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THE COMMONWEALTH OF INDEPENDENT STATES – CIS COUNTRIES IN TRANSITION

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Contents

List of tables

Foreword

The Northern Dimension Research Centre (NORDI) is a research institute run by Lappeenranta University of Technology (LUT). NORDI was established in the spring of 2003 in order to co-ordinate research into Russia.

NORDI's mission is to conduct research into Russia and issues related to Russia's relations with the EU with the aim of providing up-to-date information on different fields of technology and economics. NORDI's core research areas are Russian business and economy, energy and environment, the forest cluster, the ICT sector, as well as logistics and transport infrastructure. The most outstanding characteristic of NORDI's research activities is the way in which it integrates technology and economics.

LUT has a long tradition in conducting research and educating students in the field of communist and post-communist economies. From the point of view of these studies, LUT is ideally located in the Eastern part of Finland near the border between EU and Russia.

This book describes the Commonwealth of Independent States (CIS), which comprises twelve former Soviet republics. This short research report excludes Russia and Ukraine, the two largest parts of the former Soviet Union. These two CIS countries are dealt with separately in NORDI serie of books. However, Russia and Ukraine are present in some introductory tables, through which the overall framework of CIS is described.

We would like to express our sincere thanks to M.Sc. Jari Jumpponen, project manager of Northern Dimension Research Centre, as well as M.Sc. Boris Karandassov, who contributed by compiling data and background material.

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1 Introduction

The system of central planning collapsed in Europe in two waves. Communist countries of the former Eastern bloc changed their socio-economic system in 1989. The former Soviet Union with 15 republics ceased to exist in 1991. In the same year, the Commonwealth of Independent States (CIS) was established. This edifice comprises 12 independent states, everyone of which is a former Soviet republic. The Baltic States (Estonia, Latvia, and Lithuania) are also former Soviet republics, which refused to join the CIS. These three Baltic States joined EU in 2004, together with six other post-communist countries.

Occasionally, CIS is called the Former Soviet Union (FSU). This term is not correct: CIS is the former Soviet Union, minus three Baltic States. Thus, CIS has 12 member states.

It is rather difficult to define the CIS: it is neither a federation, nor a confederation. It is an edifice to advance development of its member states, but has no supranational powers. Annual meetings of the heads of the member states take place. Some agreements have been concluded within the CIS. However, the importance of this Commonwealth of Independent States in economic and political sphere is rather modest.

Four CIS countries are in Europe: Russia, Ukraine, Belarus, and Moldova. Russia is a special case occupying area in Europe, but also in Asia. Three CIS countries are in Caucasus, and thus, between Europe and Asia: Armenia, Georgia, and Azerbaijan. The remaining five CIS countries are in Central Asia: Kazakhstan, Uzbekistan, Kyrgyzstan, Turkmenistan, and Tajikistan.

There are huge differences in the size, population, and in endowment concerning natural resources within CIS countries. The population of the former Soviet Union before her collapse was about 290 million. About half of them live in Russia, while the smallest CIS, Armenia, has a population of only 3,1 million. Russia's territory comprises about three quarters of the FSU, or about 17 million square kilometres, while the territory of Armenia is only under 30 thousand km^2. Mineral wealth is very unevenly distributed within CIS.

The Soviet economy was highly centralized. The 15 republics had only marginal say in central planning. All important economic institutions (Gosplan, state planning unit, central bank, etc.) were situated in Moscow. Economic institutions in the republics had hardly any decision-making power.

Thus, all post-Soviet states (CIS countries and the Baltic States) had to create their national institutions in the early period of transition. The former members of the Eastern Bloc (Poland, Hungary, Romania, etc.) had national institutions affecting economic life already in the communist era. Thus, transition in the CIS area had a more difficult starting point, than countries in Central Eastern Europe.

After the demise of the Soviet Union in 1991, crucial supplies (energy bearers, metals, etc.) stopped suddenly to flow into CIS countries according to old system. Traditional demand factors determined in beforehand by the Soviet central planning units collapsed overnight. Thus, economies of the FSU experienced a huge shock in the early 1990s: the old "division of labour" created during several decades suddenly collapsed. All newly independent states of CIS faced economic decline.

This short research report will describe some major economic development indicators in the CIS region in the early 21st century. No attempt is made here to deal with detailed economic trends in countries under review.

A short country profile of every national economy included here will be given. Russia's economic development has been dealt with in two previous NORDI publications. Ukraine has been covered in a separate NORDI report. Therefore, no special attention is paid to these two most important CIS countries in this study. However, these two countries are included in the living standard comparison, as well as in statistics dealing with external economy.

2 Living Standard in CIS Countries

2.1 Gross Domestic Product (GDP) and Comparative Living Standard

It is a well-known fact that there are considerable living standard differentials in the global economy. In the rich part of the world, welfare is much higher than in emerging markets.

Relative well-being can be measured in different ways, when international comparisons are made. The most frequently used measure in the present-day economics used in this context the Gross Domestic Product (GDP) per head of population. It is a crude but fundamental reference point that is easy to obtain and is rather easily understood.

It is obvious that international comparisons can only be made by converting GDP figures per capita into one currency, for example, into US dollars or euros. Comparison calculated in various national currencies would not make too much sense.

Thus, it is necessary to convert output per head figures into a common currency. However, the underlying message can be distorted by exchange rate (ER) effects. Imperfect exchange markets overvalue some currencies and undervalue others. Thousand euros or dollars buy more goods and services in a poor country than in a rich one. In this case, it can be maintained that the currency of the poor country is undervalued at current exchange rate. GDP figures are thus made more accurate if dollars (euros) are converted into other countries' money via ERs calculated on a purchasing power parity (PPP) basis. This means in actual fact that official ERs need to be adjusted so that any identical sample of basic goods and services (average consumer basket) costs the same in one country as another.

Obviously, it is not easy to calculate output per capita on a PPP basis, which adjusts for national variations in the prices paid for goods and services. Some international agencies such as the World Bank produce GDP figures, PPP adjusted. Economist Intelligence Unit (EIU) also gives GDP data at PPP concerning economies in transition. Statistics below are taken from that source, which gives CIS output (GDP) figures per capita at current exchange rates and at PPP, both in US dollars.

Table 1. Some Key Figures of CIS countries, 2004

	Population	GDP per capita, $ at PPP	GDP per capita, $ at official ER	ERDI*
CIS	279,5	7.454	2.680	2,78
Russia	144,0	9.948	4.040	2,46
Ukraine	47,1	6.426	1.380	4,66
Belarus	9,8	6.823	2.330	2,93
Moldova	4,3	2.142	720	2,98
Armenia	3,1	4.004	1.160	3,45
Azerbaijan	8,3	4.014	1.020	3,94
Georgia	4,3	3.394	1.320	2,57
Kazakhstan	15,0	7.362	2.710	2,72
Kyrgyz Republic	5,1	1.932	430	4,49
Tajikistan	6,7	1.160	310	3,74
Turkmenistan	6,0	6.246	870	7,18
Uzbekistan	25,7	1.829	360	5,08

Source: EIU, Economies in Transition, June 2005.
*ERDI = Exchange rate deviation index

In the above table, the four European CIS countries come first. After that, there are three countries in Caucasus. Five last ones are situated in Central Asia.

The entire population of CIS is about 280 million. Russia is far the most populous CIS country with 144 million inhabitants, followed by Ukraine with 47 million people, Uzbekistan with almost 26 million inhabitants, and Kazakhstan with 15 million people. All other CIS countries have less than 10 million people.

The "original" living standard figures in CIS calculated at official exchange rates give very low GDP per capita results in US dollars. The average figure is about $ 2.700 in 2004. In comparison, it can be mentioned that the equivalent figure in Finland was $ 32.000, according to the World Bank (World Development Report, 2006). Thus, in this comparison, Finland's living standard seems to be about twelve times higher, than the CIS average. These figures tell very little about relative price levels.

In the light of the original GDP figures (at official ERs), there are substantial differences in wellbeing within CIS. The highest figure, $ 4.040 GDP per capita, is in Russia, while the lowest one, $ 310, is in Tajikistan. Russia seems to be thirteen times better of than the poorest FSU, Tajikistan. Moldova in the European part of CIS scores $ 720 GDP per head, which is roughly one third of the equivalent figure in Belarus ($ 2.330). In the same calculation, Kazakhstan has relatively high figure of $ 2.710.

The original GDP figures per capita in CIS countries are low, or even extremely low, which means that official exchange rates reflect relative price levels very imperfectly. Therefore, PPP adjusted figures assume considerable importance.

After the PPP adjustment, the average living standard (GDP per capita) is almost three times higher, than the original figures presuppose. This means that currencies in CIS countries are grossly undervalued.

