

Geo-economic Interests of Russia and Germany in the Field of Industry

Nikita Dmitrievich Khoroshun¹

¹ Russian University of Economics Plekhanov, Moscow, Russian Federation

Correspondence: Nikita Dmitrievich Khoroshun, Russian University of Economics Plekhanov, 1-st Neopalmimovskiy s-str, 8-8, Moscow, 119121, Russian Federation.

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Abstract

The article discusses the basic mechanisms and instruments of bilateral cooperation between Russia and Germany in the field of industry. Russia is interested in cooperation on technological development of machine industry, electrical engineering, chemical industry and other manufacturing sectors. For Germany, relations with Russia are important in terms of receiving energy resources. During the years of economic partnership between the two countries impressive results have been achieved in mutual trade. Russia occupies the 16th place among the other countries in terms of application of the German capital. The total amount of accumulated German investments in the Russian economy exceeded 16 billion Euros. Germany still remains a key supplier of equipment and technology for 20 of the 33 industries. At present, there are 6167 companies with German capital operating in 81 of the 83 territorial entities of the Russian Federation. More than 40% of German companies considered development of their businesses in Russia as "good" or "very good". Most German companies are expanding or plan to expand their production in Russia. At the same time, among the companies, localized their production in the country, there are several problems, associated with regulatory changes in connection with the accession of Russia to the WTO. At the same time, the Russian government is taking measures to improve the implementation of investment projects and expand cooperation in the field of industry. The economic future of the bilateral partnership between Russia and Germany may be greatly affected by the negative effects of the EU sanctions policy towards Russia due to political conflict in Ukraine. In case of breaking partnerships, not only Russian, but also the German economy will suffer. The consequences of tougher sanctions have already begun to affect the German business in Russia: corporations, which are represented on the Russian market, are already bearing losses. According to the author, it is exactly business that may affect policy to support equitable dialogue that would lead to a peaceful solution and translate into action the possibilities of mutual cooperation in the industrial sector.

Keywords: cooperation between Russia and Germany, field of industry, the WTO, foreign economic affairs

1. Introduction

One of the defining trends of the world economy is the growing of industrial enterprises integration associations. Liberalization of Russia's foreign economic affair, which began in the 90s of the XX century, gave a powerful impetus to the development of bilateral Russian-German economy-based relations. At present, cooperation between Russia and Germany is developing in all spheres, including the field of industry.

However, as a result of the crisis in Ukraine and cleavage in regard to the annexation of Crimea, bilateral cooperation is bound to suffer not only at the political but also economic levels that can affect both Russian and German economies. Therefore maintaining dialogue between the business circles of the two countries, search for opportunities to expand mutual cooperation in the industrial field, as well as scientific and technical areas under the existing geopolitical tensions is of particular relevance.

2. Methods

Economic cooperation between the Russian Federation, the successor state, established after the collapse of the Soviet Union, and the Federal Republic of Germany, which arose as a result of the unification of West and East Germany, began to develop actively since the early 90s of the XX century.

The Russian-German cooperation rests upon a serious economic base. As mentioned Gernot Erler, the authorized representative of the Government of the Federal Republic of Germany on relations with Russia, as far back as since the Soviet times, Russia has earned a reputation of a reliable supplier of natural resources to Europe, and if sometimes it came to the problems, they were settled easily and quickly.

Within the current economic cooperation between Russia and Germany, a unique statutory conditions and institutional base were created between the two countries. At that, Russia does not have similar juridical base with other countries.

One of the key mechanisms of direct interaction between the business communities of the two countries was the Russian-German Chamber of Commerce, established in 2007. Russian-German Chamber of Commerce represents the interests of all enterprises in Russia operating by German companies, as well as the interests of Russian companies in Germany. Russian-German Chamber of Commerce has affiliated branches in St. Petersburg, Novosibirsk and Kaliningrad. It represents more than 750 German and Russian enterprises. Along with agency work and support of the startup projects this Chamber is also supporting partners by a recurrent transfer of relevant information about the economic situation in Russia.

