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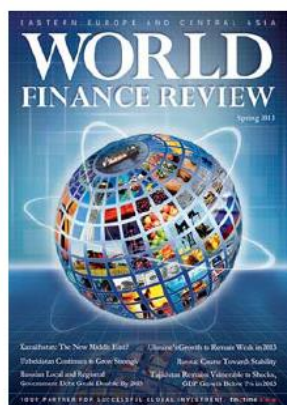
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Monitoring of Mutual Direct Investments in the Post-Soviet Area

By **Alexey Kuznetsov**, Professor, Head of the Centre of European Studies of Institute of World Economy and International Relations (IMEMO), and **Andrey Anisimov**, Head of Projects of the Centre for Integration Studies of Eurasian Development Bank.

While the recent global economic crisis induced long-term problems in the Eurozone, which is the most elaborated project of regional integration, the relatively quick post-crisis recovery in the post-Soviet area stimulated new integration efforts with Russian participation. Active development of the Common Economic Space based on the Customs Union of Russia, Belarus and Kazakhstan is currently underway. Yet, it marks far from the first attempt at tight economic integration within the post-Soviet space. As histories of the European Union and many other projects of regional integration have shown, the success of "top-down" integration efforts is only possible with intensive corporate integration.

The Institute of World Economy and International Relations (IMEMO) and the EDB Center for Integration Studies have been conducting a survey of corporate integration within the post-Soviet area (eleven CIS countries and Georgia). The monitoring of mutual CIS direct investments is the main result of the first stage of the joint IMEMO-EDB research program. The article presents key data and conclusions of this monitoring. The monitoring is based on more than 500 deals with foreign direct investments (FDI) and can be used as an alternative tool in conjunction with official FDI statistics.

METHODOLOGY

The monitoring algorithm encompasses six main stages:

1. study of leading companies' websites,
2. monitoring of press reports on FDI,
3. utilization of publications in business and scientific journals,
4. verification of all FDI data gathered from corporate reports and press releases,
5. calculation of indirect indicators or reconciliation with other figures,
6. expert verification.

As a result, rough estimates of capital-investment volumes are yielded for the overwhelming majority of specific projects.

Based on experience, and in due consideration of the approach adopted by EU statistical agencies and corporate M&A databases, the USD 3 mln level was selected as the minimum threshold for mandatory inclusion in the database. That said, a fair number of projects with lower investment levels were included in the database with the notation "just under". This list expansion is aimed at the achievement of three main goals – tracking promising (just-launched) projects, monitoring sectors critical to integration with low capital intensity (for example, education), and gradually collecting information on FDI in border areas/FDI implemented by CIS

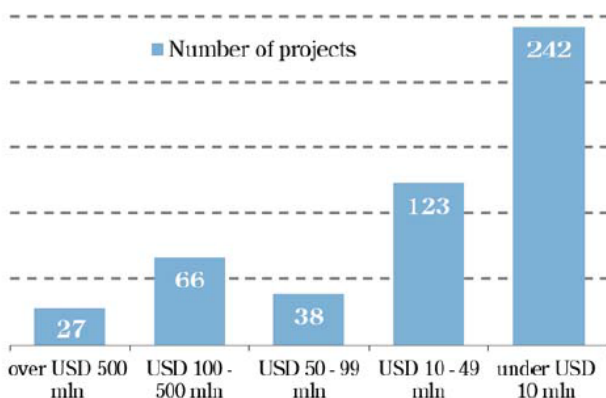
countries with low foreign business-activity levels (the majority of Central Asian republics).

Indirect FDI estimates are applied in due consideration of the sector specifics of the respective projects. In particular, noncurrent assets for industrial firms, equity capital for banks, vehicle value for transportation companies, etc. Widely used are estimates based on the application of data for similar transactions/projects (e.g. cost of building a particular type of gasoline filling stations and the value of small food-processing enterprises).

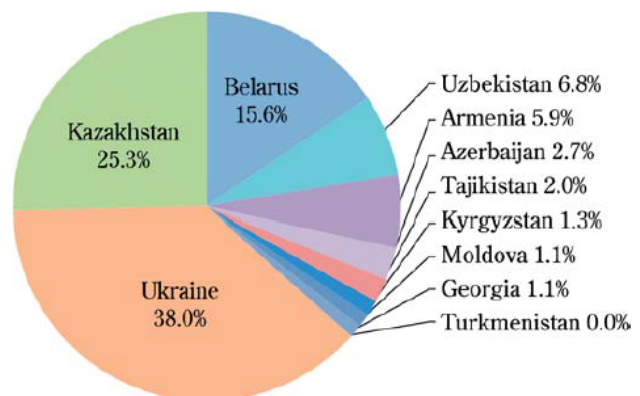
GEOGRAPHY OF MUTUAL DIRECT INVESTMENTS

The snapshot yielded by our monitoring data demonstrates the leading role played by Russia in mutual investment ties. Next come Kazakhstan, Azerbaijan and Ukraine. That said, the weight of leading CIS economies in major projects and total FDI volume is particularly high. This is associated not only with the economic and geopolitical weight of Russia within the post-Soviet space, but also with the availability of more robust national TNCs, formed, inter alia, thanks to the effective utilization of the receptive domestic market, natural resource wealth, and Soviet technological assets.