In the light of the PPP corrected figures, Russia has the highest living standard (GDP per head) in CIS region with over $ 9.900 in 2004, followed by Kazakhstan with $ 7.400, Belarus with $ 6.800, Ukraine with $ 6.400, and Turkmenistan with $ 6.250. Turkmenistan has plenty of natural gas, while Kazakhstan is rich on oil. The PPP adjusted GDP per capita in Moldova is very low, only some $ 2.100. Three Asian CIS countries, Kyrgyz Republic ($ 1.900), Uzbekistan ($ 1.800), and Tajikistan ($ 1.160), are even poorer, than Moldova. Russia is almost nine times better off, than Tajikistan.

CIS countries in Caucasus have relatively modest “real” living standard: PPP adjusted GDP is in both Armenia and Azerbaijan about $ 4.000 per capita; Georgia has an even lower equivalent figure of about $ 3.400.

In this context, some comparisons can be taken from other regions of the post-communist world. In the Baltic States (Estonia, Latvia, Lithuania), which used to be Soviet states, the average GDP per capita (PPP adjusted) was in 2004 about $ 12.400 (according to EIU). The Baltic States are thus about six times better off than Moldova, and more than ten times wealthier than Tajikistan. Welfare differences in the FSU are really enormous in the early years of the second decade of the post-Soviet period.

In the Central Eastern Europe (Czech Republic, Slovakia, Slovenia, Hungary, Poland), the GDP per capita PPP adjusted was in 2004 even higher than in the Baltic States: the average figure is $ 13.750.

The highest figure in this comparison can be found in Slovenia with $ 21.300, which is about ten times higher than in Moldova, which is geographically not too far away from Slovenia. Bulgaria ($ 8.300) and Romania ($ 7.800), which are both supposed to enter EU in this decade, are essentially better off than Moldova, the lowest level country in the European part of CIS.

The above table contains also ERDI (exchange rate deviation index) figures for CIS countries. ERDI is derived by dividing PPP adjusted GDP per capita figures in every CIS country with the "original" GDP-numbers.

Official exchange rates ought to reflect respective price levels in every country. If markets were perfect, there would be no difference in the GDP figures at official exchange rate and PPP adjusted ones. However, these two figures deviate from each others essentially in every CIS country in the above table. The average ERDI in CIS region is almost three (2,78).

This figure (ERDI value of three) means that a Western visitor of CIS region gets an undervaluation "bonus" of factor 3: his/her $ 100 or € 100 has got purchasing power of $ 300 or € 300, because the price of the average consumer basket in CIS region is only one third of the equivalent basket price in the West. Thus, Western visitors have a financial (price level connected) incentive to visit CIS countries. In this context it is important to underline, that this advantage is valid only in buying average consumer goods (this advantage is not necessarily linked with prices in luxury hotels, for example).

When a person of a CIS country travels to the West, he/she pays an undervaluation "penalty" when buying Western currency: the "price" of euro or dollar is three times higher than the PPP adjusted exchange rate presupposes.

It is occasionally maintained that undervaluation of a currency means "exchange rate protectionism": it creates price competitiveness to exportables of the country, and keeps importables expensive (in terms of local currency). Undervaluation of a currency helps visible and invisible trade components in the balance of payments on current account to be in equilibrium. Emerging markets, like transitional economies, have very often undervalued currencies (see various NORDI publications).

ERDI values in CIS region have no common level. Russia has the lowest ERDI (2,46) calculated from EIU figures. However, Russia's ERDI is higher than in any country in the Baltics, or in the Central Eastern Europe (CEE).

Russia's ERDI has decreased rather rapidly in the first years of the 21st century. Even though ER deviation index has come down lately in Russia, the country earns substantial current account surpluses annually (see Tiusanen – Jumpponen: The Russian Economy in the 21st Century. NORDI publication No. 22, Lappeenranta, 2005).

As Russia earns more money than it spends in her external economy, she is a net capital exporter (see below).

The highest ERDI value can be observed in Turkmenistan, where the figure is no less than 7,18. Obviously, this unusually high ERDI hurts local consumers (via high import prices) and favours exportables. The current account of the country is rather well in equilibrium.

Uzbekistan's ERDI value is over 5. The equivalent figure in Ukraine is not far away of 5 (4,66). Kyrgyzstan is close to that level (4,49). In addition to Russia, Belarus (2,93), Moldova (2,98), Georgia (2,57), and Kazakhstan (2,72) have ERDI values below three.

It is important to emphasize that PPP adjusted GDP figures are estimates which will never reflect reality exactly well. However, PPP based measures in transitional economies are always better than the "raw" GDP figures using existing exchange rates. The latter way understates the living standard in the poorest transitional economies by four or five times, or even seven times, as shown in the above table.

2.2 Some Structural Aspects of CIS Economies

In the communist ideology, industrialization was supposed to bring limitless welfare. The ability of the Soviet system to mobilize its human and material resources while ignoring the costs, made possible to implement many gigantic projects, from the creation of several new industries to the development of nuclear weapons and missiles. However, in the 1960s and 1970s the Soviet economy started to falter and entered a phase of deterioration.

The stagnation of the Soviet economy can be attributed to the departure from the stage of primary industrialization and the "extensive growth" that was mostly generated by the stream of new workers from the countryside in the urban economy. The impact of various chronic diseases on economic performance became obvious including a steady decline in labour ethics, the spread of drunkenness among workers, the permanent shortage of workers, the diminution of the authority of economic leaders, the disappearance of fear, the erosion of ideology, the falling appreciation of monetary income under permanent shortages of consumer goods, and the growing technological retardation. In addition, the growing depletion of natural resources started to affect the economy in the 1980s.

The economic slump in the early years of post-Soviet period was more severe than the great depression in the West in the 1930s. Many industries in CIS countries were simply abandoned. Thus, economic structures had to be radically changed.

One way to measure the development stage of a national economy is to take the relative importance of agriculture, industry and service sector in the overall economic scene. International comparisons made on this basis are getting a bit old-fashioned in the post-industrial era. However, the share of agriculture in different economies still says something about the relative sophistication of various national economies.

Table 2. Structural Features of CIS countries, Value added as % of GDP, 2004

	Agriculture	Industry	Services	Agricultural productivity*
Armenia	25	39	36	2.646
Azerbaijan	13	54	32	1.026
Belarus	16	38	46	2.259
Georgia	20	25	54	1.374
Kazakhstan	7	39	53	1.385
Kyrgyzstan	39	23	38	929
Moldova	23	21	55	726
Russia	5	34	61	2.204
Tajikistan	24	21	55	412
Turkmenistan	N.A.	N.A.	N.A.	1.253
Ukraine	14	40	46	1.442
Uzbekistan	35	22	43	1.520
Finland	3	31	66	30.391
France	3	24	73	38.647
Germany	1	29	69	22.127

Source: The World Bank. World Development Report 2006.
*Value added per agricultural worker, aggregate 2001-2003 (in dollars of 2000)

In the CIS region, the share of agriculture in value added calculation is relatively high, while agricultural productivity is low, or even extremely low. Only in Russia and in Kazakhstan the percentage of agricultural value creation is below the 10% mark. Just half of the CIS countries show a 20% figure, or higher in agricultural sphere: Georgia 20%, Moldova 23%, Tajikistan 24%, Armenia 25%, Uzbekistan 35%, and Kyrgyzstan no less than 39%. In comparison, the equivalent figures in Finland and France are 3% each. Germany's figure in the same context is only 1%.

Agricultural productivity is the highest in Armenia in CIS comparison. However, the equivalent figure in Finland is over 11 and in France even 15 times higher than the Armenian equivalent.

In Tajikistan, about one quarter of the value added is created in agriculture, in which productivity is extremely low: farm workers in France are almost hundred times more productive than in Tajikistan. In Moldova, 23% of value added comes from agriculture with very low productivity: in comparison, France is almost 30 times more efficient than Moldova in rural activity.

Azerbaijan (13%), Ukraine (14%), and Belarus (16%) have still relatively higher shares of agriculture in Western comparison. Belarus is on the same level in agricultural productivity with Russia. Germany's countryside is about ten times more productive than that of Belarus and Russia. Ukraine with excellent farming conditions has amazingly low rural productivity: Finland has 20 times better results. Azerbaijan, Georgia, Kazakhstan and Turkmenistan have figures which are below the Ukrainian level of agro-productivity, while Uzbekistan is slightly better than Ukraine.

In sum, CIS countries except Russia and Kazakhstan are still rather agrarian societies. Productivity gap in agro-business between East and West is in this comparison striking.

