THE BLEYZER FOUNDATION

Turning Transitions Into Prosperity

The Bleyzer Initiative: Completing the Economic Transition In FSU Countries

SigmaBleyzer

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Preface

Economics, it is said, is undeniably important, but it is cold and difficult, and best left to those who are at home in abstruse realms of thought. Nothing can be further from the truth. A man who thinks that economics is only a matter for professors forgets that this is the science that has sent men to barricades. A man who has looked into an economics textbook and concluded that economics is boring is like a man who has read a primer on logistics and decided that the study of warfare must be dull.

Robert L. Heilbroner

The 21st century finally arrived, with all its promises, opportunities and dangers. Our planet is divided into some 190 countries that span continents and cultural backgrounds. Various agencies like the United Nations, IMF, the World Bank and others have attempted to classify these countries into categories or blocks based on their so called "development". Depending who is counting we have 28 or 29 countries that are classified as developed. Then there are countries in a state of transition, known as transition economies. The word transition is used to describe the countries of the Former Soviet Union (FSU) and Eastern Europe that are currently believed to be transitioning to market economy. And the rest of the world is often referred to as Developing Countries, the Third World, or some combination of the two. The transition economies are often considered to be a subset of the developing countries group, however some of them do not like to be classified this way. They argue they are at a higher level of "development" than the "other" developing countries.

Since the very term "developed" versus "developing" is somewhat subjective, and the "transition" process is yet to be fully understood, it may be more interesting to think of various countries in terms of their social structure. Robert Heilbroner, in his immortal classic "The Worldly Philosophers", offers the following three systems to organize human society in order to ensure its survival. The first method is based on tradition or custom "by handing down the varied and necessary tasks from generation to generation." In this way all the tasks needed for the proper functioning of the society are performed, however the price paid is a sad fact that everyone is born into his social task, and changing one's preordained role in life is very difficult.

Another way to keep a society together is known as the "command" or "authoritarian" system. In many countries of the Communist block this system was also associated with what is known as "planned economy". Plans were developed for long periods of time with no regard for the unexpected and unforeseen. The so-called Five-Year plans of the Soviet Union were famous for their incredible cost and human sacrifice, but produced little that could compete with even their closest neighbors, Eastern European countries, much less with the West. This combination of a centrally planned economy and a command system of controlling society ultimately imploded under its own weight.

It can be easily argued that except for the 28 developed countries most of the world today relies on one or a combination of these two social structures — custom or command. The third method of organizing people and tasks in a society is known as the "market system". Most of the economists today would agree that this is the system that will dominate the world in the 21st century. It is the system, which many of the transition economies and developing countries of today are trying to build. And in my view — it is the system that will finally bring the right balance to human kind — the balance between prosperity and the freedoms of each individual and society as a whole.

Therefore, for the purposes of this book, we shall assume that the market system will be the method by which mankind will ensure its survival in the future unless an entirely new social system will be invented. As Milton Friedman once wrote "Ten years ago, many people were convinced that capitalism, based on free private markets, was a deeply flawed system that was not capable of achieving both widely shared prosperity and human freedom. Today conventional wisdom regards capitalism as the only system that can do so." It is indeed remarkable that these words were written in 1990 before the full collapse of the Soviet Union and the incredible transformation that followed in the countries of the former Soviet block.

This book proposes an approach to complete the transformation process in the countries of the FSU, contributing therefore to the overall stability in the world. The events of September 11th introduced a new understanding of one of the greatest concerns for world security and of the phenomenon I call "Assured Interdependence". The period of Cold War was known for its doctrine of "Mutually Assured Destruction". Each of the Superpowers on the opposing sides had built an enormous nuclear retaliation capacity, therefore ensuring that no matter who initiated the first strike, all would perish in the end. This doctrine obviously has never been tested in real life, but many government policies and business strategies were based on that belief. With recent dramatic breakthroughs in the relationships between the United

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States and Russia, and NATO and Russia, this period is behind us, and the danger seems to be over, at least for the moment.

But the immediate danger, most would agree, lies in dramatic increases in the world's polarization. Not only a significant percentage of the world's population lives in poverty but the freedom of information exchange and the ease of access tend to accentuate the differences and generate envy, instead of creating opportunities. It can certainly be argued whether there is a direct and immediate linkage between poverty and terrorism. President Bush said it best in his March 14th, 2002 speech at the Inter-American Development Bank "Poverty doesn't cause terrorism. Being poor doesn't make you a murderer. Most of the plotters of September 11th were raised in comfort. Yet persistent poverty and oppression can lead to hopelessness and despair. And when governments fail to meet the most basic needs of their people, these failed states can become havens for terror."

It is clear that the dependence of one part of the world on the events taking place in a far distant corner has grown significantly, and will only continue to grow over time as technology advances allow for more and easier access to information, travel, means of delivery, and an opportunity to express one's feelings in some new and unanticipated ways. With each passing day, every single being on the planet and every single social structure are becoming more and more connected, and therefore dependent on each other. This IS assured interdependence.

The world of today is facing three alternative ways of dealing with the Assured Interdependence phenomenon. I call them Standoff, Payoff or Tradeoff.

Standoff is basically where we are today, the status quo. Developed countries enjoy relative stability and prosperity, but attempt to isolate their economies. They mostly keep their wealth and their market economy know-how to themselves. Developing countries struggle to develop, but continue to be immersed in poverty, inequality, instability, and envy. They are struggling through a nightmare of the transition economy years. No one is sure how and when these transitions will ever be completed. World stability is only a dream.

Payoff is what some people are proposing as a "new approach." The developed countries have too much wealth accumulated. They are too rich! The developing countries are poor and miserable. These "bad" countries will keep making problems for the developed countries until they get enough financial aid to help them out of their poverty. Therefore, let us share some of the wealth accumulated in the developed countries by transferring more of it to the developing countries. In other words, let's pay them off not to be troublemakers for the world. This is actually an old idea of "wealth redistribution", except now on a global scale. This would be accomplished through the substantial increases in foreign aid, in order to avert future troubles in the world. While some believe you can simply pay your way to world stability, this approach will likely produce a global welfare system. Donors and recipients will be equally dependent on each other and motivated to maintain this dependency in perpetuity.

Finally the **Tradeoff**. That is where I believe the solution lies. Let's all sit down at the table — we the World! And let's do what we have done best since the dawn of civilization — let's trade! We, the developed countries, will offer our know-how and experience of building the market economy, as well as some amount of well targeted financial aid, to help create a business- and capital-friendly environment, which will lead to capital investments, economic growth and improved quality of life for the people. You, the developing countries, in turn, will trade in your commitment to build the market system, the rule of law, and a transparent and democratic society. We will jointly develop the action plans that will be necessary to help the countries in transition to complete their journey.

These three alternatives may sound as a fairly simplistic way to look at the world. And indeed they are. Why do they need to be overly complicated? After all, if we can agree on the destination — the market system and the points of departure — either a command or a custom driven social system (or a combination of the two), then the journey that must be undertaken, is also pretty clear. The institutions and organization of the society, as well as the system of personal motivation of the individual must be changed, rebuilt to be more like those of the most successful market economies of today. There are only two ways of doing it — the countries under transformation will do this by themselves or they will do it with active involvement of the currently successful market economies.

The first way is tempting and it is the one most commonly used. Even in the many cases when financial assistance is provided to a country, the approach is normally called "performance based". In other words, we shall advise them on what needs to be done, if they ask us, or if we clearly see what they are doing is wrong, but in the end we will expect them to do it. They must be willing to do it, they must commit themselves to doing it, and they must do it. We will help, if needed, through financial aid or technical assistance, but otherwise we will be standing by, ready to applaud or chas-

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tise depending on what they have done — their performance. If we like their performance we shall reward them with more aid and technical assistance, more contacts and ultimately with more recognition. If their performance is poor in our opinion, we shall withdraw aid, reduce contacts and shun them in any way we can. Some people think this approach works well with children, some disagree. But most believe it is the way to go with independent Nations.

There is a little problem here. Even setting aside the issue of national pride for a second, all countries under transformation are not created equal. If we believe that their transformation is a journey between their point of departure and the common destination called the market system, we must also accept that they are not only at very different stages of the journey, but also may have quite different levels of resources at their disposal to undertake and complete the journey. Some of them have not even started, but would like to begin… one day. Others can already see the light at the end of the long and dark tunnel, but no one is sure if this is not an oncoming train. Yet others are lost somewhere on the way, having no clue how to complete the journey, but not really wanting to go back. In fact this brings us to an interesting question — how do we know when the destination has in fact been reached? How do we know that the journey is completed? Who is the judge? Who in the world is the expert on completing transitions, transformations, country developments, etc.?

If we review the recent experiences in Eastern Europe and the FSU, the most successful countries can probably be named with relative ease. Poland, Hungary, Estonia, Czech Republic, and maybe a few others. Can we consider them to have arrived? What about Poland recently? Do their recent problems suggest that they have been on the wrong course for 10 years? How about South America? Chile is still doing pretty well. What about Argentina? Just a few short years ago Argentina was one of the leaders in creating a capital-friendly environment, attracting close to $25 billion in Foreign Direct Investments (FDI) in 1999 alone. It is hard to believe this number, knowing what happened there just a couple of years later. Of course, we can explain the specific events by analyzing the fiscal, monetary and other policies employed by Argentina in the 90's, or Poland more recently, but the question still remains — how do we start changing the balance in the world, this magic 28/160 ratio? If we, the developed countries, would like for the world to become more stable based on more countries converting to the market system, with democracy and transparency normally associated with it, should we try to identify how we go from 28 to 35, or 40? Changing this ratio of developed versus developing countries should indeed be the bottom line measurement of the progress we must be demonstrating on our way towards world security, stability and prosperity. And this ratio will be changing one country at a time. One specific country at a time! So, which is the next one?

As the countries move towards joining various organizations and alliances, like the WTO, EU, NATO and so on, should not the most important club to join be the club of the developed countries?

I believe that to answer these questions, and more importantly for the world community to answer the challenge of the next millennium, we will need a better set of methodology and tools to allow for country transformation processes to take place in a more organized and predictable fashion. We can never get it perfect, to be sure. But I believe we can improve significantly the methods and approaches currently used to help transform the societies. I also believe that it is the science of economics that will provide most of the answers needed to achieve this noble goal. I hesitate to use the term "Development Economics" because it was discredited somewhat in recent times. In fact, some even declared, perhaps prematurely as Oscar Wild would note, the death of Development Economics. Just like the term "Nation Building" now generates an immediate negative reaction from many observers, not because of what it could literally mean, but because of what it has been in the past, the failures of Development Economics can be more linked to the wrong implementation and approaches, than to the concept itself.

To achieve sustainable economic growth in developing countries and transition economies, the development of institutions, ways of organizing and governing a society, and a progressive policy environment must take place. The best way to do this is by learning from experiences of the successful market economies, which can be found in the 28 developed countries, and are best represented by the G7 advanced developed countries. These countries must have employed the best set of government policies and must have built the most effective institutions to get to where they are today. As Yujiro Hayami writes in his comprehensive treatise *Development Economics*, "A key to identifying causes of poverty and stagnation in low-income economies may be found in the experiences of economies that escaped from the same trap. It was through the process of economic development over a 200-year period since the Industrial Revolution that the majority of people in developed countries in the West were emancipated from poverty. The process was shortened to less than 100 years in Japan, and further to less than forty years in Asian NIEs."

This is in fact quite encouraging; we can learn from previous experiences and we can do it faster the next time. However in both cases mentioned (Japan and Asian Newly Industrialized Economies of Korea, Taiwan, Hong Kong and Singa-

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pore) other developed countries played a very active role, applying their know-how in addition to their capital in all of these countries. This has not been the case in other places. The most recent example can be found in the countries of the FSU. Many people in the West simply assumed that once communism is defeated and a free market is allowed to develop, the natural forces of entrepreneurship and private enterprise would take over and dramatic economic growth would quickly follow. Based on this assumption most of the multilateral and bilateral financial assistance to the FSU countries was provided in a form of short-term debt, to finance budget deficit and provide general balance-of-payment support. The last ten years proved this assumption wrong and most of the financial aid wasted.

This mistake points at another important factor in developing the transformation methodology that would work in different countries and cultures — the need to understand the nature of previous failures. This helps to establish correctly the departure point we discussed earlier. To develop the Action Plan to transform a country, both the departure point conditions and successful experiences of those that completed the journey must be studied and understood. Hayami has the same view: "While it is critically important to learn from the experience of successful development, it is equally useful to learn from cases of failure. A dramatic example in our days was the recent collapse of centrally planned economies, which until only a few decades ago were considered by many to represent an effective model for developing economies to catch up and even surpass advanced market economies. Identifying the factors underlying both the failure of centrally planned economies as well as the relative stagnation of some developing countries that tried to adopt the central planning model, would be a vital step towards understanding the sustainable development mechanism."

To summarize, I would argue that in order for us to move to the next level of development in the world the following actions will be required:

- We must develop a practical, but systematic approach to helping developing countries complete their journey
- Economic transformation methodology with an effective set of tools and techniques will need to be developed and employed
- Developed countries will have to take the lead in developing the transformation methodology, since developing countries are simply not capable of producing it
- Developed and developing countries must work together in true partnership to transform the emerging and transition economies into stable market economies
- We must measure our progress by the number of countries per year that successfully complete their transformations and we must celebrate their accomplishments together
- We must generate excitement in the developing countries that there is finally a "plan" for them, even though some may be moving away from a centrally planned system
- We must generate excitement in private capital ranks that the world is on the brink of the avalanche of the most exciting investment opportunities of the new century, which will never be repeated and therefore cannot be missed
- We must launch a new World Race — the Race of developing countries to a market system and prosperity and the Race of private capital to the best investment opportunities of a lifetime

If we can do this, we can build a better, richer, more secure world in the next decade. This book proposes a methodology and tools to accelerate the economic transition processes in the FSU countries, and consider similar approaches for other Nations attempting to build a market economy. What we propose here is based on our practical experience in both investing private capital in the early stages of a market economy, and developing and advocating an economic policy framework, which we believe is necessary to build a market economy.

Michael Bleyzer
August, 2002
Kyiv, Ukraine

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Executive Summary

This book presents a plan, called "The Bleyzer Initiative", to accelerate the completion of the transition from planned economies to market economies by the countries of the former Soviet Union (FSU).

In the FSU the transition has been more difficult than anticipated, with major declines in living standards and increased poverty contributing to world instability.

We believe that significant improvements in the quality of life in the FSU will only come from sustainable economic growth, which will require significantly increased investments in fixed assets. Various studies estimate that the countries of the FSU will require investments of up to $800 billion during the next decade to modernize their productive capabilities and sustain their economic growth.

We also think that, given low levels of domestic savings of the population and the limited capacity of domestic enterprises to internally generate funds, the most viable alternative for FSU countries to complete their transition to market economies is to accelerate their inflows of international private equity capital, and in particular, foreign direct investments (FDI).

Most of the economic reform programs proposed for the FSU recognize that there is a low correlation between FDI flows and "natural characteristics" of a country (e.g., location, size, resources, etc.), whereas there is a high correlation between some key government policies and the flows of FDI. Therefore, the emphasis should be on the implementation of those economic reform policies that have the greatest impact on attracting FDI. These reform policies, or "investment drivers", have been identified by the studies carried out by the International Private Capital Task Force (IPCTF), which was established in 1999 in Ukraine.

The Bleyzer Initiative calls for a stronger partnership between the developed and FSU counties. We believe that the transitions will be accelerated only if both FSU and developed countries work together. That is, the FSU countries need to implement the major economic reforms required to attract FDI, while the developed countries, on their part, must provide greater access to their markets, targeted aid and know-how for building the market economy. Access to developed countries' markets is essential to generate and sustain economic growth in transition economies and developing countries. The major products of the FSU countries currently face significant trade restrictions and distortions that must be addressed. Financial assistance from bilateral and multilateral agencies must also be better targeted and directly linked to the support of private sector enterprises.

This book shows that FSU countries are receiving only a small fraction of their potential flow of FDI. Benchmarking and statistical analyses indicate that these countries could increase their level of foreign direct investments, from the current level of less than $7.5 billion per year, to about $28 billion per year by year 2005, with the implementation of economic policies identified by the IPCTF study. The cumulative inflow of FDI by year 2010 could reach $300 billion, enabling these countries to successfully complete their transitions. This level of foreign investments would have an important incremental effect on GDP growth and on the quality of life of their citizens.

We start with the premise that macroeconomic stabilization, achieved by sound fiscal and monetary policies, is an essential pre-condition to achieving a favorable business climate and beginning to attract foreign direct investments. However, it is not sufficient to attract significant levels of FDI, which are necessary for sustainable economic growth. Based on statistical analysis, in order to achieve substantial increases in international capital inflows, the IPCTF study identified three key policy actions that have the strongest impact on foreign direct investments. These policy actions are the following:

Policy Group 1: Liberalize and Deregulate Business Activities

Policy Group 2: Provide a Stable and Predictable Legal Environment

Policy Group 3: Improve Corporate and Public Governance

Although the above priority actions would significantly improve the flow of foreign direct investments, the study also shows that an additional six policy areas, discussed in this report are essential to securing a significant and sustainable flow of investments. They are:

Policy Group 4: Remove International Capital & Foreign Trade Restrictions

Policy Group 5: Facilitate Financing of Businesses by the Financial Sector

Policy Group 6: Reduce Corruption Levels

Policy Group 7: Minimize Political Risks

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Policy Group 8: Expand Country Promotion and Improve Image

Policy Group 9: Rationalize Investment Incentives

The experience of many other countries shows that only a comprehensive program addressing all nine of these policy areas can lead to significant and sustainable capital investments, both foreign and domestic.

The report concludes with a call for action to implement The Bleyzer Initiative and help FSU countries complete their transition to market economy through active partnership with developed countries. If successful, this effort will become a prototype of the new compact for development proposed by President Bush in his March 14, 2002 speech on Global Development at the Inter-American Development Bank. The new Millennium Challenge Account proposed by President Bush in this speech will fund the initiatives to help developing nations improve their economies and standards of living. The three-year effort described in this report will provide invaluable experience and concrete recommendations to make this new foreign policy initiative successful.

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I. Introduction

- **Today, conflicts rarely stay within national boundaries.**
- **Today, a tremor in one financial market is repeated in the markets of the world.**
- **Today, confidence is global; its presence or its absence.**
- **Today, the threat is chaos, because for people with work to do and family life to balance and mortgages to pay and careers to further and pensions to provide, the yearning is for order and stability. And if it doesn't exist elsewhere, it's unlikely to exist here.**

I have long believed that this interdependence defines the new world we live in.

Tony Blair, October 2, 2001

During the last ten years, the countries of the former Soviet Union (FSU) have been undergoing very difficult transitions from planned economies to free-market economies. Although there have been different degrees of success, by and large this transition has been harder and more cumbersome than originally expected ten years ago. In fact, most FSU countries are still struggling to implement the economic reforms that would either revive or maintain economic growth. Furthermore, most of these countries have been experiencing deteriorations in social and health indicators.

Given the current international scenery, including the threat of international terrorism, there is now a sense of urgency to complete the transition to market economies. Without clear economic recoveries, the decline in the standards of living experienced by these countries in the last ten years is bound to generate discontent and resentment against free-market principles. This can generate economic and political instability, leaving their citizens to become easy targets for corruption and terrorism. Therefore, the international community should give the highest priority to helping these countries regain stability and improving the quality of life of their citizens.

However, this is not an easy task. The completion of the transition to market economies by the FSU countries will be expensive. For example, studies indicate that the investment needed to re-capitalize and modernize the FSU countries' productive capabilities over the next ten years may be as high as $800 billion. The financing of these investments will not be simple, given that most FSU countries have low levels of domestic savings and underdeveloped financial systems. Low domestic savings are due to low domestic personal income, low salaries, low profitability and cash flows of most domestic enterprises, and large numbers of barter/non-cash transactions. Given their low level of domestic savings, most FSU countries will not be able to maintain their pace of economic growth without recourse to international savings, particularly from international private capital and more targeted financing by bilateral and multilateral financial institutions. But over time, as the economies and national incomes grow, the levels of domestic savings will also increase, reducing the need for foreign investments. The speed at which this will happen will depend on the speed of implementation of policy reforms.

Although official lending by bilateral and multilateral institutions is a necessary element in an international program to complete the economic transition in FSU countries, official lending will not be able to provide the large amounts of financing needed at this time for sustainable long-term economic growth in FSU countries. In fact, as will be discussed later in this report, the major benefit from official lending may be the support and the conditionality it provides to implement necessary economic reforms to improve the business climate for the private sector.

Similarly, private international debt financing cannot be the major source of financing for FSU countries. Debt financing is only a temporary solution. Additional borrowing creates only short-term relief, but at the cost of increasing the burden for any future development. Furthermore, over the foreseeable future, private debt financing is likely to be of short maturity. Therefore, private debt financing should only be looked at as a "bridge" measure to get to a sustainable economic growth environment.

On the other hand, foreign direct investments are likely to be the largest and most significant sources of foreign financing in FSU countries. Private equity investment changes the fundamental nature of the economy in a very profound and healthy way. It reduces the government's role and responsibility in the overall economy, shifting them to the private sector. It promotes healthy sustainable businesses, significantly increasing the tax revenue base, and most importantly creates happy, successful and prosperous taxpayers. The creation of prosperity for the nation must be the main priority for the government, and nothing can better achieve it than private equity capital. Therefore, the success of FSU countries in maintaining high and sustainable growth and in improving the quality of life of their citizens will depend on their ability to increase the flows of international private equity capital. Without these international private capital inflows, FSU countries will not succeed over the long term.

The next section of this report discusses the evolution of economic and social parameters of FSU countries during the last ten years.

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II. Ten Years of Transition: Historical Perspective

Achievements and Missed Opportunities

The breakdown of the Soviet Union was an extraordinary political achievement. Although the FSU countries enjoy more political freedoms now, there are significant differences among them. Some countries, particularly in the Baltics, now enjoy substantial political and religious freedom under working democracies with civil liberties comparable to those of Europe. Other FSU countries enjoy better political and civil liberties than before. Their populations are now free to travel and express their religious preferences, but many of them are subject to limitations on their civil rights, including free elections.

The political achievements, however, are masked by the increase in poverty experienced by most FSU countries. In fact, it is clear that the level of poverty in most FSU countries has increased substantially during the past decade. At the beginning of the transition, the FSU had one of the lowest levels of inequality in the world. After a decade, many of these countries have income inequality ratios comparable to less developed countries. In fact, income in many of the FSU countries is now unevenly distributed, with a small portion of the population enjoying unprecedented wealth (the so-called oligarchs) while an estimated 20% of the population of the FSU now lives in poverty, with incomes of less that $2 a day, a standard international poverty line.

High levels of unemployment, calculated on the basis of the International Labor Organization methodology, are obviously another factor in the poverty problem in the FSU, particularly in the CIS. The economically active population (employed and unemployed) in the CIS countries in 2001 amounted to 131 million people, approximately half the population of these countries. About 11 million of these people are unemployed, representing an unemployment rate of about 9%. Unemployment rates for some key countries are as follows: Russia — 9%, Ukraine — 10.3%, Kazakhstan — 9.2%, and Moldova — 6.3%.

Part of the economic and social difficulties facing many FSU countries is rooted in corruption and the inability of their governments to exercise sound governance practices. Corruption is a major issue facing most FSU countries. Various international surveys suggest that, with the exception of the Baltics, FSU countries are now among the most corrupt in the world, with small numbers of privileged vested interest groups capturing a large portion of their countries' wealth.

The level of poverty and the economic crises that affect so many FSU countries cannot solely be attributed to the collapse of the Soviet Union. In fact, several studies have shown that the bulk of FSU industry was already quite inefficient during Soviet times. Given the absence of free markets and competition, production structures did not reflect economic realities, but central planning priorities and prerogatives. In particular, the Cold War and national defense considerations led to a heavy concentration of production in military goods. Even in other areas, the incentive framework and price distortions — particularly in energy — led to inefficient structures of production. For example, before the collapse of the Soviet Union, the price of oil was less than 5% of international oil prices. The use of energy per unit of GDP was high, reflecting energy intensiveness about twice that of Western Europe.

As a result of these mixed signals and distortions, by the late 1970s, a large portion of the output of the Soviet Union was not adding economic value to the country at economic international prices. In fact, in most industries, production activities had negative value-added at international prices. That is, the economic value of their output was lower than the economic value of the inputs used for production. They were subtracting value, rather that adding value to the wealth of their populations. Therefore it was just a matter of time before the economic crises for these countries emerged. The trigger for this was the political events of 1991 that led to the collapse of the Soviet Union. After the collapse, many sectors were unable to survive in a liberalized world and gradually disappeared. This was the real cause of the drastic reductions in GDP experienced by these countries.

The sections below present the main economic developments during the ten years of transition.