As a platform for dialogue between foreign businesses and the Russian authorities, the Russian Union of Industrialists and Entrepreneurs established in 2008 an advisory body, namely International Council for Cooperation and Investment (ICCI). Currently ICCI joins the leading foreign investors into the Russian economy, as well as business associations and chambers of commerce.

In addition, at the initiative of the Russian business, actively operating in Germany, in 2011, the Council of the Russian Economy was established, whose main task was to assist Russian business circles in Germany, as well as to promote high-tech Russian exports to the German market.

Business forums, economic congresses, conferences, intergovernmental consultations at the highest level, trade fairs, exhibitions and other events are important tools that contribute to the positive development of cooperation between Russia and Germany in the field of industry.

Currently, moderate pragmatic relationships based on mutual interests have created between Russia and Germany. The strength of the German industry is in what is called "advanced manufacturing", i.e. in the production of high-tech products.

For Russia, these relations are important, especially in terms of technological development of Russian industries, such as machine building, chemical industry, electrical engineering, and others. At the same time, Russia with its vast natural resources is of considerable interest to the German economy as an energy supplier.

The attractiveness of the Russian market for the German business is due to several reasons. Foremost, Russian market, both consumer and innovative, is big enough. Secondly, Russia is considered by a German business as interlink between Asia and Europe. In this respect the Russian regions, bordering with China, Japan, and Korea, are particularly attractive.

The main priorities of the state policy of the Russian Federation consist in the promotion of the restructuring and modernization of production, improvement of industrial competitiveness, and support of innovative development of the most important economy sectors. The policy persuaded aims at establishing mutually beneficial cooperation with foreign investors in the implementation of investment programs and projects.

In 2010, Russia and Germany signed a coalition agreement on key areas of economic cooperation within the partnership on modernization through the development of import-substituting production with a prospect of transition to export-oriented production. The initial basis for the creation of such productions is import of German products and capital markets, mutual investments to create conditions for the development of promising innovative technologies, production of competitive products and services and their promotion on the markets of both countries, as well as the improvement of the investment climate.

Efforts to modernize Russia suggest improving business opportunities for German companies. At present, Russia has created the basic conditions to provide a favorable investment climate. The country greatly expanded forms and methods of state regulation of investment activities and support of the industry.

As in the most developed countries, government regulation of foreign investment into the industrial sector is carried out largely by economic methods, which include fiscal and monetary system, the loan capital policy, government lending and borrowing, public insurance, and customs tariffs.

Germany pursues a preferential treatment policy in relation to foreign direct investments (FDI). German law makes no distinction between German and foreign entrepreneurs in matters of investments or the establishment of new companies.

Regulatory framework for FDI in Germany is based on the principle of foreign trade and payments freedom. There are no restrictions or barriers to capital transactions, currency transfer, bargains on real property purchase, profit repatriation or access to foreign exchanges.

Germany offers a number of subsidy programs for investors that can be grouped into two comprehensive packages, namely: the package of investment subsidies, which includes a variety of tools for the return on investment, and a package of operating subsidies intended for the provision of financial support after the investment to a specific location. The structure of investment subsidies may include cash grants, loans at a reduced interest rate, and government guarantees. Operating subsidies include all sorts of payoffs related to employment and the promotion of the R&D. Subsidies in Germany are available to all investors regardless of their country of origin.

Effective instrument to encourage foreign investors, engaged in production in Russia, are tax incentives that are provided in the following form.

Tax holidays, i.e. by establishing a certain period (usually a few years after the start of business activity), during which the taxes are not collected. The advantage of this method is relatively simple exercising, despite the fact that this allowance is not so much aimed at attracting investment, as the launching of new businesses. Application of this method requires controlling the proper distribution of profits within groups of enterprises (transfer pricing), as well as ensuring that the exempted profit derives from activity of a subject to preference.

