8 Shifts in Sector Structure of Mutual Direct Investments of the CIS Countries

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The paper presents new results of the joint project "Monitoring of mutual investments in the CIS"[1], implemented by the Institute of World Economy and International Relations (IMEMO) of the Russian Academy of Sciences and the Centre for Integration Studies of EDB. It shows the sectoral structure of foreign direct investments made by various post-Soviet countries in the CIS region. It explains the methodology of the analysis of structural changes in the investment stock.

In late 2011, the Institute of World Economy and International Relations of the Russian Academy of Sciences and the Centre for Integration Studies of EDB launched a multi-year joint programme of study of foreign direct investment (FDI) in the CIS countries. Using this programme, it is planned to significantly expand the empirical basis for the analysis of corporate integration in the Post-Soviet space, as well as to obtain new scientific conclusions about the processes of trans-nationalisation of business and to develop recommendations for further

[1] *http://www.eabr.org/e/research/centreCIS/projectsandreportsCIS/invest_monitoring/*

development of the Eurasian regional integration. In autumn 2012, the results of the pilot project of IMEMO and EDB were presented, which reflected the main trends of mutual direct investments of the CIS countries and Georgia (Kuznetsov, 2012).

At the same time, areas for further productive development of monitoring of cross-border investments in the CIS were identified. In particular, identifying within the framework of the pilot project the approximate extent of the mutual FDI stocks in individual countries and sectors of the economy, it was decided to study in detail the sectoral shifts in the structure of these investments, occurring in the context of the global crisis. This paper focuses on the methodology and the results of relevant studies in the second half of 2012. At the same time, in May 2013 a regular update of information on transactions was performed, which affected not only the information at the end of 2012, but a portion of previously collected information. The first section of the paper addresses the issues associated with the analysis of the sectoral structure of mutual FDI in the CIS, the second section examines the differences in FDI dynamics in different sectors, and the third shows the specifics of Azerbaijan, Ukraine and Kazakhstan.

SECTORAL ANALYSIS OF DIRECT INVESTMENT OF THE CIS COMPANIES

Adequate information on the sectoral structure of FDI for the analysis of corporate integration in the CIS is important for two reasons. First, due to varying capital intensity of different sectors, the importance of the projects is provided by uneven FDI stocks. Thus, accumulated investments in major foreign subsidiaries of a number of oil and gas and telecommunications companies in the region exceeded $1 billion. In the same period, for example, all Ukrainian sewing factories of "Gloria Jeans" corporation – the leader of light industry in Russia – received about $50 million in total.

Second, the impact of cross-border investment in the development of regional integration or modernisation of the economy receiving FDI varies greatly depending on the industry. In particular, for the CIS region it is shown in a number of industry researches of EDB (Kuvalin et al, 2012; Absametova et al, 2012).

Choice of any official industrial classification to analyze the data that we collected during the monitoring of mutual investments in the CIS countries and Georgia does not seem to be the best solution. Thus, only at first glance, the current All-Russian Classifier of Types of Economic Activity (OKVED), although it repeats with minor variations the International Standard Industrial Classification, allows for an unambiguous and understandable to all specialists breakdown of investment projects by sectors and industries. On the one hand, the names of some types (subtypes) of economic activity are quite lengthy, and the degree of fragmentation in different sectors varies. Moreover, given

the sectoral structure of the CIS countries, the structure of OKVED proves to be not very convenient for specific calculations in the CIS mutual investments monitoring database. On the other hand, due to the diversification of business of many multinational corporations, their representatives have the ability to specify a large number of codes by OKVED, while the majority of investment projects are still known to experts by their main specialisation. Rejection of specific terms of OKVED in this case frequently relieves growing irritation of companies.

No coincidence that many reputable business studies use their own sectoral classifications. The examples may include the lists of leading Russian companies (Expert-400, 2012), international rankings of leading multinational corporations in developing and post-socialist countries (Sauvant, ed., 2011) and others. After analysing the structure of our CIS mutual investments monitoring database, as well as the specifics of calculations for the analysis of the dynamics and structure of FDI, we came to the idea to create our own model of two-tier classification of industries. In general, it relies on OKVED, which allows to quickly jump directly to the official classification. However, to obtain generalised data, we use our own list, which will be supplemented as the database is maintained. So far it includes 15 large cross-industry complexes or groups of industries, called sectors, while the second tier is formed by 74 industries (see Table 8.1).