Evolution of GDP and Fixed Investments in the FSU countries

During the first ten years of transition, real gross domestic product (GDP) of the FSU countries followed a typical "J" curve; after the collapse of the Soviet Union in 1991, output fell sharply for the reasons outlined in the previous section. By 2000, all countries in the FSU had managed to achieve positives rates of GDP growth. However, the pace of recovery varied significantly among these countries. Some countries were able to successfully implement economic reforms and showed positive rates of growth as early as 1993. These early reforming countries included Estonia, Lithuania, Kyrgyzstan, Armenia, and Georgia. The revival of GDP growth also occurred earlier in Belarus and Uzbekistan, countries that

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initially experienced smaller declines in GDP even though they did not carry out economic reforms.

Other countries such as Ukraine, Russia, Moldova, and Tajikistan, that initially suffered large GDP declines and delayed the implementation of economic reforms, showed positives rates of growth only later in the period. In Ukraine, for example, positive rates of economic growth were achieved only in 2000. The initial decline in GDP in Ukraine was large because the country's initial conditions after independence were quite unfavorable, with major structural weaknesses and an economy highly dependent on inputs and markets of the other former Soviet Republics. The collapse of the Soviet Union cut these production and trade relations. In addition, the country had a large percentage of military industries (25% of all companies produced military goods), for which there were no markets after the end of the Cold War. Furthermore, due to negligible energy costs during Soviet times, many industrial processes were very energy intensive (in the early 1990's, Ukraine consumed 6 times more oil per unit of GDP than Western Europe). These high-energy enterprises became unprofitable when energy costs multiplied 5-10 times after independence.

Although the initial declines in GDP in Ukraine and many other FSU countries were amplified by unfavorable initial conditions, their sluggish economic recovery was mainly due to slow, piecemeal, and uneven implementation of economic reforms. In Ukraine the recession that lasted until 2000 was the longest of the FSU countries. In these countries, poor performance was due to lack of political consensus and opposition from vested interests. The structural weaknesses of the economies during the Soviet times meant that major corporate restructuring was needed after independence. Unfortunately, in many countries for a number of years after independence, very little was done. Governments followed a "preservation" strategy. That is, they tried to maintain the status quo through the payment of large, direct subsidies to these enterprises. Relying on government subsidies for their existence, state-owned enterprises had little incentive to restructure themselves and remained largely inefficient. These government subsidies led to large fiscal deficits, monetary financing of these deficits, and hyperinflation. In Ukraine, for example, hyperinflation peaked in 1993 at 10,160%, as a result of large fiscal budget deficits during 1992–1993, which reached 25% of GDP due principally to very large fiscal expenditures, which amounted to 65% of GDP.

The table below shows the evolution of GDP in FSU countries since 1991:

FSU: GDP Change over Ten Years

Country	GDP		
	1991	1998	2001
Armenia	100	70	84
Azerbaijan	100	50	66
Belarus	100	78	94
Estonia	100	82	91
Georgia	100	43	50
Kazakhstan	100	80	98
Kyrgyzstan	100	64	76
Latvia	100	58	66
Lithuania	100	44	46
Moldova	100	59	64
Russia	100	59	72
Tajikistan	100	52	64
Turkmenistan	100	55	63
Ukraine	100	44	52
Uzbekistan	100	87	104

Country	GDP: Average Annual Rate of Growth,%		
	1992–2001	1992–1998	1999–2001
Armenia	–1.7	–5.0	6.4
Azerbaijan	–4.1	–9.4	9.6
Belarus	–0.6	–3.5	6.4
Estonia	0.6	–0.7	3.5
Georgia	–6.7	–11.3	4.9
Kazakhstan	–0.2	–3.2	7.1
Kyrgyzstan	–2.7	–6.3	6.2
Latvia	–3.0	–6.1	4.7
Lithuania	–6.2	–9.3	1.2
Moldova	–4.4	–7.2	2.7
Russia	–3.2	–7.3	7.0
Tajikistan	–4.4	–9.0	7.3
Turkmenistan	–4.5	–5.8	1.3
Ukraine	–6.5	–11.1	5.1
Uzbekistan	0.4	–2.0	6.1

The charts below show the evolution of GDP for all FSU countries. On an aggregate basis, the FSU countries experienced a decline in GDP until 1996. GDP was stagnant from 1996 to 1998, and began showing positive rates of growth starting in 1999.

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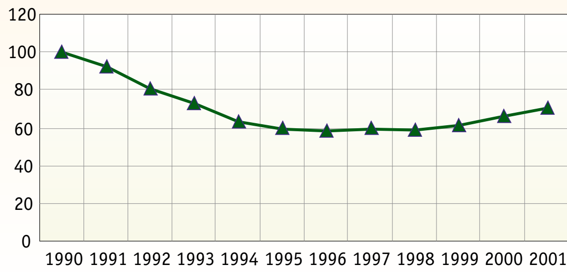
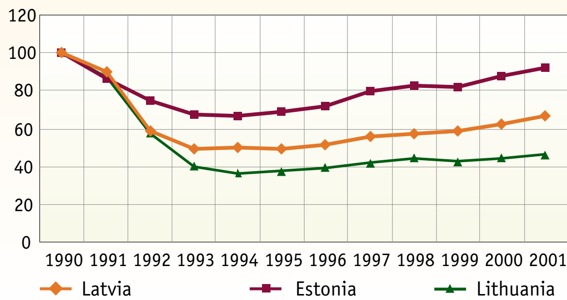
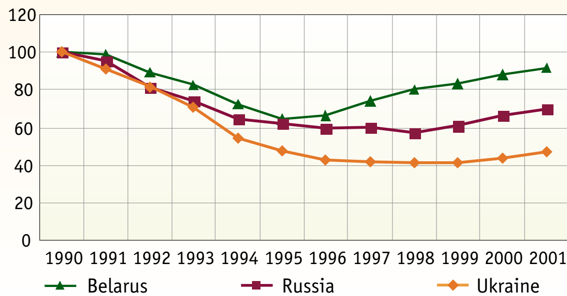
FSU: Summary Data.
Real GDP, 1990=100



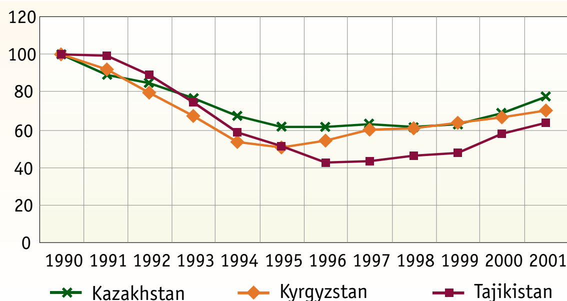
FSU: Latvia, Estonia, Lithuania
Real GDP, 1990=100



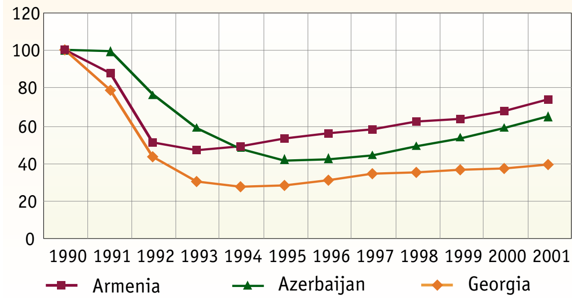
FSU: Belarus, Russia, Ukraine
Real GDP, 1990=100



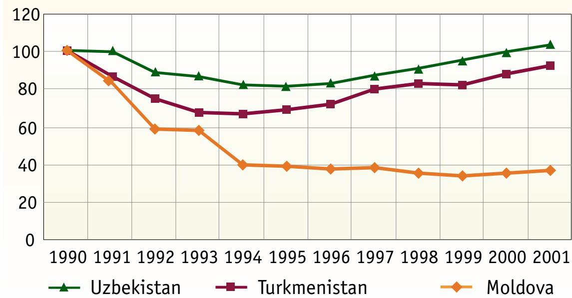
FSU: Kazakhstan, Kyrgyzstan, Tajikistan
Real GDP, 1990=100



FSU: Armenia, Azerbaijan, Georgia
Real GDP, 1990=100



FSU: Moldova, Turkmenistan, Uzbekistan
Real GDP, 1990=100



For individual countries, the above charts show that — with the exception of Uzbekistan, which suffered only a minor GDP decline after independence — in almost all of the FSU countries, GDP levels have not yet reached the levels that existed prior to the collapse of the Soviet Union. The GDP of Russia in 2001 represented 72% of the 1991 volume, Belarus — 94%, Kazakhstan — 88%, Kyrgyzstan — 76%, Ukraine — 51%, Moldova — 64%, Azerbaijan — 66%. On the average, the GDP for 2001 in the FSU countries represented only 70% of the 1991 level.

For the CIS countries, the 30% decline in GDP affected different sectors differently. Whereas agricultural production fell by 23% over the ten years of transition, their industrial production declined 35%, and investments in fixed assets collapsed by 60%, as indicated in the figure below:

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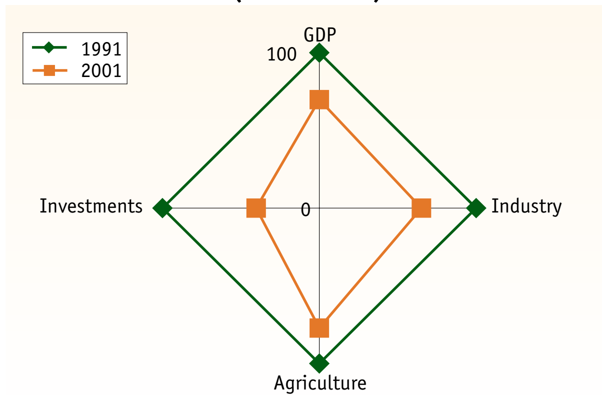
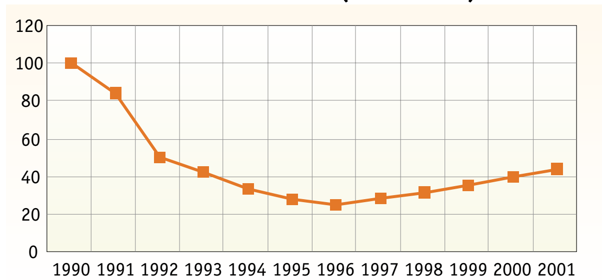
CIS: Economic Results after Ten Years of Transition (1991 = 100)



The evolution of investments in fixed assets during the ten years of transition followed a "J" curve similar to that of GDP. The level of investments for the entire block declined during the first years of independence until 1996, and then started to show positive growth only in 1997. The recent increases in investments have not been able to compensate for the initial decline. By 2001, the level of investments was only 40% of the level achieved in 1991. This is shown in the chart below:

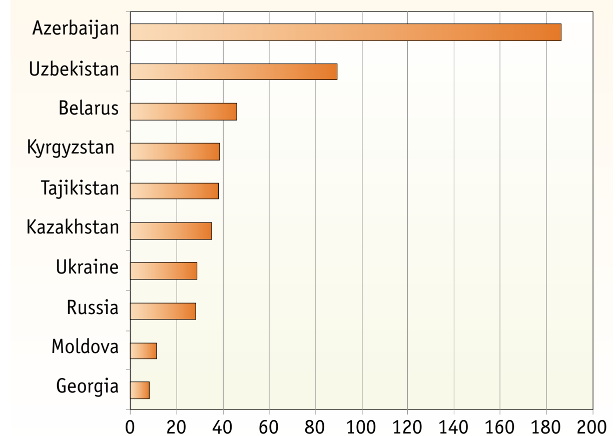
FSU: Summary Data Fixed Investment (1990=100)



This data is particularly significant due to the fact that these ten years of dramatic declines in fixed investments came on the heels of the collapse of the Soviet economy, which contributed to most fixed assets being already in poor condition.

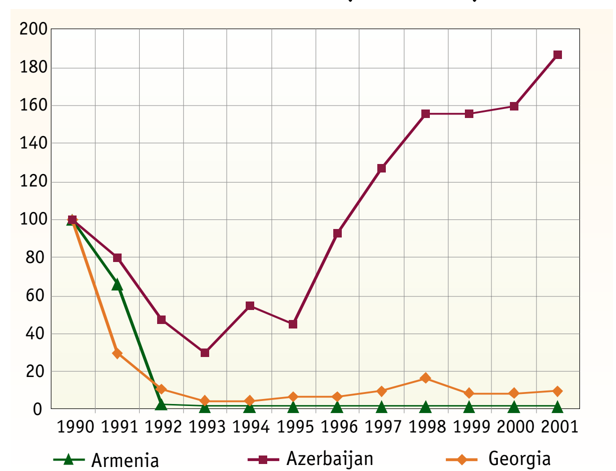
The cumulative decline in fixed investments during the last ten years for the individual countries of the FSU varies considerably. In fact, one country, Azerbaijan, with large investments in oil and gas, was able to show a cumulative increase in fixed investments of 85%. Other countries had declines ranging from 10% to 90% as shown below:

FSU: Summary Data Fixed Investment, 2001 (1990=100)

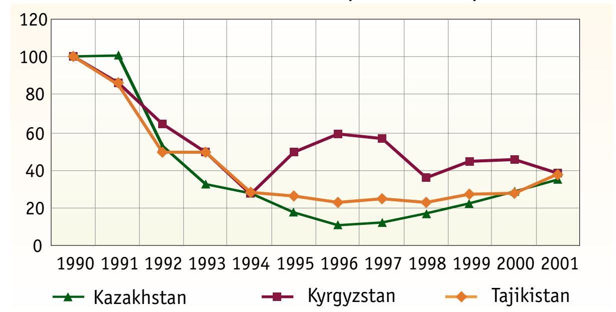


The evolution of fixed investments for individual FSU countries is depicted in the following charts:

FSU: Armenia, Azerbaijan, Georgia Fixed Investment (1990=100)



FSU: Kazakhstan, Kyrgyzstan, Tajikistan Fixed Investment (1990=100)



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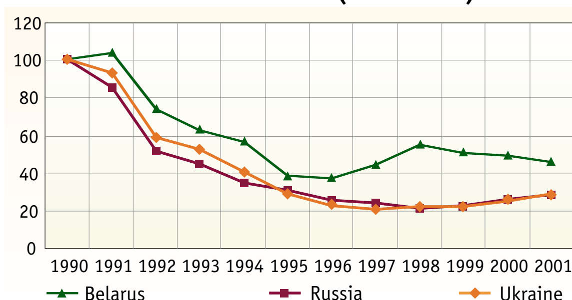
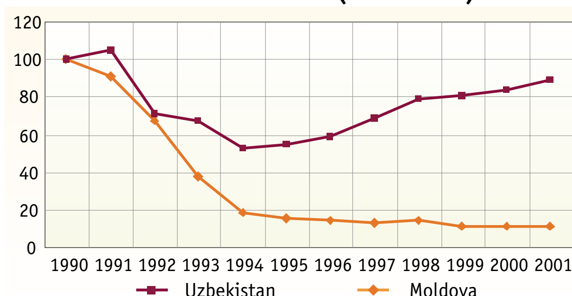
FSU: Belarus, Russia, Ukraine
Fixed Investment (1990=100)



FSU: Moldova, Uzbekistan
Fixed Investment (1990=100)



The structure of production and investments in the FSU countries has also changed during the last decade. In most FSU countries, investments have been concentrated in the natural resources industries, including oil and gas, metal mining and metallurgy, timber and pulp and paper. In fact, the share of fuel and energy output of the total volume of industrial production of the CIS countries increased from 16.5% to 32% over the last decade. The share of high technology branches — including aerospace, robotics, information technology and biotechnology — decreased accordingly.

Economic Results for 2001

As noted earlier, by 2000, all FSU countries were able to show positive rates of growth for their economies. By 2001, all major macroeconomic indicators were performing satisfactorily, including GDP, industrial and agricultural production, wholesale turnover, investments in fixed assets, and foreign trade turnover. Most countries also experienced relatively low inflation and stability of their national currency rates relative to the dollar. These positive trends were accompanied by increases in the real incomes of the population and growth of labor demand. The results for 2001 are shown in table below.

2001: Main Macroeconomic Indicators (% change)

Country	GDP	Industrial Production	Agricultural Production	Investment in Fixed Assets	Inflation	Wholesale Turnover
Azerbaijan	9.9	5.1	11.0	17.0	1.3	9.9
Armenia	9.6	3.8	12.0	14.0	–0.7	15.5
Belarus	4.1	5.4	2.0	–6.0	46.1	21.2
Georgia	4.5	–1.1	6.0	14.0	3.4	5.7
Kazakhstan	13.2	13.5	17.0	21.0	6.4	14.2
Kyrgyzstan	5.3	5.4	7.0	–16.0	3.7	5.7
Moldova	6.1	14.2	4.0	–2.0	6.3	18.2
Russia	5.7	4.9	7.0	9.0	18.6	10.7
Tajikistan	10.2	14.8	11.0	...	12.5	1.2
Turkmenistan*	20.5	11	24	26	8.2	...
Uzbekistan***	4.5	3.5****	–1.0****	...	27.2	...
Ukraine	9.0	14.2	9.9	17.2	6.1	11.6
Estonia	5.4	6.9	5.8	12.0****	5.8	6.5
Latvia	7.6	8.4	3.9****	10.8****	2.5	
Lithuania	5.9	17.0**	5.0**	12**	1.3	

* Official data, Turkmenistan's official GDP data should be treated with caution for a number of reasons. First, there is a widespread culture of over-reporting output, owed to the importance placed on meeting production targets. Second, the speed with which data is released casts further doubt on the methodology used to survey output – official real GDP data for 2001 was issued by the end of January 2002. Third, the high level of government subsidization of the economy is likely to be keeping official inflation figures artificially low, which in turn would make GDP at constant prices unrealistically high.

** Estimate

*** According to official data, real GDP growth in Uzbekistan reached 4.5% year on year in 2001. Official statistics continue to be unreliable, however. According to the IMF, because of deficiencies in consumer price collection, average price increases are not recorded accurately, leading to a consumer price index (CPI) that understates inflation. Since this index is then used to calculate the GDP deflator, it creates an upward bias in official estimates of GDP growth. As a consequence of these flaws in the calculation of CPI and output data, the IMF estimates that inflation is likely to be twice as high as that officially reported, and real growth around half of what official statistics suggest.

**** Data for 2000

Source: Statistic Committee of the CIS

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The average rate of GDP growth for all FSU countries for 2001 was 6%. This represented a small decline from the rate of 8% achieved in 2000, when growth peaked for a number of countries. The decline in GDP growth for FSU countries started in mid-2001. Although part of the decline simply reflected deteriorating world economic conditions, a more fundamental question now is whether these FSU countries will be able to achieve sustainable economic growth over the long term. Most analysts believe that they may not. In fact, except for those countries rich in oil and gas, most FSU countries have been able to revive growth on the basis of better utilization of existing capacity. In several countries, however, this existing usable capacity is reaching its limits. New investments in fixed assets are now required to sustain growth over the medium term. Without these investments, which would fundamentally change the production structure of FSU countries, there are doubts that they will be able to sustain high rates of growth in the future.

Revival of Economic Growth

The revival of sustainable economic growth is a major priority for all FSU countries. High rates of GDP growth are needed to reduce poverty in these countries. Several studies have suggested that GDP growth will need to be at least 5% per annum to have a noticeable impact on poverty reduction. It is estimated that the FSU countries will need investments totalling about $800 billion over the next ten years to maintain reasonable rates of growth, given the current deficiencies in their productive capabilities. The task is huge. But without it, poverty will continue to increase and lead to social and political instability in these countries.

Unfortunately, most FSU countries do not have the level of domestic savings to finance such a high level of investments in fixed assets. Domestic savings are low because of low salaries that are used principally for consumption, and because of enterprises that are not able to internally generate significant funds that can be reinvested. The banking sectors are underdeveloped and incapable of attracting savings.

Given the above deficiencies in the level of savings, it is clear that these countries will not be able to carry out the required changes by themselves. Most FSU countries will require significant amounts of international capital flows to finance their investment needs and sustain economic growth. Issues related to the attraction of international capital will be discussed later in this book.

The foreign exchange needed for new investments could also be secured by savings of the FSU countries in international trade transactions, discussed below.

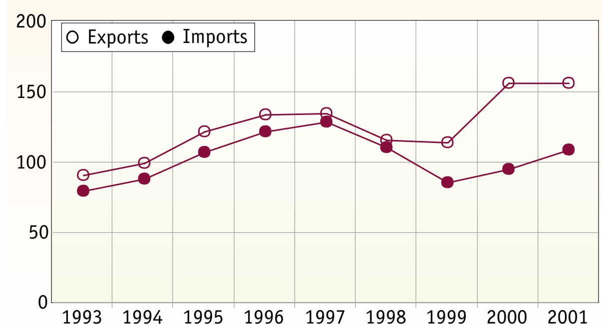
Evolution of International Trade

The charts below present the evolution of international trade for FSU countries since 1993. Overall, the block has been quite successful in expanding exports from about $90 billion in 1993 to $155 billion by 2001. This represents an annual rate of growth of 7%. An export drop in 1998 and 1999 reflected the financial crises that originated in Russia in mid-1998. It should be noted that in every year since independence, the FSU countries have shown positive trade balances that have increased significantly after 1999, reaching $65 billion by 2001. It is clear that during the last three years, this large trade surplus has been an important source of financing for the FSU as a whole.

But the charts below also show that there have been wide disparities in export performance among the countries of the FSU. Exports increased significantly in the early reforming countries of Estonia, Latvia and Lithuania, as well as in the oil-rich countries of Russia, Azerbaijan, and Kazakhstan. On the other hand, Georgia and Uzbekistan saw drops in the level of exports. In the other countries, the level of exports was stagnant. One of the reasons for the export stagnation in these countries was the delay in implementation of sound economic reforms. But the stagnation also reflects the fact that developed countries have made it more difficult for FSU countries to have access to their markets, due to protectionist policies such as those in agriculture, textiles and steel.

Exports and Imports in FSU Countries

Cumulative Merchandise Exports and Imports in FSU Countries, USD bn



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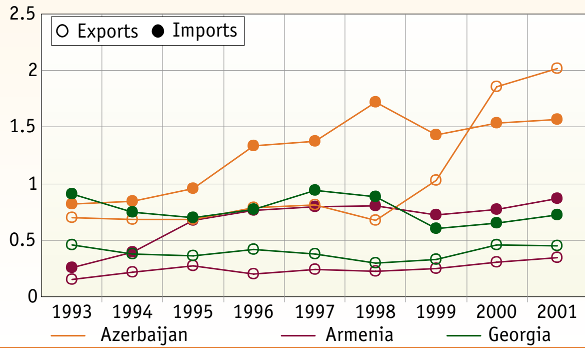
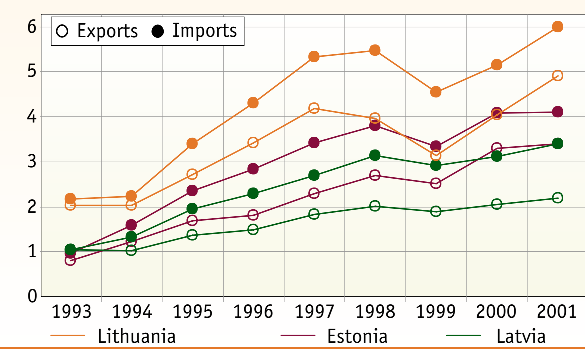
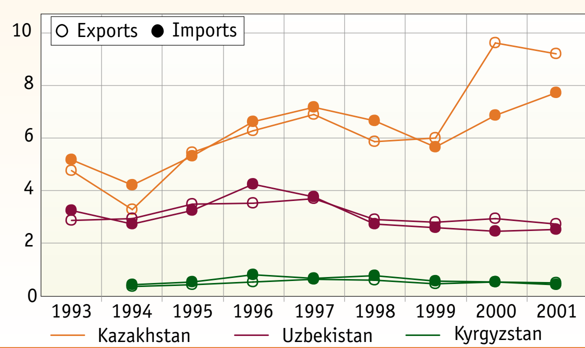
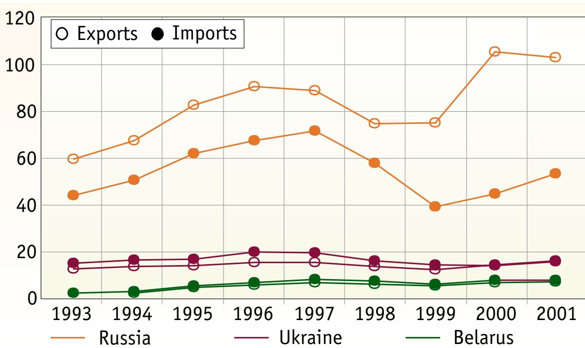
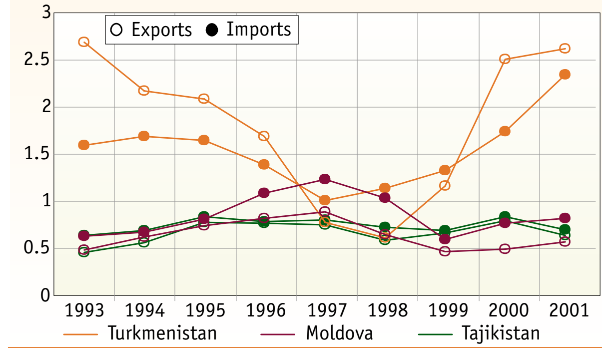
Merchandise Exports and Imports, USD bn











The above charts show that exports recovered strongly in 2000, with a growth of 39% over 1999. More recently, however, in 2001, the level of international trade of the FSU countries was stagnant, reflecting global market trends, and in particular the reduction in world trade by about 1% in 2001.