Ranking of CIS MIM projects by volume of accumulated direct investments (excluding projects for which no data is available)



Geographic structure of accumulated Russian direct investments in CIS countries and Georgia (CIS MIM)



In terms of the geography of Russian FDI in the CIS, the most important conclusion is associated with the leadership of Ukraine. The country dramatically outperforms Russia's partners within the Customs Union. Even with its less-developed formal integration, Ukraine has emerged as a highly-attractive destination for Russian companies in terms of both economic and cultural considerations. Armenia stands out among the smaller countries.

Russia is the key investor among CIS countries in all regional states aside from Georgia, where Azerbaijan and Kazakhstan dominate. Russia also serves as a significant recipient of the FDIs of other CIS countries. However capital investments by CIS countries in Russia are much lower than Russia's in the reverse direction.

Major investment couples without Russian participation are predicated on strictly economic factors. The neighbour effect is discernible in many countries within FDI geography. Also observed is the aspiration of companies to corner the market in those CIS countries where the presence of leading investor companies from Russia and the West is relatively weak. That said, the economic justification for developing alternative political-integration projects without Russian participation is not at issue.

Many projects involving mutual FDI in CIS countries are formally implemented via third countries. In their analysis of FDIs, experts are placing growing emphasis on round-tripping FDIs and trans-shipping

FDIs. Primarily at issue in the former instance is offshore use (according to the Russia-Cyprus-Russia arrangement, for example), which has no direct bearing on our study. In the latter instance, however, both off shores (complicating the ability to distinguish pseudo-FDIs from FDIs with incorrectly identified final receiving countries) and other countries (the Netherlands and Canada, for example) serve as "transit bases".

In particular, one of the most ambitious projects in our database (equity capital – roughly USD 577 mln) involves the 100% control by Russia's Alfa-Bank of PAO Alfa-Bank (Ukraine), implemented via Cypriot ABH Ukraine Ltd. Yet another example from a long list of similar illustrations is Atomredmetzoloto (part of the Rosatom structure) which controls in excess of USD 1 bln in Kazakhstan-based uranium ore production and enrichment assets via Canada's Uranium One Inc. The use of third countries is typical of other CIS countries as well. Thus, Kazakh BTA Bank invested over USD 90 mln in establishing control over JSC United Telecom of Georgia using Dutch company Black Sea Telecom Holdings B.V. The phenomenon is most pronounced in official statistics on Ukrainian FDIs, supporting arguments for the need to develop specialized monitoring for mutual investments in the CIS. Thus, over 90% of accumulated Ukrainian FDIs are formally concentrated in Cyprus. At the same time, key recipients of Ukrainian capital such as Georgia and Kazakhstan account for less than one half of one per cent, on par with the British Virgin Islands.

INDUSTRIAL STRUCTURE OF MUTUAL DIRECT INVESTMENTS

Our monitoring has allowed for a considerably broadened understanding of the sectorial structure of mutual direct investments, insofar as official statistics provide no detailed information whatsoever on individual investor companies due to confidentiality considerations.

The most ambitious investment projects were implemented by Russian companies — moreover, by those included among Russia's leading nonfinancial TNCs in terms of foreign asset volume. Of the 25 largest projects, just three were implemented by investors from other CIS countries. That said, in the case of Azerbaijan, at issue is a joint project between Azerbaijan Railways CJSC and the State Oil Fund of Azerbaijan (SOFAZ), which represents a distinct type of FDI — a concessional 25-year loan to the subsidiary joint venture. In the case of Kazakhstan, development investors instead of traditional TNCs have been detected. However Russia's leading TNCs are the primary investors in all largest mutual FDI projects in the post-Soviet space.

Not a single investor from other CIS countries compares with Russian transnational corporations, particularly those operating in the oil-and-gas and telecommunications industries. Our research confirms the conclusions of foreign experts as to the immaturity of TNCs in CIS countries other than Russia. Nevertheless, a number of companies boast sector-specific production assets in several regional countries at once — first and foremost, Minsk Tractor Factory (assembly facilities in Russia, Azerbaijan, Kyrgyzstan and Ukraine and under license in Kazakhstan), Kazakh BTA Bank (Russia, Armenia, Belarus, Georgia, Ukraine), as well as Kazkommertsbank and Halyk Bank (People's Bank of Kazakhstan). At the same time, Kazakh subsidiary banks moved quickly to focus their core business on lending to companies implementing development projects in Russia. This formed the crux of the financial difficulties that pushed BTA Bank to the brink of bankruptcy in 2008 and forced the Government of Kazakhstan to announce its nationalization. Thus, bank plans and the construction companies that acted in concert therewith were unable to withstand the test posed by the crisis. The dramatic investment expansion of Kazakh business witnessed in the mid-2000s is unlikely to be repeated in the near future, particularly since the Kazakh authorities have dramatically tightened control over the banking sector.

