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Research Note

The slow growth of foreign direct investment in the Soviet Union successor states

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Abstract

This note reviews the statistical evidence on foreign direct investment (FDI) in the countries of the former Soviet Union taking into account data from both host countries and countries of origin. The main characteristics of this FDI and its variation among the successor states of the Soviet Union are established. The contribution of FDI to economic transition is so far limited to some sectors and regions, and unlikely to accelerate in the near future.

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1. Introduction

Large amounts of foreign direct investment (FDI) have been attracted by many Central European transition economies (e.g., Meyer, 1998). Yet the countries of the former Soviet Union (FSU) are far less attractive in the perspective of potential investors. In the early 1990s, the annual inflow to the FSU was estimated to be between US$ 0.5 billion and US$ 1 billion (Meyer, 1995). Since then FDI into the region has accelerated. Official statistics report a major turnaround, especially in Kazakhstan and, more recently, in Russia. Foreign investors take a substantive role in several sectors of industry, even though the capital stock of FDI is still low. However, the evidence is incomplete due to inconsistent and changing methods of data collection, and the low level of reliability of some of the important primary sources. This note has two related objectives. We review the statistical evidence of FDI in the FSU countries taking into account data from both the host countries and the countries of origin. Secondly, we aim at establishing the main characteristics of the FDI and its variation in the region. We conclude with a cautious outlook.

2. Assessment of the investment situation

Brewer (1994) and Meyer (1995) review available sources of data on FDI in transition economies and conclude that they all have their respective shortcomings, but jointly may appropriately depict the actual developments. Reliability of data on FDI in post-Soviet countries is inhibited not only by the general problems in defining and measuring FDI (Bellak, 1998), but also by the traditionally low quality of data provided by state statistical offices in the Soviet Union and its successor states.

For cross-country comparison, the balance of payments data produced by the International Monetary Fund (IMF) are most suitable because they have, hopefully, been collected applying the common definitions of FDI established by the Organisation for Economic Co-operation and Development (OECD) and the IMF. However, they are based only on the capital transfers and may, therefore, understate actual FDI if a major transfer is made not in cash but ‘in kind’, i.e., through the provision of machinery or technology. Investors who establish operations without transferring capital may in this way be underrated. For instance, Western business service firms such as accountants, banks and engineering consultants are very active in the region (e.g., OECD, 1994). Through their interaction with local firms and authorities (e.g., consultancy for privatization agencies) they may have a major impact on the evolution of local business. However, such contributions are difficult to quantify.

The statistical evidence on FDI during the last years of the Soviet Union gives an ambiguous picture. While Western businesses started to enter the region, they were clearly reluctant to transfer capital. We consider PlanEcon data to most appropriately reflect actual investment (Meyer and Pind, 1998). They suggest that,

including 'in kind' contributions, the investment may have peaked in 1989 at US$ 641 million in the Soviet Union, US$ 454 million of which were in Russia.

Table 1. FDI inflows to transition economies. Balance of payments data, excluding reinvested profits, in million US$

	1992	1993	1994	1995	1996	1997
Russia[a]	700[c]	700[c]	637	2,016	2,478	6,241
Belarus	7[c]	10[c]	10	15	73	200
Moldova	17[c]	14[c]	12	23	24	60
Ukraine[a]	170[c]	198[c]	159	267	521	623
Kazakhstan	100[c]	165[c]	635[b]	964	1,137	1,321
Kyrgyzstan		6[f]	38	96	47	84
Tajikistan	9[c]	12[c]	12[b]	13[b]	13[b]	
Turkmenistan	11[c]	70[c]	103[b]	233[b]	108	
Uzbekistan	40[c]	4[c]	73[b]	–24[b]	50[b]	
Estonia	73	135	172	186	132	266[a]
Latvia	29	45	214	180	293	558
Lithuania	10	30	31	65	128	355[a]
Armenia		1	8	25	18	
Azerbaijan			22[b]	155[d]	591[d]	1,051[d]
Georgia			8[b]	6[b]	25[b]	
Total CIS			1,700	3,800	5,000	