A very important development in the trade area during the last decade has been that most FSU countries have been very successful in reorienting their foreign trade towards non-FSU countries. Thus, the volume of Russia's trade with the FSU countries decreased from $138 billion in 1991 to $19 billion in 1999. In the year 2000, only Belarus and Tajikistan had export-import operations with mostly FSU partners, as shown in the following table.

It is clear that the trade surplus of the FSU has been an important source of financing for six of the 15 FSU countries. These countries can count on these resources for their future foreign exchange needs. Other countries will need to revive exports or resort to an increasing amount of international capital investments in order to sustain high rates of economic growth.

Problems with Current Approach

For most countries of the FSU, it is unlikely that the current situation will enable the achievement of sustainable economic growth because of many key factors in the current situation that are unfavorable. They are the following:

i. Due to slow progress in economic reforms, most FSU countries are attracting very limited amounts of foreign direct investments.

ii. The levels of international assistance and aid provided to these countries have been wasted to a great extent.

iii. Growth in exports and international trade has not been very successful in bringing about economic recovery, in part due to excessive

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Share of Exports/Imports of an Individual FSU Country with Other FSU Countries and with the Rest of the World (%)

Country	1990		1996		2000	
	FSU Countries	Rest of the World	FSU Countries	Rest of the World	FSU Countries	Rest of the World
Exports						
Azerbaijan	92	8	46	54	13	87
Armenia	95	5	46	54	25	75
Belarus	84	16	67	33	60	40
Georgia	92	8	65	35	43	57
Kazakhstan	88	12	54	46	27	73
Kyrgyzstan	94	6	78	22	42	58
Moldova	89	11	68	32	58	42
Russia	62	38	18	82	13	87
Tajikistan	86	14	43	57	49	51
Turkmenistan	91	9	67	33	–	–
Uzbekistan	86	14	21	79	–	–
Ukraine	80	20	51	49	31	69
Estonia	82	18	15*	85	4	96
Latvia	81	19	30***	70	10***	90
Lithuania	83	17	45***	50	20**	80
Imports						
Azerbaijan	71.5	28.5	35	65	32	68
Armenia	73	27	34	66	19	81
Belarus	69.8	30.2	66	34	70	30
Georgia	69.4	30.6	39	61	32	68
Kazakhstan	77.4	22.6	70	30	55	45
Kyrgyzstan	72.5	27.5	58	42	53	47
Moldova	73.9	26.1	61	39	33	67
Russia	42.7	57.3	31	69	35	65
Tajikistan	79.6	20.4	57	43	83	17
Turkmenistan	79.6	20.4	30	70	–	–
Uzbekistan	78.5	21.5	32	68	–	–
Ukraine	68.7	31.3	63	37	58	42
Estonia	65.2	34.8	12*	88	11	89
Latvia	66.1	33.9	30***	70	13***	87
Lithuania	67.4	32.6	60***	40	30**	70

* Data for 1997, statistical office of Estonia

** Data for 2001, statistical office of Lithuania

*** Estimation

Source: The Commonwealth of Independent States in 2000. Yearbook of Statistics.

protectionism by developed countries. Trade restrictions by developed countries in agriculture, textiles and steel exemplified the problems faced by FSU countries.

iv. The application of double standards by some developed countries makes it more difficult for some FSU countries to implement reforms at home. For example, Russia and Uzbekistan are now enjoying preferential treatment and deals for political, not economic reasons.

The issue of foreign direct investments is discussed later in this book. The other issues are discussed below.

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Problems with Foreign Aid

Since the breakdown of the Soviet Union, bilateral and multilateral financial institutions have provided significant financial resources to the FSU countries to transform their economies. It is estimated that bilateral and multilateral financial assistance to the FSU has amounted to over $100 billion during the ten years of transition.

The bulk of this assistance has been provided to governments and government agencies principally to finance budget deficits and provide general balance-of-payment support. The funds were disbursed in tranches and paid to the Ministries of Finance and Central Banks of these countries. These funds were not used directly for productive purposes, but to support the balance-of-payments or to finance fiscal budget expenditures of the governments.

It general, the above lending for fiscal-budget/balance-of-payment support was accompanied by requirements and conditionality that these countries should implement economic reforms that would improve their business climate. Unfortunately, the implementation of this conditionality has not been satisfactory and countries often just paid lip service to it. In many cases, policies were reversed after the institutions had provided the financing due to pressures from political and vested interest groups. In other cases, the Ministry of Finance just did not have the influence on other parts of the government to secure the reforms agreed upon with the international financial institutions (IFIs).

We believe that this poor outcome of international lending in most FSU countries is due to the lack of a constituency and interest groups willing to push their governments for greater liberalization, improvements in the legal framework, and other measures aimed at improving the business climate. The fact is that these countries have not yet been able to break the old centralized structures that existed a decade ago. In other developing countries with a longer tradition of private sector enterprises, thanks to the lobbying efforts of the private sector, governments have undertaken major reforms. These positive, vested interest groups are absent in most FSU countries. The outcome has been that the resources from international agencies have mainly been used by the Ministries of Finance, with few results.

It is therefore essential in FSU countries that a special effort be made to directly support the creation and growth of a healthy and competitive private sector. In particular, the bulk of the inflows of financial support should be directed to the development and growth of small and medium private enterprises. It is postulated that in the FSU countries, only by assisting in the development of these new "pro-reform" vested interest groups, can lasting economic reforms be implemented.

It should be noted, however, that any financial assistance to these countries, even if directed to the private sector, should be conditional on the implementation of strong and clear economic reforms as outlined in previous sections of this report. No financing should be provided unless the governments demonstrate their commitment to implement these economic reforms. There is also room for continuation of some limited financial assistance to governments, to help them alleviate the cost of implementing economic reforms.

The European Bank lending practices are close to the principles mentioned above. In fact, it is the policy of the EBRD that at least 50% of their resources be directed to the private sector. What is missing however is the conditionality that all disbursement of EBRD resources be contingent on the implementation of a specific plan of action to improve the business environments of these countries. As a result, many EBRD investments in the private sector have failed for reasons such as poor legal environments, lack of protection of property rights, and so forth.

During the last decade, the World Bank, on the other hand, took an opposite view. It practically withdrew direct support to private enterprises. Its private investment subsidiary, the International Finance Corporation, has done little in most FSU countries. The bulk of the lending by the World Bank to FSU countries has been in the form of adjustment loans made conditional upon the implementation of economic reforms by these countries. Over time, this conditionality has become more explicit and better defined. However, the loan proceeds are given almost entirely to the Ministries of Finance to finance their fiscal deficits. These government agencies have learned how to "negotiate" on the Bank's conditionality in order to secure the funds, without effecting real changes. In part, the countries' failure to implement reforms has been due to lack of implementation capacity. But they could also get away with it, given the absence of checks-and-balances that in other countries are provided by a more developed private sector.

Financial assistance by bilateral aid institutions, such as USAID, has also been deficient. These agencies have focused most of their assistance on the social sectors, but most projects have been ineffective. Furthermore, given the limitations on procurement and the restriction that only US firms can compete for the funds, implementation has been carried out under questionable arrangements. Observers believe that these bilateral programs would require substantial revamping to provide real benefits.

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To improve the impact of bilateral and multilateral financial assistance to FSU countries, it must be focused on private sector support to achieve sustainable economic growth. This will be further discussed below.

Opening Foreign Markets to FSU Exports

The expansion of exports should play an important role in fostering economic growth in the FSU. In fact, in the past, those developing countries that were able to show the highest rates of growth in exports also enjoyed the highest rates of GDP growth. With the conclusion of the Uruguay Round of trade negotiations, which led to major reductions in import tariffs and quantitative restrictions and extended gradual market discipline to agriculture, textiles and clothing, world trade has indeed expanded significantly during the last decade. This expansion has benefited developing countries, which saw their market share of world exports of non-energy goods increasing from 7% to 25%.

Despite this progress, however, many of the goods that could be exported more expeditiously and economically by FSU countries have lagged in trade liberalization, and still face restrictions imposed by developed countries. In particular, continued restrictions on agricultural products, on labor-intensive manufactured goods such as clothing and textiles, and on steel products are strongly damaging to the export prospects for the FSU.

In the agricultural sector, the FSU countries possess some of the richest soil resources in the world. But their exports are constrained in part by a variety of protectionist measures that still exist, particularly in the European Union. The Uruguay Round Agreement on Agriculture succeeded in eliminating a number of non-tariff barriers, such as quantitative restrictions, variable import duties, and discretionary import licenses. But these trade restrictions were converted into tariffs. As a result, tariffs on imported agricultural goods by developed countries are almost twice as high as for manufactured goods. Market protection has not been reduced substantially for developing countries.

Another major factor adversely affecting agricultural export prospects by the FSU is the high level of financial support provided by the EU to its own agriculture. Total support of OECD countries to their agricultural sectors amounted to about $330 billion in 2000, of which about $250 billion represented support to agricultural producers in developed countries. These subsidies distort international trade for agriculture. They lead to excessive non-economic agricultural output in developed countries, which reduces the opportunities for imports and leads to exports of unwanted excess production to the rest of the world. They depress world prices from economic equilibrium prices and make them more volatile.

All of these protective measures in the agricultural sector impose unfair disadvantages on agricultural producers in the FSU. Although the Uruguay Round contained provisions to reduce these trade-distorting subsidies, countries were able to offset most subsidy reductions by increasing subsidies in areas not covered by the agreement. As a result, the level of agricultural support has remained unchanged.

In textiles and clothing, the Uruguay Round agreement called for the gradual elimination of country-specific quotas under multifiber arrangements over a period of 10 years. However, progress in opening up markets for developing countries has been inadequate. Progress in eliminating import quotas by the developed countries — particularly the US and Canada — has been slow because of the flexibility that importers have in selecting the products for elimination. So far, only insignificant products have been selected. But even after all the quotas are abolished in 2005 in accordance with the agreements with the World Trade Organization, trade restrictions will remain, since these quotas are just being replaced by high import duty tariffs.

Trade in steel products, which are major export commodities for the FSU, is also suffering from the recent tariff increases first enacted by the US, and then repeated by the European Union. In fact, the tariff on steel products recently imposed by the US affected FSU countries directly (for products exported to the US) and indirectly (since the EU and other countries had to impose protective restrictions on imports from other countries, including from the FSU).

The removal of these restrictions on exports from the FSU should be a priority if the objective is to facilitate the completion of the economic transition of these countries.

Double Standards

The use of double standards by some developed countries makes it more difficult for the FSU countries to deal with domestic political opposition to the implementation of economic reforms.

For example, a key premise is that foreign aid should be conditioned on the implementation of sound economic reforms that would attract increasing amounts of private capital. It is also argued that the provision of aid, without these economic reforms, is likely to be counterproductive for these countries over the long term. However, following the terrorists acts of September 11, 2001, some countries that have performed poorly in the

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implementation of economic reforms, such as Uzbekistan or Pakistan, are now targeted for special aid programs for political, not economic reasons. But without accompanying economic reforms, this aid may in fact be counterproductive. While it may be important to reward constructive help in critical situations with some form of financial assistance, it must be made clear that long-term progress can only be accomplished through a sound program of economic development.

The perceived double standards make it more difficult for some governments to secure political support within their own countries for the implementation of reforms. The arguments made in those countries are that the larger or more "strategically" important or even simply more "strategically located" countries can get away with a number of political and economic missteps, for which other "less important" countries get chastised and cut off from aid and political support. This policy of applying double standards to developing countries has never been openly admitted by the developed countries, making this issue not only controversial, but also more difficult to tackle.

From the short-term policy perspective, applying some level of differentiation to transition economies based on criteria other than sound government policy implementation may be convenient for the West. However, it is bound to fail over the long term, and may generate more problems in the future than the short-term issues this approach is trying to solve. It also makes the position of the developed countries much more difficult to defend in the transition economies, because it removes the most critical objective basis for pro-reform decisions, and in some cases, even the moral justification for certain actions. From the legitimately elected government point of view, in any transition economy, no matter how small and "unimportant", if their big or more "important" neighbors can get away with something, they feel morally justified to expect that they should be able to do the same thing and get away with it just as well.

The issue of double standards comes up frequently in the discussions on human rights, freedom of the press, trade (including arms trade), dealing with terrorism and criminals and so on in a given country. It is therefore a very important area that must be addressed by the West to improve its credibility in the FSU countries, as well as in many other developing countries in the world.

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III. The Conceptual Framework to Successfully Complete the Transition

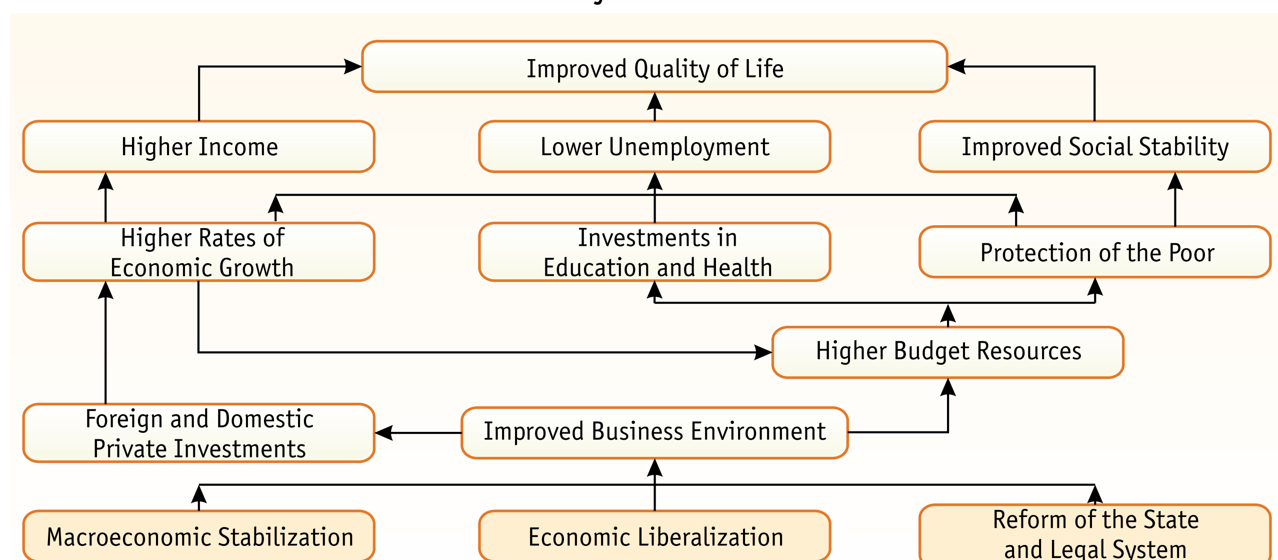
The task for FSU countries to complete their transition from centrally planned economies to market economies is a complex one, since it involves multifaceted changes, as noted in the table below. The task is complicated by the inherent characteristics of transition, usually fraught with chaotic decision-making, low domestic savings, weak and inefficient markets, unclear property rights, and corruption.

Transition to a Market Economy

	Centrally Planned Economy	Transition Economy	Market Economy
Decision Making	Centralized	Chaotically Decentralized	Mainly Decentralized
Sources of Savings for Investments	The State	Initially without domestic savings, source is principally foreign capital, and primarily debt	Savings of Individuals and Corporations (Retained Earnings)
Coordination	Compulsory Plans, Overly Restricted	Weak State and Inefficient Markets	Primarily Market, but with some State Regulation
Ownership	The State	State, Legally Private, Semi-Private, and Shadow	Primarily Private
Incentives	None, Collective Success	Money	Individual Success

The completion of a transition to a free market economy should be pursued not just for economic reasons but because it is the only sustainable way to improve the quality of life of the FSU population. The chart below demonstrates the relationship between improvements in the quality of life, sustainable growth and economic reforms. It shows that the quality of life will improve to the extent that salaries and incomes increase, the level of unemployment is reduced, and there is improved social stability. To achieve these results, a key factor is a high rate of sustainable economic growth. Investments in health and education and protection of the poor are also required. But it is only a high rate of economic growth that will provide the higher fiscal budget resources that are needed for these investments.

Why Transition?



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Sustainable growth, therefore, is the key to improvements in quality of life. High economic growth, in turn, will require high levels of new private investments, both domestic and foreign, as well as better utilization of existing investment assets. The level and use of investments will depend on the adequacy of the business environment, which can be summarized as the combination of three factors: macroeconomic stability, economic liberalization and sound government and legal systems.

The revival of investment growth is the key factor in the FSU in achieving improved quality of life. This is still a challenge for the FSU countries, including Russia. But the expansion of investments will not be enough. There is also a need to intensify investment effectiveness and to secure the willingness of the population to pursue economic objectives.

Intensifying Investment Effectiveness

Modern western economies derive their growth mainly from productivity gains. In fact, the expansion of production inputs, both labor and capital, explains less than 50% of the increases in output achieved by the US during the last two decades. Productivity gains are secured through the application of better technical and management skills, including business process reengineering, better technology, better strategy formulation and implementation, and better know-how.

The FSU countries will need to equip themselves with these skills. However, this transfer of technical knowledge should not be undertaken by government agencies, but by the private sector. Experience in many emerging markets indicates that the most successful way to introduce better technical and management skills is by facilitating foreign direct investments, including joint ventures with local firms. Therefore, in the FSU, foreign direct investments will have a dual role: first, to bring international capital, and second, to bring best international practices in technology and management.

Individual Motivators

Unleashing the willingness of individuals to get involved in a market economy will also be a key ingredient to encouraging high rates of GDP growth in the FSU. After many decades of communism, a portion of the population has been marginalized. However, it has been proven in many countries under different cultural conditions that the population will respond quickly to the right economic incentives. In his books "The Other Path" and "The Mystery of Capital", Hernando de Soto has shown the important role played by clear property rights. Once individuals have property rights and a stake in a private market system, they will seek fulfillment through all kinds of investments to improve their lot. Clear property rights give them the ability to take advantage of ownership.

David McClelland, in his book "The Need of Achievement," has also shown that one of the critical factors explaining the rise and fall of civilizations throughout history has been the degree of motivation of a population, as measured by the individuals' Need of Achievement, that is, the intensity of the desire of a people to succeed and achieve results in any field, be it in war, in sports or in peace.

In today's society, the legal base to provide incontestable property rights can play a major role in motivating people to seek economic improvements. It can not only permit the better use of assets by facilitating formal credit operations and mortgages, but more importantly, it can unleash the energy of the population to secure economic improvements based on assets that are theirs.

Education and training will also play critical roles in motivating people to participate more actively in a market economy. The financing of these services should be a fundamental task of governments. As noted before, however, governments should finance these activities from budget resources that would be generated by high rates of economic growth.

Assured Interdependence Between Developed and Developing Countries

During the Cold War, an often discussed doctrine was "Mutually Assured Destruction". With the capacity by major countries to use nuclear weapons for retaliation, their mutual destruction in the event of use would be assured. No reasonable government would start this nightmare. Therefore, this doctrine was felt to be the key to world peace.

Today, with the end of the Cold War, the world is entering a new phase of "Assured Interdependence." With improved communications, technology and globalization of economic activities, developed countries can no longer ignore what is happening in the rest of the world. They cannot ignore that a large portion of the world is in a state of transition, and is therefore inherently unstable.

The main goal in the world today is to successfully complete transitions to market economy and democracy by all transition economies and developing countries and thus achieve stable economic growth and improved political stability. If this goal can be successfully accomplished not only will poverty, starvation, disease and misery in the world diminish, but the global security

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will be improved significantly. Although transition economies and developing countries must do their part, the developed countries hold the keys to the successful transition and must lead the effort. After all if no one today can claim the experience in completing transitions to market economy, at least the 28 developed countries have some experience in living with it. It is therefore the relationship between the developed and developing countries (or countries in transition), which will determine the future on this planet. Today we are faced with three alternatives in this relationship.

1. Standoff This best describes the current state of affairs. Developed countries enjoy relative stability and prosperity. In spite of occasional recessions and stock market surprises, the future of their citizens is fundamentally secure. These countries however, attempt to isolate their economies from poverty and instability, which plague the rest of the world. Developing countries struggle to develop, but they continue to be immersed in poverty, inequality, instability, misery, and envy.

2. Payoff This alternative is an age-old idea of wealth redistribution but this time on a global scale. Developed countries would commit themselves to providing substantial increases in foreign aid to avert future troubles in the world, in effect paying potential "troublemakers" for world security. The proponents of this insane idea believe that the new financial aid will solve the problems that the old aid could not solve by simply doubling the amounts of financial assistance and hoping this would equalize the chances for the world's dispossessed. In reality this alternative will surely lead to a global welfare system. The donors and recipients will be equally dependent on each other and would have a built-in incentive to maintain this system in perpetuity.

3. Tradeoff This option implies a joint effort by developed and transition/developing countries. They would jointly apply best practices to manage economic change. On the one hand, developed countries can provide better access for exports of transition countries to their markets, support for foreign direct investments, and precisely targeted aid and know-how. On the other hand, developing countries and transition economies would commit to implementing the agreed upon necessary economic changes to make their business environments more attractive to private sector investments, achieve higher rates of economic growth, and consequently reduce poverty and improve stability.

In our opinion, the first and second alternatives are not acceptable, nor are they realistic. The Standoff will not work, given the degree of integration and ease of communications we have now. The second alternative, Payoff, is not acceptable either to developed or developing and transition countries in the long term. It assumes that the rest of the world would accept a position of financial dependency. In fact, nobody likes to be part of a welfare system.

Therefore, the third alternative, Tradeoff, is the only viable option. It is based on what people can do best — trade. Except this time we will be trading market economy know-how against commitments to change; precisely targeted aid against real economic reforms; private capital investments against joint opportunities to realize profits. This alternative requires real partnership between developed and transition/developing countries in which both parties assume direct responsibility for the outcomes. The developing countries must implement sound reforms that will encourage investments and growth. It is critical, however, for transition countries to have a proven set of "best practices" from other countries that can be used as guidelines in implementing economic reforms.

Identifying the Best Practices in Economic Reforms

In 1999, SigmaBleyzer launched a major effort to identify best practices in economic reforms in a number of successful developing countries. Through an agreement between the Ukrainian Government and SigmaBleyzer, the International Private Capital Task Force (IPCTF) was created to carry out the review. The IPCTF Steering Committee included representatives from private sector companies in Ukraine, international bilateral and multilateral agencies, economic NGO's, and representatives from the Ukrainian Government.

The study was conducted by a team of SigmaBleyzer professionals and the Thunderbird Corporate Consulting Group of the Thunderbird School of International Management of Phoenix, Arizona. Many members of the Steering Committee provided substantial and valuable input to this study. The Thunderbird Corporate Consulting Group carried out a benchmarking study of selected countries and built an econometric model to identify best practices in economic reforms that directly affect the flows of foreign direct investments. This model was then used to predict the flows of foreign direct investments to Ukraine based on the key "policy" drivers identified through benchmarking and statistical analysis. This analysis was later supplemented and expanded by a team of SigmaBleyzer specialists led by Dr. Edilberto Segura, the former Head of the World Bank Mission to Ukraine and SigmaBleyzer Chief Economist.

The benchmarking study produced an initial set of some 70 investment drivers, which were then grouped

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into 9 policy actions and prioritized. The statistical analyses indicated that a significant portion of the variations in foreign direct investments in a group of 50 developing countries could be explained by these 9 investment drivers (policy groups), in roughly the following order of priority:

1. Liberalize and Deregulate Business Activities

2. Provide a Stable and Predictable Legal Environment

3. Enhance Governance & Reform Public Administration

4. Remove International Capital & Foreign Trade Restrictions

5. Facilitate Financing of Businesses by the Financial Sector

6. Reduce Corruption Levels

7. Minimize Political Risks

8. Expand Country Promotion and Improve Image

9. Rationalize Investment Incentives

The study showed that a country could increase the level of foreign direct investments by a factor of two to five by narrowing the policy differential with the best countries identified in the benchmarking analysis. The nine drivers outlined above can constitute a comprehensive framework for any country's transformation. This framework is now known as the IPCTF Economic Policy Framework.

This initial study provided the basis for the development of an Initiative, called "The Bleyzer Initiative", with the objective of accelerating the completion of the transition from planned to market economies in the FSU countries. The Bleyzer Initiative can be further expanded to developing countries. The IPCTF Framework and The Bleyzer Initiative are discussed in the next three chapters.

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IV. IPCTF Economic Policy Framework

The objective of the IPCTF Economic Policy Framework is to provide a set of rules for a transition economy or a developing country that will accelerate its transformation into a country with an improved quality of life, higher per-capita income, less income inequality, and fair protection of the poor. Countries that follow these rules and create better conditions for their people will be less susceptible to harboring terrorism and political instability.