In the majority of CIS countries, service sector is relatively more important in value added creation than industry. Only in Armenia (industry 39%, services 36%), and in Azerbaijan (equivalent figures 54% and 32%) industry is more dominant than the service sector.

2.3 External Economy

Russian Federation inherited from the Soviet Union the best resources including the big bulk of former Soviet oil and natural gas wells. In the transitional period, Russia has exported these important energy bearers in massive scale. About 60% of Russia's export is oil and gas. Other CIS countries are not in the same favourable position.

Table 3. Foreign Trade 2004 (USD Billion)

	Exports	Imports	Current account
CIS	267,9	172,6	63,7
Russia	183,5	96,3	60,1
Ukraine	33,4	29,5	7,0
Belarus	13,9	16,0	-1,0
Moldova	1,0	1,8	-0,1
Armenia	0,7	1,2	-0,2
Azerbaijan	3,7	3,6	-2,6
Georgia	1,0	1,8	-0,4
Kazakhstan	20,6	13,8	0,5
Kyrgyz Republic	0,7	0,9	-0,1
Tajikistan	1,1	1,2	-0,1
Turkmenistan	3,9	3,3	-0,2
Uzbekistan	4,3	3,2	0,7
Finland	61,1	51,0	7,8

Source: EIU, IBRD.

Russia counts more than two thirds of CIS regions exports and over half of its imports. Russia earns annually substantial current account surpluses and is thus an important net capital exporter.

The second most important CIS exporter is Ukraine with $ 33,4 billion in 2004. Import value was somewhat lower with $ 29,5 billion.

In the new century, Ukraine has every year earned current account surpluses. In 2004, this surplus was rather high in relative terms, about 10% of the local GDP. Obviously, the very grave undervaluation of the Ukrainian currency plays a decisive role in positive current account (CA) results. ERDI value in Ukrainian case is excessive.

Ukraine's population is almost ten times higher than that in Finland. However, the latter exported in 2004 almost twice as much as the former. Also Finland had a sound surplus in her CA in 2004.

Kazakhstan is the third most important CIS exporter with $ 20,6 billion in 2004. This country with 15 million inhabitants is presently exporting oil from her offshore wells in the Caspian Sea. Kazakhstan earns surpluses in her trade balance, as well as in her overall current account.

Belarus earned about $ 14 billion export income, while import expenditure was higher, circa $ 16 billion in 2004. Belarus exports foodstuffs extensively to the neighbouring Russia. Current account in Belarus is slightly in deficit.

Uzbekistan has plentiful natural resources, including natural gas. However, this country with about 26 million inhabitants had exports in total value of only $ 4,3 billion. That CIS country achieved a CA surplus in 2004.

Also Turkmenistan is rich on natural gas. Her export in 2004 was less than $ 4 billion, and CA slightly in deficit.

Azerbaijan is one of the first oil production locations in the world. The country has offshore oil which has started to flow to the global market. However, export income in 2004 was with $ 3,7 billion relatively modest. Azerbaijan has the highest CA deficit within CIS. In relative terms, the deficit is very high, about 30% of local GDP, which is unsustainable.

Export income in Tajikistan was $ 1,1 billion and in Georgia just one billion dollars in 2004. Also Moldova hit this round figure in her export activity. Armenia and Kyrgyz Republic earn less than a billion a year in dollar terms export income.

Russia, Ukraine, Kazakhstan, and Uzbekistan had CA surpluses in 2004, while the other 8 CIS countries had deficits in their external balance.

Transitional economies have lately competed with each others to attract foreign direct investment (FDI). For receiving countries, FDI offers several advantages. Unlike debt taken abroad, FDI does not need to be serviced and cannot flee at short notice. As a result, providers of FDI themselves bear the risk attached to the investment. In addition, FDI normally brings in new technology and techniques into the host country. Many FDI actions in transitional economies are export-oriented and/or import-substituting. Thus, FDI often helps to keep host-country CA in relative equilibrium.

Transitional economies in the Baltics and in CEECs have received a substantial inflow of FDI (see Tiusanen, Kinnunen, Kallela: EU's Enlargement Process: Investment Climate in 10 Transitional Economies. NORDI publication, No. 7, Lappeenranta, 2004). Estonia, the Czech Republic and Hungary have been especially successful.

Table 4. FDI Inward Stock (USD Million)

	1995	2000	2003	Per capita 2003 (USD)
Kazakhstan	2.895	10.078	17.567	1.171
Azerbaijan	330	3.735	8.639	1.041
Russia	5.646	25.226	52.518	365
Armenia	34	513	840	271
Georgia	32	423	1.036	241
Turkmenistan	415	944	1.314	219
Belarus	50	1.306	1.897	194
Moldova	94	459	789	183
Ukraine	910	3.875	6.953	148
Kyrgyzstan	144	439	501	98
Uzbekistan	106	699	917	36
Tajikistan	40	146	223	33

Source: UNCTAD. World Investment Report 2004.

Russia, far the largest CIS country has attracted far more FDI in absolute terms than her CIS neighbours. The FDI inward stock in Russia exceeds $ 50 billion. However, calculated in per capita terms, the Russian FDI stock is only $ 365, compared with over $ 4.000 in Estonia, Czech Republic, and Hungary, each.

The second highest absolute figure in the above table is in Kazakhstan, which has a FDI stock of $ 17.600 million, which is per head $ 1.170, or over three times more than in Russia. Azerbaijan also exceeds $ 1.000 mark in the FDI stock per capita statistics. These two countries have attracted especially oil-related investment in their respective territories.

In the European part of CIS, FDI inflow has been very modest. Belarus and Moldova have a FDI stock per capita of less than $ 200 each, while Ukraine has an even lower figure of $ 150. Armenia, Georgia, and Turkmenistan have equivalent figures of over $ 200 each, all rather modest results. Kyrgyzstan is close to $ 100 FDI per capita, while Tajikistan and Uzbekistan have even lower figures.

In the UNCTAD (United Nations Conference on Trade and Development) statistics inward FDI stock is calculated as a percentage of the local GDP. This comparison gives the relative importance of FDI stock from a different angle.

Table 5. FDI Inward Stock, 2003 (% of GDP)

Azerbaijan	117,7
Kazakhstan	60,1
Moldova	40,5
Armenia	31,9
Kyrgyzstan	28,6
Georgia	26,3
Turkmenistan	16,8
Tajikistan	14,1
Ukraine	14,1
Russia	12,1
Belarus	10,8
Uzbekistan	10,6
Estonia	77,6
Hungary	51,8
Czech Republic	48,0

Source: UNCTAD.

In this comparison, Azerbaijan with a low nominal GDP has a high figure of 118%, which means that FDI stock is higher than her annual GDP. The second highest figure can be observed in Estonia of almost 78%. This small Baltic state has attracted plenty of FDI.

Kazakhstan's figure is just over 60% indicating also this way the importance of foreign investment in the local economy. Central Eastern European members in the table, Hungary and the Czech Republic, have rather high markings of about 50% each.

Uzbekistan and Belarus have the lowest figures of the table with less than 11% each. Russia, Ukraine, and Tajikistan are also at the bottom of the scale.

This measurement also shows how unevenly FDI is distributed in the area of transitional economies. The value of FDI stock in Azerbaijan exceeds yearly output value, while in Belarus FDI stock equals only one tenth of the annual GDP.

It is not surprising that Azerbaijan and Kazakhstan have the highest scores in the UNCTAD statistic within CIS. Oil extraction is the common denominator in FDI inflow in these two CIS countries. In this business investment sums are large.

According to UNCTAD data, FDI stock in "Central Asia" (comprising five CIS countries in Central Asia plus three CIS members in Caucasus) had the total value of $ 31 billion in 2003. More than half of this sum is invested in one country, Kazakhstan.

The same source gives the equivalent figure for “Central and Eastern Europe”, which contains the European part of former Soviet Union, the former Yugoslavia, the former Eastern bloc and Albania. In this region the total FDI sum is $ 263,3 billion. In this aggregate figure, Russia and Poland are the largest FDI host countries with over $ 50 billion each. Hungary and the Czech Republic come next with $ 40 billion each.

There are several studies published annually dealing with business environment in different countries. One of these yearly reports is compiled by the World Bank and the International Finance Corporation (the latter is a daughter company of the former). This annual report with very interesting content is not often referred to in the financial press. The issue of this report is called “Doing Business in 2006. Creating Jobs”, the content of which is summarized below.