Reduction in the tax rate, which, in contrast to the "tax holidays", is permanent and therefore more attractive to encourage the long-term investments. However, application of this method does not exclude the need to administrate the intended use and suppress the attempts to "attribute" profit from other activities to the qualifying subject.

Expedited depreciation that suggests advanced capabilities for deduction of capital investments from the tax base. This method is more efficient than the "tax holidays" and a reduced tax rate. However, it is necessary to conduct monitoring on an objective assessment of the actual cost of capital investments, as well as the implementation of measures that control the justification for the provision of benefits (job creation, social development of the region, etc.).

Creation of special economic zones for the production of export-oriented products and high technology by reducing tax rates for certain types of taxes and implementing special customs regimes.

In recent years, steps are being taken to simplify procedures for the importation of goods from certain kind of importers. Thus, since 2013, pursuant to the Order # 202, any party of foreign economic activities, subject to certain requirements, is eligible to apply for the status of "person engaged in productive activities". Exactly these company-importers are the first to get easier access to customs clearance. The customs authorities will no longer apply the so-called "risk profiles" and carry out customs control of imported products in regard to these companies. The order defines quite clearly a number of criteria, according to which the customs authorities should include a foreign economic activity participant to the list of "manufacturing companies". These criteria include the following requirements.

Availability of industrial premises or land for industrial purposes in the ownership or lease;

The net asset value no less than 1 million Rubles;

The minimum amount of the authorized capital no less than 10 million Rubles;

The main activity of the company is production;

The minimum number of staff no less than 50 people;

Experience in foreign economic activities no less than 1 year;

The company shall not use the simplified taxation system.

3. Results

Business contacts between the Russian Federation and Germany are currently dynamically developing. Thus, in 2013, the mutual turnover amounted to 76.52 billion Euros according to German statistics. This is 5.4% lower than that in 2012.

However, it should be noted that the Russian statistics shows different figures. According to Russian data, in 2013 turnover grew by 2.2%. This is due to different calculation techniques of turnover, and in particular, the transit delivery of a number of goods from Russia to Germany through third countries, such as Holland, for instance.

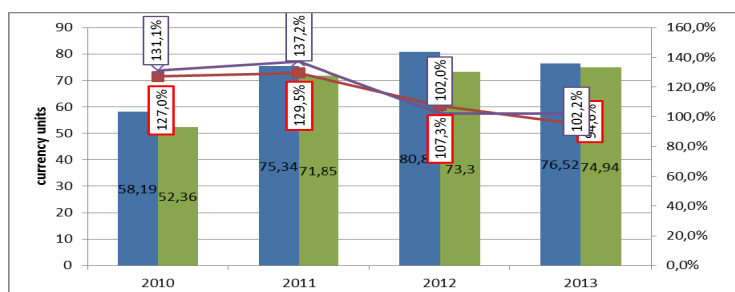


Figure 1. Behavior of foreign trade turnover between Russia and Germany in 2009-2013

Russia considers Germany as a leading European partner and, at the same time, is an important trading partner for Germany. Germany's share in Russia's foreign trade in 2013 reached almost 8.9%, i.e. Germany holds 3rd place behind China (10.5%) and the Netherlands (9%). In the Germany's trading partners ranking, in 2013 Russia ranked 11th.

According to the Russian Customs Service, imports from Germany by the end of 2013 amounted to 37.92 billion USD (Table 1). Over the period from 2010 to 2013 the volume of imports from Germany to Russia increased by 42%. However, in 2013 it fell by 1% as compared to the previous year. At that, the total volume of Russian imports increased by 0.2% up to 318 billion USD.

Table 1. Exports and imports of Russia and Germany for 2010-2013

Indicator	2010	2011	2012	2013
Export from Russia to Germany, bln. USD	25.66	34.17	35	37.03
Rate of export growth/decrease, %	137.1%	133.2%	102.4%	105.8%
Import from Germany to Russia, bln. USD	26.7	37.68	38.3	37.92
Rate of import growth/decrease, %	125.8%	14.,1%	101.6%	99.0%

Germany exports to Russia mainly three types of goods. These include machine building products (22.5% of total exports), vehicles and vehicle parts (21%), and chemical products (8.8%).