The framework has two components: macroeconomic stabilization policies and investment drivers. The first component is necessary to curtail the rate of economic decline, which is usually associated with the initial stages of transition to market economy, and to achieve a certain level of macroeconomic stability. While critically important for a country's ability to function in a market environment, this component by itself has proven insufficient to move the country to the next stage of economic growth. The key to economic growth is capital investment, which may begin once macroeconomic stabilization has been achieved, but which is driven by certain investment drivers that are very similar in all countries moving towards market economy.

Macroeconomic Stabilization Policies

Macroeconomic stabilization policies are those policies and actions that would over time result in stable prices with low inflation (internal stability), and a stable foreign exchange rate (external stability). Internal and external instability increase the risk of doing business in the country. As a result, investors require significantly higher rates of return to compensate for the risks of instability. Because of this high risk premium, few projects would qualify for investments, reducing the overall level of investments and therefore economic growth. In order to achieve internal and external stability, two sets of policies are necessary: fiscal policies and monetary policies.

Fiscal Policies are those that will lead to a Government's fiscal budget in which the fiscal deficit can be financed by borrowings on a sustainable basis, normally no more than 3% of GDP. This includes actions to increase fiscal revenues (by increasing the tax base, eliminating tax exemptions, and improving tax structure, tax administration, and cost recovery of public services), and to improve management of public expenditures (by reducing current expenditures of government, improving treasury operations, reforming the pension system, and eliminating subsidies.)

Monetary Policies are those under which the creation of money (money supply) will not exceed the demand for money, which is affected by the level of income, inflation and interest rates.

Investment Drivers

Investment Drivers are those policies and actions that would generate a high rate of GDP growth that can be maintained over a long period of time. Macroeconomic stabilization policies, although necessary, are not sufficient by themselves to achieve long-term stability and sustainable growth. This is because stabilization policies fail to remove deep-rooted structural economic and social distortions. To bring sustainable economic stability and growth, stabilization policies must be complemented by policies for sustainable investment activity or investment drivers.

Sustainable investment activity will depend on the adequacy of nine investment drivers identified by IPCTF benchmarking and statistical work:

1. Liberalization and Deregulation of Business Activities
2. Stability and Predictability of the Legal Environment
3. Corporate and Public Governance
4. Liberalization of Foreign Trade and International Capital Movements
5. Financial Sector Development
6. Corruption Level
7. Political Risk
8. Country Promotion and Image
9. Targeted Investment Incentives

Since many of the investment drivers deal with government policies and actions, it is important to define what we mean by "government". In many transition countries, the term "government" is conveniently defined as narrowly as necessary to avoid accepting responsibilities. Unless clearly spelled out, it may be used to mean just the Cabinet of Ministers, or just the Central Government apparatus, but not the President's Administration or Parliament, or local authorities. Therefore, for the purposes of our discussions here, we will define "govern-

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ment" in the broadest possible way. Specifically, ***"Government" shall mean all governing bodies of all branches and at all levels, including for example executive, legislative, judiciary branches, local and regional governments, and others.***

The nine investment drivers are discussed below.

Driver 1: Liberalization and Deregulation of Business Activities

This driver includes government policies and actions that reduce government interventions, enabling private businesses to operate freely and make profits in a competitive environment. An on-going system must be created to remove barriers to entry, operations and exit. The following are examples of what must be done in this area:

- Facilitate the formation of new businesses.
- Reduce licensing and registration requirements.
- Remove price controls and domestic trade restrictions.
- Reduce the number of government inspections, interventions and interferences in business activities.
- Simplify reporting requirements.
- Reduce the cost of doing business, including taxation levels.
- Simplify closure of failing enterprises.
- Liberalize labor markets, improving labor mobility and reducing excessive labor costs imposed by the government (such as excessive minimum wages, payroll taxes, high unemployment compensation).

Driver 2: Stability and Predictability of the Legal Environment

This driver includes policies and actions to enact and implement stable and predictable laws and regulations that would support and encourage private sector businesses in a free market. They require, among others, the following actions by the Executive, Legislative and Judiciary branches of Government:

- Enact appropriate legislation that would define the "rules of the game" for all businesses, without discrimination or preferential treatment, including modern civil, labor, tax and commercial codes and legislation to protect intellectual property rights, patents, technology transfer policies, and direct foreign investments.
- Improve the processes for drafting, presenting, and carrying out public reviews of proposed business-related legislation.
- Create an independent Judiciary, with an independent budget.
- Make the Courts more efficient and capable of settling commercial disputes.
- Empower the Executive branch to enforce judgments made by the Courts, including those on commercial contracts.
- Review existing legislation for inconsistencies among different legal documents.

Driver 3: Corporate and Public Governance

This driver includes policies and actions aimed at improving the governance of private companies and public administration, to support private sector activities in a free market economy. They include policies related to corporate governance, public administration and privatization of state properties.

The objective of corporate governance policies is to establish appropriate rules that would guide the activities of businesses in the best interest of their shareholders, protecting ownership rights. Key policies and actions include:

- Enact appropriate corporate governance legislation.
- Require all companies listed in stock exchanges to switch over to international accounting standards and to submit annual reports.
- Encourage the creation of non-government organizations to support corporate governance and issue corporate governance codes and model charters and by-laws.
- Implement a comprehensive corporate governance training program for board members, shareholders, managers, etc.

The objective of public administration policies is to redefine the role of the Government to support the private sector and secure the provision of sound and efficient government services without corruption. The implementation and sustainability of economic policy reforms over time also requires strong — though smaller — Government, with strong management and administrative capacity. A public administration reform program should include:

- Establish a clear strategy and vision for the role of the Government as complementary to and supportive of the private sector.
- Introduce adequate regulations to avoid monopolistic behaviors.
- Consolidate ministries and agencies to avoid responsibility over-lapping.
- Undertake "functional" and "operational" reviews of individual ministries and agencies.

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- Reform and modernize the Civil Service by providing adequate incentives for performance and market controls.
- Reform government procurement practices.
- Reform central-local government fiscal relationships.
- Reduce shadow economy activities by drastically lowering cost of compliance with legislation in effect.

The objective of privatization-related policies is to improve the efficiency of resource use through private ownership, minimize the possibilities of undue market power by the government, and concentrate government resources on public goods. Key measures include:

- Pass appropriate legislation to permit the privatization of land and state enterprises.
- Develop appropriate mechanisms to register ownership rights, including land titling and land registration.
- Create and encourage an independent agency to carry out the privatization of state properties.
- Approve fair and transparent procedures for the privatization of state properties
- Rapidly complete the privatization of all state enterprises under clear and transparent procedures.
- Take early actions to prepare state companies for privatization, including actions to protect minority shareholder rights, and transfer social assets to local authorities.

Driver 4: Liberalization of Foreign Trade and International Capital Movements

This driver includes policies and actions to facilitate the exports and imports of goods and transfer of capital internationally. This will require the following actions:

- Remove restrictions to exports, including export quotas, duties, indicative prices, advance deposits, and foreign exchange surrender requirements.
- Remove restrictions to imports, including high import duties, critical import list, and indicative prices.
- Simplify and expedite customs services, including procedures for customs clearances.
- Develop more modern and consistent procedures for certification requirements and standards of products.
- Liberalize foreign exchange transactions and eliminate restrictions on foreign direct investments.
- Cancel all restrictions on purchase of securities in foreign currency.

Driver 5: Financial Sector Development

This driver includes policies and actions to develop a healthy financial sector capable of meeting the financing needs of growing businesses. Key measures are the following:

- Liberalize interest rates on bank deposits and lending.
- Eliminate preferential credit programs imposed by the government on banks
- Increase the independence and autonomy of the Central Bank to operate efficiently without political considerations, with its main goal being the maintenance of internal and external stability.
- Ensure the health of the banking sector by improving bank supervision and enforcing prudential regulations.
- Develop appropriate mechanisms to deal expeditiously with troubled banks.
- Strengthen the Securities and Exchange Commission.
- Introduce international accounting standards and external auditing requirements for all banks.
- Encourage competition and efficiency in the financial sector by facilitating the expansion of foreign banks and other financial institutions.

Driver 6: Corruption Level

This driver includes policies and actions to minimize corruption and protect businesses from abuse of power by government officials. Key measures include:

- Undertake measures to "prevent" corruption, reducing the opportunities for corruption and making corruption more difficult to undertake.
- Develop the legal framework to ensure better enforcement of anticorruption measures and impose visible, harsh, swift and certain penalties for official corruption.
- Get public support for anti-corruption programs by making people aware of their rights and the rules of the game.

Driver 7: Political Risks

This driver includes policies and actions to minimize the effects of political uncertainties on business activities. Key measures include:

- Pass appropriate legislation to reassure investors that arbitrary expropriation of private property, including "creeping expropriation", will not be permitted in the country.

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- Introduce strong measures to eliminate power abuses by government authorities, bring tax collectors and local officials under the control of the central administration.
- Give government the total authority to do their jobs unimpeded by vested interests.
- Provide governmental stability, including the longevity of key officials.
- Ensure law and order.
- Minimize the risks of civil and external disturbances that may affect businesses.

Driver 8: Country Promotion and Image

This driver includes policies and actions to promote the country and improve its image as perceived by foreign and domestic investors. Key measures include:

- Announce and disseminate widely the government's policy and commitment to implement strong market oriented policies and show implementation progress.
- Vocally support foreign investment by changing the attitude of officialdom at central and local levels.
- Require all embassies abroad to have their commercial section strengthened, and to go on sales drives to better disseminate business opportunities.
- Assist in the establishment of a private investment promotion agency.

Driver 9: Targeted Investment Incentives

This driver includes policies and actions to bring investment incentives to levels similar to those of its trading partners, while avoiding targeted incentives that may lead to distortions and inefficient allocation of resources. Key measures include:

- Set taxes at levels comparable to those of the country's neighbors or competitors.
- Eliminate special investment incentives targeted to specific sectors, enterprises or regions.

Since this driver had a negative correlation in our statistical analysis, we believe that providing special investment incentives without improving the overall investment climate in the country would not produce desired results over the long term. The objective here must be to provide a level playing field for all investors — foreign and domestic — while providing competitive incentives, as compared to neighbouring countries vying for similar investments.

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V. The Bleyzer Initiative for FSU Countries

The History of The Bleyzer Initiative

The idea to accelerate the transition to market economy by the FSU countries came to us as a result of some ten years of investing in the region. Our private equity funds, focused primarily on Ukraine, have done quite well relative to competition, but the lessons we have learned from operating in the extreme conditions of a transition economy simply had to be organized, documented and analyzed. It is our strong belief that Ukraine is a typical case of a nation that is lost somewhere on the way to a market economy. They have been on this long and rocky road for over a decade now. They do not really want to go back to the failed centrally planned economy and discredited communist ideology. And they probably could not, even if they wanted to. That road back is closed, gone for good.

We have often been asked if Ukraine and other countries in the region are indeed on a truly irreversible course to market economy and democracy. We believe they are, but the reason may surprise you. It is vested interest. The various vested interest groups, while not exactly transparent or civilized from our point of view, would be the first to fight any attempt to revert back to state ownership and central planning. They already have too much to lose. Their wealth, power and position in society have been established under the new paradigm — private property. Their property rights may not quite be protected yet under the emerging rule of law, but they know how to protect it using the current rules of the game. And in many cases, they are now more interested in fully establishing the rule of law to protect private property rights for their children, than in going back ten years to the uncertainty and inefficiency of "collective ownership". More and more of them are beginning to understand that the only way they can have the rule of law protecting the rights of their children is by having it protect those rights for everybody.

Our experience in the region, as a private investor, would not have been sufficient however to fully analyze our findings, had we not come together three years ago with Dr. Edilberto L. Segura. Edi was completing his impressive 27-year career with the World Bank, which provided him with a unique opportunity to serve in senior positions in some 35 countries all over the world. His last posting was in Ukraine as the Head of the World Bank mission there from 1996 to 1998. It was Dr. Segura's first-hand experiences in Argentina with Menem, Peru with Fujimori (the early years), Mexico during the 1994 crisis, Venezuela, China, Africa and other countries that drove our interest and desire to develop a methodological answer to the problems of transition economies and developing countries. When Edi joined SigmaBleyzer as a Chief Economist in 1999, we were able to systematize our findings from investing private equity capital in Ukraine and compare them with his vast knowledge of other countries that faced similar challenges.

The initial benchmarking study, conducted in 2000, to review the government policy actions that attract or deter foreign investors focused on Argentina, Chile, Hungary, Poland, Russia, and Ukraine. A team of students and faculty members from Thunderbird International School of Management in Phoenix, Arizona was contracted by SigmaBleyzer to identify and analyze the investment drivers in these 6 countries. The Thunderbird team was led by Professor Krishna Kumar, the Head of Corporate Consulting Group at Thunderbird. Dr. Kumar and his team had a lot of experience in benchmarking business practices, including several studies they conducted for SigmaBleyzer business units and portfolio companies in Ukraine. But this time we asked them to benchmark government policies, utilizing this tried and proven business technique to help us understand macroeconomic trends in FDI flows to developing countries.

The initial results of the benchmarking study and statistical analyses conducted by the Thunderbird team, and later by the team of SigmaBleyzer professionals led by Dr. Segura, were quite interesting. We have built on them to develop the IPCTF Economic Policy Framework. The application of the IPCTF framework was then expanded to include all 15 of the former Soviet republics. We have assigned IPCTF ratings to all these countries and calculated potential flows of FDI based on several scenarios of government policy actions. A mathematical model was developed that allows us to predict FDI flows based on economic policy actions that reduce the gap between a given country's rating and the Best-in-Class in each of the nine policy areas or investment drivers. This model was based on multiple regression analysis of statistical data on 50 countries. Finally, the IPCTF Nonagon was introduced in 2001 as an easy graphic representation of a given country and its current investment climate as compared to the Best-in-Class (see chapter VIII).

Over the last two years we have made a number of public presentations on the potential applications of the IPCTF framework, the use of best practices identification in government policies, the gap analysis and quantification of impact of various economic policies on the flows of foreign direct investments. The audiences in Washington, London, Kyiv, St. Petersburg, Prague, Tbilisi and other places expressed a lot of interest in our work. But they also asked a lot of good questions, which

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helped us better understand how to apply IPCTF framework in different situations.

What eventually emerged was an approach we developed and are now actively advocating to help both transition economies and developing countries accelerate and successfully complete their journeys to market economy. The focus must indeed be on the completion of the transition. While many countries have left their points of departure, be it centrally planned economies or any other socio-economic structures, nobody is yet sure how to get to the intended destination, in other words — how to complete the transition to market economy. This approach was fist called "The Bleyzer Initiative" by a good friend of SigmaBleyzer, Mr. Martin Hoffmann. I am not sure that he meant for this to be a permanent name for this effort, but it kind of stuck, and we began using it to describe in one phrase a comprehensive set of measures, techniques and methodologies we are proposing.

The audiences for The Bleyzer Initiative are the government leaders of the developed countries, the transition economy countries of Central and Eastern Europe, the developing countries, the thought leaders and economists, business leaders and the public at large. This report describes our approach to solving one of the most critical problems of the early 21st century — how to improve global security in the new age of assured interdependence.

The Partnership between Developed Countries and Transition Economies

The Bleyzer Initiative is based on the belief that there is a need to strengthen the partnership between developed and transition economies to complete the transition process expeditiously. This partnership should have three elements: (1) open markets by developed countries for transition economies' exports; (2) financial support by bilateral/multilateral financial institutions with better targeting of aid; and (3) strong commitment to reform by transition countries using the reform framework provided by the IPCTF.

Open Markets for Transition Economies

Developed countries should significantly open their domestic markets for exports from the FSU, conditioned on strong economic reforms by the FSU. As noted earlier, the countries of the FSU face a number of trade restrictions in areas that are critical to their exports, including agriculture, labor-intensive industries such as textiles and clothing, and steel. This opening of trade should involve the elimination of all quotas and quantitative restrictions on exports from FSU countries, and the reduction of import tariffs.

The opening of markets, however, should be conditional on the successful implementation of economic reforms that would remove production and trade distortions.

Financial Support by Bilateral and Multilateral Financial Institutions with Better Targeting of Aid

A fundamental principle of the Bleyzer Initiative for international financial support to FSU countries is that the bulk of this aid must be focused on economic growth through the development of private enterprises. Today, the lion's share of international aid goes to a large number of other objectives, including social and environmental objectives. Although these objectives are laudable, we believe that international resources, which are scarce and temporary by nature, should be used to create wealth and economic growth in FSU countries. With sustainable economic growth, the countries themselves should be able to finance their social and environmental programs.

We believe that financial assistance should be refocused, minimizing government-to-government money transfers and blind pools of money, such as those provided by adjustment lending. Adjustment lending finances budget deficits and provides temporary balance-of-payment support. Unfortunately, experience in the FSU countries shows that this form of financing only prolongs the unwillingness to reform. Although the rationale for adjustment lending is that it provides financing during a transition and requires economic reforms by the beneficiary countries, the experience in the FSU is that many of the countries just pay lip service to reform requirements.

An important consideration in the provision of financial assistance must be the use of aid proceeds. It is just as important as the conditionality of lending or providing other forms of assistance. The international financial institutions should significantly reduce the level of adjustment lending and budget deficit financing and maximize investments that would directly benefit private sector development — small and medium enterprises and joint ventures with international corporations, which can bring know-how and technology. Additionally, it is very important to leverage private capital investments with financial assistance dollars. Official financial assistance itself could also be structured as quasi "private equity funds" managed by money managers from the private sector.

Strong Commitment to Reform by Transition Countries Using the IPCTF Framework.

Targeted aid and opening of markets should be provided only on the condition that transition economies do implement economic reforms to make their business

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environment more favourable to domestic and foreign investments and remove distortions to production and trade. Initially, volunteer countries should be sought to sign up for the program of trading their serious commitments to reform and honest all-out efforts to implement them, as described under the Tradeoff option in Chapter III. Once successful experience is gained and real progress towards market economy and improved quality of life is demonstrated in the initial group of countries, more and nations will become interested in this approach.

The countries selected for the program would be required to develop Action Plans for implementing new economic policies using the IPCTF framework as a tool to measure their current investment climate, prioritize their policy actions based on their specific situation and demonstrate measurable progress toward market economy on an annual basis. Once a year, these countries would be measured again using IPCTF framework methodology, their Action Plans adjusted accordingly and financial aid for the next year more appropriately targeted to focus on the most important sectors of development. The success stories would be widely publicized in the global media, thus attracting the attention of new potential private investors.

The Bleyzer Initiative and New US Government Policy

In his recent speech in Monterrey, Mexico on March 22, 2002, President George W. Bush outlined a new US Government policy to help developing nations. He said that combating poverty in the rest of the world is a moral imperative for the US and it will be a priority for US foreign policy. The goal of US development aid will be for nations to grow and prosper beyond the need for any aid.

To meet this challenge, the President has proposed a "new compact for development" that increases accountability for rich and poor nations alike, linking greater contributions by developed nations to greater responsibility by developing nations. The new compact recognizes that economic development assistance can be successful only if it is linked to sound policies in developing countries. The President said that in sound policy environments, aid attracts private investment by two to one. The ratio, in fact, may be significantly higher than that (see for example Net Capital Flows to Developing Countries table in Chapter VII), but the basic notion is quite important. Aid must be linked to sound economic policies, which will create the investment and business environment that attracts private capital investors. In countries where poor public policy dominates, aid can actually harm the very citizens it was meant to help.

Therefore, President Bush proposed an increase in US foreign aid, by an amount of $5 billion per year, under the "Millennium Challenge Account". The use of this account would be based on the following principles:

- **Good governance.** Rooting out corruption, upholding human rights, and adherence to the rule of law are essential conditions for successful development
- **Sound economic policies that foster enterprise and entrepreneurship.** More open markets, sustainable budget policies, and strong support for development will unleash the enterprise and creativity for lasting growth and prosperity
- **The health and education of the people.** Investment in schools, health care, and immunization provide for healthy and educated citizens who become agents of development

The following table compares the new US foreign policy initiative with the IPCTF framework.

President Bush	IPCTF Framework
Good governance. Rooting out corruption, upholding human rights, and adherence to the rule of law are essential conditions for successful development	⇒2. Provide a Stable and Predictable Legal Environment ⇒3. Enhance Governance & Reform Public Administration ⇒6. Eliminate Corruption ⇒7. Reduce Political Risks (non-economic country risks) ⇒8. Expand Country Promotion
Sound economic policies that foster enterprise and entrepreneurship. More open markets, sustainable budget policies, and strong support for development will unleash the enterprise and creativity for lasting growth and prosperity	⇒1. Liberalize and Deregulate Business Activities ⇒4. Remove International Capital & Trade Restrictions ⇒5. Facilitate Financing of Businesses ⇒9. Rationalize Investment Incentives ⇒*Sound fiscal and monetary policies (framework pre-condition)*

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VI. The Bleyzer Initiative for Developing Countries

The principles outlined above are based on the review of a sample of 50 emerging countries. Therefore, its applicability goes beyond the transition economies of the Former Soviet Union. In fact, many countries in Africa, Asia and Latin America can achieve significant increases in their inflows of foreign direct investments if they choose to apply the principles above. The use of the IPCTF framework provides a unique tool that allows for measuring various country policy environments in quantitative terms based on benchmarking, best practices identification and gap analysis. Based on this measurement, an action plan for any developing country can be developed, which would allow this country's strategy to close the gaps between them and the Best-in-Class in each of the nine government policy areas of the IPCTF framework.

Furthermore, the econometric models developed as a part of the IPCTF effort offer predictions of the FDI flows to a given country based on the speed with which the gaps with the best practices can be closed. The use of the IPCTF framework may provide the first methodology to move developing countries and transition economies towards a market system.

The unique features of the IPCTF methodology are outlined below:

- Quantifies statistically the relative importance of individual economic policies (investment drivers) on FDI and economic growth.
- Permits establishment of priorities for government action, based on the above quantification of policy impacts.
- Provides formulas that calculate the increases in foreign direct investments over time, if the country were to narrow its policy gap with the Best-in-Class countries.

We believe that other economic reform indexes say nothing about the relative importance of individual policy reforms. There is no attempt to quantify their relative impact on real economic performance.

In fact, we have not seen any other index or a framework anywhere in the world that uses all of the following:

- Benchmarking government policies
- Identifying best practices in government policies
- Measuring based on gap analysis
- Measuring statistical significance of different economic policies
- Measuring / quantifying impact of economic policy changes on investments and therefore economic growth
- Predicting future flows of investments using a non-linear mathematical model where the values of regression coefficients are not constant, but change depending on the value of the individual indexes. This accounts for the evolving relative importance of each of the nine policy action groups

The key to the successful implementation of The Bleyzer Initiative is active engagement of developed countries, and a true partnership between the developed and developing countries. Only in this way can we hope to achieve stability in the world and prosperity for the most people.

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VII. The Evolution and Role of Foreign Direct Investments

The previous sections have shown the importance that foreign direct investments could play in improving the quality of life in the FSU on a sustainable basis. In fact, for most FSU countries there are no alternatives but to secure larger amounts of FDI to support economic growth at least for the near future. This section discusses the evolution and role of FDI.

The Flow of Different Forms of International Private Capital

During the 1990s, the flow of international private capital to all developing countries' markets increased significantly, from an average of $12 billion in 1984-1989, to about $220 billion by the mid-1990s, as noted in the Table below. However, several financial crises in the last decade — including the Mexico Crisis of 1994, the Asian Crisis of 1997 and the Russian Crisis of 1998 — significantly reduced the flow of total international private capital to developing economies. In fact, there was a drop of 44% in the flow of private capital in 1997, followed by a drop of 65% in 1998.

A very important point, however, is that in spite of these crises, the flow of foreign direct investment (FDI) has been very stable, increasing throughout most of the period, as noted in the table below. It now represents the most important source of financing for developing countries. The table also shows that the flows of official assistance and commercial bank lending have been quite unreliable and unstable.

Net Capital Flows to Developing Countries (in US Dollar billions)

	1984–89	1994	1995	1996	1997	1998	1999	2000
Total Net Int'l Private Capital	12	141	189	224	126	45	71	32
Foreign Direct Investment	13	81	97	12	145	149	153	146
Portfolio Flows	4	110	43	85	43	24	54	58
Commercial Bank Loans	5	50	50	19	62	127	136	172
Official Assistance	26	4	12	1	23	45	3	1

Source: IMF, August 2001

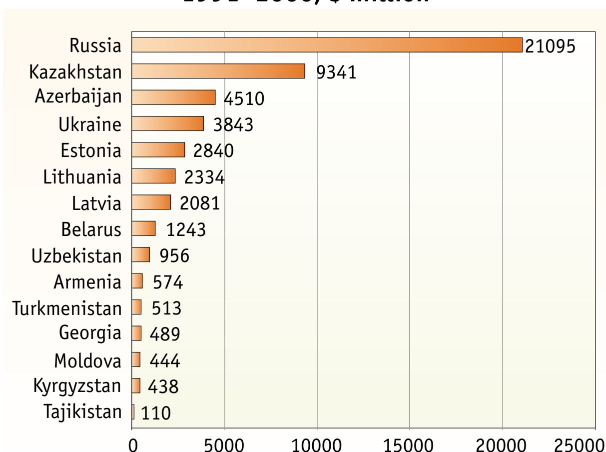
As shown in the above table, in 2000, the flow of foreign direct investment to developing countries reached $146 billion. The largest recipients were developing countries in Latin America and East Asia.