The IBRD report 2006 covers ten indicators on business regulations and their enforcement across 155 countries. The 10 indicators are as follows: starting a business; dealing with licenses; hiring and firing workers; registering property; getting credit; protecting investors; paying taxes; trading across borders; enforcing contracts; closing a business. These components are measured separately. The report provides at the end a composite index, called the ease of doing business ranking countries reviewed from 1 to 155. The composite index is calculated as the ranking on the simple average of country percentile rankings in each of the 10 topics covered. The ranking on each topic is the simple average of the percentile rankings on its component indicators.

In the very beginning of the report, the topic is clarified with following examples:

“If you were opening a new business in Lao PDR, the start-up procedures would take 198 days. If you were opening one in Syria, you would have to put up $ 61.000 in minimum capital – 51 times average annual income. If you were building a warehouse in Bosnia and Herzegovina, the fees for utility hook-up and compliance with building regulations would amount to 87 times average income. And if you ran a business in Guatemala, it would take you 1.459 days to resolve a simple dispute in the courts. If you were paying all business taxes in Sierra Leone, they would take 164% of your company’s gross profit.”

It is evident that none of the composite indexes published regularly on business climates in various parts of the global economy can give exact information for investors choosing new target markets. This fact is recognised in the World Bank report:

"There remains an unfinished agenda for research on what regulations constitute binding constraints, what package of reforms is most effective and how this is shaped by country context. The *Doing Business* indicators provide a new empirical dataset that may improve understanding of these issues. The ease of doing business index is limited in scope. It does not account for a country's proximity to large markets, quality of infrastructure services (other than services related to trading across borders), the security of property from theft and looting or macroeconomic conditions or the strength of underlying institutions. Thus while Jamaica ranks similarly (at 43) on the ease of doing business to France (at 44), this clearly does not mean that businesses are better off operating in Kingston rather than in Paris. For example, crime and macroeconomic imbalances – 2 issues not directly studied in *Doing Business* – make Jamaica a less attractive destination for investment."

The Ease of Doing Business Index contains in its ranking plenty of post-communist countries. However, two CIS countries are excluded: Tajikistan and Turkmenistan. The former has the lowest figure of FDI per capita within CIS, and thus, is obviously of little interest for international companies. Turkmenistan is because of her considerable natural gas reserves potentially important market, but it is not an information-friendly country.

In the table below, 20 countries at the top of the list are mentioned. After that, post-communist countries with their ranking are picked up.

Table 6. Ease of Doing Business Ranking

1	New Zealand
2	Singapore
3	United States
4	Canada
5	Norway
6	Australia
7	Hong Kong, China
8	Denmark
9	United Kingdom
10	Japan
11	Ireland
12	Iceland
13	Finland
14	Sweden
15	Lithuania
16	Estonia
17	Switzerland
18	Belgium
19	Germany
20	Thailand
26	Latvia
37	Slovakia
41	Czech Republic
46	**Armenia**
52	Hungary
54	Poland
62	Bulgaria
63	Slovenia
78	Romania
79	**Russia**
81	Macedonia, FYR
83	**Moldova**
84	**Kyrgyz Republic**
86	**Kazakhstan**
87	Bosnia and Herzegovina
92	Serbia and Montenegro
98	**Azerbaijan**
100	**Georgia**
106	**Belarus**
118	Croatia
124	**Ukraine**
138	**Uzbekistan**

Source: IBRD, Doing Business in 2006.

New Zealand is in the first place in the above ranking which measures the institutional framework of doing business in various national economies. All Scandinavian countries are among the fifteen best performers. The Nordic states are well positioned in many composite indexes measuring international competitiveness.

It is rather surprising that two transitional economies, Lithuania (15th) and Estonia (16th) are among the 20 best countries of 155 competitors. Both of them score better than Switzerland or

Germany. The other 6 TEs, which are EU-members since 2004, are Latvia (26th rank), Slovakia (37th), the Czech Republic (41st), Hungary (52nd), Poland (54th), and Slovenia (63rd).

These 8 post-communist EU-members were closely monitored in the 1990s and in the early 21st century by EU-officials in the economic policy-making procedure. The candidates were asked to apply Western models in order to create institutions and rules suitable for a viable market system. Administration was not supposed to manage the economy anymore, but shape an environment, in which private businesses can prosper by reacting on market signals. In this context, EU-officials also monitored, how rule (law) enforcement takes place.

Obviously, European integration is really vital for the Baltic States, which are small and thinly endowed with natural resources. Thus, it was essential in the Baltics in the early period of transition to establish institutional frames, in which local and foreign businesses can function properly. It can be assumed that Lithuania, Estonia, and Latvia are not high up in the above ranking by accident: much attention has been paid to the development of favourable business environment.

Slovenia is the most prosperous TE within EU with 2 million inhabitants only. It is in the 63rd place in the above table, behind Bulgaria, which was not able to enter EU in 2004. These two rankings are rather surprising. The Czech Republic (41st) and Hungary (52nd) have attracted plenty of FDI (in relative terms), but offer no perfect business climate. Poland (54th) has somewhat lower ranking than Hungary.

The best CIS country in the above table is Armenia which is 46th in the ranking. Armenia is a small, land-locked country with scarce natural riches. Thus, it must create favourable business environment to survive. Therefore, her relatively positive ranking in the index is not completely surprising.

Russia is the second best CIS country in the above table, but her rank (79th) is relatively modest. In actual fact, Russia's large and resourceful national economy offers plenty of potential for international companies, but doing business on the spot is not necessarily easy: business climate in Russia is sub-optimal from the point of view of institutional framework (see Hellevig, Usov, Tiusanen: The Russian Tax Reform Paving Way for Investment. NORDI publication No. 21, Lappeenranta, 2005).

Moldova has the 83rd rank in the index, and Kazakhstan the 86th position. These two CIS countries differ from each other fundamentally. Moldova is a small and relatively poor

country with low natural endowment, and thus, rather unattractive for foreign investors. Her position shows that the institutional business background is far from perfect. Kazakhstan is a country of huge territory with natural wealth, which has attracted the highest per capita FDI inflow in the CIS region. Her ranking indicates that it is not necessarily easy to do business within the largest CIS country in Central Asia. Kyrgyzstan is between Moldova and Kazakhstan, with rank 84.

Azerbaijan (98th) and Georgia (100th) are close neighbours geographically and in business ranking. The former has oil, and thus, high FDI stock figure, while the latter is lacking both. These two countries ought to pay attention to improving their respective investment climates.

Belarus has a favourable geographical location close to EU. In her transition, institutional reforms have been very slow. The country has an authoritarian rule and rather mild decentralization of the economy. Thus, the country, which in the above index is on the 106th place, is hardly able to attract FDI in large scale.

Ukraine with almost 50 million inhabitants offers plenty of business potential, but her economic reform has been far from perfect: her position (124th) in the World Bank index partially explains her very low FDI stock per capita.

Uzbekistan is the worst-ranked CIS country in the business environment index: her position is 138th in the list of 155 countries. However, Uzbekistan is the most populous CIS country in Central Asia, and has interesting natural resources. Thus, Uzbekistan is potentially interesting target market for Western investors. Increasing FDI inflow obviously presupposes improvement in the institutional framework.

CIS region offers a huge variety of countries with different size, living standard and mineral wealth. The World Bank business environment index shows that the transition from Soviet central planning to decentralized market economy has advanced unevenly in the FSU. The former Soviet republics in the Baltics have carried out market-oriented reforms with remarkable speed. The twelve countries of CIS under review in this report have been less successful in applying market reform in comparison to Estonia, Latvia, and Lithuania.

3 Country Profiles

Russia and Ukraine comprise together some two thirds of CIS region's population. These two large countries have been investigated in NORDI series of books (see NORDI publications No. 6 and No. 22). Therefore, Russia and Ukraine are not dealt within this chapter.

3.1 Central Asia

3.1.1 Kazakhstan

Kazakhstan has attracted more FDI per capita than any other CIS country, as pointed out above. Thus, it is of special interest from the point of view of international business.

Kazakhstan is the world's ninth largest country in area encompassing 2,7 million square kilometres, which is roughly 12% of total ex-Soviet territory. When the Soviet Union collapsed, Kazakhstan had about 17 million inhabitants, or about 6% of Soviet population, Kazakhs, were in minority of about 40%.

The former Soviet Union suffered of a permanent shortage of foodstuffs. To overcome this crisis, different large-scale campaigns were organized. One of them in the 1950s was called "the virgin land" project. The core of this scheme was to urge young people to go to the East and start cultivating corn on the almost endless steppes of Kazakhstan. Millions of people responded to that call and moved to the virgin land. However, the climate in Kazakhstan did not favour cornfields. However, many immigrants stayed on the steppes and continued farming, mainly cultivating wheat.

This massive migration at least partially explains why the titular population was in minority in Soviet Kazakhstan which now has a population of 15 million. After the collapse of the Soviet Union, many former immigrants moved to Russia.

