

Trends in Investment Cooperation between CIS Countries and the Global Economic Crisis *

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Crisis impact on CIS economies

The Commonwealth of Independent States (CIS) remained the most rapidly growing region in the global economy throughout the 2000s. In 2003-2007, it was second only to Asian emerging markets in terms of annual economic growth rates. On the other hand, the region suffered worst from the fallout of the global economic and financial crisis: in 2009 real gross domestic product (GDP) in post-Soviet countries dropped by 6.6%, compared to 3.7% in Central and Eastern Europe, 1.8% in the western hemisphere, and continuing economic growth in some developing countries (IMF, 2010).

The economic dynamics varied greatly across the CIS. The worst GDP drop was recorded in Ukraine and Armenia (by 15.1% and 14.2% respectively); these countries were followed by Russia and Moldova (7.9% and 6.5% respectively) in 2009. The Belarusian and Kazakh economies were nearly stagnant. At the same time, Azerbaijan, Turkmenistan and Uzbekistan demonstrated economic growth at over 4%.

However, this general GDP performance was the product of complex interaction between very different components. The crisis has the most serious negative influence in investment demand. Investments in fixed assets in 2009 declined in six of the ten region's countries for which data is available. The largest decline in investments was observed in Ukraine (41% of the previous year's level), Armenia (37%) and Moldova (35%). In Azerbaijan and Tajikistan, investments dropped by 18% and in Russia by 16% (according to the CIS Interstate Statistics Committee).

This decline in investment in national economies was largely attributable to the decrease in foreign capital inflow. According to balance of payments

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statistics, direct investments in 2009 dropped by 51% from the 2008 level in Russia, by 20% in Kazakhstan, by 13.6% in Belarus, and by 56% in Ukraine (International Financial Statistics, November 2010). Notably, in 2009 the item *Other Investments & Payables* in the balance of payments of Russia, Kazakhstan and Ukraine became negative, which indicated not only disruption of capital inflow through this channel (which had been the principal source of foreign investments in the pre-crisis period), but also reversion of capital flows (particularly, repayment of foreign debt).

We can identify several directions of the impact of the crisis on investments and the general economic dynamics in CIS countries:

- 1) reduced opportunities to raise capital or refinance existing debt on global financial markets, which led to a decline in portfolio and other investments. This influence became evident at an early stage of the crisis and first affected the CIS' most developed and open financial systems (those of Kazakhstan, Russia and Ukraine);
- 2) decrease of foreign direct investments resulting from challenges faced by parent companies in their home countries and a lack of global demand for the products of recipient companies from the CIS - most of these are from the extractive or metallurgy sectors which were suffering from collapsing prices¹;
- 3) persisting decline in foreign investment due to internal factors (recession in national economies and a lack of domestic demand). This factor was especially critical to investment in companies oriented towards domestic markets.

The discussion of the main trends in investment cooperation between the CIS countries during the time of the crisis and a preliminary assessment of the role of the intraregional channel in delivering crisis fallout to these economies are offered below.

The hypotheses

Prior to the crisis joint investment was the most rapidly growing area of economic cooperation within the CIS. The emerging Russian transnational companies (TNCs) started a massive invasion into post-Soviet markets, and were joined by TNCs from Kazakhstan in the mid-2000s. The preconditions for this boom were the high rates of economic growth in both TNCs' home countries, which allowed the TNCs to gather momentum for entering regional markets, and recipient countries, which made them attractive targets for investment.

¹ According to the IMF, in 2009 annual average prices of oil dropped by 36.3% and prices of metals by 28.6% (IMF, 2010).

This model of regional integration could not escape the influence of the 2008-2010 crisis. Obviously, Russian and Kazakh TNCs had to revise their overseas investment strategies. It is hardly possible to identify any general direction of this transformation. To simplify the task, we offer three hypotheses of how the crisis influences investment cooperation in the CIS; we will term them investment recession; replacement growth; and interstate cooperation. Whereas our first hypothesis is based on the assumption that investment cooperation between CIS countries has declined to some degree, the other two, by contrast, forecast an upsurge or at least sustained continuation of investment activity, however, driven by different factors.

Investment recession. The most readily forthcoming assumption is that progress in investment activity has been suspended or even reversed. The crisis reduced the financial potential of Russian and Kazakh companies (particularly, their ability to raise the foreign capital necessary to support their expansion in the CIS or overseas sales), made them more cautious about selecting potential investment targets abroad, and forced them to give up many ambitious projects, while concentrating on consolidation of assets in their home countries. In this case the logical chain appears fairly simple: a decline in business activity and hostile environment causes companies to phase out their international business to the detriment of domestic business and to refrain from embarking on new projects to the detriment of on-going ones.

Replacement growth. A drawback to the investment recession hypothesis is that it effectively ignores the possible reaction of intraregional players and businesses from recipient countries to the changing global and regional situation. In recent years the most serious factor restricting Russian expansion was competition from large TNCs from highly industrialised countries. The latter also had to limit their activity, thus vacating a niche for Russian corporations. Similarly, the crisis led to a dramatic depreciation of assets located in the CIS countries and made their owners and beneficiaries more concessive. As a result, although the resources of post-Soviet TNCs formally shrank, in fact they may have even increased as external pressure eased, which in turn would have led to an increase in investments.

In other words, the 2008-2010 crisis can be viewed as the "creative destruction" process in which a new system of interrelations emerges and replaces the existing one; the intensity of economic cooperation declines in one place and increases in another. It is important to remember that, whereas the crisis did impede transnational expansion in quantitative terms, it may well be the case that TNCs sacrifice their "image" projects for the sake of transactions that pay back. And this, in a longer term, works to promote regionalisation. We cannot subject this assumption to any reliable

empirical study due to the scarcity of available data, but at least it cannot be discarded.

Interstate cooperation. The crisis has affected not only regionalisation: during its two years, some serious positive developments were observed in interstate cooperation both within the framework of formal integration initiatives and on a bilateral basis. The crisis forced states to adopt a more cooperative stance. This was dictated by the need to overcome the crisis fallout (EurAsEC Anti-Crisis Fund) and a broader integration agenda (Customs Union). Generally, an upsurge in formal cooperation in crisis time is a peculiarity of post-Soviet integration (which makes it distinct from many other integration projects) (Libman, Vinokurov, 2010). Whereas in the mid-2000s some CIS governments were becoming increasingly sceptical of foreign investment in general (e.g. in Kazakhstan) (Libman, Ushkalova, 2009) or, more particularly, Russian companies' involvement in key economic sectors (e.g. in Tajikistan) (Libman, 2009), the recession and need for investments may have reversed this sentiment.