For comparison	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
Bulgaria	42	55	105	90	109	498
Czech Republic	983	654	878	2,568	1,435	1,286
Hungary	1,479	2,350	1,144	4,519	1,982	2,079
Poland	524	1,516	1,493	2,771	4,254	4,908
Romania	77	94	341	419	263	1,215
Slovakia	72	199	203	183	281	165

Interpretation: 1. Since most countries in the region do not collect data on reinvested profits, we exclude them for better comparability across countries. In the Balance of Payments Statistics, only Poland and the Baltics report reinvested profits separately. 2. With the exception of Poland, the data from EBRD and IMF do not differ by wide margins where both are available. Differences could be due to the use of different exchange rates, or the deduction of outward FDI, different treatment of reinvested earnings and the like. For Poland, the EBRD uses data from the National Bank of Poland, which uses a far narrower definition of FDI than that applied by the IMF.

Sources: Balance of Payments Statistics Yearbook and International Financial Statistics (IMF).

Notes: [a]includes reinvested earnings, [b]net FDI-inflows, estimate by EBRD (1997, p. 126), [c]Economic Reviews (IMF), [d]*Azerbaijan Economic Trends*.

Table 2. FDI inflows to CEE, adjusted for the size of the economy

	FDI *per capita* in US$		FDI in per cent of output (GDP)		FDI in per cent of investment (GDI)	
	1992–94	1995–96	1992–94	1995–96	1992–94	1995–96
Russia	5	15	0.2	0.7	0.7	2.6
Belarus[b]	1	1	0.0	0.0	0.1	0.1
Moldova	3	8	0.4	1.0	4.8	13.9
Ukraine	3	8	0.2	0.5	NA	NA
Kazakhstan	18	62	1.7	4.8	6.9	21.7
Kyrghyzstan	NA	16	NA	2.3	NA	14.7
Tajikistan	2	2[a]	0.6	0.6	NA	NA
Turkmenistan	14	39[a]	1.2	3.3	NA	NA
Uzbekistan	2	1	0.2	0.6	0.8	2.6
Estonia	84	106	2.8	4.0	8.6	14.7
Latvia	38	95	1.7	3.9	18.3	18.7
Lithuania	6	26	0.5	1.4	2.5	7.2
Armenia	NA	5	NA	0.9	NA	10.0
Azerbaijan[b]	NA	50[a]	NA	10.5	NA	65.8
Georgia	NA	3[a]	NA	0.8	NA	25.0
For comparison						
Bulgaria	8	12	0.7	0.8	3.1	3.9
Czech Republic[b]	81	194	2.3	4.5	11.6	17.9
Hungary[b]	161	319	4.0	7.4	19.1	32.3
Poland	31	91	1.3	3.0	8.0	17.6
Romania	8	15	0.6	1.0	2.1	3.7
Slovakia	30	43	1.3	1.3	7.5	4.7

Sources: Own calculations based on Table 1, and World Bank (1996, 1997), Tables 1, 12 and 13. The data for population, GDP and GDI are 1994 (for 1992–94) and 1995 (for 1995–96) unless otherwise indicated. The World Bank reports the data for the former Soviet Union countries as 'preliminary

Notes: [a]calculations used population data for 1994; [b]GDP components are calculated at purchaser values.

After the collapse of the Soviet Union in 1991, the continuity of data series was inhibited for two reasons: new countries became the relevant reference unit, and statistical offices in the new entities initially had no appropriate procedures to collect the relevant data. Fortunately, balance-of-payments statistics are now available for most countries, although often as estimates. Table 1 gives an overview of FDI inflows in the period 1992 to 1997. It should be kept in mind, however, that

the international organizations rely on primary data from the respective countries, which are not free from distortions.