According to data of the Automotive Industry Union, Russian vehicle imports from Germany fell slightly in 2013. During 2012, Russia imported from Germany about 156,800 cars, whereas in 2013 - just 132,400 cars (-15.6%). As an export market of passenger cars in 2013, Russia was in 9th place after the UK, the USA, France, China, Italy, Spain, Belgium, Luxembourg and Japan.

The German automotive industry operates in Russia for many years and continues to expand its presence. Manufacturers and suppliers of automotive components secured numerous cooperative ties. In March 2013, the proportion of German manufacturers in the market of passenger cars and light commercial vehicles amounted to 21%, at that much of it was made in Russia.

After several years of growth and record profits in 2012, demand for cars in 2013 declined. According to the Association of European Businesses (AEB), the market for passenger cars and light commercial vehicles in Russia decreased by 161 thousand vehicles, i.e. by 5.5% down to 2.78 million cars.

Germany accounts for almost a quarter of Russian imports of equipment. For German suppliers Russia is the fourth-largest market after China, the USA and France. Germany is the most important foreign supplier in the 20 of 33 sectors of Russian industry, including the technological equipment and apparatuses, handling facilities, agricultural machinery, pumps, as well as the equipment for food production and packaging, and metalworking equipment.

Germany is a major supplier of chemical products to the Russian market. According to the Federal Council on

Foreign Economic Relations and Marketing (GTAI), every sixth delivery to Russia is from Germany.

Germany is on the 6th place in terms of investments, accumulated in Russia, after Cyprus, the Netherlands, Luxembourg, China and the UK. Russian economy has accumulated more than 16 billion Euros of German capital, though in recent years there is a gradual decrease in noted volumes. Accumulated direct investment, on the contrary, show a steady growth, and by the end of 2013 its volume has reached 9.6 billion Euros (Figure 2).

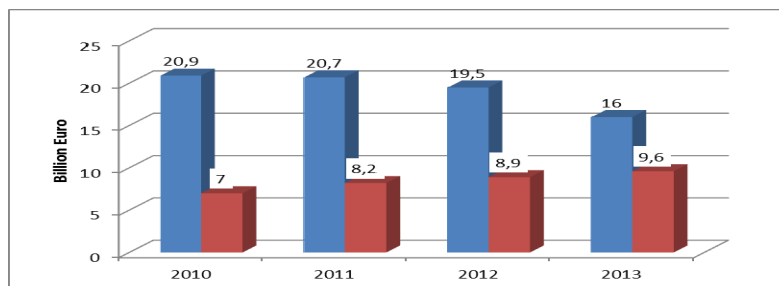


Figure 2. Behavior of German investments in Russia in 2010-2013, billion Euros

According to the German-Russian Economic Yearbook (2014), in 2013 Russia has implemented more than 20 projects in some 20 industries and industry sectors with the involvement of the German investment and technology.

The sectorial structure of the German industrial investments in Russia (Figure 3) is dominated by raw materials and semi-finished products (37%) industry, as well as manufacturing industry and transport (14%).

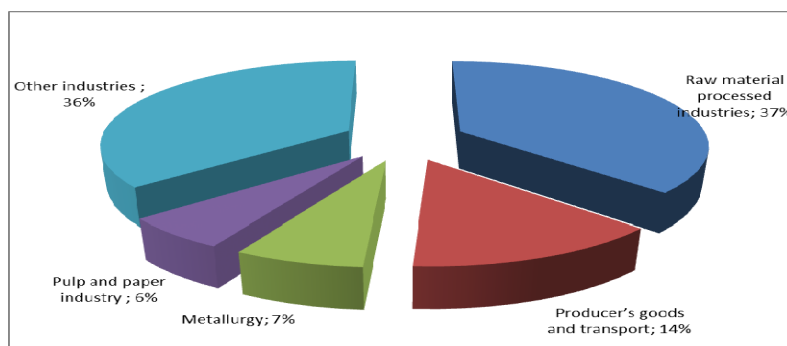


Figure 3. Structure of the German industrial investments into the Russian Federation in 2013

Russia occupies the 16th place among the countries using the German capital. Since 2005, the Russian FDI in Germany increased by factor of four and now accounts for nearly 3.2 billion Euros.