In addition, the severe economic crisis of 2008-2009 fostered political changes in Ukraine and created preconditions for the improvement of relations with Russia in 2010 with favourable implications for business. This can be viewed as an indirect positive impact of the crisis. Since April 2010, broader Russian involvement with the Ukrainian economy was discussed at many occasions: primarily regarding access to denationalised Ukrainian assets for Russian companies, and also broader cooperation in key sectors such as nuclear power, aircraft building and ship building (Rosbalt-Ukraine, April 24, 2010; Gritsenko, 2010).

An upsurge in interstate cooperation can also influence business activity through other channels. The fact that the government is assuming a more active role in the Russian (and, to a lesser extent, Kazakh) economy is obvious, and the influence of this process on the overseas policies of Russian companies is not uniform. Many observers theorise that the government's influence on overseas transactions by Russian companies is not significant or at least does not contradict the standard decision-making logic (Vahtra, 2007); the state's presence in key sectors targeted by foreign expansion (e.g. oil & gas) is limited in principle (Hanson, 2009). However, we can assume that in crisis time at least selected large transactions are being made under government pressure (as the government's role as the main source of support is increasing), i.e. for political considerations; later we will discuss this factor in more detail.

We should stress that all these hypotheses are largely speculative. The investment recession hypothesis is based on the premise that the resources of Russian businesses have shrunk; it is not definite, however, bearing in mind sizeable government support programmes that target large corporations.

The replacement growth hypothesis essentially assumes that companies from post-Soviet states are the only group capable of seizing the vacated niche. But there are a number of other countries whose foreign trade has been affected by the crisis even less than that of Russia, and they are also keen to expand their presence in post-Soviet markets; this is particularly the case for China (SKOLKOVO, 2009).

The assessment of formal progress in formal integration is not as easy as it may seem. Firstly, we should remember the example of "integration for survival" in the 1990s, when similar factors (economic hardship) encouraged businesses to actively pretend integration without any real action (Libman, 2007). Secondly, even if we assume that the existing institutions do function (for the Customs Union that statement is fairly true, at least for now); their impact on the business is not yet clear. There are grounds for expecting the emerging system to be overly intricate and plagued by inconsistencies (at least in the medium term), which may impede cooperation. Thirdly, as has been noted on many occasions, a formal institutional environment is no advantage for Russian business: quite the opposite, it functions far more confidently under unclear and poorly formalised rules.

Now we will attempt to summarise at least some indirect evidences in support of the above hypotheses. We will focus on the first two hypotheses: interstate cooperation will be discussed only to the extent to which Russian corporations are exposed to political pressure in crisis time. Let us look at official statistics, published news, and information available from corporate websites. These sources should be treated with a degree of caution in the context of our study. Official statistics obviously understates investments in post-Soviet countries; in addition, investments vary considerably from one country to another. It is likely that official figures will include payments under transactions made in the pre-crisis period, i.e. the impact of the crisis will be reflected with a time lag. As for press releases and corporate websites, this information is likely to distort the picture in favour of replacement growth: typically, start-up of a new transaction or project receives much greater coverage than any consequent withdrawal (with the exception of very large transactions). These circumstances should be kept in mind when looking at the empirical data (largely incomplete or indirect) available to us.

Finally, we should remember that the outbreak of the crisis coincided with the next phase of quantitative transformation of Russian TNCs, i.e. their geographic reorientation. The notion that the post-Soviet space is an isolated region, the development of which is determined principally by its internal logic has little to do with reality. Informal integration has long since moved beyond the borders of the former Soviet Union, although the scale of this process varies depending on the form of business activity. Whereas

the traditional targets for Russian investment are European and post-Soviet countries (SKOLKOVO, 2008; Sethi, 2009), in recent years Russian expansion went further, to Africa and Asia (Kuznetsov, 2010). The fact that this phase coincided with the outbreak of the crisis complicates the task of verifying our hypotheses.

Investment cooperation as reflected by national statistics

First, let us look at quantitative data on investments in post-Soviet countries. To evaluate Russian investment in the region, we will use two main sources: the Federal State Statistics Service of the Russian Federation, and the balance of payments (as stated by the Central Bank of Russia). As shown in *Figure 2.1a*, in 2009 both Russian investments in CIS countries and investments by CIS countries in Russia declined significantly (according to data from the Federal State Statistics Service). The decrease

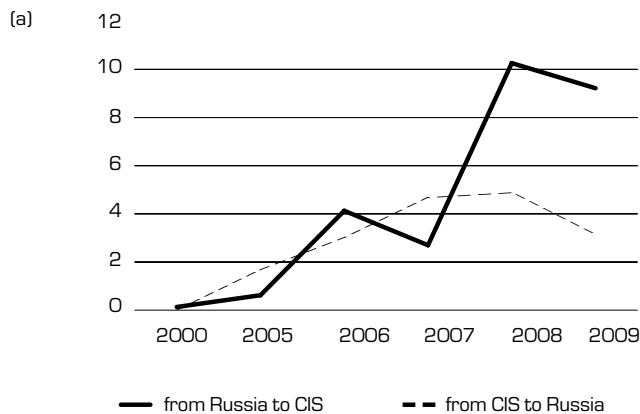
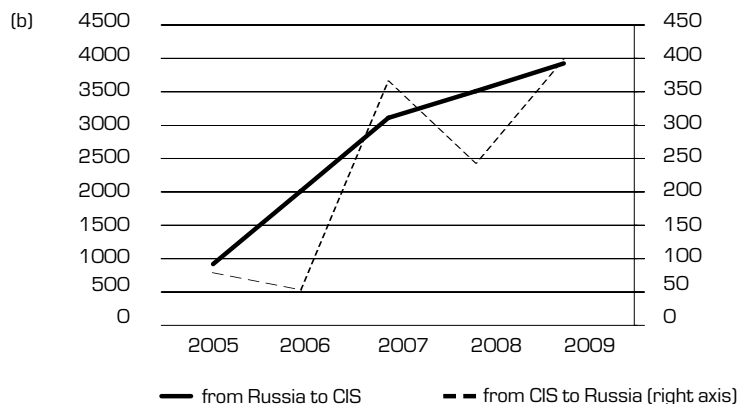


Figure 2.1.
Inflow of investments
from Russia to CIS
countries

Source: Federal State
Statistics Service
of Russia; Bank of
Russia

Note: a) \$ billion;
b) direct investments,
\$ million, Central
Bank (balance of
payments)



was about 10% for Russian investments and over 30% for investments by CIS countries. This trend was observed in all post-Soviet states except Tajikistan, Moldova and Turkmenistan (whose investments in the Russian economy increased; however, these three countries together contribute only 2% of all investment). For example, Ukraine's investments in Russia in 2009 reached only 43% of the 2008 level; the same indices for Kazakhstan and Belarus were 61% and 72%, respectively.