In the period of Cold War, the Soviet superpower tested her nuclear weapons in the huge territory of Kazakhstan. Obviously, this testing had negative repercussion on the environment. Nuclear contamination has naturally long-term, may be permanent, effects.

The vast area (2,7 million square kilometres) of Kazakhs is blessed with an array of mineral resources comprising major coal reserves, iron ore, lead, zinc, copper, manganese, chromite,

and petroleum. Natural gas and oil reserves are found in the Caspian Sea and the Mangyshlak Peninsula. Gold and other rare metals are mined. Phosphates are a part of the natural riches.

It is obvious that oil is the most valuable wealth of Kazakhstan. In addition, it is evident that the position of the country is not ideal from the logistics point of view. Transporting exports and imports is complicated. Neighbouring countries are not necessarily optimal: business activities have risks. In the early months of 2005, plenty of tension was observed in the neighbouring republics of Kyrgyzstan and Uzbekistan, which did not spill over seriously to Kazakhstan. However, the political situation in the FSUs in the Central Asia is delicate.

Emerging markets often suffer of capital shortage. Therefore, there is the temptation that the best natural riches are sold to foreigners who repatriate their profits. The local economy enters a vicious circle of underdevelopment.

The post-Soviet Kazakhstan has decided to avoid this poverty trap by establishing a National Oil Fund in 2000 to invest a part of the export income in global financial market for the benefit of future generations. The Oil Fund had over $ 6 billion capital in the summer 2005. It is estimated that Oil Fund's capital will increase at least by $ 1 billion a year (Financial Times, August 30th, 2005). Currently, Kazakhstan produces 1 million barrels of oil a day, but the output is expected to be 3 million barrels/day by 2015, as extraction from the two major wells, Tengiz and Kashagan, is stepped up. Increasing export quantity combined with high world market prices of oil will increase Kazakhs oil income substantially in the next ten years.

The largest oil producer by far in Kazakhstan is Tengizchevroil (TCO), a joint venture between Chevron Texaco and Exxon Mobil (US), the local state-owned entity Kazmunaigaz, and LUKArco itself a joint venture between the Russian oil giant LUKoil and Arco, the American group which is now part of British Petroleum (BP).

The original oil production deal was signed between the Kazakhs and Chevron in 1993, but disputes between partners soon occurred. Obviously, frictions between local and foreign partners were settled by the TCO deal, via which the consortium clinched a 40 year license to pump oil.

TCO's principal assets lie in Western Kazakhstan where the Tengiz reservoir holds an estimated 6-9 billion barrels of readily extractable oil. This reservoir is one of the best oil wells ever discovered. The company also has production rights in other Kazakh oil sources,

and thus, TCO's estimated reserves are about 25-30 billion barrels. The big Karachaganak oil reservoir is developed by a consortium led by the BG Group and ENI.

In the turn of the century, an international consortium was formed to construct the Caspian Oil Pipeline from Tengiz oilfield to the Black Sea. The Kazakh port, Aktar, plays a vital role in expanding Kazakhstan's oil export by handling 8-9 million tons of oil a year. This pipeline project made headlines in the international press, because the use of it allows Kazakh oil export to reach the global market without crossing the Russian territory.

Kazakhstan has Central Asia's largest recoverable coal reserves, including the world's biggest open coal mine operated by Bogatyr Access, a joint venture involving the US based Access Industries. This JV has had a decisive impact on productivity increase in coal mining. The outdated Soviet mining technology based on using rail carts has been replaced by large mining trucks and hydraulic excavators. Kazakh coal is now internationally price competitive. In the local electricity generation, there are two large coal fuelled stations, one owned and operated by the American company AES.

Metallurgy has excellent preconditions in Kazakhstan because of local ore deposits and cheap energy supplies. The long and strong economic boom in China has enhanced demand for products of the metallurgy sector.

The London-based Mittal Steel is presently the world's largest steel-maker. The company is 77% owned by Mittal family which originates from India.

In the 1990s, Mittal brought the largest Kazakh steel-mill, Karmet. In the first ten years of Karmet plant, Mittal has invested about $ 1,2 billion basically in new technologies. In 2005, Mittal announced its new investment programme of $ 600 million (Fortune, No. 19, 2005). Mittal employs no less than 55.000 people, and is thus the country's largest simple employer.

Mittal Steel has R&D centres in the USA and France. In the framework of Karmet acquisition, Mittal inherited a R&D unit originating from the Soviet era. Local specialists are now employed by the new owner of the Karmet steel-mill.

About 40% of Karmet's output is exported to China. Other important clients are in different CIS countries. Neighbouring Iran is also an important customer of Kazakh steel.

Kazakhstan has launched an industrial policy programme with the aim to diversify her economy. In the Soviet era, the republic was a net “exporter” of foodstuffs (within the Soviet Union). Thus, Kazakhstan has good preconditions in food processing industry. Textile and clothing branch is emphasized, because the country has plenty of cheap labour force with experience in this field. Development of a technology cluster in extractive activities and energy generating field is in the agenda.

Kazakhstan with an area of 2,7 million square kilometres is larger than Western Europe. Apart from its Caspian Sea coastline, Kazakhstan is completely landlocked. Her geographical position at the very heart of Central Asia imposes unusual challenges in infrastructure development. The great historic trade route, the fabled Silk Road that once linked China with Europe, is crossing Kazakh territory. Presently, increasing trade between Europe and Asia offers potentially interesting prospects for Kazakhstan to earn money from transit traffic. The country has been held back by its ageing transport infrastructure originating from the Soviet era. Now, the government has good reasons to channel “petro-dollars” into building new roads and upgrading existing routes. As one of the long-term programmes of the government is to increase tourism, the transport system is likely to receive funding in large scale during the next ten years.

The Kazakh GDP has grown in real terms by an annual rate of 10% during the last 5 years. Thus, the oil boom is very real. At the same time, there are cumulative effects of “petro-dollars”: the economy has rather broadly-based dynamism. Inflation has annually been over 8% in the same period of time. Obviously, the oil-related boom has triggered inflationary pressure, which is likely to continue. However, inflation rates of 5-8% a year are rather usual in emerging markets with strong economic growth. Double-digit inflation rates would be harmful from the point of view of investment.

Kazakhstan still has a clearly undervalued currency, as shown above. Her exchange rate deviation index (ERDI) has a relatively high value of 2,72. With this figure, the country ought to have price competitiveness in her foreign trade. Current account surplus gives evidence that Kazakh’s international competitiveness is on a sound basis.

In sum, Kazakhstan is a positive example of post-Soviet transition. She has got a higher living standard (GDP per capita at PPP) than any other CIS, except Russia. In the FDI stock per capita comparison, Kazakhstan is number one in the CIS region. Her economic growth is extremely strong, but the economy is in relative equilibrium with no rampant inflation and no deficit in the current account.

However, the institutional framework of Kazakhstan is far from perfect. In the World Bank's "ease of doing business" Kazakhstan's ranking (86th) is rather low: the country is not an easy place to do business; administration is extensive and heavy. In the Corruption Perceptions Index published every year by a non-profit organisation "Transparency International", Kazakhstan is permanently scoring badly, which means that corruption is rampant. Risks in doing business, but opportunities to make profits are obviously better than in the other CIS countries in Central Asia.

3.1.2 Uzbekistan

Uzbekistan is the most populous country in the Central Asian region of CIS. Its area is about 450.000 square kilometres and population about 26 million. Also Uzbekistan is blessed with a multitude of mineral wealth, including huge reserves of natural gas, coal, gold, uranium, copper, tungsten, lead, zinc, and petroleum. However, the oil reserves of the country are very modest in comparison to the oil wealth of Kazakhstan. That is one of the most important reasons for the relative poverty of the country, which has alongside Tajikistan attracted less FDI per capita than any other CIS country.

In the Soviet era it was said that Uzbekistan had "cotton monoculture". Extensive irrigation systems were created to maximize the cotton crop. This system depleted water supplies and left plenty of salinated wasteland around the Aral Sea, one of the most important salty lakes on earth. This legacy of the Soviet system is regarded as one of the most severe environmental catastrophes of modern times.

In the post-Soviet era, the independent state of Uzbekistan has been slow in carrying out economic reforms and creating democratic institutions. Human rights have been abused. Militant Islamic groups cause plenty of tension.

Privatization in the country has hardly advanced. Exploitation of natural resources is rather tightly in the state's control.