The data suggest that FDI in the successor countries of the Soviet Union took off in 1995. Russia has been by far the leading recipient, which is not surprising given the size of the country. The inflow has been estimated at US$ 700 million for 1992 and 1993, but it increased in 1995 to more than US$ 2 billion and over US$ 6 billion in 1997. With the receipts of investments in major utility privatization projects, Russia temporarily overtook even the Czech Republic and Hungary. In 1998, this trend was not continued, as FDI inflows in the first half of the year were already down to US$ 1.1 billion. The economic crises of summer 1998 further depressed investment.

Kazakhstan received the second largest amount of FDI with more than US$ 1 billion in 1996 and 1997. On the other extreme, the small and least reform-oriented countries, Belarus and Tajikistan, received the least FDI. The total balance-of-payments recorded inflow of FDI in the former Soviet Union amounts to about US$ 5 billion in 1996, and more than US$ 10 billion in 1997. This is a remarkable turnaround and would have — if it had been sustained — placed the region amongst the top emerging markets.

The cross-country variation shows a very unequal pattern once the size of the host economy has been taken into account. We adjust FDI figures using three alternative nominators: population, gross domestic product (GDP) and gross domestic investment (GDI). To control for the high volatility of FDI data, we report multiple year averages (Table 2). Hungary has established itself among the leading recipients in emerging markets, with US$ 314 *per capita* in 1995–96. None of the FSU states comes even close to this *per capita* inflow. Estonia reached US$ 84 *per capita* in the period 1992–94, which is second only to Hungary (US$ 161). In the FDI in the Czech Republic accelerated, but Estonia (US$ 106) and Latvia (US$ 95) still stay ahead of Poland and Slovenia in *per capita* terms. The least attractive countries are, by this measure, Belarus and Uzbekistan with only US$ 1 *per capita*.[2]

Table 2 also reports FDI in relation to the size of the economy (FDI/GDP) and to domestic investment (FDI/GDI). The latter is a suitable measure to assess the contribution that foreign investment makes to restructuring and development of the economy (e.g., Desai, 1997).[3] In relation to the GDP, Azerbaijan receives what must be one of the highest inflows worldwide: 10.5 per cent of GDP. This leads to more than 65 per cent of investment in the Azerbaijani economy being controlled

2 For Uzbekistan, the official data may however be incomplete. According to our correspondence with the Korean National Bank, Korean investment in Uzbekistan amounted to US$ 180 million by the end of 1996. This is far more than Korean investment in Russia, and more than the cumulative total reported by the IMF for Uzbekistan.

3 A note of caution: FDI/GDI is not a perfect measure of the foreign contribution, especially because FDI includes the price that investors pay for an acquisition, which is not necessarily used for investment. Only in the case of greenfield is the FDI-capital actually invested in new productive activity. However, the FDI over GDI ratio gives an indication of how many new productive assets are foreign controlled.

by foreigners. The exploration of attractive oil deposits in an underdeveloped economy with few other industries leads to such foreign dominance. The attraction of natural resources also accounts for the strong Kazakh position by these measures, with an FDI over GDP ratio of 4.6 per cent. They are followed by the Baltic countries, which have reformed more comprehensively and in addition benefit from good relationships with their Western neighbours. Relative to the size of the economy, these transition countries receive more FDI than other economies at a similar income level.

Yet other countries are disappointing. FDI in Russia amounts to only 0.7 per cent of GDP, and 2.6 per cent of GDI. The laggard is Belarus. With 0.03 per cent of GDP or 0.12 per cent of GDI, FDI is negligible. This can be attributed to Belarus' continued reliance on central planning and the lack of operational freedom for domestic and foreign businesses.

However, many areas within Russia are also void of foreign investment. The balance of payments disguises the huge variation within Russia (Bradshaw, 1995; Brock, 1998). The OECD (1997a, p.127) reports Goskomstat data on the regional dispersion of FDI in Russia: FDI is concentrated in the capital, Moscow and its surroundings, showing a pattern that is typical for countries with a highly centralized industrial structure, but not for countries spanning a large geographical area. The time trend 1994 to 1996 shows that the area surrounding Moscow, and the Far East, are increasingly attracting foreign investors, while the relative position of thinly populated but resource-rich regions of the Far North and Western Siberia declines.