Table 8.1.

List of sectors and industries used in the CIS mutual investments monitoring database

Sectors	Industries
Agricultural and food complex	Crop growing, including elevator facilities Processing of crop products Production of bakery and confectionery products Fish industry Livestock and meat processing Dairy production Production of juices and mineral water Brewing industry Production of alcoholic beverages Cigarette production
Fuel complex	Crude oil and natural gas production Oil refining Gas processing Transportation and sale of gas Coal mining
Steel complex	Iron ore mining Coke production Production of pig iron, steel and rolled products Production of iron and steel pipes Manufacture of fabricated metal products Collection and recycling of scrap metal
Non-ferrous metal complex	Mining non-ferrous metal ores Gold mining and processing Uranium ore mining and processing Production of non-ferrous metals

Sectors	Industries
Machine-building complex	Manufacture of agricultural machinery Production of cars and trucks Production of vehicles, other than cars Production of machinery and equipment Production of electrical and electronics devices Arms production
Chemical complex	Basic chemicals (production of sulfuric acid, chlorine, etc.) Petrochemicals, basic organic synthesis chemistry Manufacture of plastic products, including plastic pipes Production of mineral fertilizers Perfume and cosmetic manufacture Paint and coating industry Pharmaceutical production and biotechnology
Other manufacturing industries	Pulp and paper production Manufacture of wood and of wood products Manufacture of furniture Textile and garment production Fur production
Utilities	Electric power industry Gas networks and housing and public utilities
Construction complex	Production of cement and concrete products Production of refractories Glass production Production of insulation and roofing materials Production of other construction materials Construction and real estate development
Transport complex	Air transport Rail transport Ports and maritime transport Warehousing and logistics Mainline pipelines
Communications and information technology	Telecommunications (telephone and Internet) Software development and system integration Media and advertising
Wholesale and retail trade	Chain stores Petrol stations Distribution networks Raw materials and semi-finished goods wholesale trade (oil, electricity, fertilizers, steel products, etc.) Finished goods wholesale trade (cars, electronic components, cosmetics, medicines, etc.)
Finance sector	Banking Insurance Real estate (excluding construction) Other financial services (private equity funds, brokerage, etc.)
Tourist complex	Accomodation industry Catering industry Tour operators and travel agencies
Other service industries	Education Repair Gambling industry

Given the fact that our database includes more than 1000 projects, there is an average of 14 projects for each industry. However, there is a great disparity between sectors and industries in the number of completed projects. The following is an analysis of the proportion of projects that received FDI by different industries. With that, we must consider a significant diversification of business of many of the leading investors. One of the most striking illustrations is the Russian group VS Energy, ranking 10th among the leaders in mutual investments in the CIS, which has invested several hundred million dollars in steel complex, tourist complex and utilities (electric power industry). More examples are associated with diversification along the value chains. For example, LUKoil has made substantial investments both in oil refining industry of various CIS countries (crude oil and natural gas), and in companies of chemical complex (petrochemicals, basic organic synthesis chemistry), as well as in wholesale and retail trade (petrol stations).

DYNAMICS OF MUTUAL INVESTMENTS IN THE CIS IN 2009-2012, BY INDUSTRIES

In the overseas expansion of Russian transnational corporations that dominate among the investors in the CIS, three stages are distinct – slow process of internationalisation in the 1990s, export boom of FDI in the 2000s (before the