Whilst Russian investments in CIS countries increased significantly in 2008, investments by Ukraine and Kazakhstan in Russia declined. Interestingly, if we exclude Belarus from our analysis of 2009, we will obtain a picture of serious decline in Russian investments: 65% of the 2008 level in Ukraine and 51% in Kazakhstan. Thus, quantitative indicators of investment activity clearly speak in favour of the investment recession hypothesis, although this conclusion is better justified for CIS countries than for Russia itself. The crisis also reversed the upward trend in CIS countries' investments in Russia (Libman, 2008): Russian investments clearly prevailed in the investment balance of 2009, mainly due to a sharp increase in 2008 when other CIS countries were already exposed to the crisis. This is logical, bearing in mind the role of financial system component of the crisis in Kazakhstan and deep economic recession in Ukraine.

Russian direct investments data from the balance of payments (see Figure 2.1b) present a somewhat different picture. The 2008-2009 crisis did not suspend the growth of Russian investments in post-Soviet economies, but caused it to slow. Investments from CIS countries did indeed drop in 2008, but then continued to increase. The situation with portfolio investments was not as good (Golovnin, Ushkalova, Yakusheva, 2010). The assets of Russian investors in the CIS shrank from \$113 million to \$24 million in 2008, but in 2009 increased to \$71 million, thus exceeding the 2006 level, yet falling short of the 2007 level. Payables dropped from \$192 million in 2007 to \$152 million in 2008, and the year 2009 saw net withdrawal of CIS countries' portfolio investments from Russia, with a slight improvement in the first quarter of 2010 (however, the pre-crisis level was much higher).

An analysis of CIS national statistics allows us to look at the situation from a different perspective.

According to the National Statistics Committee of Kyrgyzstan (see Figure 2.2a), investments from other CIS countries to this country in 2009 were 10% down, whilst Russian investments increased significantly (by contrast, Russian statistics indicate a significant decrease). Kazakhstan's standing in the Kyrgyz economy deteriorated: whereas in 2007-2008 it nearly achieved the status of the largest foreign investor, in 2009 its investments in the country shrank dramatically. Notably, the overall investment inflow into Kyrgyzstan continued to grow, but the level of Chinese

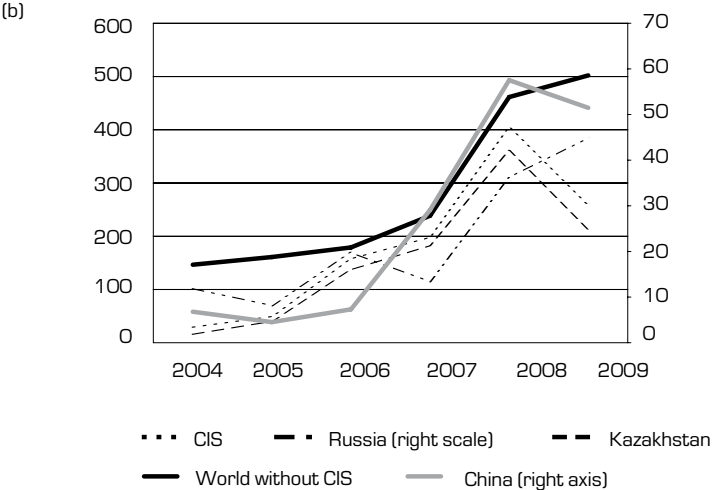
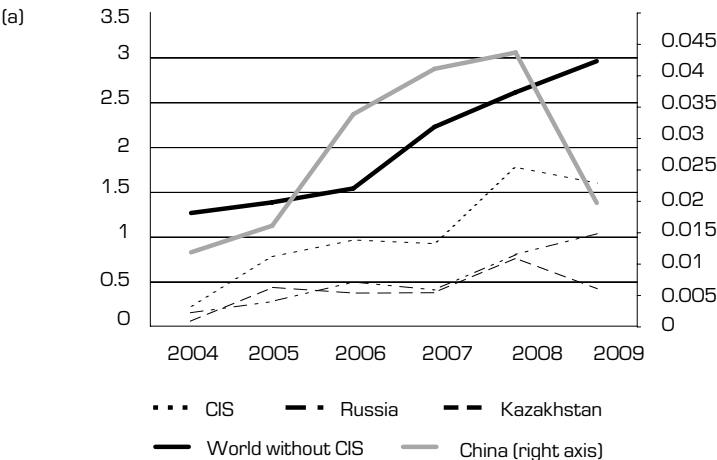
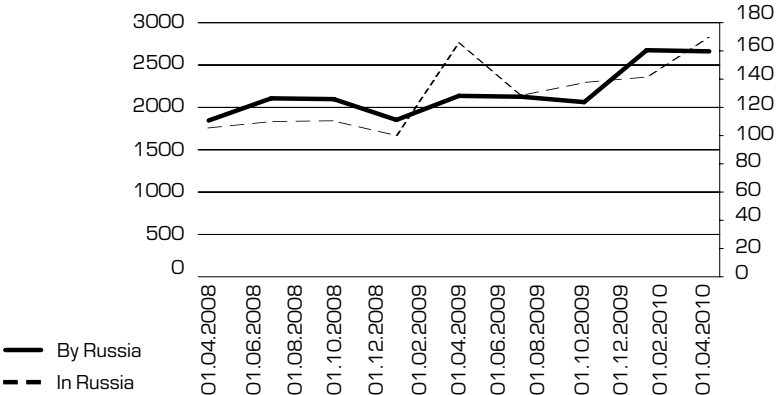


Figure 2.2.
Inflow of investments
and direct
investments in
Kyrgyzstan
Source: National
Statistics Committee
of Kyrgyzstan
Note: a) \$ billion,
b) \$ million

Figure 2.3.
Accumulated direct
investments by
Ukraine in Russia and
by Russia in Ukraine
Source: State
Statistics Committee
of Ukraine
Note: right scale
(Accumulated direct
investments by
Ukraine in Russia,
\$ million)



capital decreased, i.e. there were no signs of "seizing the niche". Direct investments showed comparable dynamics (see Figure 2.2b): investments from CIS countries dropped by 35%, and investments from Kazakhstan (the main source of foreign investments) dropped by more than 40%; the decrease in Chinese investments was not as big, and Russian investments increased slightly.