Foreign Direct Investments in the Former Soviet Union

In 2000, of the total amount of FDI, FSU countries received only about $7.5 billion, or 5% of total FDI flow. Excluding Russia ($3.0 billion) and Kazakhstan ($1.6 billion for oil investments), other FSU countries received only $2.9 billion in FDI.

Since independence, FSU countries have been able to obtain $50 billion of FDI. The main beneficiaries of these investments were the oil rich countries of Russia, Kazakhstan and Azerbaijan, which received 70% of the total cumulative FDI for the period, as noted in the chart at right:

Cumulative FDI to FSU countries, 1991–2000, $ million



But for all FSU countries, since independence, foreign direct investments have been very low when compared to the flow of FDI received by other transition countries. The $7.5 billion received by the 15 FSU countries in 1999 compare unfavorably to the annual amounts of FDI received by other developing countries in 1998, in-

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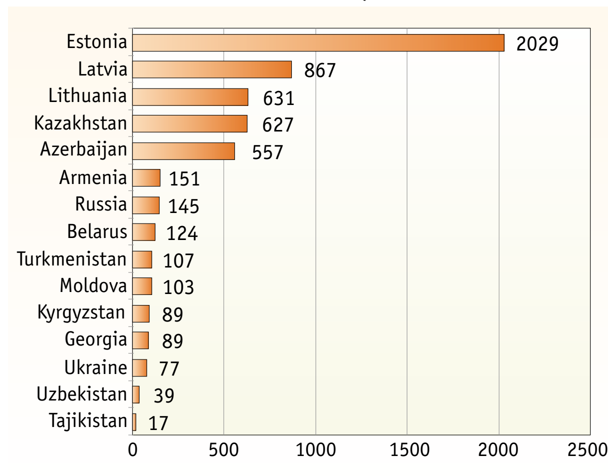
cluding China ($43 billion), Brazil ($30 billion), Mexico ($10 billion), Korea ($10 billion), Argentina ($6.1 billion), and Chile ($4.6 billion). It also compared unfavorably to the amounts of FDI received that year by other Eastern European countries, such as Poland ($6.4 billion), Czech Republic ($2.6 billion) or Hungary ($2.0 billion). The FSU countries have ample room to expand their inflows of international private capital. They have not tapped even a small percentage of their potential.

On a per-capita basis, the cumulative amount of FDI received by various FSU countries shows a somewhat similar picture, as noted in the chart below. Among the largest recipients on a per capita basis were the oil rich countries of Kazakhstan and Azerbaijan. In addition to these two countries, the Baltic countries received large inflows of FDI per capita, reflecting their more successful implementation of economic reforms.

Cumulative FDI per Capita to FSU Countries, 1991–2000, $



The lack of foreign direct investment since independence cannot be attributed only to macro-economic factors. To a large extent, the lack of sustainable growth and international capital is due to exceptionally difficult conditions for business activities in FSU countries. These poor business conditions are the main obstacles that deter foreign investors.

Principles to Increase the Flow of Foreign Direct Investment to FSU Countries

FSU countries must compete for investment dollars on global capital markets. While there is a lot of investment capital available in the world, the countries must provide the upside revenue potential commensurate with the underlying risk in order to attract investment.

An appropriate balance of risk and reward must be present to attract private capital. Today, FSU countries are viewed as too high a risk as compared to the potential reward. FSU governments must work on both sides of the equation simultaneously — reducing risk and increasing potential reward.

Reducing risk is a long-term process, but the signals should be loud and clear: the countries are on a decisive and irreversible course toward competitive free-market-based economies. To achieve this goal, it should be shown that the FSU countries are actively pursuing economic reforms, including securing internal and external economic stability, providing a stable and predictable legal system, developing a private land-ownership-based agricultural sector, pursuing liberalization and deregulation of business activities, and eliminating barriers to market entry and market exit. In addition, the progress of reforms should be clearly visible and constantly improving.

In order to increase potential rewards for private capital, there are many variables to consider. They include creating a favorable tax environment, facilitating the growth of internal markets and competitive export-oriented business, permitting the realization of potentially higher revenues and profits, providing logistical advantages, and facilitating the potential for integration into global supply chains.

In order to attract foreign capital, FSU countries must be seen as modern countries that understand their strengths and weaknesses, and therefore their role in the global economy. They should be seen as fast growing economies that nobody can stop, instead of old bureaucracies with heavy vested interests. A dynamic image must be created for these new economies. This represents a fundamental change and creates a marketing challenge, but both can be managed. Other countries have done it successfully in the past.

A key signal for investors is the "speed of change" that is taking place in the countries. Indeed, change attracts private capital. Once capital markets perceive that a radical, positive change is taking place, they reward it quickly and dramatically. More investment is made every day on the basis of the potential of tomorrow, rather than in the current business per se. But this potential must be seen, understood and accepted by the market, and this process always starts with a perceived change in the status quo.

In order to create the conditions necessary to attract foreign private capital, the governments of the FSU countries must define and implement the concrete measures that are needed to improve the business climate in their countries. Based on the pre-condition that a sound macroeconomic stabilization framework must be in place, additional measures should aim at improving "Transparency", encouraging "Simplicity" and facilitat-

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ing "Predictability" in business activities in the FSU countries.

"Transparency" is like "clear air" for private equity capital investment. At the early stages of transition, only large globally diversified investors would invest in equities in FSU countries. There are many of these investors, and they control an enormous amount of free capital reserves that would be more than sufficient to cover all of the investment needs of FSU countries for years to come. However, with their size comes sophistication and experience. All of these investors have had experience investing in liquid, efficient markets with great transparency, and in more "murky" markets. They all know from experience that real returns on their investments can only be made when transparency arrives at a market place. Unfortunately, in FSU countries today, many decisions and business activities are made in a non-transparent manner. Furthermore, a lot of the information available to investors on business opportunities in the countries is not clear and not consistent with international standards.

"Simplicity" is also vital to the investment process. There is nothing more damaging to a foreign investor than a cumbersome, complicated, difficult-to-understand investment and business environment. The more difficult it is to register, set up and operate a business in the country, to transfer funds in and out of the country, and to participate in various privatization and other investment processes, the more negative an adjustment the investor has to make to his perceived risk / reward ratio.

"Predictability" is a third important consideration for investors. All successful business people and investment professionals all over the world pride themselves on their ability to understand, and then manage and control risk. They must be able to predict, at least in their minds, what the consequences of certain actions by them and their competitors will be. For this purpose the "rules of the game" should be clear and stable.

IPCTF Economic Policy Framework described in this report helps identify and prioritize concrete measures that are needed to improve Transparency, Simplicity and Predictability.

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VIII. Benchmarking and Statistical Analysis

Identifying Best Practices in Government Policies

The methodology used in the Benchmarking and Statistical Study was as follows:

- The study compared and benchmarked the current status of key economic factors — called "drivers" — that influence the flows of private capital in the fifteen FSU countries. It also compared them with the situation in other countries, including Argentina, Chile, Poland and Hungary. This Benchmarking Analysis assigned values to the policy actions of these countries — policy actions that could explain their flow of capital.
- For a larger group of 50 countries, using regression analysis, the study quantified the individual contributions of these "drivers" to the actual flow of foreign direct investment into these countries. It then established the relationship between policy actions and foreign direct investment and their relative importance for success.
- The study developed a mathematical model to estimate the flow of international private capital that FSU countries would be able to obtain over time, if they were to implement policies carried out by the most successful benchmarked countries.
- The study then made recommendations on a Plan of Action — The Bleyzer Initiative — to assist FSU countries in completing their transitions to market economies.

Benchmarking Results

The first step in the benchmarking analysis was to identify those economic policies that have an impact on the inflows of foreign direct investments. These are the "drivers" for FDI. In the second step, the economic policies or drivers in each one of the FSU countries were assessed and quantified using indexes that range from one to 100. A similar exercise was carried out for a number of other developing countries with whom the FSU countries can be compared or "benchmarked". The following countries were selected for benchmarking: Argentina, Chile, Hungary, and Poland.

Policies Affecting Business Climate

The study starts from the premise that macroeconomic stabilization, achieved by sound fiscal and monetary policies, is an essential pre-condition to achieving a favorable business climate and to attracting foreign direct investments. Within this macro framework, the study identified the nine key "policy actions" or "drivers" that generate foreign investment:

1. Liberalization and Deregulation of Business Activities
2. Stability and Predictability of Legal Environment
3. Corporate and Public Governance
4. Liberalization of Foreign Trade and International Capital Movements
5. Financial Sector Development
6. Corruption Level
7. Political Risk
8. Country Promotion and Image
9. Targeted Investment Incentives

Scores were assigned to these nine individual policy action groups in all FSU and benchmarked countries, based on policy rankings carried out by a number of international agencies, including the World Bank (Country Policy and Institutional Assessment Index), UNDP (International Business Climate Index), the Heritage Foundation (Index of Economic Freedom), Political Risk Service (International Country Risk Guide), Transparency International (Corruption Perception Index), and Freedom House (Nations in Transit).

To minimize subjectivity in assigning values to these factors, and to further validate the accuracy of the estimates, the study team reviewed research carried out by other institutions. Furthermore, data was aggregated from multiple sources to eliminate evaluator bias. Values (ratings, scores etc.) for individual line items were normalized using a scale of 1.0 to 100.0 with higher scores indicating a better item score. For the FSU countries, the highest score of 100 was given to the best country in the class.

The results of the benchmarking analysis for FSU countries are given in the charts below.

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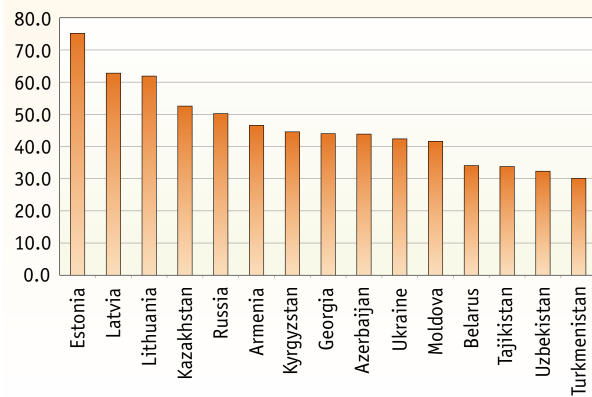
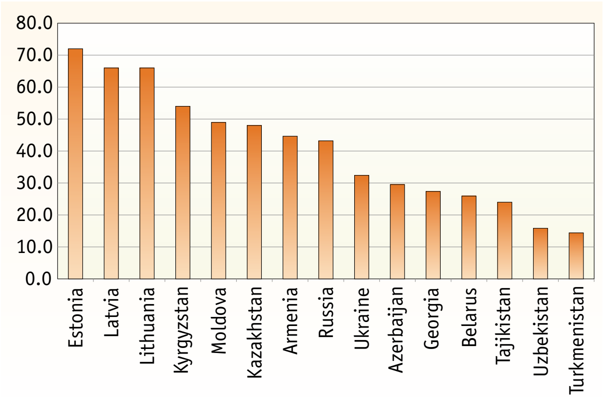
FSU Benchmarking Analysis

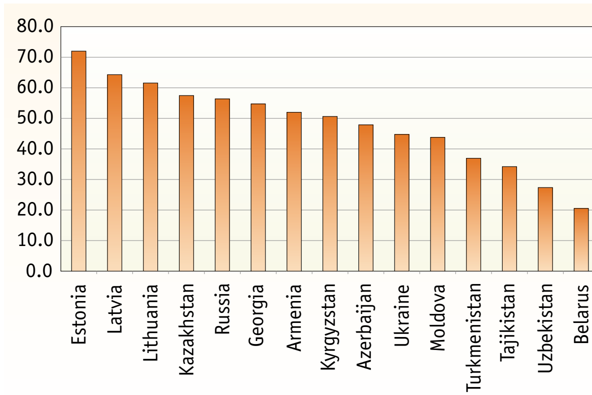
Average Ratings for FSU Countries



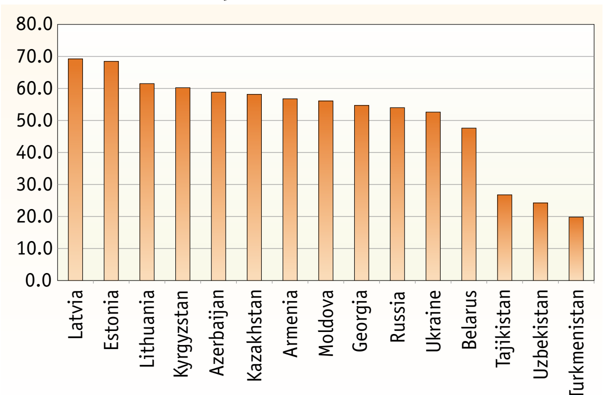
Corporate and Public Governance



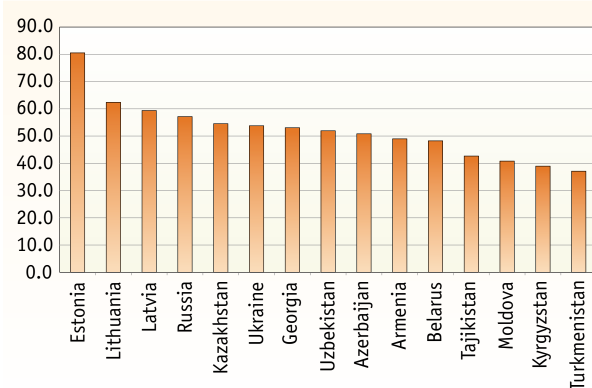
Liberalization and Deregulation of Business Activities



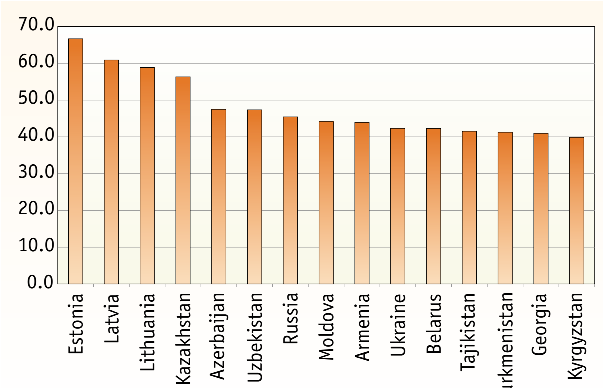
Liberalization of Foreign Trade and International Capital Movements



Stability and Predictability of Legal Environment



Financial Sector Development



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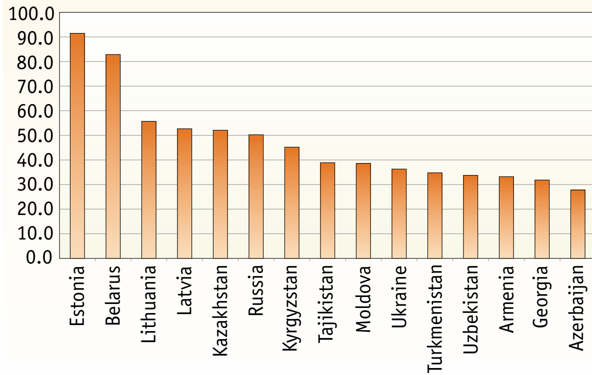
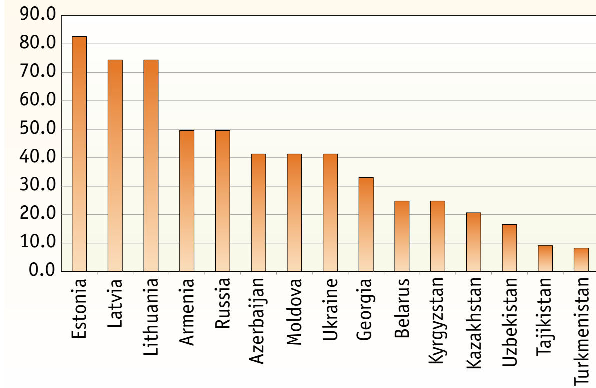
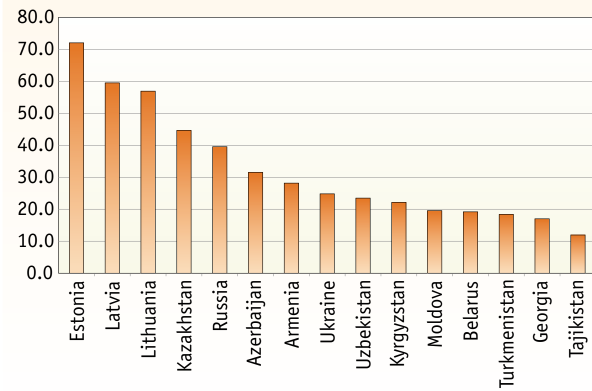
Corruption Level



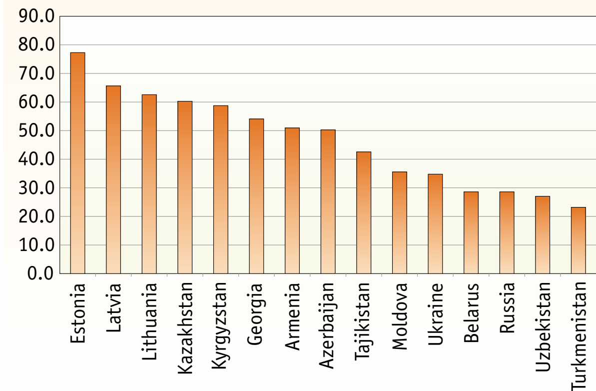
Country Promotion and Image



Political Risk



Targeted Investment Incentives



The above charts show that Baltic countries (Estonia, Latvia, and Lithuania) are ahead of the other FSU countries in implementing economic reforms aimed at improving their business climate. At the other extreme are countries with strong governments that are not inclined to carry out reforms (such as Belarus, Turkmenistan and Uzbekistan). The countries in the Caucasus fall in the middle ground.

The charts below present the IPCTF ratings by country relative to the average rating in each of the nine areas.

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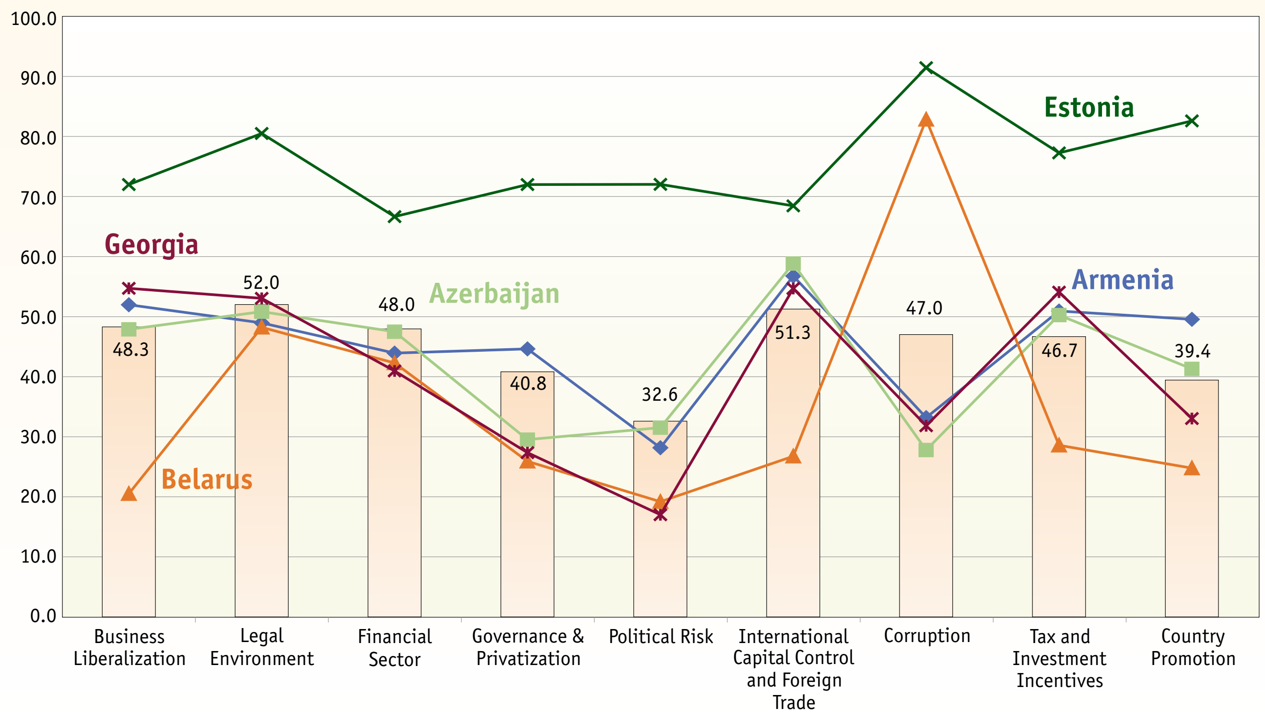
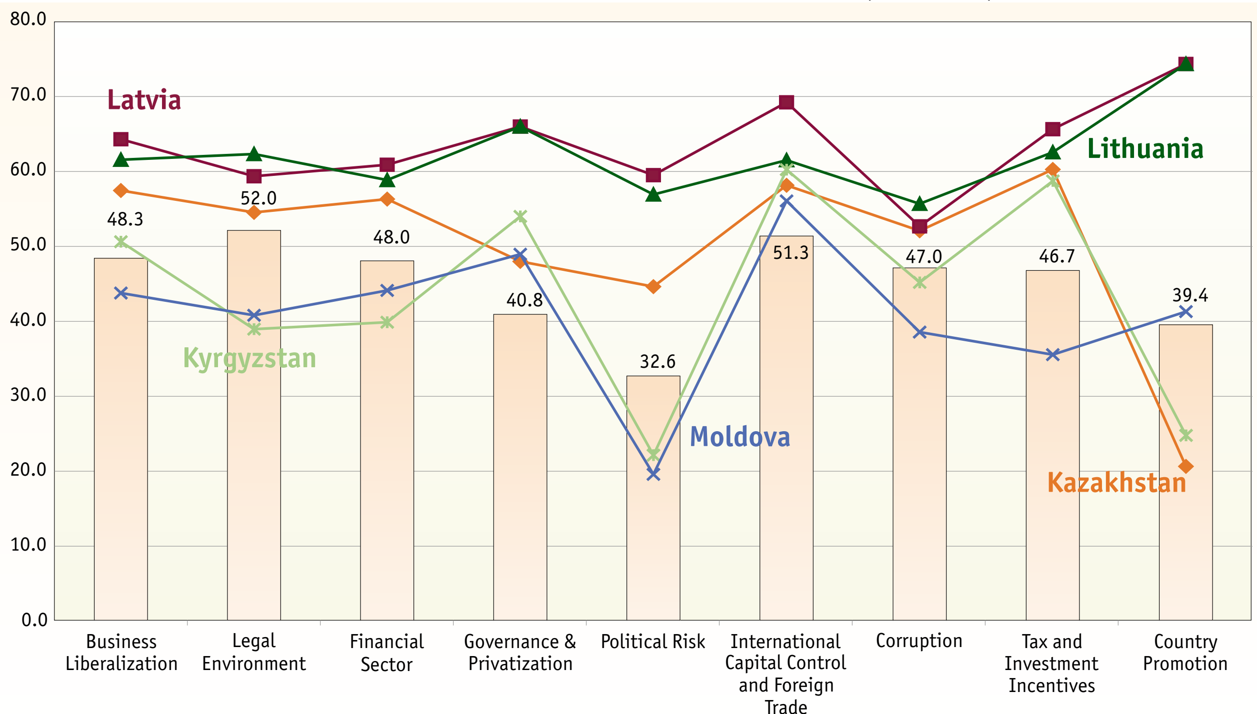
Benchmarking Analysis for FSU Countries, 2000–2001



Benchmarking Analysis for FSU Countries, 2000–2001 (continued)