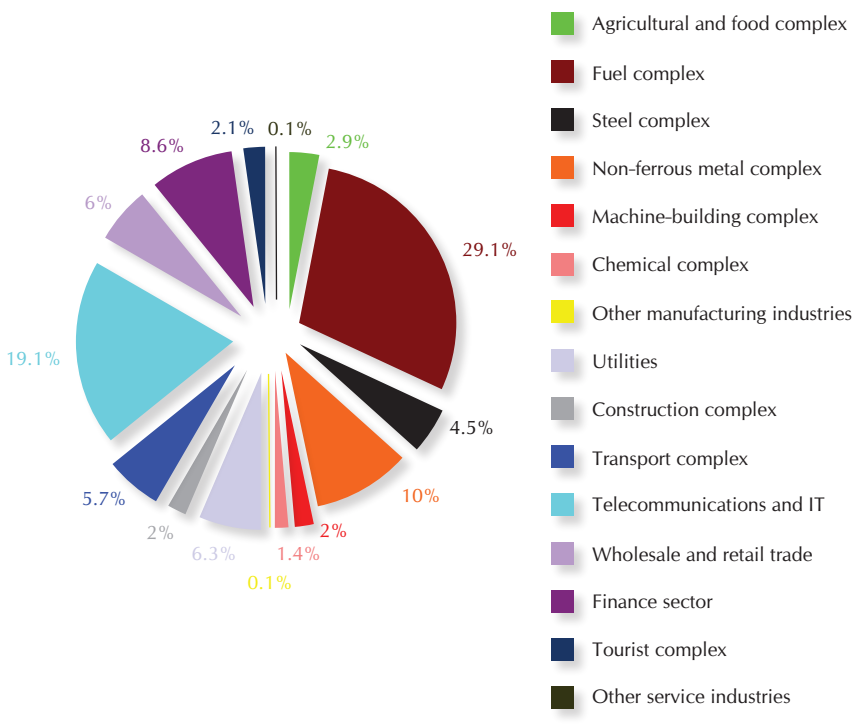


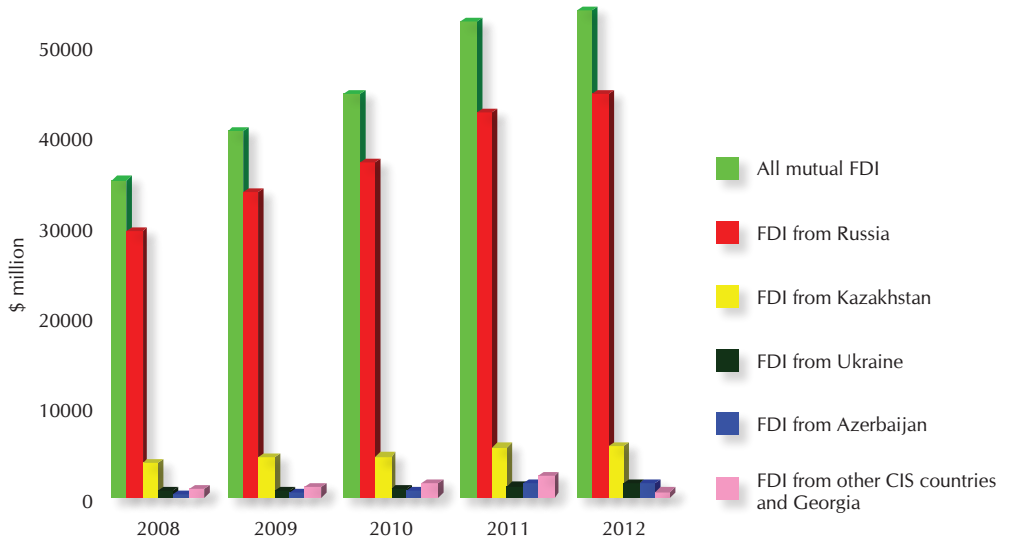
Figure 8.1.
Mutual FDI stock structure of the CIS countries and Georgia at the end of 2008 by industries

impact of the global crisis) and, finally, transformation of foreign activity after 2008 (Kuznetsov, 2011; Vinokurov and Libman, 2012). Similar dynamics are demonstrated by investor companies from other countries of the CIS.

Since transformation of FDI in the context of the global crisis is inevitably associated with structural shifts, of particular interest is the change of the role of various economy sectors in the accumulated amount of mutual investments in the CIS. At the end of 2008, the fuel complex accounted for 29.1% of this amount, and communication and information technologies for 19.1% (see Figure 8.1). Shares of non-ferrous metal complex (10%) and finance sector (8.6%) were roughly comparable. Utilities, wholesale and retail trade, transport sector and steel complex also stood out.

Despite the outbreak of the global economic crisis, which struck many post-Soviet companies, in 2009-2012 there was gradual build-up of mutual FDI. Their stock increased by 53.5% over four years (see Figure 8.2). This indicates a certain stability of corporate integration processes in the CIS against external shocks. Moreover, the involvement in corporate integration of business representatives from different countries of the CIS accelerated. At the absolute increase in FDI stocks of all leading investor countries, the share of Russian outward FDI declined from 84% at the end of 2008 to 82.6% at the end of 2012. Kazakhstan's share also declined (by 0.4%), but the share of Azerbaijan and Ukraine significantly increased, which in this case were almost equal in terms of the value.