Investor country	Total number of projects	No. of projects with direct investments of USD 100 mln or more	No. of projects with direct investments of less than USD 3 mln	Total volume of direct investments, USD bln
Total of 12 countries	526 (2 - two countries)	96 (1 - two countries)	185	55.97
Russia	391	76	127	47.94
Kazakhstan	42	13	3	4.86
Azerbaijan	9	2	0	1.38
Ukraine	23	5	6	1.15
Georgia	8	1	2	0.41
Belarus	41	0	36	0.18
Other	14	0	11	0.05

As concerns general data about the sectorial structure of FDIs, it largely is determined by the parameters of Russian FDIs. Interestingly, some of the sectors that prove significant for Russian TNCs play no role whatsoever in other regional countries, even when reasonably well developed in the respective markets (production of crude oil and natural gas, electric power). Also modest are investments in branches such as steel and non-ferrous metal industries. Conversely, almost 21% of all regional mutual investments in banking have been implemented by non-Russian banks, which likely points to the vulnerable competitive position of Russian banks compared to Russia's industrial TNCs. The same thing could be said of the hotel business, which continues to struggle in its attempts to meet modern operating standards in Russia. With just one major project implemented each, it would be inexpedient to compare data for the rail transport and chemical production industries.

Among the more than fifty abandoned projects included in our database, a few main groups can be identified:

- failed projects originally launched as trial balloons for foreign expansion

(for example, branches of private Russian institutions of higher education);

- assets sold during the course of business restructuring in the respective country (in particular, major shareholdings in Ukrainian electric power companies held by Russian K. Grigorishin);
- winding-down of what had initially been planned as long-term operations in the respective country due to serious economic and/or political considerations (for example, MTS in Turkmenistan or Wimm-Bill-Dann in Uzbekistan);
- company sell-off due to the financial problems (bankruptcy) of the investing parent firm (for example, the conglomerate of Kazakh businessman M. Abyazov, Ukrainian alcohol producer Soyuz-Viktan, Russian scrap-metal processor MAIR).

Also worth mentioning are Russian companies purchased by investors from third countries (mainly from the EU) for the purposes of being used as springboards for further expansion in the CIS region.

CONCLUSION

Investor companies from post-Soviet countries represent, in many respects, a special kind of TNCs. Despite the fact that they share certain common features with the majority of other TNCs, these companies exhibit a whole range of particularities predicated on low language, cultural and a number of other noneconomic barriers to investment expansion within the CIS, as well as the unique entrepreneurial environment of former Soviet republics still in the process of transitioning to a market economy. Additionally, TNCs forming in Russia, Kazakhstan and Ukraine share common traits with the TNCs of developing countries.

In essence, analysis of investor companies from the CIS countries and Georgia, supported by a qualitative, empirical and statistical base, allows for an expansion of the current theoretical understanding of TNCs. It should come as no surprise that each significant "geographical" expansion of the empirical base prompted new theoretical developments in the field of direct investments.

The creation of a relatively accurate snapshot of regional cross-border investment ties, made possible by our monitoring, means gains not only for consumers involved in public administration and those within the research community, but for business representatives as well. Companies with active operations in CIS countries have a vested interest in receiving the appropriate consulting services, which leading Western agencies, by virtue of FDI nuances in the post-Soviet region, cannot provide. At the same time, simultaneously combining a qualitative information product (database) with a well-substantiated general analysis is capable of setting a "bar" of sorts for leading Western competitors in a position to mobilize significant resources for more competent work in the post-Soviet space. To a certain extent, such a phenomenon is already occurring in the research field — abstract theorizing in the absence of hard facts about Russian companies is gradually becoming a thing of the past. It is being replaced by productive cooperation between qualified American and European experts and leading specialists in Russia; that said, the level of research on Russian TNCs is simultaneously increasing at home and abroad.

Type of activity	Russian direct investments, USD bln	Direct investments of other CIS countries and Georgia, USD bln	Total direct investments, USD bln
Telecommunications	10.79	0.01	10.89
Production of crude oil and natural gas	6.19	-	6.19
Gas shipment and sales	5.62	0.34	5.96
Production of cast iron, ferro-alloys, steel and rolled metal, as well as coke	4.15	0.12	4.27
Banking	3.29	0.87	4.16
Electric power	3.17	-	3.17
Mining of non-ferrous metal ores, including gold mining	2.54	0.05	2.59
Production and enrichment of uranium and thorium ores	2.34	-	2.34
Oil refining	1.65	-	1.65
GF chains	1.49	0.16	1.65
Coal mining	1.00	0.40	1.40
Rail transportation	0.28	1.10	1.38
Hotel business	0.60	0.76	1.36
Chemical production, incl. production of polymer pipe	0.62	0.28	0.90
Gas refining and sales	0.89	-	0.89
Retail commerce	0.82	0.06	0.88