According to Ukrainian statistics (see Figure 2.3), slow but sustained growth in accumulated investments by Russia in Ukraine and by Ukraine in Russia was observed in 2008-2010, except several short periods of decline. The assessment of this data is complicated by the fact that the main investor in Ukraine is Cyprus, which, in the opinion of some experts, masks the inflow of Russian capital, especially into the financial sector (Obozrevatel, June 12, 2010).

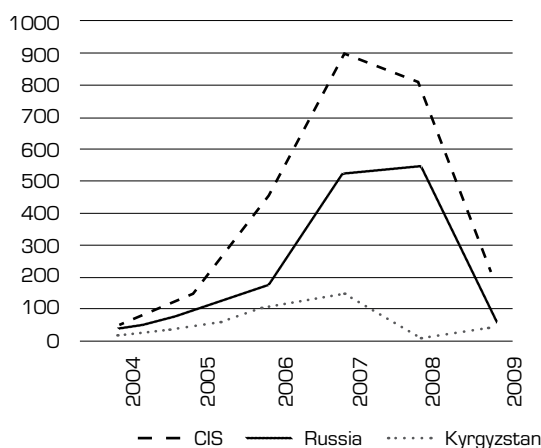
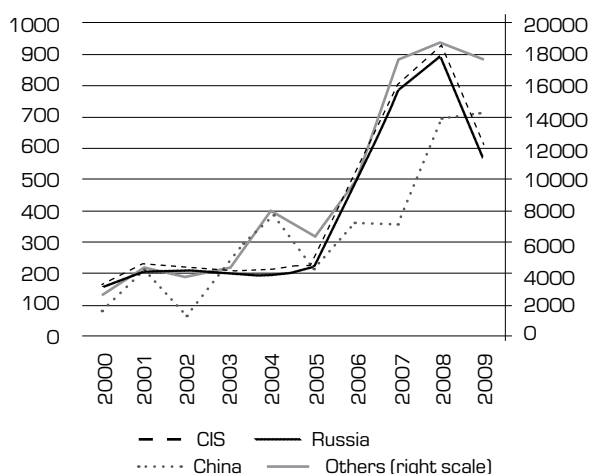


Figure 2.4.
Investment inflow and outflow in/out from Kazakhstan (\$ million)
Source: National Bank of Kazakhstan

Kazakhstan's statistics are most supportive of the negative expectations of investment recession. Investments by CIS countries in the Kazakh economy dropped sharply, which is attributable mainly to Russian withdrawal. In 2009, Kazakh investments in CIS countries dropped eight times, and investments in Russia nearly ten times (however, investments in Kyrgyzstan grew slightly, but this trend was unsustainable² and turned into withdrawal in the first quarter of 2010). Total investments in

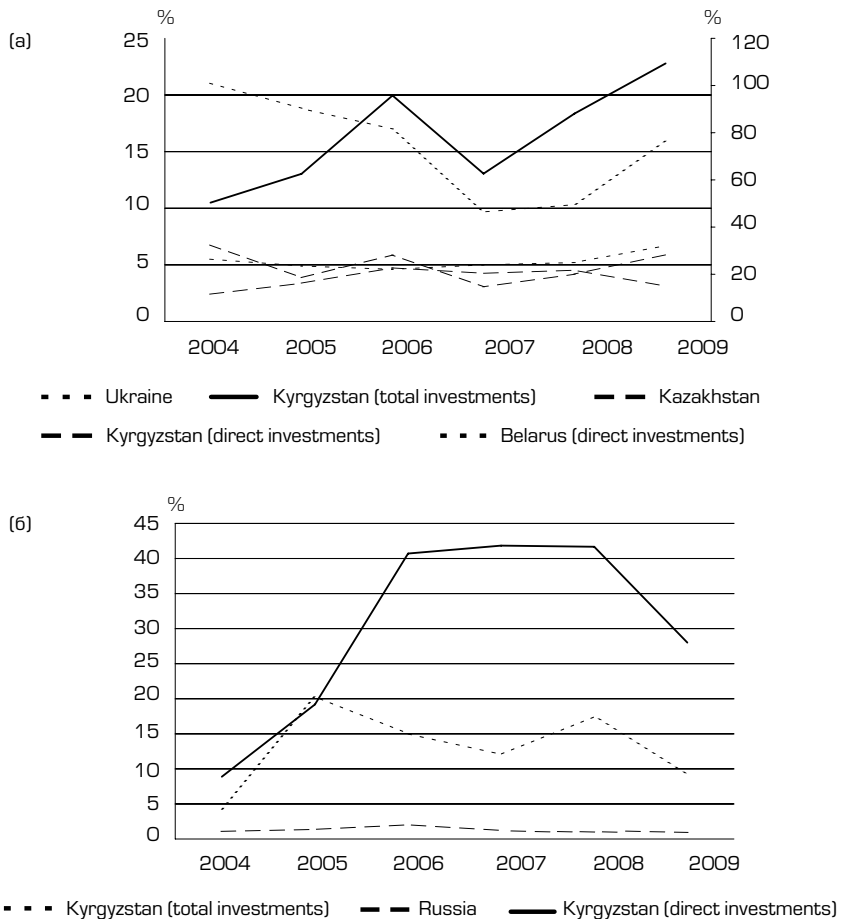


Figure 2.5.
The share of Russian
(a) and Kazakh (b)
investments in total
investments in CIS
countries
Sources: see Figures
2.1–2.4; for Belarus
– the National Bank
of Belarus

Notes: For Ukraine – share in accumulated direct investments as at January 1, of the following year; for Belarus – data on direct investments; the share is calculated as ratio of the *Payables (Direct Investments)* item of the financial account of the balance of payments in respect of Russia to the credit of the *Investments in Domestic Economy (Direct Investments)* item of the financial account of the balance of payments. For Russia – data from the Federal State Statistics Service. Data for Belarus is shown in the right scale

² This contradicts Kyrgyz statistics.

Kazakhstan from other world countries also declined in 2009 compared to 2008, but investments from China slightly increased.

In the case of Belarus, we can use data from the balance of payments in respect of Russia that reflects the inflow of direct investments into the country. However, this source contains no indications of decline during the crisis, showing gradual growth from \$828.6 million in 2007 to \$1.0688 billion in 2008 and \$1.4201 billion in 2009. This effect may be attributable to Gazprom's regular payments for the purchase of Beltransgaz (Heifetz, 2009; Yermeeva, 2009).