3. The source countries

FDI can be measured in the host country, as is common practice, or in the country of origin. The OECD collects detailed data on FDI outflows from the source countries. These data can be used to estimate the inflow to major host countries, although this approach has certain limitations:

- The data are not available for all countries. Notably some countries that serve as a formal residence for businesses operating elsewhere, such as Cyprus or Liechtenstein, are not included.
- If individual data-points are classified as confidential, an aggregation across countries may count them incorrectly as zeros.[4]
- Most authorities register projects only above a certain threshold of capital investment. Since many projects in the transition economies are small in terms of capital invested, this may lead to systematic under-reporting.

3 We have contacted several of the national statistical authorities reporting to the OECD. We found that often the Soviet Union and its successor states are included in categories like 'other Europe' or data were 'confidential' because of the small number of projects (especially before 1992). If such data are aggregated, missing values would be counted as zeros leading to an underestimation of actual FDI.

These limitations imply that aggregated source country data may under-report FDI, especially if the total FDI in the host country is small. However, this approach provides a lower limit for actual investment that is unlikely to be subject to political bias.

For Russia, OECD data are available from 1992 onwards (Table 3). The total FDI that can be traced from OECD countries increases from some US$ 100 million in 1992 to US$ 1 billion in 1995. The OECD publishes its data with considerable time lags, but the data we obtained for individual source countries confirm the upward trend. The home country data are consistent with the host country data for 1994 at about US$ 650 million. Yet in other years, the Russian balance of payments seems to over-report FDI. In 1995, the OECD data show only half the volume claimed by Russian authorities. This is a large margin of measurement error, even considering the limitations of the data.

Table 3. FDI flows from the OECD to Russia, 1992–97, in million US$

	1992	1993	1994	1995	1996	1997
Austria	5.5	6.9	7.0	4.8	10.1[a]	53.5[a]
Belgium/Luxembourg	1.4	61.2	6.8	26.4[a]	7.3[a]	97.7[a]
Denmark		0.7	4.7	–0.2	5.7[a]	21.4[a]
Finland	14.5	–2.8	13.2	10.5		
France	61.8	15.9	108.0	84.5		
Germany	10.9	17.5	105.4	80.9	150.2[b]	117.1[b]
Italy	0.8	4.5	3.7	5.5		
Japan	44.0	22.0	19.0	29.0[c]	20.0[c]	10.0[c]
Korea[d]	4.0	18.0	83.0	89.0		
Netherlands	–39.2[a]	–15.1	–13.7	78.5	116.9[a]	129.7[a]
Poland		1.0	1.0	1.0		
Sweden	0.3	1.0	–17.6	6.7		
Switzerland		–5.4	40.9	30.4		
United Kingdom	–15.9	15.0	179.7	62.4	124.9[a]	
United States	19.0	222.0	142.0	525.0		
Total	107.3	362.5	683.1	1,031.4		

Main source: *OECD International Direct Inv. Statistics Yearbook*, 1997.

Notes: [a]correspondence with Austrian National Bank, National Bank of Belgium, Danmarks Nationalbank, De Nederlandse Bank and Office for National Statistics (UK); [b]Deutsche Bundesbank, Zahlungsbilanzstatistik; [c]Japanese Ministry of Finance, 1997 refers to January to September; [d]According to correspondence with the Bank of Korea, these data reported by OECD actually refer to the CIS, about 30 per cent of this amount is in Russia.

The OECD data suggest that the USA accounts for more than 50 per cent of FDI

in Russia in 1993 and 1995. Other important investors are Germany, the UK, France and the Netherlands, all of which reported more than US$ 100 million in some years. Data like those reported in Table 3 for Russia are also partially available for the Baltic countries and for Ukraine. However, the time series is short and important source countries did not report the information. Therefore, we abstain from tabulating the data. For the Baltic countries, Denmark (US$ 72 million in 1995), Finland (43), Germany (27) and Sweden (25) appear the most important source countries. For Ukraine, Germany is the only source country reporting major FDI with a cumulative total of US$ 157 million by 1997.