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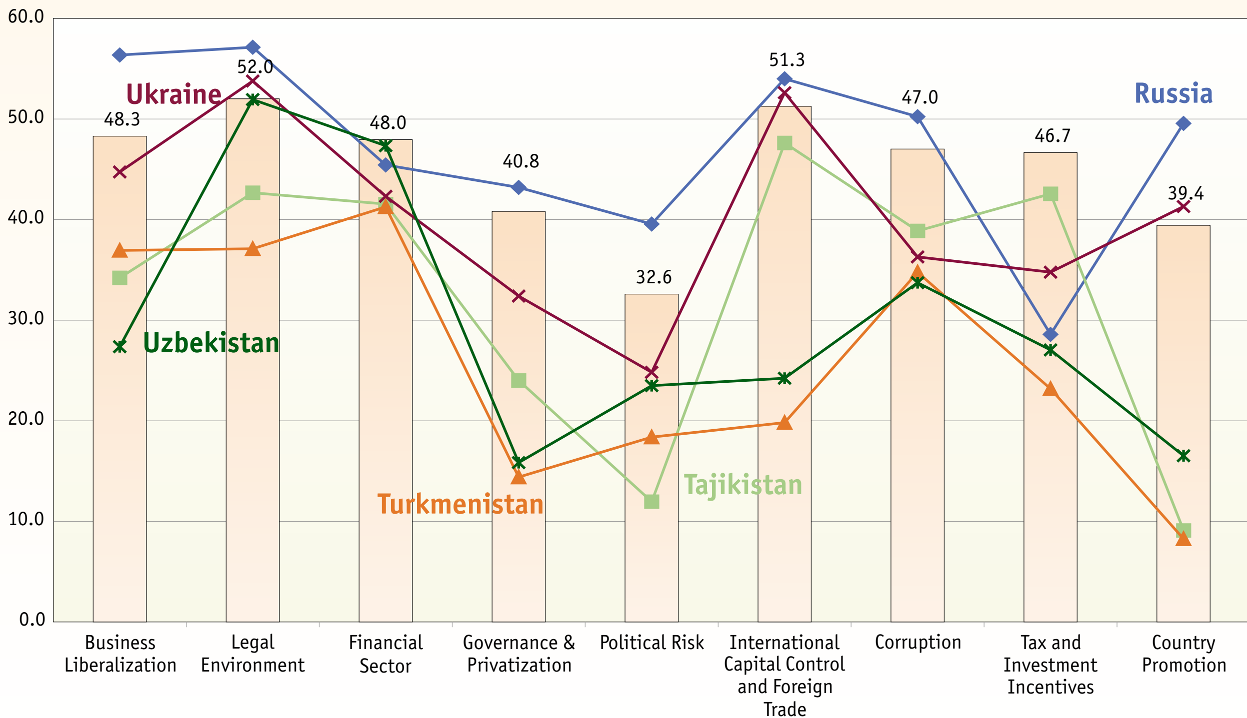
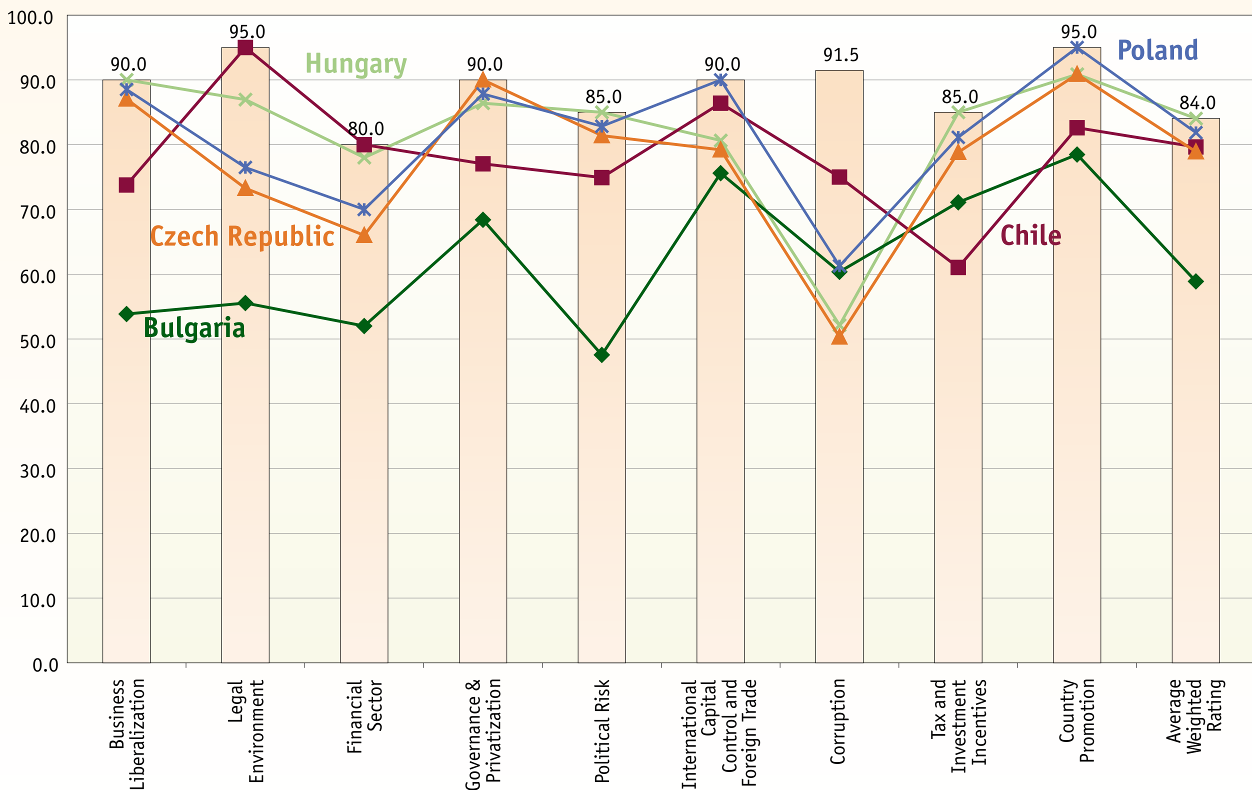
Benchmarking Analysis for FSU Countries, 2000–2001 (continued)



Benchmarking Analysis for CE Countries and Chile, 2000–2001, Compared to Best-in-Class



The average results for all FSU countries are on the following page in a chart called the IPCTF nonagon. The countries outside the FSU included Hungary, Poland, the Czech Republic, Bulgaria, and Chile.

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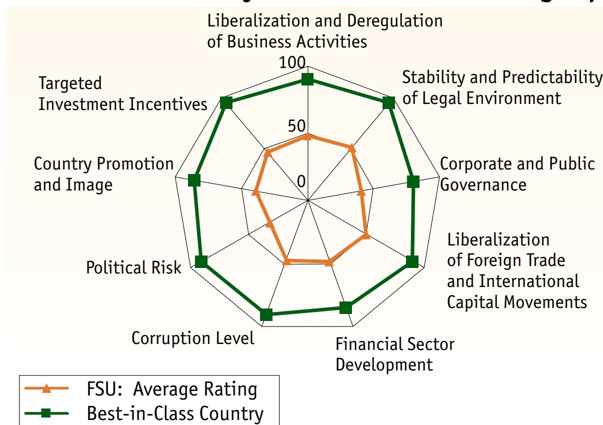
IPCTF Nonagon

Best-in-Class Country and FSU Countries: Rating Gap



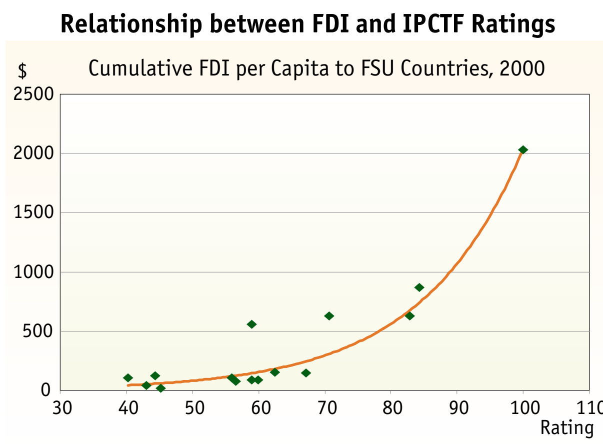
The IPCTF Nonagon shows that the economic policy environments of the FSU countries are weaker in all areas, with all average indicators of policy performance at or below 50%. The weakest areas are those relating to political risk, country promotion efforts, and governance. On the other hand, the FSU countries' policy environment is slightly better in the areas of legal environment, international capital controls and business liberalization, but still significantly lower than the Best-in-Class.

IPCTF Nonagons for all 15 countries of the FSU have been developed by our study and are included in APPENDIX C.

IPCTF Ratings and FDI Flows Correlation

The table below indicates that, indeed, there is a close correlation between the average IPCTF rating of a country and its inflows of foreign direct investments:

Relationship between FDI and IPCTF Ratings



The effect of the individual nine policy drivers on the flows of foreign direct investments will be discussed in the next section.

Econometric Model and Results

The objective of the statistical analysis was to quantify in numbers the 'relationship' between capital inflows and actionable policy measures in a cross-section of countries. Several statistical tests were run to establish this relationship, ranging from simple correlation models to multiple regression techniques to structured equation modeling.

In the statistical analysis carried out by SigmaBleyzer, the scores on the nine policy actions were statistically tested against the capital inflows in 50 countries to arrive at the coefficients of a "formula" for FDI. The coefficients of the multiple regressions are the relative weights of the nine factors in explaining FDI.

The following countries were included in the SigmaBleyzer statistical study: Angola, Argentina, Armenia, Azerbaijan, Belarus, Bolivia, Botswana, Bulgaria, Burkina Faso, Cameroon, Chile, Colombia, Costa Rica, Croatia, the Czech Republic, Ecuador, Egypt, El Salvador, Estonia, Ethiopia, Ghana, Hungary, India, Indonesia, Jordan, Kazakhstan, Kenya, Lithuania, Malawi, Moldova, Morocco, Mozambique, Nigeria, Peru, Philippines, Poland, Romania, Russia, Senegal, Slovak Republic, South Africa, Tanzania, Tunisia, Turkey, Uganda, Ukraine, Venezuela, Vietnam, Zambia, and Zimbabwe.

The results of the multiple regression analysis indicated that four "drivers" were the most significant in explaining the flow of foreign direct investment into the above 50 countries. In fact, these four drivers would explain about 60% of the variations in foreign direct investments in the group of 50 countries. These four drivers were statistically significant. The results of the regressions are presented in Attachment 1 of the report.

Three of the four significant "drivers' had a strong positive impact on foreign direct investment. These three "drivers" were as follows:

- Liberalization of business activities (including domestic trade liberalization.)
- Adequacy of the legal environment (law and order).
- Governance and accountability of public administration.

The fourth significant "driver" had a negative impact on foreign direct investment. This driver was the level of investment incentives. This is a plausible result, because a high level of investment incentives is used by many poorly performing countries in lieu of a free and competitive business environment. The level of ad hoc investment incentives cannot outweigh the other negative factors, and the use of special conditions, such as "free economic zones", rarely produces positive results for the country if other policy areas are not improved.

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Other "drivers" - including financial sector, political risk, international capital controls, corruption, and government promotion — were not statistically significant in the regressions, but this does not mean that they are not important. Their lack of statistical significance may be explained by multicollinearity problems, since these factors were highly correlated to the other significant factors. In fact, corruption was 82% correlated to public governance; removal of capital and trade restrictions was 79% correlated to liberalization; financial sector reform was 70% correlated to liberalization; and political risk was 71% correlated to governance.

Statistical Research Done by Others

(a) Statistical Analysis Done by the Thunderbird Corporate Consulting Group.

The Thunderbird Corporate Consulting Group of Phoenix, Arizona, ran economic regressions similar to the ones performed by SigmaBleyzer, but for a smaller group of 23 countries, including: Argentina, Bangladesh, Bulgaria, Chile, Colombia, the Czech Republic, Egypt, Hungary, Indonesia, Kenya, Nigeria, Pakistan, Peru, Poland, Romania, Russia, South Africa, Sri Lanka, Thailand, Ukraine, Venezuela, Zambia, and Zimbabwe.

In this set of regression analyses, four major government policies (liberalization of business, legal environment, financial sector and governance) were aggregated into a single index called "Major Government Policy". The other variables included political risk, corruption, capital and foreign trade restrictions, and tax and investment incentives.

The results of this analysis show similar conclusions to the analysis performed by SigmaBleyzer: for the sampled countries, "Major Government Policies" had the most significant effect on the amounts of foreign direct investment received by the countries, with a significance level of 94%. Corruption and political risks followed in significance. As was the case with the other set of regressions, investment incentives also had a negative coefficient, though at a lower level of significance.

(b) Study Done by Morgan Stanley Dean Witter

A USAID-funded regression study of 67 emerging economies was conducted by Morgan Stanley Dean Witter in July 1998 (titled "*Foreign Direct Investment and its Determinants in Emerging Economies*"). The main findings of the study were as follows:

Finding 1: Foreign investment inflows are influenced very little by generic variables such as: location, proximity to financial centers, total population, and size of the country. These variables show little significance throughout the regressions.

Finding 2: On the other hand, the countries' policies and institutions heavily influence foreign investments.

Finding 3: The above means that even though initial, country-inherent conditions may play a certain role, they can be overcome by sound policies and their thorough implementation.

Finding 4: Economic policies allowing for free open markets, investment and trade are key determinants of FDI inflows (Economic Openness had the highest coefficient value).

Finding 5: The key determinants of "Economic Openness" were:

- Little government interference in markets, that is, "free" markets with minimum directive regulation.
- Open import and export regimes.
- An exchange rate that reflects a currency's true value, with no controls on currency exchange.

(c) Study Done by the International Center for Policy Studies

Another important study was carried out by the Ukrainian International Center for Policy Studies in June 2000 (titled "*Foreign Direct Investment in Ukraine, Policy Study No. 11*"). This study carried out a survey of 65 foreign companies with representation in Ukraine. These companies had committed over $2 billion of FDI in Ukraine, representing about 2/3 of total FDI flow. They were asked to identify the major deterrents to foreign investment in Ukraine, to estimate the importance of privatization for FDI, and to indicate their motives for investing in the country.

The survey's result confirmed that the main reason for poor performance in attracting foreign capital was an inferior investment climate. The main conclusions were as follows:

Major Deterrents for FDI. The survey ranked the major deterrents to FDI in the following order, descending in significance:

- Instability and exorbitance of government regulations
- Ambiguity of the legal system
- Uncertainty of the economic environment
- Corruption
- High tax burden

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- Problems establishing clear ownership conditions
- Depressed disposable income levels
- Difficulty negotiating with government authorities
- Volatility of the political environment
- Lack of physical infrastructure

Recommended Policies. The respondents to the survey suggested the following policy agenda to improve the business climate and attract foreign direct investment:

- Liberalization of controls on capital, foreign exchange and profit repatriation
- Lifting of restrictions on foreign ownership and control
- Minimization of red tape
- Reduction of tax rates and number of taxes

Importance of Privatization. The surveyed companies indicated that they had invested in Ukraine mostly through Greenfield projects or joint ventures with private companies. Privatization had not been important in their investment decisions. Nevertheless, 95% of the companies felt that proper privatization policies could significantly improve the business climate in the country.

Investment Motives. The most important motive for investment in the country was market seeking. Most investors were attracted to Ukraine by its extensive market of 50 million people. This factor was well ahead of others, including cheap labor. Ukraine's lower wage rates were offset by its lower labor productivity, inferior management and regulatory burdens. All of these factors made labor costs higher. It is also interesting to note that tax/investment incentives, available qualified labor, and existing production capacities were regarded as unimportant.

(d) Study Done by the European Bank for Reconstruction and Development (EBRD)

In connection with its "*Transition Report 1999*" (Transition Report 9, November 1999), the EBRD carried out a "Business Environment and Enterprise Performance Survey". This survey contains indicators of the problems accountable for the rather negative perception of the FSU countries' investment climate. For the survey, managers of over 3,000 enterprises in twenty Central European, Eastern European and FSU countries were asked to assess the business/investment climate in their respective countries. Questions focused on macroeconomic conditions (policy instability, inflation, exchange rate), microeconomic conditions (business regulations and taxation, and access to finance), law and order (functioning of the judiciary, corruption, and crime), and the physical infrastructure.

Out of the 20 countries surveyed by the EBRD, FSU countries occupied the lowest places. FSU countries were also close to the bottom with respect to their effectiveness in affording security of property and contract rights.

(e) Study Done by the German Advisory Group

In 1999, the German Advisory Group to the Ukrainian Government carried out a survey of 20 foreign companies with operations in Ukraine, to find out the most important impediments for investing in the country (Siedenberg, Hoffmann (eds.), "Ukraine at the Crossroad", New York 1999.) The study also ranks these impediments to define the importance of their disincentive potential. The following were the main deterrents to investments, in order of importance:

1. Legal uncertainty
2. Government's failure to abide by its commitments
3. Government control and remnants of command economy
4. Lack of support from authorities
5. Corruption
7. Long processes for obtaining necessary permits

Each of these studies validates the results from our own primary analysis and statistical tests. In fact, their results are very consistent with the results of our study. How these findings are used to predict foreign direct investments to FSU countries is discussed in the next section.

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IX. Estimating Foreign Direct Investment to FSU Countries

Methodology to Predict Foreign Direct Investment

The benchmarking and statistical analyses results were used to construct a mathematical model that defines changes over time in the flows of international capital to FSU countries as a function of the nine investment drivers discussed earlier. The model is based on two factors: the value of the nine investment drivers index, and the changes in the importance of these investment drivers over time.

The economic-mathematical model is summarized in APPENDIX B.

Estimating Foreign Direct Investment into FSU Countries

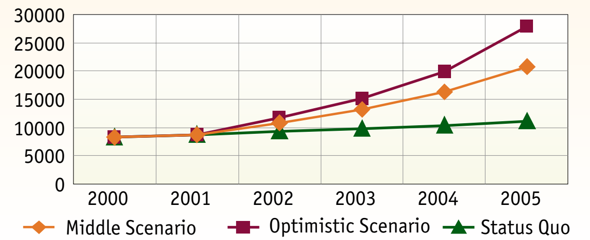
Based on the above forecasting model, for the next few years the FSU countries have three possible scenarios for their level of foreign direct investment, depending on the depth of economic policy reforms aimed at improving the business climate. The continuation of the current policies would mean a Status Quo. That is, FSU countries would continue to receive around $10 billion per year in foreign direct investment by year 2005.

On the other hand, under an aggressive reform program that would significantly improve the business climate in the country (to close the policy gap with the Best-in-Class by 80%), FSU countries would be able to increase the flow of foreign direct investment to a level of about $28 billion per year by 2005. Over the 2001 to 2005 five-year period, the cumulative amount of foreign direct investments under this optimistic scenario would be $85 billion. Over the second five-year period, FDI could reach $52 billion per year by 2010, bringing the total cumulative FDI amount over the ten-year period to about $285 billion. This scenario would make a major difference in the capacity of the FSU countries to undertake the bulk of the investments needed to modernize their economies.

Under a more modest, middle scenario in which the policy gap with the Best-in-Class is reduced by 50%, FSU countries may be able to increase the flow of foreign direct investment by year 2005 to about $21 billion per year. The cumulative amount from 2001 to 2005 would be $70 billion. For the 10-year period to 2010, the cumulative amount would reach about $220 billion.

The possible evolution of foreign direct investment under these three scenarios is given in the chart below.

FSU Countries — FDI, in US Dollar million



The flow of foreign direct investment will have a multiplier effect on GDP growth. Under the middle scenario, the incremental FDI would generate an incremental GDP growth of about 5% per year in most FSU countries.

The discussion in this section illustrates that FSU countries will be able to reap significant economic benefits from the implementation of specific economic policies that accelerate the flow of foreign direct investment. For this purpose, these countries must create an environment in which private foreign capital is allowed and free to work effectively. The study showed that Liberalization of Business Activities, followed by improvements in the Legal Framework and improvements in Governance were the three most important policy actions that the country could take to increase capital inflows today. However, in order to get more significant increases in capital flows over the next five years, actions on all nine factors are required.

It should be noted that the above levels of financing from the international private sector would go a long way toward meeting the requirements of the FSU countries to re-capitalize and modernize their economies. This financing would enable these countries to accelerate their rates of economic growth and would be an essential factor in improving the quality of life of their citizens. The individual predictions of the FDI flows resulting from various economic policy scenarios have been developed by our study and are included in Appendix C.

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X. Conclusions and Action Plan for The Bleyzer Initiative

This book draws the following conclusions:

- In the FSU, the transition has been more difficult than anticipated, with major declines in living standards and increased poverty that can be a source of world instability.
- Improvements in the quality of life will only come from sustainable economic growth, which will require significant inflows of foreign direct investments (FDI), since domestic savings are low.
- Both FSU and developed countries must work together, under an arrangement in which the FSU implements major economic reforms to attract FDI, while the developed countries provide access to their markets, targeted aid and know-how.
- The economic reform programs of the FSU must recognize that there is a low correlation between FDI flows and "natural characteristics" of a country (e.g., location, size, resources, etc.). On the other hand, there is a high correlation between some key government policies and the flows of FDI.
- Private capital is attracted by business environments that provide for a liberalized market where profits can be secured, where the rules of the game are clear and stable, where the legal environment protects property rights and enforces business contracts, and where corporate governance protects shareholders' rights.
- It is possible to measure the economic impact of government policies based on the gap between the policy stance of a given country and the Best-in-Class in each of the nine government policy areas identified in this report.
- Econometric models of transition economies can predict the level of FDI flows based on government policies.
- Therefore, the IPCTF Economic Policy Framework provides a comprehensive tool for building consensus and developing an action plan for any transition economy or developing country.

Based on these conclusions, The Bleyzer Initiative proposes a stronger partnership between developed countries and FSU countries to complete the transition in the region. These partnerships would have the following elements:

- Developed countries would open their domestic markets to transition economy's exports.
- The financial support provided by bilateral/multilateral financial institutions will have better targeting of aid. In particular, developed countries and IFIs should refocus multilateral and bilateral assistance to FSU countries on the creation of market economies to sustain economic growth. Most financial assistance should be focused on creating private businesses - small and medium enterprises and conditions for large multinationals operations in the FSU countries. Private capital should be leveraged with donor's money.
- The FSU countries must demonstrate strong commitment to reform using the reform framework provided by the IPCTF. The use of the IPCTF framework will create capital-friendly environments in the FSU countries and attract private equity capital.

An Action Plan to implement the Bleyzer Initiative would have the following elements:

- Convince US and EU governments at the most senior levels of the need to actively support the creation of market economy and democracy in the FSU countries to sustain economic growth. Just like many transition economy governments pay lip service to implementing changes required by financial assistance programs, the developed country governments often pay lip service to their role in transforming developing countries. Actions are clearly needed here that go beyond the approaches used in the 90's.
- Build an alliance of developed countries to promote the market-economy-focused program in FSU countries and later in Africa, Asia and other developing countries to achieve stability and improved security in the world.
- Use IPCTF Economic Policy Framework as broad conditionality for all financial assistance to developing countries.
- Work with the FSU countries' governments to create specific Action Plans for each country using IPCTF framework.
- Create a series of satellite private equity funds in the FSU countries to advance Action Plans implementation (later in other countries).
- Publicize the program in the Western press to attract private capital.

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APPENDIX A

Statistical Results

1. Statistical Analysis carried out by SigmaBleyzer

The results of the multiple regression analysis, using a two-year average for Foreign Direct Investment, are as follows:

Multiple Regression Analysis - Coefficients

	Standardized Coefficients Beta	t-values	Signif. Level	Standard Error of Beta
Business Liberalization	1.140	3.09	0.003	0.368
Legal Environment	0.646	1.99	0.053	0.325
Governance/Pub Adm	0.719	1.87	0.067	0.384
Investment Incentives	−1.863	−4.54	0.001	0.409

R	R Square	Adjusted R Square	p-value
0.779	0.607	0.574	<0.00000

The above results indicate that Business Liberalization, Legal Environment and Governance/Public Administration had strong positive effects on the flow of FDI among the sample of 50 countries. Investment incentives, on the other hand, were significant, but with a negative statistical impact. As noted earlier, this suggests that poorly performing countries that use Investment Incentives will not be able to increase the flow of international capital. These policy variables explained about 60% of the variations in FDI in the sample of 50 countries. The regression p-value of less than 0.00000 indicates that the significance level of this relationship is almost 100%. The statistical significance of these variables is very high: 99% for Investment Incentives, 99% for Business Liberalization, 95% for Legal Environment, and 93% for Governance/Public Administration. The contribution of Investment Incentives was significant and negative.

2. Statistical Analysis Done by the Thunderbird Corporate Consulting Group

The results of this regressions carried out by the Thunderbird Management Consulting Group are shown below.

Multiple Regression Analysis - Coefficients

	Standardized Coefficients Beta	t -values	Signif.level	95% Confidence Interval for E	
				Lower Bound	Upper Bound
(Constant)		−2.071	0.059	−6.649	0.14
Mj Gov Policies	1.778	2.859	0.013	0.008	0.061
Polit Risk	0.760	1.448	0.171	−0.012	0.059
Corruption	0.422	1.213	0.247	−0.01	0.034
Cap/TF Rt	0.272	0.967	0.351	−0.02	0.053
Tax/Inv Inc	−0.036	−0.165	0.872	−0.008	0.07

Model	R	R Square	Adjusted R Square	Std. Error of Est.
1	0.715	0.511	0.323	0.350

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3. Statistical Analysis Done by Morgan Stanley Dean Witter

The statistical results of this USAID/Morgan Stanley study is as follows:

Morgan Stanley Model

	Standardized Coefficients Beta	t
(Constant)	0.898	–2.105
Econ.Openness	0.789	3.052
Corruption	0.171	1.926
Tax on Pvt. Sector	–0.061	–3.101
Credit Availability	0.007	1.969
Adjusted R-square	0.38	

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APPENDIX B

Mathematical Model to Predict the Flows of Foreign Direct Investments

Foreign direct investment flows $FDI(t)$ for each year (t) are calculated by the following formula:

$$FDI(t) = \sum C_k(I_k(t)) \times I_k(t)$$

Where: $I_k(t)$ are the values of the nine Indexes of policy actions at time t;
$C_k(I_k(t))$ are the regression coefficients for the nine indexes.