German companies with production in Russia contribute to the extension of the value chain by producing goods worth 40 billion Euros and creating about 120,000 skilled jobs. Currently in Russia there are 6167 companies with German capital, operating in 81 out of the 83 territorial entities of the Russian Federation.

The most well-known German companies, having their own production facilities in Russia, include BASF, E.ON, Siemens, Volkswagen, Henkel, and Adidas.

BASF, as a leader in global chemical industry, has in Russia four production facilities: a plant for manufacturing of automotive coatings in Pavlovsky Posad; Production Complex "BASF Building Systems Ltd." in the Podolsk District of the Moscow Region, the production of polyurethane-based systems in the premises of JSC "Nizhnekamskneftekhim", and the production of additives for concrete on the basis of a "Himgrad" technopolis in Kazan.

In the oil and gas segment, this global leader in the chemical industry is related to Russia mainly through its oil and gas daughter Wintershall, which established JV "Achimgas" together with "Gazprom" to produce gas in the Urengoy. Wintershall is a co-owner of the South-Russian reserves in Siberia, the "Nord Stream" pipeline and the "South Stream" landfall, currently being under construction. In addition, the company produces oil in Volgograd together with "Lukoil".

Russian enterprises of the BASF consortium demonstrate sustainable performance. Thus, by the end of 2013, the volume of BASF products sales in Russia increased by 5.9% to 1.42 billion Euros. Currently, the Russian offices of the company employ more than 1,100 people.

E.ON, a leading German energy company, is the largest foreign investor in the Russian energy market. Since 2007 the company has invested 6 billion Euros in the Russian electric-power supply industry. Currently, the "E.ON Russia" produces 6% of all electricity in Russia. The number of employees of E.ON companies in Russia is 5,037 people. At the same time E.ON is one of the EU largest importers of Russian natural gas. Along with "Gazprom" consortium it owns stakes in the South Russian gas field in Siberia and in the "Nord Stream" pipeline. In 2013, E.ON investments in Russia increased by 35% as compared to the previous year and amounted to 15.2 billion Rubles. Russian subsidiary's revenue increased from 75 to 78.8 billion Rubles.

Siemens. The leading German technology consortium operates in Russia for more than 160 years and is not only a manufacturer and supplier of advanced equipment for Russian companies, but also a partner that offers efficient system solutions for the modernization of infrastructure. Currently, Siemens supplies Russian customers different electrical products, basically, turbines for power plants and rail transport systems. These are high-speed "Sapsan" trains and electric multiple-unit trains "Lastochka". Company is represented in all Russian federal districts almost in 30 cities across the country. In the Russian regions the consortium implements dozens of projects in the field of urban infrastructure, transport, energy and medicine. Investments of Siemens consortium into the projects in Russia in 2011-2014 amounted to about 800 mln. Euros. In general, the annual turnover of Siemens in Russia is about 2 billion Euros. Russian subsidiaries of the consortium employ 3,200 people.

Volkswagen. Europe's leading car manufacturer invested in Russia more than 1.3 billion Euros and thus became one of the largest foreign investors in the Russian automotive industry.

Since 2007, the consortium manufactures Volkswagen and Skoda car brands at its facility in Kaluga. In 2011, the consortium had entered into an agreement on contract assembly of vehicles at GAZ plant in Nizhny Novgorod.

In 2013, the company's sales in the Russian market amounted to 299,143 vehicles, of which 188,000 cars were produced in Russia, which is 4.5% higher than a year earlier.