The pattern of FDI in the FSU is affected by two phenomena that can explain some of the discrepancies between data sources: round-tripping and investment withdrawal. Round-tripping is the return of flight capital through FDI by Russian firms registered abroad. They form joint-ventures to enjoy benefits with respect to taxation, tariffs and currency convertibility.[5] Cyprus especially has earned a reputation as a haven for Russian flight capital, which is reflected in the fact that Cyprus appears as the fourth most important source country for FDI in 1996 (Table 4). Round-tripping is formally FDI, but brings few of the externalities associated with FDI, and analysts may prefer to exclude it, depending on their research question. Much of this FDI is not covered by source country statistics because the firm abroad, which formally undertakes the FDI, is too small to be covered by its host's statistical surveys, or it may be located in a country where data are not available.

FDI in Russia is furthermore reduced by frequent disinvestments. Table 3 contains several negative entries for FDI flows, which is a rare occurrence for FDI-outflow statistics. These reflect a net capital transfer from the affiliate to the parent or a discontinuation of projects. The exit of investors from a project in the former Soviet Union is not rare. Even globally operating multinationals have disinvested in manufacturing projects, discouraged by the risks of unfavourable local business environments and interference by local bureaucrats (Bridgewater, 1998; McCarthy and Puffer, 1997). In addition, foreign investors are seeking to reduce their exposure to investment risk by withdrawing capital at an early convenience. Host country surveys, let alone registration data, are not sensitive to such trends.

The cross-country pattern is reported in Table 4 based on host country data. The main feature is proximity, as firms have a preference for investment in neighbouring countries or follow special ethnic or cultural ties. This corresponds to similar observations in Central and Eastern Europe (Meyer, 1995). Yet the US is remarkably important. The proportion of FDI accounted for by US multinationals is much higher in Russia and Kazakhstan than in other transition countries. This may be in part due to globally operating multinationals who experience fewer obstacles in bridging large distances. It also reflects that the US, like the UK and Norway, is home to major oil companies.

5 The phenomenon is, however, not unique to Russia. In China, as much as one-third of FDI in the early 1990s was thought to be capital originating in China itself and channelled through Hong Kong (Encarnation, 1996).

Table 4. Countries of origin according to local statistics, in per cent

	Origin	EST	LAT	LIT	RUS	UKR	KAZ
European Union	Austria	2.0		2.4	6.7	1.7	
	Belgium				1.8	2.5	
	Denmark	2.0	20.0	5.1		0.0	
	Finland	23.0		6.0		0.0	
	France				1.8	1.1	5.2
	Germany	3.0	7.3	11.3	9.8	17.0	1.1
	Ireland	7.0	4.7	3.5		0.0	
	Italy				0.7	2.2	2.5
	Luxembourg			6.0			
	Netherlands				1.4	6.3	1.3
	Sweden	21.0	4.7	12.2	1.9	1.8	
	UK	6.0	5.1	7.4	5.3	7.7	6.7
Eastern Europe	Poland			1.0		2.3	
	Hungary					2.3	
	Russia	10.0	10.4	1.5		8.3	
Other Europe	Cyprus				(6.6)[a]	6.0	
	Liechtenstein					3.5	
	Norway			2.4			1.3
	Switzerland		3.4		5.2	3.8	
	Turkey						6.8
North America	USA	8.0	9.1	27.1	40.3	20.2	45.9
	Canada					2.0	1.6
East and South-East Asia	Japan					0.1	4.1
	Singapore		9.0				
	Korea (Rep.)						17.0
Other	Other	18.0	26.3	14.1	na	11.2	6.5
	Total	100.0	100.0	100.0	100.0	100.0	100.0

