the relationship between hosting major sporting events and foreign direct investment, as is analysed in *Fool's Gold: Major Sport Events and Foreign Direct Investment* (Jakobsen et al., 2013) then the data would show that the hosting of the Winter Olympics had a profoundly negative impact on the Russian economy. This is an important aspect of data analysis that must be kept in mind when assessing data and when faced with headlines or seemingly incredible impacts of one element on another.

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