Figure 8.2.
Dynamics of mutual FDI of the CIS countries and Georgia in 2009-2012



Among individual sectors by the end of 2012 the largest increase in the share (by 0.8%) was demonstrated by construction complex, with utilities sector slightly behind it. The share of agri-industrial and tourist complex has become more noticeable. In contrast, the share of telecommunications and IT declined very significantly (by 2.5%). This is partly explained by the specifics of investment in telecommunications (substantial investments are made to hold captured market position), as well as complexities of adequate assessment of FDI stocks. Long-term (non-current) assets remain to be an important indirect indicator, as in other industries. However, in case of telecom companies their amount as reflected in their financial statements is two to three times lower than the accumulated investment in infrastructure claimed by investors. With that, in general, the sectoral structure of mutual FDI has undergone no radical changes (see Figure 8.3).

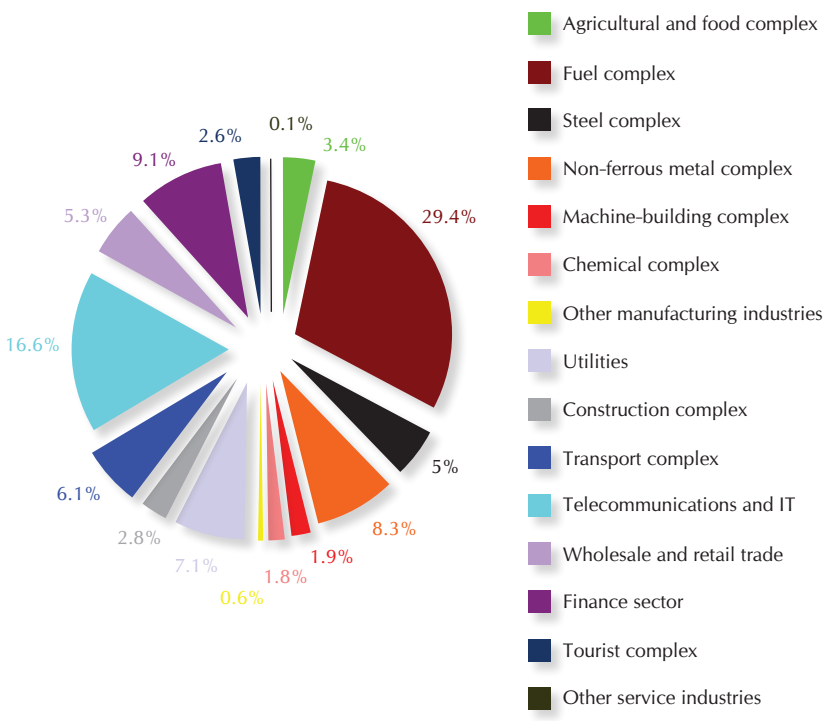


Figure 8.3.
Mutual FDI stock structure of the CIS countries and Georgia at the end of 2012 by industries

It should be noted that significant changes in the structure of mutual investments are still provided by individual projects of large companies. Thus, in eight of them, the increase in four years exceeded $0.5 billion (see Table 8.2). Russia's leading multinational corporations especially stand out.

Investor	Investment sector	Country receiving FDI	Investment object	FDI growth in 2009–2012 ($ million)	FDI stock at the end of 2012 ($ million)
Gazprom	Fuel complex	Belarus	Beltransgaz	3750	5000
VimpelCom	Telecommunications and IT	Ukraine	KyivStar and other companies	1981	3671
VEB	Steel complex	Ukraine	Industrial Union of Donbass	1000	1000
VEB	Finance sector	Ukraine	Prominvest-bank	755	755
Capital Partners*	Construction complex	Russia	Metropolis Shopping centre	700	1000
LUKoil	Fuel complex	Uzbekistan	PSA in Southwest Gissar	728	2098
Azerbaijan Railways, GNFA	Transport complex	Georgia	Karzakhi-Marabda	575	775
VimpelCom	Telecommunications and IT	Uzbekistan	KyivStar and other companies	511	861

Table 8.2.