Abbreviations and sources:
EST: Estonia: registered FDI, July 1995, Estonian Investment Agency.
LAT: Latvia: registered FDI, September 1997, Central Statistical Office, Latvia.
LIT: Lithuania: registered FDI, October 1997, Lithuanian Investment Agency.
RUS: Russia: direct and portfolio investment, flow 1996, Goskomstat data reported by US department of commerce and by Russian investment promotion agency on their respective web sites. (The total is US$ 2.14 billion of which US$ 0.05 billion are portfolio. Using these as approximation for FDI is thus appropriate.)
UKR: Ukraine: stock of registered FDI, July 1996, (Yegorov, 1997, citing the Ukrainian Ministry of Statistics).
KAZ: Kazakhstan: Cumulative flow 1993–96, National Statistical Agency of Kazakhstan.
Note: [a]refers to total investment (including purchase of goverment securities) — no details given on the kind of foreign investment.

Table 5. Sectors of foreign direct investment in per cent of total FDI

	Largest projects		Registered FDI			
	CIS	Other than CIS	Russia (a)	Russia (b)	Ukraine	Kazakhstan
Mining and quarrying	76.7	2.4				77.7
Metallurgy						23.0
Oil & gas				16.0		54.7
Manufacturing	19.4	63.2			34.1	
Food & tobacco			2.6	9.2	12.6	
Light industry			1.3	3.6*	2.9	
Chemicals			19.3	2.7	3.2	
Metals			2.3	2.9	1.0	
Engineering			24.1	4.3	11.9	
Other manufacturing			15.9		2.3	
Construction	0.0	8.0	8.5			
Trade	0.0	2.2		4.8	26.4	
Transport & communic.	1.2	12.8	3.2		4.1	
Financial services	0.7	5.2		32.5	6.3	
Other services	0.1	1.3	28.0	10.7	16.6	
Other, N/A	1.8	4.8		13.3	12.5	

Sources and notes: Largest projects: UNECE (1995).
Russia (a): UNECE (1996a), data refer to the stock of registered FDI at the end of 1994.
Russia (b): Foreign Investment Promotion Center (http://www.fipc.ru) citing Goskomstat. Data refer to the total investment registered by the end of 1997. Forty-six per cent of this investment is registered as direct investment, but no sector breakdown for this is available. *the entry refers to the wood industry only.
Kazakhstan: National Statistical Agency of Kazakhstan, referring to new FDI in 1996.
Ukraine: Yegorov (1997) citing Ukrainian Ministry of Statistics, referring to registered FDI, July 1996.

An outlier is Korea, as its multinationals appear to focus on Central Asia as the door to entry into the region. This can be attributed to the role of the Korean minority in Uzbekistan and other central Asian countries. This ethnic group established itself after the Korean War, coerced by Stalinist resettlement policy. Russia itself is emerging as a major source of FDI in the 'near abroad' countries. This is in part due to the reorganization of firms after the break-up of the Soviet Union, but may also have been enhanced by capital flight.

4. The sectors of foreign investment

The available information on the sectors of investment is based on the registration of investment projects with the usual shortcomings of such data (Table 5). The UNECE (1995) compares the pattern of FDI in the CIS countries with other transition economies based on the investment in the largest investment projects. These data show an enormous difference: Three-quarters of major investment projects in the CIS are in mining and quarrying activities, whereas almost two-thirds of major projects elsewhere are in manufacturing. Also the telecommunications sector in the CIS received only a fraction of the investment capital attracted to the other transition economies. The actual differences may not be as huge if all the small projects in both services and manufacturing are considered, yet it indicates a major trend.

The data obtained for Russia appear very contradictory. The UNECE (1996) reports that investment until 1994 is concentrated in manufacturing. Presumably, this includes exploration of natural resources as well as their processing. Recent data from Goskomstat do not distinguish between direct, portfolio and other investment, i.e., foreign acquisition of Russian government bonds (US Government, 1997). Apart from this financial investment, the oil and gas industries receive the largest share. This confirms the attraction of Russian resource deposits that are now explored by Russian-international consortia.