Uzbekistan holds world's 4th largest reserves of gold and the 5th largest deposits of uranium. These two valuable minerals are found in the Kyzylkum region, where the Navoi Mining and Metallurgical Combinat (NMMC) employ about 60.000 people. The most valuable part of this state-owned giant is the Zarafshan Gold Extracting Complex (ZGEC), which manages the world's largest single open-pit gold mine (the Muruntau Quarry), with estimated reserves of 2.000 tons of gold.

Uranium is extracted from sandstone deposits of Uchkuduk area. The raw base of uranium is estimated at 235.000 tons. As the global demand for uranium is increasing, this branch of mining in Uzbekistan has favourable conditions for further development.

NMMC's gold and uranium mining activities have attracted foreign capital into joint ventures, through which the country obtains modern technology linked with gold and uranium extraction. It is estimated that some $ 400 million has been invested by foreign companies into JVs with NMMC. Actually, these joint ventures with foreign and local state ought to be called mixed ventures, because Uzbek state is the equity-sharing partner in these ventures.

In the Eastern part of Uzbekistan, in the Almalyk region, there is one of the largest non-ferrous metal deposits in the CIS area. Copper reserves in this region comprise over 7 million tons of ore. Mining of non-ferrous metals of the country is carried out by Almalyk Mining and Metallurgical Complex (AMMC), which is a joint-stock company, in which the state is shareholder. AMMC employs about 24.000 workers.

Alongside with copper mining, AMMC produces gold and silver, as well as 12 chemicals as by-product of mining. The complex includes a copper smelting plant and a unit producing fertilizers.

In the turn of the century, AMMC was reorganized as an open shareholding company laying the basis for partial privatization. Obviously, it is the aim of the government to attract foreign investors in the framework of AMMC's privatization.

Alongside with various metal deposits, Uzbekistan also possesses substantial hydrocarbon reserves. With natural gas reserves standing at 66 trillion cubic feet, Uzbekistan is one of the richest countries in terms of natural gas deposits, and momentarily the 4th biggest producer of this energy bearer in the world. It proven oil reserves stand at 600 million barrels. Intensive oil exploration is under way, and it is expected that considerable new oil findings will be made.

The hydrocarbon branch is obviously the most important part of the Uzbek economy. In the late 1990s, an umbrella organisation, Uzbekneftegaz, was set up as a holding company comprising several joint-stock companies. In the autumn 2003, Uzbekneftegaz (UNG) was restructured to comprise four units in the state-owned holding: Uzgeoburneftegazdobycha for oil and gas exploration, drilling and production, processing of natural gas and the recovery of gas liquids; Uzneftemakhsulot for oil refining, oil product sales and distribution (including

petrol station); Uztransgaz for transportation and distribution of natural gas, Uzneftegazmash for manufacturing of oil and gas related equipment.

Official sources in the country maintain that the oil and gas branch has attracted about $ 2 billion foreign capital. Since 2000, the government is offering a range of incentives to foreign companies involved in oil and gas exploration. Newly discovered oil and gas fields may be given to foreign developers, who were also involved in the prospecting activities. In 2005, the state offered 15 exploration blocks with estimated reserves of about 1,2 billion barrels of oil. In the next 15 years, annual gas production is expected to increase from 40 billion cubic meters to 120 billion, which presupposes heavy involvement of foreign capital.

In 2002, Uzbekneftegas set up its first drilling JV with Swiss-based company Zeromax to produce bentonite mud powder, which is used as a lubricant for drilling. The end-product covers local needs and is exported to several countries.

As mentioned above, Uzbekistan has a long tradition in cultivating cotton. Also silk is produced in the country, which thus offers good preconditions for development in textile industry.

In the Soviet era, all productive assets were in the hands of the public sector. The former Ministry of Textiles supervised the Uzbek textile branch. This Ministry was converted into a joint stock company, Uzbekyengilsanoat, which remained state-owned in the early period of transition. Parts of this Textile Holding Company (THC) have been privatized.

Presently, THC is acting on behalf of the government and trying to help local textile mills attract foreign investors. THC is shifting its role from supervisory function to industry promotion.

Foreign investors can take part in the privatization process by creating new ventures in the country, which receive tax benefits provided, that foreign investor's share in the statutory capital is at least 30%. The aim of the state in this context is that the state's share is in the form of apportionment (investment in kind): the local state contributes real estate, premises, and probably existing equipment, while the foreign investor contributes cash and/or new technology. According to Uzbek State Privatization Committee, foreign investor can buy a non-controlling share of more than 30%, but less than 51% of an Uzbek textile mill, and make large investments into the privatized venture. In this case, the state can decide to transfer a state-owned enterprise to the investor directly, without competition in bidding. This system

allows the foreign investor to control management and cash flow (further information: Embassy of Uzbekistan, London, www.uzbekembassy.org).

Uzbekistan seems to get interested in foreign capital in the middle of the current decade. The country has plenty of attraction from the point of view of potential foreign investors in her resource base. However, the investment climate is far from perfect. Export in Kazakhstan is almost 5 times higher than in Uzbekistan, which has a per capita GDP (PPP adjusted) only one quarter of the Kazakh level.

Uzbekistan is in several measures (including Transparency International's Corruption Perceptions Index) found to be one of the most corrupt countries. In the World Bank "ease of doing business" ranking (quoted above) Uzbekistan is the worst scoring CIS country. Authoritarian regime of the country can obviously not guarantee social stability. The economy is still rather centralized and run by a thin elite.

Obviously, the government has realized that capital import ought to be accelerated in order to carry out modernization of the economy. This process calls for improving of the investment climate. In this sphere, plenty of work is in need. However, Uzbekistan's resource base is not unattractive in the eyes of potential foreign investors.

3.1.3 Kyrgyz Republic

Kyrgyz Republic or Kyrgyzstan has a population of 5,1 million which is the lowest figure in the Central Asian part of the former Soviet Union. Her territory of 199 thousand square kilometres is tiny in comparison to that in the neighbouring Kazakhstan.

Kyrgyzstan has a very low living standard measured by GDP per capita at purchasing power parity: the figure in 2004 was below $ 2.000 which is approximately on the same level with Uzbekistan. Kyrgyzstan's merchandise export had a total value of $ 700 million only in 2004. Thus, the country is relatively isolated from the global economy. Anyhow, Kyrgyzstan was the first CIS country achieving the membership of WTO already in 1998.

The very low annual export figure of less than one billion dollars is naturally directly linked with the narrow resource base of the country. Kyrgyzstan has no exportable surpluses of energy bearing materials. Therefore, the small and remote country has a marginal attraction only in the eyes of international investors.

For the same reasons, Kyrgyzstan was not high up in the priority list of central planners sitting in Moscow during the Soviet era. Thus, Kyrgyzstan did not inherit a heavy industrial structure from the old system. Soviet-time immigration was very limited as a consequence of the rather thin industrialization of Soviet Kyrgyzstan.

The Kyrgyz area of 199.000 square kilometres contains mountainous regions, and thus, the country has several hydroelectric power stations erected in the Soviet era. Natural riches contain uranium, lead, zinc, gold, and marble, but these minerals are not abundant, and large-scale mining is thus not profitable. The country has also minor reserves of hydrocarbon in the form of oil shale and some natural gas.

As Western companies interested in mining and exploiting of oil and gas wells have not come to Kyrgyzstan with their funds, FDI activity has remained on a modest level. Per capita FDI in the country is just below $ 100.

In the post-Soviet Kyrgyzstan, the rural economy has become very important: the highest value added share is created in agriculture, no less than 39% of total GDP. This is the highest figure in the whole CIS. The second highest equivalent figure with 35% is in Uzbekistan.

In Corruption Perceptions Index 2005 Uzbekistan holds the 137th place. In this index, Kyrgyzstan has a bit better ranking (130th). In the ease of doing business ranking Kyrgyzstan is on the 84th place, two ranks above Kazakhstan.

3.1.4 Tajikistan

Tajikistan is the only post-Soviet republic in Central Asia, which had a civil war in the aftermath of the collapse of the Soviet Union. Tajikistan has a long border with Afghanistan in the South. Afghanistan has a considerable Tajik minority.

The armed conflict in 1992-1993 took place between Islamic fundamentalists, who received military assistance from the Afghan mojahedin, and moderates, who were supported by Russian military force. It is estimated that some 25.000-30.000 people were killed in this armed conflict, which also caused heavy material destruction.

It is not the aim of this report to cover this internal conflict in Tajikistan in detail. It suffices to state here that the country had the most unfavourable start in her transitional period among the five post-Soviet states in the Central Asian region.

Therefore, it is not surprising that Tajikistan with 6,7 million inhabitants has clearly the lowest living standard within CIS: per capita GDP (with PPP adjustment) is somewhat over $ 1.000 a year. In 2004, the country exported goods in total value of $ 1,1 billion only. Thus, it is evident that Tajikistan has no extensive resource base to support her foreign trade.