More than 150,000 vehicles were assembled at Kaluga plant. In 2013, about 38,000 Skoda Yeti, Volkswagen Jetta and Skoda Octavia cars of next generation were produced in the frameworks of the contract manufacturing at GAZ plant in Nizhny Novgorod.

Construction of a new plant "Volkswagen Group Rus" to produce internal combustion engines was launched in 2012. A new plant covering an area of 30 thousand sq. meters will be located next to the VW automobile plant and will be operational in 2015. It will produce about 150 thousand internal combustion engines each year. Consortium investments into the project amounted to about 1 billion Euros. Construction of the plant for the production of the internal combustion engines will allow Volkswagen to expand its production capacity in Russia and at the same time fulfill the provisions of the additional agreement on industrial assembly, signed in May 2011. Under the terms of this agreement, starting from 2016, about 30% of cars produced in Russia, must be equipped with engines made in Russia.

The "Volkswagen Group Rus" company is one of the largest employers in the Kaluga Region. The number of employees of the Kaluga plant is about 5,450 people. With the construction of engine plant, which will be launched in 2015, "Volkswagen Group Rus" will create at least another 400 jobs in the Kaluga Region.

Henkel. For leader of the German household cleaning products, producing in particular, detergents, shampoos and glues, Russia has become the fourth most important markets in the world. Eight Russian Henkel enterprises employ about 2,500 people. The company's factory in Perm is the second largest producer of synthetic detergents in the Russian Federation.

Adidas. Second world's largest manufacturer of sportswear, footwear and equipment holds the position of market leader in Russia as early as since the Soviet era. Today the company has in Russia about 1,000 branded stores. The company is the official partner of the Russian national football team, so that in the World Cup 2014 in Brazil, the Russian team worn the Adidas sports uniform.

4. Discussion

German manufacturers are working in Russia for many years and continue to expand their activities. They secured numerous cooperative ties. Most German companies show good growth, not abandon to invest in Russia; on the contrary, they still invest and plan to expand their productions. This testifies the fact that Russia is an interesting and attractive country to cooperate with in the field of industry.

In January 2014 the Eastern Committee of the German Economy and the Russian-German Chamber of Commerce conducted among their member companies the 11th annual survey on the business climate in Russia.

The results of the survey showed that 41% of respondents rated their own company business development in Russia as "good" or "very good", whereas 54% of companies were planning to increase a number of their employees in Russia. However, compared with 2012, the economic situation for German companies operating in Russia worsened in 2013. Thus, about 39% of the companies still were planning to implement in Russia specific investment projects that is by 8% less than in the previous year. The total investment of 105 enterprise respondents should have made up 566 million Euros. This is significantly less than in previous surveys (800 million Euros in 2013), but still quite an impressive amount, proving that a large number of German companies rely on Russia and see it as a promising market.

At the same time, about one-third of German companies noted that regulatory changes due to the accession of Russia to the WTO created problems for companies, which have localized their production in Russia. In mid-2012, Russia had ratified the Protocol of Accession to the WTO that resulted in immediate reduction of import duties on the average from 10% to 7.8%. But there and then Russia imposed additional tariffs and introduced various non-tariff barriers to protect national producers. German companies note the high level of additional requirements set by the Russian government for foreign manufacturers. Thus, as a protectionist measure, Russia introduced a car recycling tax for imported vehicles, which completely blocked the winnings of automakers obtained due to reduction of import duties. In some cases, companies even had to raise the selling price.

In order to improve conditions for the implementation of investment projects, in July 2014 the Federation Council has approved the Law on support of automobiles and car components manufacturers, operating in industrial assembly regime, aimed at adapting the specific economic sectors into the World Trade Organization.

Russia and Germany are associated by a number of joint projects in the frameworks of bilateral commercial, economic and investment cooperation in the field of industry. However, the deterioration of the political situation in the world is not conducive to further fruitful cooperation and the development of international projects in the field of industry. Thus, the sanction measures against Russian enterprises, introduced towards Russia from the United States and the EU under the baseless pretext concerning Russia's involvement in the armed conflict in Ukraine, include restrictions in terms of sectorial cooperation with the Russian Federation, as well as Russia's access to financial resources and technology.