Similarly, FDI in Kazakhstan is aiming primarily at deposits of natural resources. The main investment capital flows into natural resource exploitation, not only oil and gas but also various kinds of mineral deposits like copper, aluminium and titanium (Meyer and Pind, 1998). In Azerbaijan, oil consortia alone accounted for over 70 per cent of FDI in both 1996 and 1997.[6]

The food and tobacco industries receive major investment aimed primarily at supplying the local markets throughout the transition economies, including Russia and Ukraine. This reflects the market orientation that investors report consistently in many recent enterprise surveys.[7] In Russia, investors stress the long-term potential of the market, as many firms appear to make losses for a rather long initial time period. However, small initial projects enable the investor to learn about the local business environment, to establish contacts and to explore future business opportunities. In oligopolistic industries, firms pursue perceived first-mover advantages and enter early before the market has grown sufficiently to permit profitable operations (Lankes and Venebles, 1996; Meyer and Estrin, 1998).

Labour costs are lower in the former Soviet Union than in Central Europe

6 This figure has been calculated from balance of payments statistics in *Azerbaijan Economic Trends* (1/1998). In 1997, oil consortia invested US$ 780.1 million.

7 Investor surveys focus on Central Europe, as the base population of firms active in Russia is rather small. Some surveys cover several countries and thus permit some inference about the differences between transition countries (e.g., OECD, 1994; Meyer, 1998; Lankes and Venebles, 1996). Other surveys focus on selected successor countries, mainly on Russia (e.g., Thornton and Mikheeva, 1996) but also on Kazakhstan (Charman, 1998), Ukraine (Bridgewater, 1998) and the Baltic countries (Borsos-Torstila, 1998).

suggesting a major potential for labour-cost oriented relocation. However, few if any investors appear to invest in labour-intensive export-oriented projects, even fewer than in Central Europe. The reasons for this are the higher transportation costs, and lower productivity due to dated machinery, weak managerial skills and inadequate infrastructure. Also, many investors considered the quality of locally available supplies as unsatisfactory. In consequence, there is so far little investment in typically export-oriented FDI sectors such as textiles or electronics.

5. Outlook

A wide diversity of experiences with FDI can be observed in the countries and regions of the former Soviet Union. Three trends emerge: the countries that are most advanced in economic transition receive FDI of more than 3 per cent of GDP, which is above the West European average. The resource-rich countries, Azerbaijan, Kazakhstan and Turkmenistan receive very large amounts of FDI, which are focused on the exploitation of natural resources. Less reform-oriented countries like Belarus and Uzbekistan have received very little FDI so far. FDI in Russia is similarly diverse as foreign investors respond to resource endowment and regional reform policies.

The policy implications are thus different for different countries. Estonia and Latvia appear to be well positioned to take advantage of the potential benefits of FDI. In the resource-rich countries, investment appears to be concentrated on a few industries, which limits the spillovers that this investment will create for the economy. Their prime task thus is to create linkages between the foreign-dominated sectors and other economic activity and to encourage FDI in processing rather than just in the exploration of natural resources. For both groups of regions it would, however, be premature to rest on their laurels as their stock of inward FDI is, due to the short history of receiving FDI, not particularly high.

FDI is still minor in most other successor states, and in most of Russia itself. A turnaround cannot be expected soon because the main obstacles arise from the weak legal and institutional framework, or even the lack of a civic society (e.g., Lankes and Venebles, 1996; Thornton and Mikheeva, 1996; Meyer, 1998). The reform of this business environment is a daunting task that will take several years to accomplish, even under an optimistic scenario. Foreign investors will continue to observe the evolution of the institutional environment, not just the laws issued but also the track record of the host governments, before committing major capital investment.

The devaluation of the rouble in August/September 1998 is unlikely to boost business. Local production becomes cheaper and may thus replace exports to Russia. Yet added uncertainty and lower purchasing power deters capital transfers and market-oriented investment. FDI in the exploitation of natural resources is more influenced by world market prices which have been falling during 1998, and

thus discourage exploration.

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