Tajikistan is with 143.000 square kilometres a bit smaller in area than neighbouring Kyrgyzstan. The country has minor reserves of non-ferrous metals, including gold, hence large-scale mining is not feasible. Oil and natural gas deposits are small.

Therefore, it is not surprising that FDI stock per capita in Tajikistan is only $ 33, the lowest figure in the whole CIS region. Widespread corruption does not attract investors to the country either; Tajikistan is on the 144th place in the Corruption Perceptions Index.

The share of agriculture in value added creation is relatively high with 24%. Productivity in Tajik agriculture is on the lowest level in the whole CIS region.

In sum, Tajikistan is at the bottom of the living standard scale in CIS comparison. The economic environment offers hardly any viable options to international investors.

3.1.5 Turkmenistan

Turkmenistan, which is occasionally called “Kuwait of Central Asia”, has 6 million inhabitants. The above comparison between Kuwait and Turkmenistan has come into being because both countries have a rather small population and large deposits of hydrocarbon containing materials.

The existence of large oil and natural gas deposits in a broad band stretching from the Caspian Sea basin into Western Siberia is affecting essentially the Turkmen economy. It has unusually high reserves of natural gas.

In the CIS comparison, Turkmenistan has a relatively high living standard of about $ 6.300 GDP per capita, PPP adjusted a year. That figure is almost six times higher than the equivalent figure in Tajikistan, but somewhat lower than in Kazakhstan. Turkmenistan is three times better off than the neighbouring Uzbekistan, which is, however, exporting in absolute terms more than Turkmenistan. Her export value in 2004 was less than $ 4 billion.

Turkmenistan occupies an area of 488.000 square kilometres stretching from the Caspian Sea to Afghanistan border in the South-East. Most of Turkmenistan is a desert, but the country has extensive river valleys and oases where crops may be grown.

Turkmenistan has significant natural gas deposits in the Western part of the country and under the Caspian Sea. Oil deposits are not substantial. Turkmenistan also has potassium, sulphur, sodium chloride, and magnesium chloride.

Turkmenistan with her hydrocarbon reserves is potentially rich, and thus, "Kuwait of Central Asia" in the future. However, in the post-Soviet time, the country has been facing a transportation problem of her most substantial natural resource, natural gas, which is continuously going via the old Soviet-time pipeline system. The major part of this transportation system is controlled by Russia.

Thus, it is understandable that in Turkmenistan export value and inflow of FDI are on a rather modest level. Per capita FDI stock in Turkmenistan is only about $ 220, which is low in comparison to Kazakhstan's equivalent figure of about $ 1.200. The investment climate in Turkmenistan is extremely unfavourable. In Corruption Perceptions Index the country is ranked to 155th place, which makes it the worst performing CIS country. The legislation in Turkmenistan is undeveloped and corruption is rife in the country.

3.2 European CIS Countries

Outside of Russia and Ukraine, there are only two CIS countries in Europe: Belarus and Moldova. These two post-Soviet national economies have both very limited attractions for foreign enterprises: Belarus and Moldova are not blessed with abundant mineral wealth.

Both Belarus and Moldova could potentially benefit from future membership of EU. However, these two post-communist countries have not even an official EU-candidate status so far.

3.2.1 Belarus

Belarus with an area of 208.000 square kilometres and about 10 million inhabitants was one of the most developed republics in the former Soviet Union. In the living standard comparison above, Belarus was below the Russian but above the Ukrainian level.

In the post-Soviet period, Belarus has had an authoritarian rule by Alexander Lukashenko, the President. The economy is only partially decentralised, which means that the state still owns plenty of assets, and that the administration is allowed to interfere directly in countless business issues.

In the turn of the century, Belarus and Russia signed a treaty of two-state confederation. Very little is known about this agreement and its implementation.

Belarus has very small reserves of oil, coal, and potassium, but is otherwise poor in natural resources. Belarus uses peat to fuel local power stations.

Belarus is in many senses a special case among European transitional economies. It is not interested in Western orientation in her economic policy-making. Instead, it carries out authoritarian methods internally, had has "Eastern orientation" externally. As a result, Belarus has achieved a relatively high living standard in CIS comparison, but is lagging behind TEs, which joined EU in 2004. Living standard in the Baltics (Estonia, Latvia, and Lithuania, which are former Soviet republics) is higher than in Belarus.

Total export value in Belarus was $ 13,9 billion in 2004. The big bulk of exports go to the neighbouring Russia which buys plenty of Belorussian agricultural products and foodstuffs. Belarus has a long tradition in producing agricultural machines and tractors, which have questionable competitiveness in the global market. Thus, this export group has its best markets in the other CIS countries.

Agriculture has a rather high share of 16% in Belorussian value added creation. Agricultural productivity is relatively high (on the second place after Armenia) in CIS comparison, but very low in Western comparison. However, natural preconditions for farming are in Belarus very good, and thus, agricultural produce can be rather easily sold to neighbouring CIS markets.

Belarus has a good logistic position close to the enlarged EU, but the country has been able to attract FDI only in a very limited manner. In 2004, FDI stock per capita was less than $ 200. This meager result is not surprising. The country cannot offer options for mining companies. In the "ease of doing business" ranking made by the World Bank, Belarus has a low position of 106. Frequent interventions in the business scene by civil servants are not an attraction to start business in Belarus.

3.2.2 Moldova

Moldova is a small country with a population of 4,3 million, and an area of 34.000 square kilometres. There are no natural resources to speak of, except rather fertile soil.

Moldova's living standard is virtually on the same level as that in Uzbekistan and Kyrgyzstan. Moldova is the poorest country in Europe. Its annual export value is just $ 1 billion. Moldova imports almost all of its energy supplies from Russia due to the lack of domestic mineral deposits. Thus, it is no surprise that the country has deficit in her current account.

Therefore, it is understandable that foreign investors have found hardly any options in the Moldovan economy. FDI stock per capita is below $ 200. In the "ease of doing business" table Moldova is on the 83rd place, which is relatively good rank within CIS. However, this moderately good rank is not high enough to cause a substantial FDI inflow.

3.3 Caucasus

There are three CIS countries in Caucasus: Georgia, Armenia, and Azerbaijan. The political situation in this region is extremely delicate.

Azeris are of Turkish ethnic origin, who have a long historical hatred with their Armenian neighbour. In the last years of Soviet power, both republics started preparing themselves for sovereignty. In the fight for independence, Armenia occupied a region within the neighbouring Azerbaijan, called Nagorno-Karabakh. This region had mainly Armenian population (80%). Armenia was able to occupy this area, and has therefore an enclave within Azerbaijan. Azeri inhabitants of Nagorno-Karabakh were forced to leave, and became refugees in Azerbaijan proper.

In January 1990, Soviet army used military power to prevent Azerbaijan's separation from the Union. Several hundred people were killed in this conflict in Baku, the capital city of Azerbaijan.

Georgia has a multi-ethnic composition. South-Ossetians, Abkhazians and Adjaris live alongside with Georgians in the Georgian territory. The first three-named ethnic groups aim at autonomic or even sovereign status. Thus, there is plenty of internal tension within the post-Soviet Georgia.

Thus, all three Caucasian post-Soviet states are not ideal playing grounds for international business. However, there is one special attraction in this region: oil in Azerbaijan. Baku is one of the first oil producing location of the world. Azerbaijan still has got oil in the post-Soviet era, and thus, that country has a very special meaning in the eyes of multinational companies.

3.3.1 Azerbaijan

Azerbaijan is with 8,3 million inhabitants the most populous state in the CIS Caucasus region. Living standard in Azerbaijan is about $ 4.000 GDP per capita, PPP adjusted, rather modest in comparison to equivalent figures in Turkmenistan and Kazakhstan. However, Azeris are twice as well off as Uzbeks.

As an oil-producing country, Azerbaijan has a rather modest annual export value of less than $ 4 billion. It means that the country has rather small export surplus of hydrocarbon bearing materials. However, the export value of these materials is likely to increase in the near future.

Because of her oil deposits, Azerbaijan has attracted in relative terms rather much of FDI: the per capita stock is over $ 1.000, and thus, the country is in FDI statistic on the second place after Kazakhstan within CIS.

In the “ease of doing business” index by IBRD, Azerbaijan is on the 98th place, which is better than Ukraine and Uzbekistan. In the Corruption Perceptions Index by Transparency International Azerbaijan is permanently scoring low points (137th in 2005). Thus, the country offers a rather corrupt business environment, where starting and closing business is not easy.

3.3.2 Armenia

Armenia has a population of 3,1 million, and an area of 30.000 square kilometres. This small country has some non-ferrous metal deposits in its territory, but these reserves are rather thin.