About 39% of German enterprises expect negative consequences for their businesses because of the political conflict between Russia and the European Union on the issue concerning future orientation of Ukraine. These figures suggest that further course of events in Kiev can significantly affect the economic future of German business in Russia.

Currently, when political relationships between Russia and Europe have not yet stabilized, it is difficult to give a final assessment of the sanctions impact, both for Russia and for Germany. Opinions of leading Russian and German experts in the field of economy, expressed in the mass media, are completely opposite.

Thus, according to Economic Development Minister A. Ulyukaev, although the pace of economic growth and investment will become negative, inflation will increase and income will reduce, the effects of sectorial sanctions will not lead to the dramatic events, and Russia's economy will withstand the sanctions.

The largest rating agencies Moody's and Fitch believe that sanctions will not lead to a liquidity crisis in Russia. Moody's, in its report, notes that the USA and the EU sanctions against Russia will significantly restrict access to foreign financial markets. Though, they will not lead to a liquidity crisis, as most issuers have sufficient monetary funds and financial assets. Sanctions, however, reinforce the gradual downswing in the country and affect the growth potential that can lead to loss of creditworthiness of the various economy sectors.

Fitch notes that in the short term the economic constraints will not significantly affect the creditworthiness of Russia and its banks. Fitch Ratings estimates banks' liquidity as "comfortable that reduces the likelihood of a sharp increase in refinancing risk".

Many German experts and the business community concur that the sanctions against Russia do not contribute to the economic interests of both countries and could have a negative impact on the economy of Germany itself, which largely affects the well-being of the euro-zone countries.

These fears are not baseless. The consequences of toughening sanctions have already begun to affect the German business in Russia. International companies and corporations, which are represented on the Russian market, are already bearing losses, trimming contracts, turning deliveries and closing offices in Russia in accordance with

the imposed restrictions.

For example, shares of Adidas consortium fell by 15% after the company reported the imminent closure of its stores in Russia, because, in the opinion of management, there was a danger of declining purchasing power in the regions. Largest German carmaker Volkswagen reported a decrease in sales in Russia in the 1st half of 2014 by 8%. Tangible effects of sanctions experienced German machine industry. According to the German Machine Tool Builders' Association, a number of orders and tenders from Russia since the beginning of the year fell by more than 60%.

5. Conclusion

Today, Russia and Germany are no longer just the two European countries that are closely related by joint economic interests. These are the two future global players in the world economy, and thus it is important to maintain good relations and to develop bilateral partnerships, that have evolved over the years.

Unfortunately, the economic interests of Germany are of secondary importance in relation to the geopolitical ambitions. As a result, long-term partnerships and trusted relationship between Russia and Germany that were step by step established with great efforts are gradually destroyed.

It should be noted that the Russian authorities are doing everything in order to improve the investment climate and to enhance cooperation with German partners, as evidenced by the lack of response to economic sanctions. However, in case of further tightening of the EU sanction policy, Russia will have to take countermeasures against foreign enterprises operating in key sectors of the Russian economy.

At the same time, a full-scale economic blockade of Russia will not succeed. Russia is an attractive market for foreign players; Russia's economic viability is still high enough in many branches of production industry. In case of breaking partnerships, not only Russian, but the German economy will suffer as well. On the other side, China is becoming a promising partner for the Russian industry. China can completely replace Russia's partnerships with the West.

Thus, the current situation in Ukraine is a challenge not only for the foreign policy relations between the East and the West and the strategic partnership, but above all, for economic cooperation between Russia and Germany.

It is very important for business to take occasion by a forelock, to take responsibility and to support equitable dialogue between Russia, Ukraine and Europe. Today the economy must influence the policy and find a peaceful solution that would take into account the interests of all parties.

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