The values of the regression coefficients $C_k(I_k(t))$ are not constant, but they change depending on the value of the Index per se $I_k(t)$. Therefore the model is non-linear and more realistic. In fact, we can expect that the importance of a particular investment driver (such as Liberalization) would not be constant, but would evolve over time, as this investment driver evolves.

For a given year (such as year 2002), a sample formula is given in the table below:

	Cap/TF R	Polit Rk	Corrup	Govt Pol	Tax/Inv In	Prom Eff
(IF) Value	62	85	34	42	48	62
(THEN) Coefficient	2	2	10	10	4	6

Formula:
2(Cap/TF)+2(Polit Rk)+10(Corrup)+10(Govt Pol)+4(Tax/Inv In)+6(Prom Eff)
FDI Value for 2002, $m: 1618

As indicated above, for other years, the values of the coefficients will change. The model tested various assumptions regarding the relationship between the coefficients $C_k(I_k(t))$ and indices $I_k(t)$. In one scenario, it is assumed that while the value of a policy action [$I_k(t)$] grows, that growth will also make its overall importance in defining FDI [i.e., the value of the coefficient $C_k(I_k(t))$] to grow as indicated in the chart below. Thus, we model the multiplicative impact of a factor's growth on investment flows and take into account time dependencies.

The values for the index coefficients [$C_k(I_k(t))$] are calculated with the help of the benchmarking and statistical analysis discussed in the previous section and further regressions of the coefficients vis-a-vis the indices.

In order to estimate FDI to FSU countries, we first had to estimate the value of the Indices for policy action [$I_k(t)$] over time. These values will depend on the depth of implementation of policy measures. We assumed the following three scenarios for implementation of policy measures:

Status-Quo Scenario: Continuation of current policies.

Middle Scenario: Implementation of policy actions to reduce 50% of the policy level differential in five years with the Best-in-Class country identified in the Benchmarking analysis (e.g., Chile on Liberalization, Financial Sector Reform, Anticorruption and International Controls; Poland on Legal Framework, Governance, and Political Risk; and Hungary on Government Promotion and Taxation).

Optimistic Scenario: Implementation of stronger policy actions to reduce 80% of the policy differential with the Best-in-Class in five years.

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APPENDIX C

FSU Country Profiles

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Armenia

Key Social and Economic Indicators

POVERTY and SOCIAL	Armenia	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	3.8	475	2459
Urban Population (% of population)	70	66	32
GDP per Capita (Atlas method, $)	520	2010	420
GDP (Atlas method, $ billions)	2.0	956	1030
Average Annual Growth, 1994–2000			
Population (%)	0.3	0.1	1.9
Labor Force (%)	1.1	0.6	2.4
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	55	...	...
Life Expectancy at Birth (years)	74	67	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	73	77
Agriculture (1991=100)	100	115	112
Industry (1991=100)	100	53	56
GDP ($ billions)	4.0	1.8	2.0
Gross Domestic Investment/GDP	47.1	19.5	18.2
Export of Goods and Services/GDP	35.0	21.0	40.0
Gross Domestic Savings/GDP	35.8	–9.3	–13.0
Current Account Balance/GDP	...	–16.6	–7.1
Total Debt/GDP	...	50.5	50.1
Most Recent Estimate (%)	1992–2001	1992–1998	1999–2001
GDP	–1.7	–9.4	9.6
Agriculture	2.3	0.2	3.3
Industry	–5.3	–9.9	5.2

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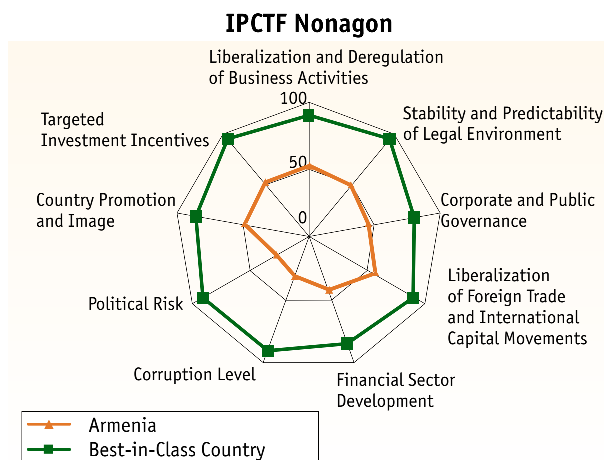
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	52.0	7
2	Stability and Predictability of Legal Environment	49.0	10
3	Corporate and Public Governance	44.6	7
4	Liberalization of Foreign Trade and International Capital Movements	56.8	7
5	Financial Sector Development	43.9	9
6	Corruption Level	33.2	13
7	Political Risk	28.2	7
8	Country Promotion and Image	49.6	4
9	Targeted Investment Incentives	50.9	7

IPCTF Nonagon



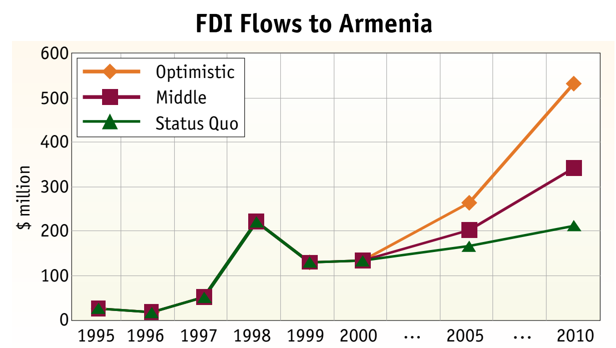
FDI Flows to Armenia

With continuation of current policies, FDI flows to Armenia will increase only slightly from their current levels, reaching approximately $150 million per year in 2005 and $210 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best–in–Class Country in five years, Armenia could increase annual FDI flows to about $200 million per year by 2005 and to $340 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best–in–Class Country in five years, the level of FDI flows to Armenia could increase to $265 million per year by 2005 and to $530 million by 2010.

FDI Flows to Armenia



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Azerbaijan

Key Social and Economic Indicators

POVERTY and SOCIAL	Azerbaijan	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	8.1	475	2459
Urban Population (% of population)	57	67	32
GDP per Capita (Atlas method, $)	630	2010	420
GDP (Atlas method, $ billions)	5.0	956	1030
Average Annual Growth, 1994–2000			
Population (%)	1.0	0.1	1.9
Labor Force (%)	1.7	0.6	2.4
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	68	...	...
Life Expectancy at Birth (years)	71	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	53	60
Agriculture (1991=100)	100	57	64
Industry (1991=100)	100	33	35
GDP ($ billions)	...	4.6	5.0
Gross Domestic Investment/GDP	...	33.7	25.8
Export of Goods and Services/GDP	...	28.2	40.9
Gross Domestic Savings/GDP	...	19.7	28.3
Current Account Balance/GDP	...	–13.2	–2.8
Total Debt/GDP	...	22.8	22.5
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	–4.1	–9.5	9.9
Agriculture	–3.4	–8.6	10.0
Industry	–9.5	–15.2	5.2

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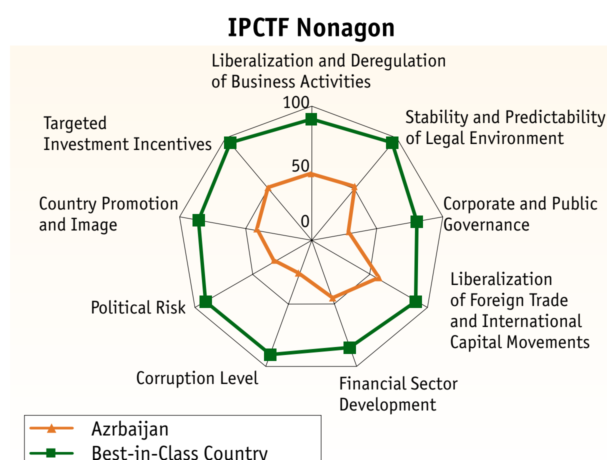
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	47.9	9
2	Stability and Predictability of Legal Environment	50.8	9
3	Corporate and Public Governance	29.5	10
4	Liberalization of Foreign Trade and International Capital Movements	58.8	5
5	Financial Sector Development	47.5	5
6	Corruption Level	27.8	15
7	Political Risk	31.5	6
8	Country Promotion and Image	41.3	6
9	Targeted Investment Incentives	50.3	8

IPCTF Nonagon



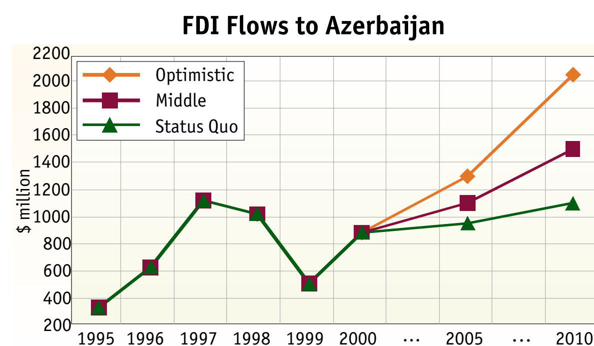
FDI Flows to Azerbaijan

With continuation of current policies, FDI flows to Azerbaijan will increase only slightly from its current levels, reaching $950 million per year in 2005 and $1100 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differential with the Best-in-Class in five years, Azerbaijan could increase annual FDI to about $1100 million per year by 2005 and to $1500 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class in five years, the level of FDI flows to Azerbaijan could increase to $1300 million per year by 2005 and to $2044 million by 2010.

FDI Flows to Azerbaijan



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Belarus

Key Social and Economic Indicators

POVERTY and SOCIAL	Belarus	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	10	475	2046
Urban Population (% of population)	70	66	42
GDP per Capita (Atlas method, $)	2990	2010	1140
GDP (Atlas method, $ billions)	29.9	956	2327
Average Annual Growth, 1994–2000			
Population (%)	–0.5	0.1	1.0
Labor Force (%)	–0.2	0.6	1.3
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	42	...	...
Life Expectancy at Birth (years)	70	67	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	89	94
Agriculture (1991=100)	100	77	75
Industry (1991=100)	100	94	102
GDP ($ billions)	35.2	26.8	29.9
Gross Domestic Investment/GDP	26.5	23.7	22.8
Export of Goods and Services/GDP	46.0	59.2	67.8
Gross Domestic Savings/GDP	28.8	22.4	22.3
Current Account Balance/GDP	...	–0.7	–0.5
Total Debt/GDP	...	4.2	2.8
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	–0.6	–3.5	6.4
Agriculture	–2.6	–2.5	–3.1
Industry	0.7	–2.3	8.8

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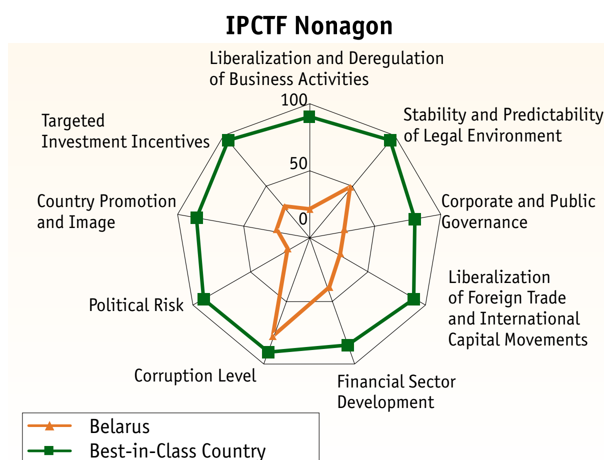
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	20.5	15
2	Stability and Predictability of Legal Environment	48.2	11
3	Corporate and Public Governance	25.9	12
4	Liberalization of Foreign Trade and International Capital Movements	26.8	13
5	Financial Sector Development	42.3	11
6	Corruption Level	82.9	2
7	Political Risk	19.2	12
8	Country Promotion and Image	24.8	10
9	Targeted Investment Incentives	28.6	12

IPCTF Nonagon



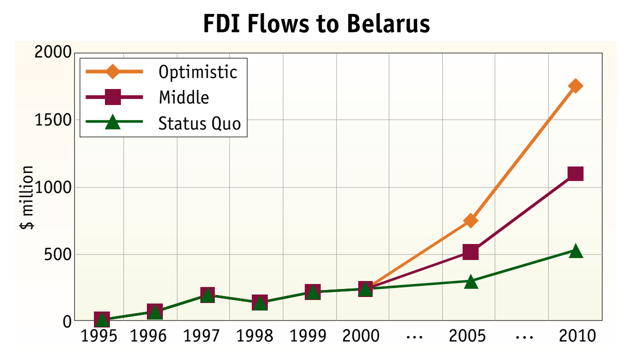
FDI Flows to Belarus

With continuation of current policies, FDI flows to Belarus will increase only slightly from their current levels, reaching approximately $300 million per year in 2005 and $530 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Belarus could increase annual FDI flows to about $520 million per year by 2005 and to $1100 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Belarus could increase to $750 million per year by 2005 and to $1750 million by 2010.

FDI Flows to Belarus



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Estonia

Key Social and Economic Indicators

POVERTY and SOCIAL	Estonia	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	1.4	475	647
Urban Population (% of population)	69	67	76
GDP per Capita (Atlas method, $)	3530	2010	4620
GDP (Atlas method, $ billions)	5.1	956	2986
Average Annual Growth, 1994–2000			
Population (%)	–0.7	0.1	1.3
Labor Force (%)	–0.4	0.6	2.0
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	9	...	...
Life Expectancy at Birth (years)	71	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	95	101
Agriculture (1991=100)	100	...	...
Industry (1991=100)	100	95	...
GDP ($ billions)	6.8	5.2	5.1
Gross Domestic Investment/GDP	30.2	24.7	24.1
Export of Goods and Services/GDP	...	77	96.5
Gross Domestic Savings/GDP	22.3	18.7	19.8
Current Account Balance/GDP	...	–4.7	–6.3
Total Debt/GDP	...	47.4	50.5
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	0.6	–0.7	3.5
Agriculture	...	...	...
Industry	...	–0.23	...

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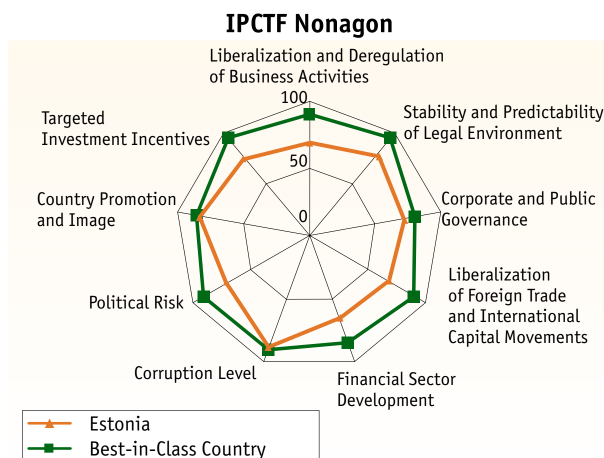
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	72	1
2	Stability and Predictability of Legal Environment	80.5	1
3	Corporate and Public Governance	72	1
4	Liberalization of Foreign Trade and International Capital Movements	68.5	2
5	Financial Sector Development	66.7	1
6	Corruption Level	91.5	1
7	Political Risk	72	1
8	Country Promotion and Image	82.6	1
9	Targeted Investment Incentives	77.3	1

IPCTF Nonagon



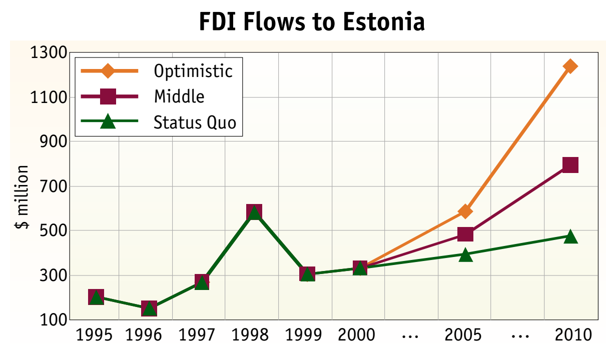
FDI Flows to Estonia

With continuation of current policies, FDI flows to Estonia will increase only slightly from their current levels, reaching approximately $395 million per year in 2005 and $475 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Estonia could increase annual FDI flows to about $485 million per year by 2005 and to $795 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Estonia could increase to $585 million per year by 2005 and to $1240 million by 2010.

FDI Flows to Estonia



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Georgia

Key Social and Economic Indicators

POVERTY and SOCIAL	Georgia	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	5.5	475	2459
Urban Population (% of population)	61	67	32
GDP per Capita (Atlas method, $)	610	2010	420
GDP (Atlas method, $ billions)	3.3	956	1030
Average Annual Growth, 1994–2000			
Population (%)	0.1	0.1	1.9
Labor Force (%)	0.3	0.6	2.4
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	11	...	...
Life Expectancy at Birth (years)	73	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	47	48
Agriculture (1991=100)	100	106	90
Industry (1991=100)	100	19	23
GDP ($ billions)	...	2.8	3.3
Gross Domestic Investment/GDP	...	14.6	14.5
Export of Goods and Services/GDP	...	26.3	37.7
Gross Domestic Savings/GDP	...	–4.3	5.6
Current Account Balance/GDP	...	–8.3	–4.3
Total Debt/GDP	...	60.1	53.4
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	–6.8	–11.3	4.9
Agriculture	–0.5	–0.3	–1.0
Industry	–13.4	–18.6	–1.2

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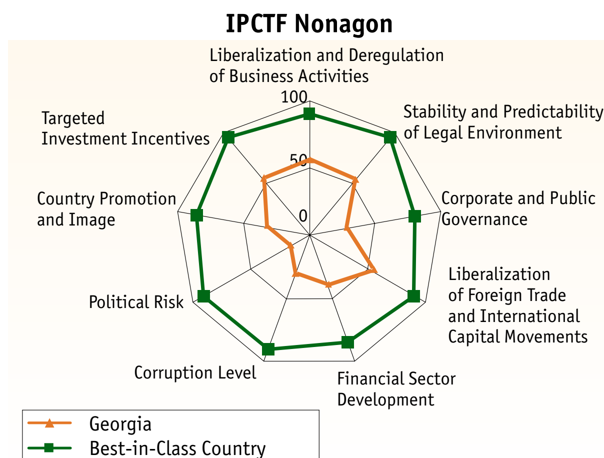
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	54.7	6
2	Stability and Predictability of Legal Environment	53.1	7
3	Corporate and Public Governance	27.4	11
4	Liberalization of Foreign Trade and International Capital Movements	54.7	9
5	Financial Sector Development	41.0	14
6	Corruption Level	31.8	14
7	Political Risk	17.0	14
8	Country Promotion and Image	33.0	9
9	Targeted Investment Incentives	54.1	6

IPCTF Nonagon



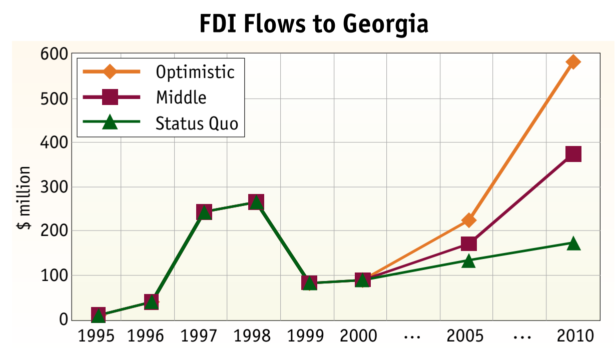
FDI Flows to Georgia

With continuation of current policies, FDI flows to Georgia will increase only slightly from their current levels, reaching approximately $130 million per year in 2005 and $170 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Georgia could increase annual FDI flows to about $170 million per year by 2005 and to $370 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Georgia could increase to $220 million per year by 2005 and to $580 million by 2010.

FDI Flows to Georgia



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Kazakhstan

Key Social and Economic Indicators

POVERTY and SOCIAL	Kazakhstan	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	14.9	475	2046
Urban Population (% of population)	62	67	42
GDP per Capita (Atlas method, $)	1260	2010	1140
GDP (Atlas method, $ billions)	18.8	956	2327
Average Annual Growth, 1994–2000			
Population (%)	–1.2	0.1	1.0
Labor Force (%)	–0.1	0.6	1.3
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	35	...	...
Life Expectancy at Birth (years)	65	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	71	78
Agriculture (1991=100)	100	70	68
Industry (1991=100)	100	51	58
GDP ($ billions)	40.2	16.9	18.8
Gross Domestic Investment/GDP	46.7	14.6	13.9
Export of Goods and Services/GDP	7.8	42.5	58.9
Gross Domestic Savings/GDP	24.0	16.9	25.5
Current Account Balance/GDP	...	–1.4	5.9
Total Debt/GDP	...	36.6	36.6
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	–0.2	–3.2	7.1
Agriculture	–2.2	–8.2	13.3
Industry	–4.1	–9.6	10.1

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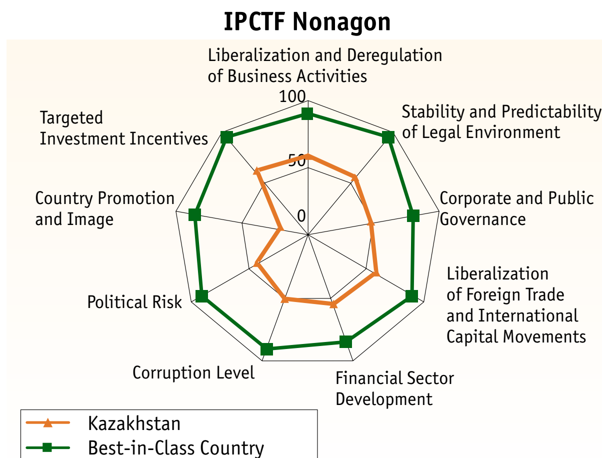
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	57.5	4
2	Stability and Predictability of Legal Environment	54.5	5
3	Corporate and Public Governance	48.0	6
4	Liberalization of Foreign Trade and International Capital Movements	58.2	6
5	Financial Sector Development	56.3	4
6	Corruption Level	52.1	5
7	Political Risk	44.6	4
8	Country Promotion and Image	20.7	12
9	Targeted Investment Incentives	60.3	4

IPCTF Nonagon



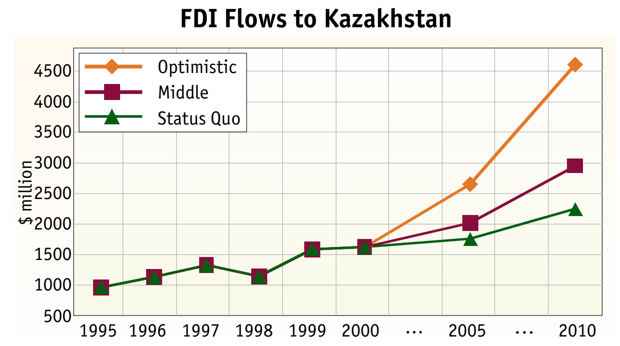
FDI Flows to Kazakhstan

With continuation of current policies, FDI flows to Kazakhstan will increase only slightly from their current levels, reaching approximately $1750 million per year in 2005 and $2250 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Kazakhstan could increase annual FDI flows to about $2025 million per year by 2005 and to $2950 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Kazakhstan could increase to $2650 million per year by 2005 and to $4600 million by 2010.