In Figure 2.5a we summarise our analysis of the Russian share in total investments in CIS countries. This share increased in three of the four countries under review (Belarus, Kyrgyzstan and Ukraine), and slightly decreased in Kazakhstan. Data on Kazakhstan's overseas investments (see Figure 2.5b) are available only for Kyrgyzstan and Russia: in both countries Kazakhstan's share in total investments shrank in 2009. In other words, Russia's scenario fits the replacement growth hypothesis, whilst pure investment recession is being observed in Kazakhstan.

Summing up these quantitative assessments, we should note that the 2008-2009 statistics differ significantly in individual CIS countries and may lead to contradicting conclusions. However, we can say safely that the crisis has resulted in dramatic decrease of Kazakhstan's investments in post-Soviet countries (especially in Russia; the situation with Kyrgyz assets is somewhat more difficult to assess). Russia's situation was not as plain: although it had a period of decline in 2009, this decline was less dramatic than in other CIS countries (according to Ukrainian statistics, there were no setbacks at all). On the whole, quantitative data cannot decisively justify the investment recession hypothesis in the case of Russia. Its standing should not be overestimated, since the results of the assessment were strongly influenced by investments in Belarus. However, the Russian share in total investments did increase, which flatly correlates with the replacement growth hypothesis. Finally, the behaviour of external players was also not uniform: China was actively expanding its presence in Kazakhstan but withdrawing from Kyrgyzstan.

Another drawback of quantitative analysis is the fact that the crisis has forced businesses to actively employ various non-transparent investment schemes in order to optimise accounts. Of course, under increasing pressure from fiscal authorities (which were concerned about dramatic decline in tax revenue in crisis time) business practices may have ultimately reverted to type, but it is very likely that what we observed in 2009 was not a decline in investments but transfer of a large number of transactions to the informal sector or a boom in offshore schemes (which in any case dominate the mutual investments structure in the CIS). Therefore we

deem it necessary to look into individual transactions and companies in post-Soviet states in the crisis period.

Key transactions: general trends

The picture resulting from an analysis of individual transactions is somewhat different from that painted by the statistics. In this section we concentrate on Russian investment projects. There is practically no news of any recent investment initiatives from Kazakhstan, and not surprisingly: the country's strong financial sector which had been the main engine of its expansion in CIS markets fell as the first victim of the global crisis. In essence, Kazakhstan was the only CIS economy that fully suffered the first tide of the crisis in 2007-2008 (Golovnin, Ushkalova, Yakusheva, 2010:5).

To date there are several assessments of Russian TNCs' response to the crisis from the perspective of expansion beyond the CIS (Kuznetsov, 2009; Vahtra, 2009; SKOLKOVO, 2009). During the first half of 2008 Russian overseas investment activity continued in direct contradiction to the global downward trend. Moreover, according to some sources (Kuznetsov, Chetverikova, 2009), leading TNCs started to reduce staff in Russia in the pre-crisis period whilst hiring more personnel for their overseas subsidiaries. Their standing deteriorated in the second half of 2008, i.e. when the second wave of the crisis reached CIS countries. Many transactions were cancelled or postponed for the indefinite future. Notably, it was the most active players in the past years' expansion who had to revise their strategies. However, it would be incorrect to speak about a standstill, as overseas assets of Russian companies grew continuously in the face of the crisis.

As for situation in the CIS region, at an early stage of the crisis some Russian companies were forced to abandon their projects³, particularly, in construction (PIK, Inteco, Mirax Group) in Ukraine. Thus, in October 2008, Inteco froze its project to construct the Moskovskiy residential district in Kyiv. Mirax Group sold its unfinished Mirax Plaza Ukraine skyscraper in Kyiv to AEON (Pappe, 2009) – the latter is also Russian-controlled. The situation in Russia's building industry was extremely adverse even against the backdrop of the overall economic recession; incidentally, this industry was hit by the crisis at an early stage. In 2009, Russian construction companies made a number of large transactions in Ukraine: Promyshlenniy Kontsern acquired 99.99% in Planeta-Bud (which had suffered a 57.8% loss of profit)⁴ in Crimea. As

³ According to some estimates, this trend was attributable to emerging opportunities to buy attractive assets in Russia and therefore was temporary (*investory.com.ua*, March 23, 2009).

⁴ It is not clear whether this was a new transaction or redistribution of control: previously 95% of shares was held by Vilmorin Holdings of Cyprus; Promyshlenniy Kontsern declined to comment on its affiliation to this company on account of commercial confidentiality (*Interfax-Ukraine*, July 29, 2009).

commented by Y. Tsukanov, Director of Link Development, "the building industry is in a miserable condition like no other: demand and prices collapsed together with credit, and prices for building materials hold so far. That is why construction assets are the first to be sold at "crisis" prices. So far, only Russians show interest in these acquisitions: they are ready for our [i.e. Ukrainian] risks" (Kommersant-Ukraine, September 22, 2009).

Setbacks were also observed in other sectors: for example, LUKoil cut investment in its petrol stations network in Ukraine (Blyakha, 2009). LUKoil's forthcoming investment in the Khvalynskoye oilfield and other oil & gas projects in Kazakhstan also came into question (Paramonov, Strokov, Stolpovsky, 2009).

In some instances the crisis produced complex effects. In October 2008, EuroChem acquired the government's block of shares in Sary-Tas (50.7%), establishing EuroChem-Udobreniya LLP to this end, and paid up the company's debt for fifteen years of standstill. Investment in this project is expected to total \$2.5 billion by 2015. The facility, which has remained idle for many years, will be used as a basis for a new industrial complex comprising a mining and ore dressing works and three plants producing phosphate (1 million tons a year), nitrate (0.8 million tons) and combined (0.5 million tons) fertiliser. The company intends to finance this project exclusively from its own funds. Possibly, this sizeable initiative by EuroChem was inspired principally by the favourable situation on the global mineral fertiliser markets in the pre-crisis period (which enabled the company to accumulate enough liquidity to support its investment programme even after the outbreak of the crisis) and lower cost of electricity and labour in Kazakhstan (RBC Daily, October 10, 2008).

But EuroChem's other projects in Kazakhstan were delayed due to the crisis. In February 2009, the company asked the Kazakh government to refrain from putting out to tender the Araltobe and Kestiktobe phosphate deposits (in which the company showed interest in 2008), so as to allow it to return to this matter later, when the situation on the phosphate fertiliser and capital markets improves (Ekspert, March 4, 2009; Novyye khimicheskiye tekhnologii, March 4, 2009). EuroChem finally secured mining rights in respect of these two deposits plus Gimmelfarbskoye in June 2010. However, according to V. Torin, Head of PR & Communications at EuroChem, this delay was due not only to the crisis but also bureaucratic procedures: "the project is fairly big, and unnecessary rush may play a negative role. Support from authorities at all levels and prompt decision-making will be critical to implementation." (Kursiv, July 1, 2010). It is not really possible to say to what extent the delay was attributable to the crisis or political and bureaucratic reasons. From the very beginning, the Sary-Tas project was positioned as CIS-oriented, and the three abovementioned deposits are

intended to support sales in Kazakhstan or, if domestic demand is not sufficient, elsewhere.