In the Soviet era, an extensive hydroelectric power complex was build up in Armenia. This power network has been an invaluable asset for the post-Soviet Armenia.

Armenia is in living standard roughly on the same level with the neighbouring Azerbaijan: both countries have a per capita GDP figure of $ 4.000 PPP adjusted.

Armenia's export performance is rather poor: export value in 2004 was no more than $ 700 million. This figure reflects the very limited resource base of the country.

Just one quarter of Armenia's value added originates from agriculture. The country has the highest farm-sector productivity in the CIS region.

Armenia has the highest rank within CIS in the "ease of doing business index" (46th). Thus, the administrative framework is in relatively good shape in CIS comparison. However, the country has not been able to attract FDI in large scale: FDI per capita stock is about $ 270, which is more than in Ukraine, Belarus, and Moldova, but cannot compete with equivalent figures in resource-rich CIS countries, like Azerbaijan and Kazakhstan.

3.3.3 Georgia

Georgia has an area of 70.000 square kilometres and a population of 4,3 million. The country is one of those post-Soviet republics which are not blessed with abundant resources.

Thus, Georgia has a lower living standard than Armenia and Azerbaijan (GDP per capita, PPP adjusted: $ 3.400). Georgia exports goods in value of $ 1 billion. The country must import a big bulk of its energy needs.

About one fifth of Georgia's value added comes from agriculture, in which productivity is much lower than in Armenia, but higher than in Azerbaijan. The agricultural machinery is outdated and infrastructure weak in Georgia, but the agriculture has potential to develop its productivity and increase production amounts. The area of arable land remains relatively small, but soil is fertile, especially on the coastal line of the Black Sea.

Georgia's FDI record per capita is rather modest, $ 240 only. The foreign investments have been done mainly in the field of gas and oil sector. The country is on rank 100 in the World Bank "ease of doing business" table and on rank 130 in Corruptions Perceptions Index. The natural beauty of the country offers opportunities in tourism, but large scale FDI in this branch in unlikely to take place.

4 Conclusions

After the collapse of communism in Europe, in 1989-1991, there were high hopes in the Western part of the Old Continent that centralized economic system will be decentralized and dictatorships replaces by democratic order in all post-communist states very rapidly. The end of Cold War started a new page in European history.

The end of communist era was a rather peaceful event. In the former Eastern bloc comprising the satellite states of the Soviet Union, the systemic change was carried out via negotiations. Only in Romania, there was violence involved with several thousand casualties. The break-up of the former Yugoslavia was a different story: complicated armed conflicts with terrible consequences took place.

In the last years of the Soviet power, several conflicts with bloodshed occurred, when republics of the Union started seeking sovereignty. In August 1991, a military coup by some supporters of the old system was in making. However, this August 1991 coup stopped before it even started. The Soviet Union broke up into 15 independent states.

In the early period of transition, the countries of the former Eastern bloc expressed their willingness to join EU. Three former Soviet republics in the Baltics did the same. Slovenia as a part of the former Yugoslavia joined EU-candidate group.

The EU applicants were told that membership will be given by merit. Democratic system, functioning market economy, and Western-type legal system with proper law-enforcement were required as preconditions for EU-entry, which took place in May 2004 with eight TEs. Romania and Bulgaria were relegated among ten TEs knocking the door of EU.

This preparation for EU-entry has been missing within CIS. Obviously, this in one of the reasons that 12 members of CIS have not been in a hurry to complete the systemic change.

The text above did not deal with the democratization of CIS countries. It is evident, however, that the 12 countries under review have not reached ideal political circumstances. Various degrees of authoritarian rule can be observed in the former Soviet Union.

Living standard differentials in the post-communist world are striking. Slovenia is about 20 times richer than Tajikistan. Kazakhstan is four times better off than Uzbekistan.

The former Eastern bloc has received a huge quantity of FDI. Multinational enterprises have improved living standard and export competitiveness in that part of Europe substantially. Thus, it can be maintained that investment climate must be in reasonable shape. Natural riches in the former Eastern bloc are not abundant, and thus, mining and extracting investors have not played a decisive role in that area.

In CIS it is easy to observe that FDI flows have targeted countries with ample resources. Kazakhstan is more interesting than Tajikistan, and Azerbaijan more attractive than Georgia in the eyes of foreign investors.

CIS countries with narrow resource base ought to concentrate on institutional reform and make establishing, running, and cancelling businesses easy. That is obviously made in Armenia, which is more an exception than the rule within CIS. Corruption in business life means that firms ought to pay official but also "unofficial" taxes. Corruption, which is a serious problem in CIS region, is an impediment of business creating welfare for the local community. Much attention must in the near future be paid to this problem.

Questionable business environment with administrative interference and illegal payments creates tension in the society. Popular discontent may cause riots. This point is not mentioned by accident in CIS context.

Agriculture is not an important source of wealth in modern societies. In the post-Soviet era, some de-industrialization and de-urbanization has obviously taken place. Almost 40% of value added creation takes place in Kyrgyzstan in the rural economy. The equivalent figure in Russia is only 5%. In other CIS countries the share of agriculture is rather high in Western comparison. Productivity in the rural economy is in CIS region generally very, very low.

The export performance of ten CIS countries under review here (excluding Russia and Ukraine) is extremely modest. The overall population of ten CIS countries is 88 million. These ten countries exported in 2004 together goods in total value of $ 51 billion, of which Kazakhstan exported about $ 21 billion. The value of exports in 2004 from Finland was € 49 billion, or in US dollars about 59 billion. Thus, Finland with 5,2 million people exported clearly more, than ten CIS countries under review here taken together.

In the foreign trade statistics official exchange rates are used when national figures are converted into dollars or into euros. It was described above how these official exchange rates (ERs) have biases, which can be measured via a special tool called exchange rate deviation

index (ERDI). Official ERs in transitional economies do not reflect local price levels correctly. All currencies are undervalued in the CIS region. The higher the ERDI value, the higher is the distortion in the local official ER.

The highest ERDI value was found in Turkmenistan with about 7,20, and the lowest in Russia with 2,46. In the Russian case it means that if somebody visits Russia and buys an average consumer basket there, he/she receives goods in value of € 246 with € 100 banknote, because prices in the eurozone are higher than in Russia. ERDI average value in CIS is 2,78 as pointed out above.

It is occasionally maintained that undervaluation of a currency is a protectionist method: it gives price competitiveness to local exports and makes imports expensive (in the eyes of local buyers). Exchange rate protectionism takes place in CIS countries. However, ER protectionism is not on the same level in different CIS countries: Turkmenistan has high undervaluation protection for her economy, while Russia has a rather moderate one in comparison to Turkmenistan.

Undervaluation of a currency means that the country in question seeks equilibrium in her balance of payments on current account. In the plain language it can be said that the country looks for a balancing act between her export income and import expenditure via undervaluation of her currency.

This short research report shows that wealth and income within CIS are unevenly distributed. Foreign investors have not treated all CIS countries equally. The uneven distribution of welfare between different CIS members will be aggravated in the near future provided that world market prices of oil remain on a high level. Countries with hydrocarbon deposits will gain, energy importers will suffer in relative terms. CIS as an organization has no mechanism to redistribute income between her member states, or there is no such system known to outside observers. Economic dynamism and social stability must be created via state-level economic policy-making. Every CIS country is an independent unit responsible for her own economic affairs.

In the poorer CIS countries low wages are a serious problem, and thus, there is incentive to emigrate. In Moldova, the poorest European CIS country, it is estimated that workers' remittances exceed 25% of GDP: about one quarter of the annual output comes from Moldovans working abroad and sending back home part of their earnings. Similar effects in smaller scale are present in Armenia and Tajikistan.

It is impossible to measure how many “guest workers” are active in CIS (workers from one CIS country working in another). Uneven development in the CIS region obviously favours workers’ migration. However, there is no unified labour market in CIS: every member country can control its immigration.

It is no secret that in the immediate aftermath of the collapse of the Soviet Union, a massive “brain drain” took place: plenty of scientists and other people with skill left the region. Also capital flight took place.

One of the dangers many impoverished CIS countries are facing, is human capital flight. The local state educates her citizens, but graduates leave the country in the hope of better earnings elsewhere. This danger is very real in several CIS countries. Neighbouring CIS countries may benefit from this movement of human skill. It is evident that Russian language is widely used in the former Soviet Union making human factor mobility easy from the linguistic point of view.

The overall population of CIS is circa 280 million, and thus, as a big market, it offers plenty of business opportunities. However, this market is fragmented. Opportunities and risks in this region have no common denominators.

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