Projects with largest FDI in 2009-2012 in the CIS mutual investments monitoring database

Note: *Kazakh investor resold the project to investors outside the CIS in early 2013

We should give one more comment on our methodology for analysing FDI dynamics. For some projects (mostly medium-sized) implemented by companies with a low degree of transparency, few publications are available, that contain only data on planned or final cost of the project. In such cases, we were considering uniform distribution of stated investments by periods when the actual increase of investments was performed (for example, active construction of a new foreign plant). If no further modernisation activities (or other forms of project development) were reported for the following period, or, conversely, material facts were disclosed that led to the impairment of previous investments, we considered the amount of FDI stock to be stable.

SPECIFICS OF INDIVIDUAL POST-SOVIET STATES

Fundamental changes in the structure of Russian FDI stock in the CIS are reflected as the most important industry shifts and in general in mutual direct investments in the region. Therefore, of the greatest interest is the comparison of changes in the structure of FDI of Kazakhstan, Azerbaijan and Ukraine made in other post-Soviet republics, which are often in the shadow of the changes associated with Russian investments.

The growth of the Azerbaijan's outward FDI stock in the CIS and Georgia of 4.3 times over the four years could not but cause a significant change in the structure of these investments. However, rather narrow international specialisation of the economy of Azerbaijan restricts the possibility for fundamental shifts. The first place (because of the development of the projects for modernisation of

railways and terminals in Georgia started in the 2006-2007) still remains with the transport sector, and its importance in the structure of the Azerbaijanian FDI has not changed. The second place is held by wholesale and retail trade (due to SOCAR, which greatly expanded the network of petrol stations in Georgia and Ukraine). Investments in the Georgian gas networks increased several times, which according to our methodology were referred to the fuel complex (and this is justified as the investor is Azerbaijan's oil giant SOCAR). The International Bank of Azerbaijan increased in 2011 the share capital of its subsidiary bank in Russia, however, the proportion of the financial sector in Azerbaijan's direct investment in the former Soviet republics declined over the four years from 9 to 3%. In 2009, Azersun Holding started to invest in Russia. Nevertheless, the share of its investment in the agricultural sector in the sectoral structure of Azeri FDI in the region slightly exceeds 1%.

During 2009-2012, the structure of Ukrainian FDI in the CIS countries and Georgia has undergone significant changes. Despite the fact that the share of Ukraine in the mutual investment in the Commonwealth changed by only 1% (from 1.9 to 2.9%), the absolute volume of Ukrainian FDI stock increased by almost 2.5 times. For a long time the leadership was held by fuel complex, and, in contrast to Russia, not because of the oil and gas industry, but due to coal mining. However, the increase of Ukrainian FDI was much more dynamic in agricultural and food complex. In 2012, this sector came in first place, first leaving behind steel comlex, which is another key sector of the international specialisation of Ukraine (now the industry is already on the 5th place, although it was on the 2nd four years). "Other manufacturing industries" sector gained the third place due to a major wood processing project in Russia. Among other industries, the financial sector can be noted (4th place), as well as wholesale and retail trade.

Although FDI of Kazakhstan accumulated in the CIS and Georgia for the four years under review increased only 1.5 times, due to divergent trends in individual sectors the sectoral structure of investments has changed significantly. The largest negative impact of the economic crisis was suffered by financial sector (due to significant drop even in absolute index the sector's share dropped by 8.7%) and the transport sector (due to the sale of warehouse and logistics facilities). However, tourism and construction complexes, also largely related to real estate market conditions, increased their share in Kazakhstan's FDI stock in the CIS countries and Georgia. In general, these four sectors by the end of 2012 accounted for almost 70% of Kazakhstan's investment in the region. With that, agricultural and food complex went to the second place. The most dynamic in the industry in 2009-2012 was demonstrated by chemical complex and non-ferrous metal complex. Some other sectors also stand out. As a result, in terms of FDI stocks and their degree of industrial diversification, Kazakhstan gives way in the CIS only to Russia.

Due to low level of FDI, other CIS countries are not of particular interest for analysis. The most striking event of the end of 2011 and beginning of 2012 was the sale of assets of Bidzina Ivanishvili in Russia in order to win the elections in Georgia. As a result, Georgian FDI in general declined sharply in the CIS countries, and, of course, their structure has changed.

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Our analysis has shown preservation of growth of mutual FDI in the CIS region, not only in general but also in the context of the majority of individual industries and countries. Continued monitoring of these investments over time will allow to significantly expand the statistical information. This will enable to assess the impact of political integration projects in the Post-Soviet space on the dynamics of corporate integration in various sectors of the economy.

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