Later in 2008-2010 Russian companies implemented a number of large projects in the CIS (this list is less impressive than several years ago; in many cases these were the completion of projects from previous years rather than new ones). In June 2009, Polymetal acquired 100% in the Varvarinskoye gold and copper deposit in Kazakhstan (Three K Exploration and Mining Ltd) from Orsu Metals of Canada (vesti.kz, June 17, 2009). As the company announced, this transaction reached up to \$20 million. TNC-BP purchased two oil bases and 36 petrol stations in Kyiv Oblast and the city of Kyiv from Gepard Group, and now intends to further expand this petrol stations network in Ukraine (covering Dnepropetrovsk and Donetsk). Vimpelcom acquired 7% of shares in the cellular operator Unitel in Uzbekistan, thus securing 100% control over the company (Starostenkova, 2010). Just prior to the crisis, in June 2008, TMK Group was joined by KMK-Kazakhstan, manufacturer of compressor pipes and casing tubing for the oil & gas industry. In autumn of 2008, the construction company Promstroï Group completed acquisition of Kazmekhanomontazh and Avtomatika of Kazakhstan (this evidences the stability of investment activity of small TNCs in crisis time, see Kuznetsov, 2009).

Despite the crisis, Russian investors were expanding their presence in Ukraine's metallurgy. In September 2008 EVRAZ completed the acquisition of Palmrose Ltd (Sukhaya Balka and Petrovsky Dnepropetrovsk Metal Works; shares in Bagleikoks, Dneprokoks and Dneprodzerzhinsk Charred Coal & Chemical Plant) from Privat group that was initiated in April 2008. The total cost of this transaction exceeded \$2 billion. In December 2009 a group of Russian investors affiliated with shareholders of Metalloinvest and EVRAZ purchased the controlling block of shares in Industrialny Soyuz Donbassa (ISD). This transaction also exemplifies the complex effects of the crisis: according to available information, in 2008 EVRAZ and ISD were about to complete the transaction, but the progress halted as the crisis started to manifest itself. However, in a year the Russian investors managed to form a large pool (the total transaction amount was \$2-2.5 billion, and was financed by Vneshekonombank). In other words, investment recession did take place, but it resulted in temporary suspension of investments rather than repudiation of the project. It is also presumed that the asset was sold at a material discount (due to its indebtedness), which can also be viewed as evidence of replacement growth (Kommersant, January 11, 2010; Bankir, January 17, 2010).

Another transaction that has been negotiated since 2008 and continued into the crisis period is the acquisition of KazakhGold of Kazakhstan by Polyus Gold. This transaction deserves closer attention due to its importance.

KazakhGold Group owns Kazakhaltyn, a major Kazakh gold producer, which operates three largest gold mines. The company's principal shareholder was the Asaubayev family. Since 2005, KazakhGold's shares have been traded on the London Stock Exchange (LSE). In November 2008, the Kazakh Ministry of Energy and Mineral Resources permitted Polyus Gold to buy 50.1% of shares in the company (under Kazakh law, the state has the pre-emptive right in such cases); and in September 2008 the company's value was estimated at \$746 million (BFM.ru, November 17, 2008). In June 2009, the transaction was officially closed and announced on the LSE: Polyus Gold acted as guarantor under KazakhGold's \$200-million bond issuance with maturity in 2013, and also provided KazakhGold with two loans for a total of \$100 million. In June 2010, Polyus Gold announced a reverse takeover that would enable it to register in a foreign jurisdiction and access the LSE (finam.ru, June 30, 2010).

But in 2010 it became clear that KazakhGold's financial statements published by its former owners were materially misleading: its asset value was overstated by 14% and profit by 40%, and net loss was understated by 163% (Kursiv, March 26, 2010; MAonline, July 1, 2010). The Russian party filed a claim with the High Court in London demanding the former owners pay \$450 million in damages. In July 2010, the Kazakh government declared that the transaction would be revised on account that Polyus Gold had allegedly paid much less for KazakhGold than the initial assessment of \$269 million. The permit for selling KazakhGold shares to Polyus Gold was cancelled, and the Kazakh Ministry of Industry and New Technology forbade Kazakhgold to issue additional shares to Polyus Gold. In conjunction with that, a media campaign against the Russian company was staged in Kazakhstan. Experts believe that this hostile about-turn was provoked by legal action against the Asaubayev family who have close ties with the Kazakh elite. This transaction is very illustrative of risks associated with attempts to enter non-transparent post-Soviet economies (Eurasia Internet, August 10, 2010). On the other hand, the potential for trouble was already there when Polyus Gold's omitted to do any due diligence prior to the transaction – presumably, in an attempt to outstrip the other bidder, Zijin of China (Gornopromyshlennii portal Rossii, August 9, 2010).

In October 2010, Polyus Gold and KazakhGold admitted that they reached deadlock and the merger process could not be finalised by October 29, 2010, i.e. the proposed closing date of reverse takeover (RBK, October 26, 2010). However, in December 2010, Polyus Gold and the Asaubayev family (AltynGroup Kazakhstan LLP) compromised on the sale of all Polyus Gold assets in Kazakhstan, Kyrgyzstan and Romania to AltynGroup for \$509 million (payable in two instalments until March 11, 2011 and June 8, 2012). According to available estimates, this transaction only covers the cost of acquisition of KazakhGold in 2009, but does not compensate Polyus Gold

for investments made in KazakhGold or any associated damage. Ultimately, the Russian investor will acquire the parent company KazakhGold without assets, which can be used as a vehicle for listing on the LSE (through reverse takeover) and then, possibly, merger with a large international gold producer. In other words, the KazakhGold transaction was reduced from an investment project designed as part of expansion in the post-Soviet space to a mere technical procedure of accessing international financial markets (the latter issue is still up to the Kazakh government which has to restore the revoked permit for Polyus Gold to buy KazakhGold shares) (Fincake, December 8, 2010).

Polyus Gold's transaction exemplifies the standard philosophy of post-Soviet business expansion (i.e. reliance on non-transparent arrangements and the manner in which external competition risks are handled), but, for the purposes of our study, it is primarily an example of how a Russian investor completed a promising acquisition that it had deemed strategic in the face of the crisis. Moreover, no crisis developments could make the acquisition of the desired assets by Russian TNC more prudent. Despite the global crisis, the TNC was conducting business as usual, and with a great deal of post-Soviet specific features at that.

Financial sector transactions

More interesting observations can be made on some landmark transactions in the financial sector.

The transactions under review were clearly dictated by economic recession in post-Soviet countries. They allow us to study the role of a political agenda (at least potential) behind them. Remarkably, these two transactions in the banking sector had similar background but brought about very different results, and this adds interest to our comparative analysis (we can even talk about compliance with the most similar different outcomes criterion which is used in comparative studies in social sciences).

One of the uncompleted transactions negotiated in 2009 was an inconclusive attempt by Sberbank at buying Bank TuranAlem (BTA) of Kazakhstan. This investment initiative in itself exemplifies the logic of replacement growth: BTA, one of the backbone Kazakh banks, was put up for sale solely due to the serious problems caused by the first tide of the global crisis. In view of the bank's financial troubles, the Kazakh government resorted to partial nationalisation: 75.1% of BTA shares were purchased by the public holding company Samruk-Kazyna (this contradicted the general government line in banking sector management of the recent two decades which was based on the flat premise of private sector domination). The government announced that its shareholding in the bank would be temporary, 3-5 years at most.

The search for potential buyers began, and Russian Sberbank (which already had a subsidiary bank in Kazakhstan) was most favoured, especially in view of the recent admission of Samruk-Kazyna's head Kairat Kelimbetov to the Supervisory Board of Sberbank in the summer of 2009. On June 2, 2009, Anvar Saidenov, Chairman of BTA, announced that the bank had received a single official bid from Sberbank. Earlier, in April, news came of Sberbank doing a due diligence exercise in the respect of BTA and negotiations over purchase of all Samruk-Kazyna's share. In his interview to Kommersant (Kommersant, June 3, 2009), German Gref, President of Sberbank, said that he was awaiting the completion of the restructuring of BTA (whose foreign debt was estimated at \$13 billion) and execution of all investment agreements, after which he would consider buying the shares.

However, by autumn of 2009, it was rumoured that Sberbank would refuse to buy BTA due to the latter's poor standing. Observers were speculating about the political aspect of the negotiations, which is relevant to our study, i.e. the stance of the Russian government that was interested in the transaction (of course, acquisition of BTA would be very opportune in the context of the new wave of talks over closer regional integration). Overall, the word is that the political agenda is unlikely to force Sberbank into a clearly uneconomic deal, and the most probable future scenario is "endless talks" without flat refusal (Respublika, September 4, 2009). Finally, in October 2009, BTA signed a memorandum of understanding with a creditors committee on restructuring, which granted the creditors long-term control over the bank, thus making the chances of acquisition even fainter (Zarschikov, 2009).

The second similar project in the banking sector was more successful. In December 2008 – January 2009 (i.e. much earlier, during a more acute phase of the crisis) Vneshekonombank purchased Ukrainian Prominvestbank. This transaction has much in common with the inconclusive BTA transaction. Prominvestbank was founded in 1992 on the basis of former Prominvestbank of the Ukrainian Soviet Socialist Republic, and in 2008 ranked sixth in Ukraine in terms of assets. Massive withdrawal of private deposits in the autumn of 2008 (which totalled \$1 billion in the first week of October alone) forced the National Bank of Ukraine to introduce provisional administration in Prominvestbank (for the first time in the country). Apparently, this decision was dictated not only by the crisis but also a raider action in 2008 allegedly backed by Russian players (Advisers, March 13, 2010). The search of a potential strategic investor was made in a desperate rush (according to Vladimir Krotiyuk, interim administrator and Deputy Chairman of the National Bank of Ukraine, bids from western financial institutions were turned down on account that they requested several months for the decision-making process; see Prostobankir.co.ua, March 4, 2010). Potential buyers included individual investors and private and public banks from Russia and Ukraine (Sberbank, NRB and Alfa Bank were all mentioned). Eventually, Vneshekonombank

won and invested 1.1 billion hryvnias (\$158 million) in Prominvestbank's charter capital. Another 7 billion hryvnias was provided in long-term loans. Vneshekonombank acquired 75% +3 shares in Prominvestbank. On February 10, 2009, Vneshekonombank transferred to Prominvestbank the first \$390 million from a subordinated loan, and a week later Prominvestbank announced that its operation stabilised.

Vladimir Dmitriyev, Chairman of Vneshekonombank, said that until recently the bank had not seriously considered entering the Ukrainian market, concentrating instead on internal reform and creation of a development bank. But eventually that step was made despite the difficult financial position of the acquired bank and the little promise Ukraine's banking sector offers at the moment (NewsRu.ua, December 21, 2009). Vneshekonombank's head explains the choice of Prominvestbank by the role it plays in lending to the Ukrainian industry: it has a large number of clients, and many of them have close ties with Russian manufacturers. Vneshekonombank intends to use Prominvestbank for adjusting settlement with Ukraine (UGMK, April 1, 2009). It is also planned to make the bank one of Ukraine's top five (RBK-Ukraine, March 5, 2009). Vneshekonombank received a bid to purchase Prominvestbank from Slav AG owned by the Ukrainian politicians and businessmen Sergei and Andrei Klyuyev who also hold shares in Prominvestbank (they were among the potential buyers of the controlling block of shares). Vladimir Dmitriyev jokingly comments that this acquisition was made out of "proletarian internationalism", meaning that at that difficult time neither private nor public Russian banks had resources necessary for rehabilitation measures⁵.

As we have mentioned above, this transaction closely resembles Sberbank's BTA project, but there are two material distinctions. First, Vneshekonombank as a public corporation can be expected to be far more politically motivated. Second, Vneshekonombank's overseas platform is no match for that of Sberbank, although it has a subsidiary in Belarus (since the Soviet period). Therefore, we cannot discard either motive for investment expansion: replacement growth (taking advantage of the critical condition of a potentially lucrative asset, since the transaction was made at the very peak of the crisis) and political interests (which, however, are always important to Vneshekonombank irrespective of the crisis). It is likely that the commercial and political considerations were both present in this case.

Comparing the BTA and Prominvestbank projects allows us to make several observations. Russian banks (especially government-owned ones), heavily injected with public funds during the crisis, were well positioned to embark

⁵ Interview of Vladimir Dmitriyev at Prominvestbank's website, www.pib.com.ua/pr/biznes/20090608.php.ru, 12.08.2010.

on buying up crisis-stricken assets in CIS countries in accordance with the replacement growth scenario. In many cases they took a very prudent stance on the emerging opportunities, carefully selecting truly promising assets. And in some cases, by contrast, they took fairly high risks. Government control, albeit formal, does not necessarily mean that political considerations will prevail, even in crisis conditions; this depends on the government's part in an individual company.

Some illustrative crisis-time transactions related to the stock market infrastructure. Notably, before the crisis cooperation between stock exchanges and depositories from different CIS countries was rather formal and hardly went beyond memoranda of understanding or membership of business associations (The International Association of CIS Stock Exchanges and the Association of Central Depositories of Eurasia) (Golovnin, 2009). However, the Moscow Interbank Currency Exchange (MICEX) often assumed an active role in promoting financial integration initiatives.

The crisis changed the situation dramatically, especially as concerns cooperation between Russian (RTS) and Ukrainian stock exchanges (Golovnin, 2010). Earlier, Russian stock exchanges have made several inconclusive attempts at entering the Ukrainian market through joint projects with local infrastructure organisations. Finally, at an early stage of the crisis (in May 2008) the RTS launched the Ukrainian Stock Exchange jointly with Ukrainian players (this time, we can refer to a "brand new" investment rather than acquisition of an existing asset). Trade on the new exchange opened in March 2009; for the first time in Ukraine, Internet trading facilities were introduced, which at once elevated the new exchange to a leading position and wrecked the monopoly of the First Stock Trading System (FSTS). Notably, the latter had grasped the threat at an early stage, and in June 2008 secured the supply of a new trading platform (also capable of supporting Internet trading) by the MICEX. However, the FSTS failed to outstrip its competitor in launching the new system (this was done in April 2009). As a result, the FSTS lost its position permanently and started to consider selling shares to a foreign strategic investor. According to the FSTS management, the only response to the offer came from the MICEX (Investgazeta, January 25, 2010). In December 2009, the management approved the sale of 50% + 1 share to the MICEX, and the transaction was closed in mid-2010.

Thus, the main part of Ukraine's stock market infrastructure came under the control of Russian capital, including government-owned structures (the principal shareholder of the MICEX is the Central Bank of Russia).

The above two transactions, especially the MICEX's FSTS project, fit the replacement growth scenario. In addition, investments by the Russian stock exchanges are clearly strategic in essence, whereas

Vneshekonombank will most probably sell its Ukrainian asset that does not fully correspond to its core business (and most probably to another Russian player). These transactions pave the way for future financial cooperation between post-Soviet countries, and success of this cooperation will largely depend on Russian stock exchanges' performance in Ukraine. The first upgrade to the national infrastructure has been already made (the launch of Internet trading).

The crisis and entering global markets

There are also a number of other examples of how Russian businesses took full advantage of the crisis conditions to improve their international standing. In this case we refer not only to expansion in the CIS but also the associated asset diversification processes. In June 2009, Atomredmetzoloto (ARMZ), a member of Rosatom, secured a strategic alliance with Uranium One of Canada. The company exchanged its 50% stake in the Karatau deposit in Kazakhstan (the remaining 50% is held by Kazatomprom) for 16.6% of additionally issued shares in Uranium One plus \$90 million (the latter amount may increase by \$60 million depending on Karatau's performance in the next three years). The Canadian party was granted the pre-emptive right to buy ARMZ assets outside Russia (obviously, Uranium One is chiefly interested in Kazakhstan). ARMZ became the first strategic investor in formerly public Uranium One. Thus, ARMZ secured itself access to Uranium One's global resources scattered over several continents (ARMZ's own resources in Russia are very costly to operate due to the harsh climate) (Ekspert, June 16, 2009). ARMZ also strengthened its presence in Kazakhstan where Uranium One operates a number of deposits (Akdalinskoye and Yuzhno-Inkayskoye (70%) and Kharasanskoye (30%)) that can be developed at a fabulously low cost.

Bearing in mind that in June 2010 ARMZ increased its share in Uranium One to at least 50%, this transaction holds even greater promise for the Russian party. It appears that the crisis forced Russian companies to seek expansion beyond their priority target regions of Europe and the CIS. In this particular case, however, internal political developments in Kazakhstan played a role: some time ago Uranium One became involved in a major scandal (the so-called "Dzhakishev case") relating to unlawful privatisation of a number of uranium deposits. Experts believe that the transaction with ARMZ will provide Uranium One with a degree of protection in Kazakhstan. The latter consideration becomes even more important in view of the fact that the proposed sale of about 20% of shares in Uranium One to Toshiba has not so far been authorised by the Kazakh government (although Toshiba was not refused flatly and, according to its Vice-President Yasuharu Igarashi, is already participating in Uranium One's operation; the approval process lasts beyond reason) (Kursiv, June 10, 2010).

Conclusions

Although the cited information is largely incomplete and non-systematic, we can draw certain conclusions. Kazakh companies, one of the two investment forces in the CIS, have acted generally in accordance with the investment recession scenario. Therefore, the formation of the CIS' second integration core in this country is open to question (Vinokurov, Libman, 2010). In this respect, however, the Kazakh government and TNCs will have the final word.

The situation with Russian TNCs is not as simple. Evidence of investment recession, i.e. suspension of announced projects and a decline in the number of new initiatives, is in place. However, not all developments in Russia speak in support of the investment recession hypothesis: later in 2008-2010, Russian TNCs completed several sizable transactions (it does not matter that most of them had been initiated in the pre-crisis period). In other words, Russian investment activity in CIS countries and elsewhere proved resistant to the crisis. Notably, most of the projects suspended in the autumn of 2008 were finalised in 2009, when the peak of the crisis was over (e.g. in metallurgy and mining).

We have also found evidence of replacement growth, first of all in the financial and banking sectors (and, partially, in construction and metallurgy); but the outcomes of the reviewed projects were different. The replacement growth logic was clearly visible in projects to diversify the overseas assets of Russian TNCs and promote expansion beyond the post-Soviet space. In this case, however, complex interrelation between crisis developments and changes in the strategy of Russian TNCs makes the analysis of resulting effects a challenging task. In quantitative terms, the Russian share in total investments in those CIS countries for which data is available increased (the only exception was Kyrgyzstan), which also fits the replacement growth hypothesis.

The role of interstate cooperation in investment remained insignificant throughout 2008-2009. We have grounds for assuming that the warming of Russian-Ukrainian relations in the spring and summer of 2010 and inception of the Customs Union will give an added impetus to investment cooperation. However, since these changes in international relations coincided with economic recovery in Russia, it is difficult to put a simple valuation on this role. An analysis of the above assumption will only become possible in a few years. A political agenda may have exerted certain influence in some implemented and proposed transactions, but the degree of this influence should not be overstated.

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