FDI Flows to Kazakhstan



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Kyrgyzstan

Key Social and Economic Indicators

POVERTY and SOCIAL	Kyrgyzstan	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	4.9	475	2459
Urban Population (% of population)	35	67	32
GDP per Capita (Atlas method, $)	270	2010	420
GDP (Atlas method, $ billions)	1.3	956	1030
Average Annual Growth, 1994–2000			
Population (%)	1.3	0.1	1.9
Labor Force (%)	2.9	0.6	2.4
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	52	...	...
Life Expectancy at Birth (years)	67	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	69.0	72.0
Agriculture (1991=100)	100	98.0	101.0
Industry (1991=100)	100	48.0	51.0
GDP ($ billions)	...	1.3	1.3
Gross Domestic Investment/GDP	24.2	18.0	16.0
Export of Goods and Services/GDP	29.2	42.2	43.5
Gross Domestic Savings/GDP	3.7	3.2	4.3
Current Account Balance/GDP	...	–14.4	–5.9
Total Debt/GDP	...	133.3	135.8
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	–2.7	–6.3	6.2
Agriculture	0.8	–1.3	5.8
Industry	–6.0	–9.5	2.6

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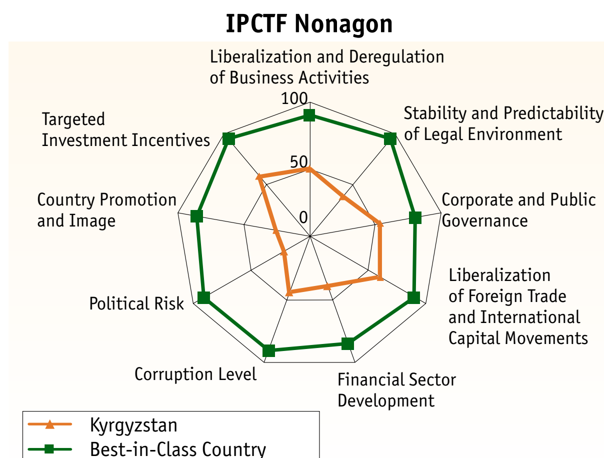
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	50.6	8
2	Stability and Predictability of Legal Environment	39.0	14
3	Corporate and Public Governance	54.0	4
4	Liberalization of Foreign Trade and International Capital Movements	60.2	4
5	Financial Sector Development	39.9	15
6	Corruption Level	45.2	7
7	Political Risk	22.1	10
8	Country Promotion and Image	24.8	11
9	Targeted Investment Incentives	58.7	5

IPCTF Nonagon



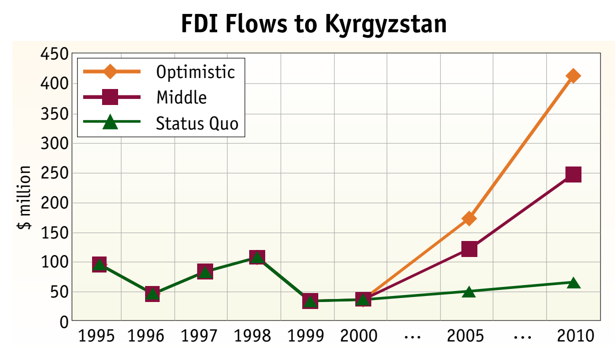
FDI Flows to Kyrgyzstan

With continuation of current policies, FDI flows to Kyrgyzstan will increase only slightly from their current levels, reaching approximately $50 million per year in 2005 and $63 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Kyrgyzstan could increase annual FDI flows to about $123 million per year by 2005 and to $215 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Kyrgyzstan could increase to $170 million per year by 2005 and to $348 million by 2010.

FDI Flows to Kyrgyzstan



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Latvia

Key Social and Economic Indicators

POVERTY and SOCIAL	Latvia	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	2.4	475	2046
Urban Population (% of population)	69	67	42
GDP per Capita (Atlas method, $)	2870	2010	1140
GDP (Atlas method, $ billions)	6.9	956	2327
Average Annual Growth, 1994–2000			
Population (%)	–0.9	0.1	1.0
Labor Force (%)	–0.8	0.6	1.3
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	...	...	...
Life Expectancy at Birth (years)	70	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	65	69
Agriculture (1991=100)	100	45	47
Industry (1991=100)	100	70	72
GDP ($ billions)	12.5	6.7	7.2
Gross Domestic Investment/GDP	40.1	27	27.1
Export of Goods and Services/GDP	47.7	43.8	45.8
Gross Domestic Savings/GDP	38.8	16.7	18.6
Current Account Balance/GDP	...	–9.7	–6.8
Total Debt/GDP	0.0	39.9	41.0
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	–3.0	–6.1	4.7
Agriculture	–9.0	–10.9	–2.0
Industry	–4.0	–5.0	–0.8

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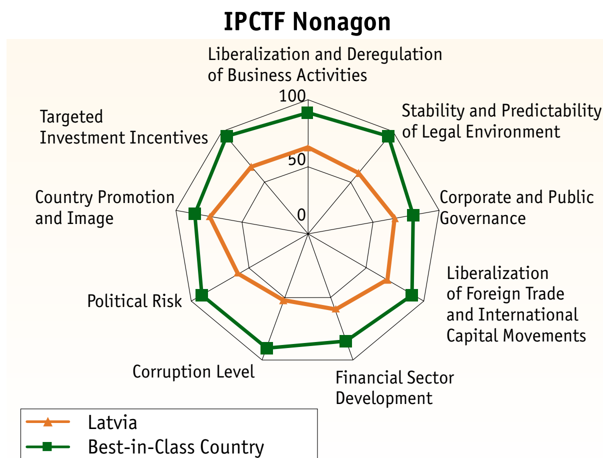
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	64.3	2
2	Stability and Predictability of Legal Environment	59.4	3
3	Corporate and Public Governance	66.0	2
4	Liberalization of Foreign Trade and International Capital Movements	69.2	1
5	Financial Sector Development	60.9	2
6	Corruption Level	52.7	4
7	Political Risk	59.5	2
8	Country Promotion and Image	74.3	2
9	Targeted Investment Incentives	65.6	2

IPCTF Nonagon



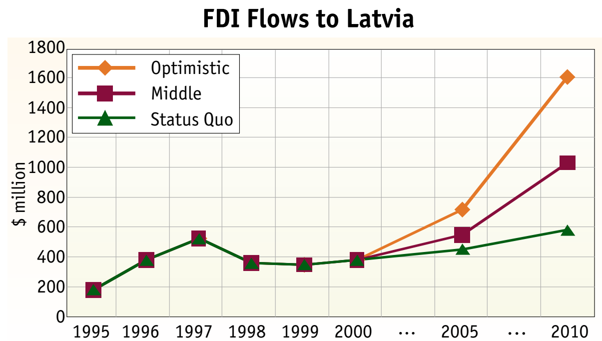
FDI Flows to Latvia

With continuation of current policies, FDI flows to Latvia will increase only slightly from their current levels, reaching approximately $449 million per year in 2005 and $579 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Latvia could increase annual FDI flows to about $547 million per year by 2005 and to $1030 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Latvia could increase to $715 million per year by 2005 and to $1607 million by 2010.

FDI Flows to Latvia



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Lithuania

Key Social and Economic Indicators

POVERTY and SOCIAL	Lithuania	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	3.7	475	2046
Urban Population (% of population)	68	67	42
GDP per Capita (Atlas method, $)	2750	2010	1140
GDP (Atlas method, $ billions)	10.2	956	2327
Average Annual Growth, 1994–2000			
Population (%)	–0.1	0.1	1.0
Labor Force (%)	–1.0	0.6	1.3
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	16	...	...
Life Expectancy at Birth (years)	72	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	49	50
Agriculture (1991=100)	100	83	87
Industry (1991=100)	100	60	64
GDP ($ billions)		10.2	10.2
Gross Domestic Investment/GDP	32.6	22.7	20.7
Export of Goods and Services/GDP	52.1	39.7	45.5
Gross Domestic Savings/GDP	24	12.3	14.2
Current Account Balance/GDP	...	–11.7	–6.0
Total Debt/GDP	...	44.4	43.2
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	–0.5	–1.3	1.3
Agriculture	–1.6	–0.5	–3.4
Industry	–5.4	–6.3	–1.6

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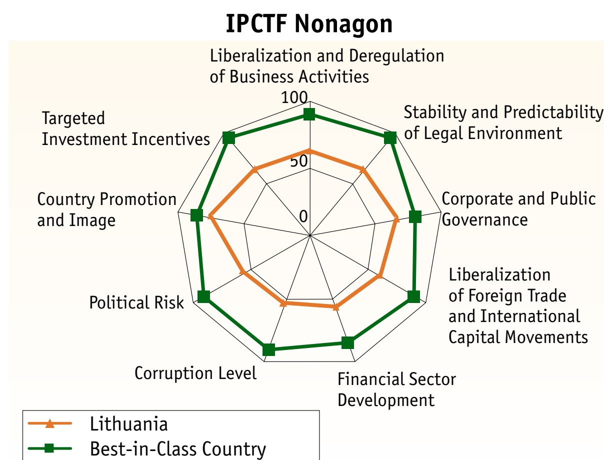
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	61.6	3
2	Stability and Predictability of Legal Environment	62.3	2
3	Corporate and Public Governance	66.0	3
4	Liberalization of Foreign Trade and International Capital Movements	61.5	3
5	Financial Sector Development	58.9	3
6	Corruption Level	55.7	3
7	Political Risk	56.9	3
8	Country Promotion and Image	74.3	3
9	Targeted Investment Incentives	62.6	3

IPCTF Nonagon



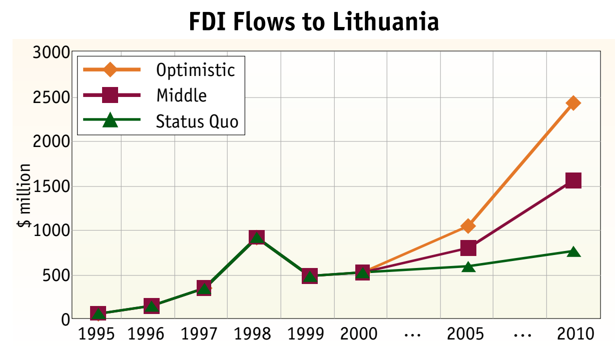
FDI Flows to Lithuania

With continuation of current policies, FDI flows to Lithuania will increase only slightly from their current levels, reaching approximately $598 million per year in 2005 and $767 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Lithuania could increase annual FDI flows to about $800 million per year by 2005 and to $1560 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Lithuania could increase to $1050 million per year by 2005 and to $2436 million by 2010.

FDI Flows to Lithuania



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Moldova

Key Social and Economic Indicators

POVERTY and SOCIAL	Moldova	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	4.3	475	2459
Urban Population (% of population)	46	67	32
GDP per Capita (Atlas method, $)	400	2010	420
GDP (Atlas method, $ billions)	1.4	956	1030
Average Annual Growth, 1994–2000			
Population (%)	–0.3	0.1	1.9
Labor Force (%)	...	0.6	2.4
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	55	...	...
Life Expectancy at Birth (years)	46	67	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	57	60
Agriculture (1991=100)	100	56	56
Industry (1991=100)	100	36	37
GDP ($ billions)	10.6	1.2	1.3
Gross Domestic Investment/GDP	25.2	22.8	22.3
Export of Goods and Services/GDP	48.8	52.3	49.8
Gross Domestic Savings/GDP	22.8	8.8	–5.0
Current Account Balance/GDP	...	–3.8	–9.4
Total Debt/GDP	...	89.9	99.9
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	–4.4	–7.2	2.7
Agriculture	–5.3	–6.8	–1.6
Industry	–8.3	–12.2	1.5

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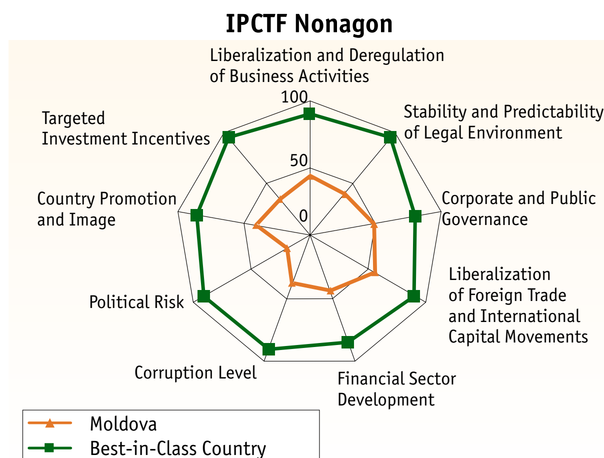
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	43.8	11
2	Stability and Predictability of Legal Environment	40.8	13
3	Corporate and Public Governance	49.0	5
4	Liberalization of Foreign Trade and International Capital Movements	56.1	8
5	Financial Sector Development	44.1	8
6	Corruption Level	38.6	9
7	Political Risk	19.6	11
8	Country Promotion and Image	41.3	7
9	Targeted Investment Incentives	35.6	10

IPCTF Nonagon



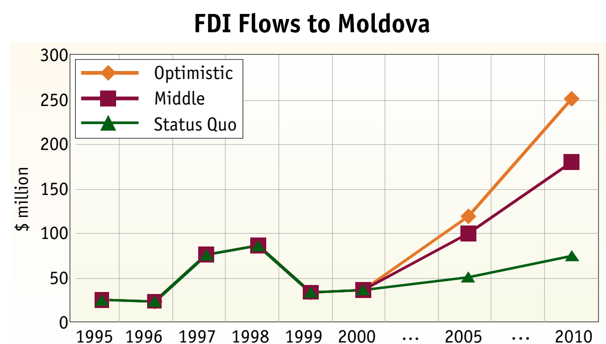
FDI Flows to Moldova

With continuation of current policies, FDI flows to Moldova will increase only slightly from their current levels, reaching approximately $52 million per year in 2005 and $75 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Moldova could increase annual FDI flows to about $100 million per year by 2005 and to $180 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Moldova could increase to $120 million per year by 2005 and to $250 million by 2010.

FDI Flows to Moldova



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Russia

Key Social and Economic Indicators

POVERTY and SOCIAL	Russia	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	145.5	475	2046
Urban Population (% of population)	73	67	42
GDP per Capita (Atlas method, $)	1660	2010	1140
GDP (Atlas method, $ billions)	241.6	956	2327
Average Annual Growth, 1994–2000			
Population (%)	–0.3	0.1	1.0
Labor Force (%)	0.0	0.6	1.3
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	30	...	...
Life Expectancy at Birth (years)	66	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	61	68
Agriculture (1991=100)	100	62	64
Industry (1991=100)	100	54	59
GDP ($ billions)	1100.1	193.2	241.6
Gross Domestic Investment/GDP	30.1	14.8	17.2
Export of Goods and Services/GDP	18.2	43.9	45.9
Gross Domestic Savings/GDP	30.3	31.2	38.2
Current Account Balance/GDP	...	10.6	16.7
Total Debt/GDP	...	90.6	64.5
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	–3.2	–7.3	7.0
Agriculture	–3.7	–7.1	4.7
Industry	–4.4	–9.4	8.2

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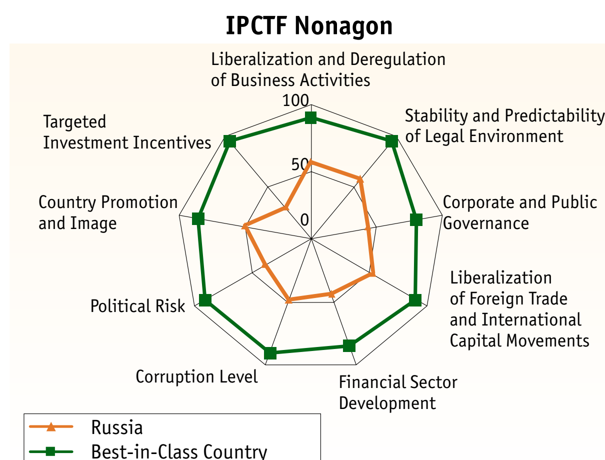
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	56.4	5
2	Stability and Predictability of Legal Environment	57.1	4
3	Corporate and Public Governance	43.2	8
4	Liberalization of Foreign Trade and International Capital Movements	54.0	10
5	Financial Sector Development	45.4	7
6	Corruption Level	50.2	6
7	Political Risk	39.6	5
8	Country Promotion and Image	49.6	5
9	Targeted Investment Incentives	28.6	13

IPCTF Nonagon



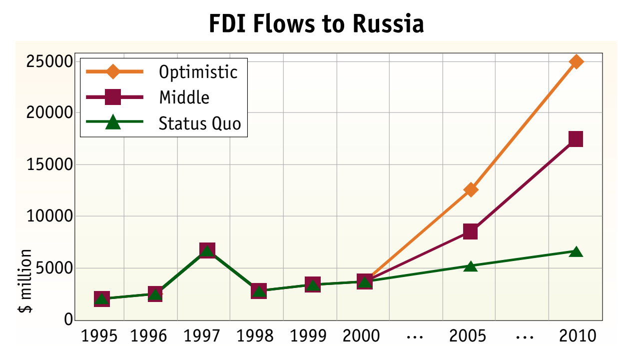
FDI Flows to Russia

With continuation of current policies, FDI flows to Russia will increase only slightly from their current levels, reaching approximately $5155 million per year in 2005 and $6611 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Russia could increase annual FDI flows to about $8500 million per year by 2005 and to $17500 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Russia could increase to $12500 million per year by 2005 and to $25000 million by 2010.

FDI Flows to Russia



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Tajikistan

Key Social and Economic Indicators

POVERTY and SOCIAL	Tajikistan	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	6.3	475	2459
Urban Population (% of population)	28	67	32
GDP per Capita (Atlas method, $)	170	2010	420
GDP (Atlas method, $ billions)	1.1	956	1030
Average Annual Growth, 1994–2000			
Population (%)	1.6	0.1	1.9
Labor Force (%)	2.7	0.6	2.4
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	83	...	...
Life Expectancy at Birth (years)	69	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	...	58
Agriculture (1991=100)	100	56	73
Industry (1991=100)	100	38	42
GDP ($ billions)	...	1.1	1.1
Gross Domestic Investment/GDP	24.8	19.1	19.9
Export of Goods and Services/GDP	27.8	62.4	80.7
Gross Domestic Savings/GDP	17.5	17.6	16.0
Current Account Balance/GDP	...	−3.3	−6.2
Total Debt/GDP	...	5.9	6.6
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	−4.4	−9.0	7.3
Agriculture	−2.1	−8.3	14.1
Industry	−7.0	−13.5	9.9

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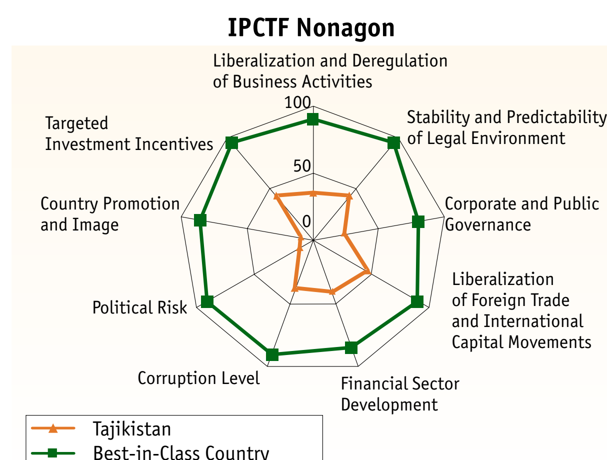
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	34.2	13
2	Stability and Predictability of Legal Environment	42.7	12
3	Corporate and Public Governance	24.0	13
4	Liberalization of Foreign Trade and International Capital Movements	47.6	12
5	Financial Sector Development	41.5	12
6	Corruption Level	38.9	8
7	Political Risk	12.0	15
8	Country Promotion and Image	19.1	14
9	Targeted Investment Incentives	42.6	9

IPCTF Nonagon



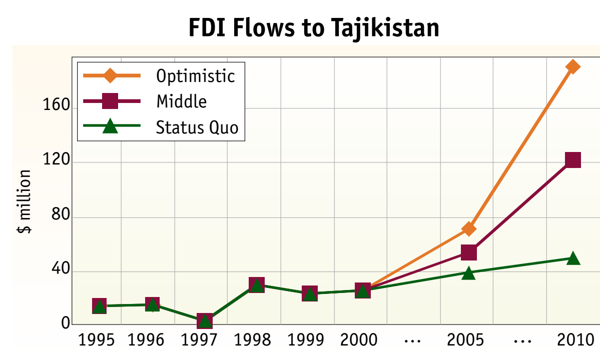
FDI Flows to Tajikistan

With continuation of current policies, FDI flows to Tajikistan will increase only slightly from their current levels, reaching approximately $39 million per year in 2005 and $50 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Tajikistan could increase annual FDI flows to about $54 million per year by 2005 and to $120 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Tajikistan could increase to $70 million per year by 2005 and to $190 million by 2010.

FDI Flows to Tajikistan



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Turkmenistan

Key Social and Economic Indicators

POVERTY and SOCIAL	Turkmenistan	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	4.8	475	2046
Urban Population (% of population)	45	67	42
GDP per Capita (Atlas method, $)	840	2010	1140
GDP (Atlas method, $ billions)	4.0	956	2327
Average Annual Growth, 1994–2000			
Population (%)	1.6	0.1	1.0
Labor Force (%)	2.3	0.6	1.3
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	58	...	...
Life Expectancy at Birth (years)	66	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	55	64
GDP ($ billions)	...	3.3	4.8
Gross Domestic Investment/GDP	40.1	46.3	39.7
Export of Goods and Services/GDP	...	41.6	63.0
Gross Domestic Savings/GDP	27.6	26.0	49.4
Current Account Balance/GDP	...	–17.3	9.4
Total Debt/GDP	...	70.0	52.3
Average Annual Growth (%)	1991–2000	1999	2000
GDP	–4.8	17.0	17.6

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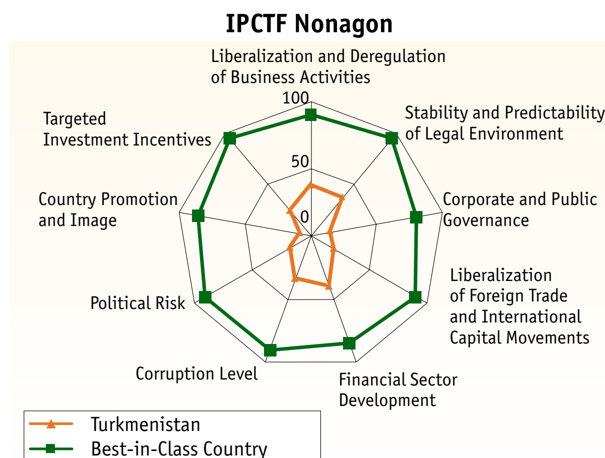
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	36.9	12
2	Stability and Predictability of Legal Environment	37.1	15
3	Corporate and Public Governance	14.4	15
4	Liberalization of Foreign Trade and International Capital Movements	19.8	15
5	Financial Sector Development	41.3	9
6	Corruption Level	34.8	11
7	Political Risk	18.4	13
8	Country Promotion and Image	8.3	15
9	Targeted Investment Incentives	23.2	15

IPCTF Nonagon



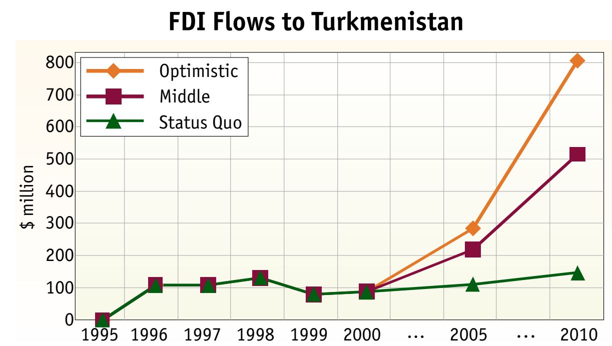
FDI Flows to Turkmenistan

With continuation of current policies, FDI flows to Turkmenistan will increase only slightly from their current levels, reaching approximately $110 million per year in 2005 and $145 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Turkmenistan could increase annual FDI flows to about $218 million per year by 2005 and to $517 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Turkmenistan could increase to $285 million per year by 2005 and to $806 million by 2010.

FDI Flows to Turkmenistan



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Ukraine

Key Social and Economic Indicators

POVERTY and SOCIAL	Ukraine	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	49.5	475	2459
Urban Population (% of population)	68	67	32
GDP per Capita (Atlas method, $)	790	2010	420
GDP (Atlas method, $ billions)	39.3	956	1030
Average Annual Growth, 1994–2000			
Population (%)	–0.7	0.1	1.9
Labor Force (%)	–1.1	0.6	2.4
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	28	...	...
Life Expectancy at Birth (years)	68	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	45	47
Agriculture (1991=100)	100	56	62
Industry (1991=100)	100	54	60
GDP ($ billions)	91.3	39.4	39.3
Gross Domestic Investment/GDP	27.5	17.4	18.6
Export of Goods and Services/GDP	27.6	53.7	61.5
Gross Domestic Savings/GDP	26.4	23	23
Current Account Balance/GDP	–5.5	4.0	4.2
Total Debt/GDP	...	35.5	35.6
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	–6.5	–11.0	5.1
Agriculture	–3.8	–7.0	4.0
Industry	–3.7	–9.0	10.0

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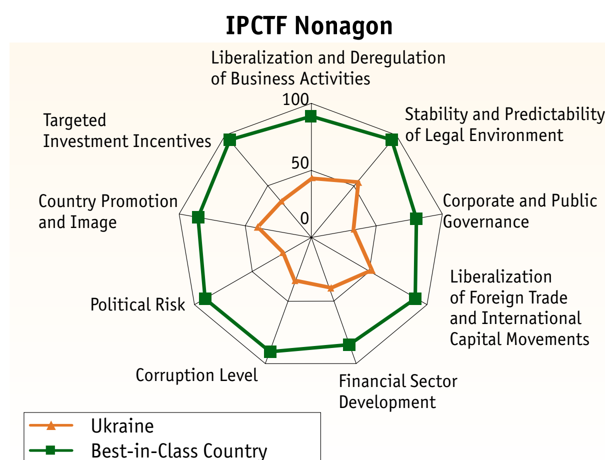
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	44.7	10
2	Stability and Predictability of Legal Environment	53.8	6
3	Corporate and Public Governance	32.4	9
4	Liberalization of Foreign Trade and International Capital Movements	52.6	11
5	Financial Sector Development	42.3	10
6	Corruption Level	36.3	10
7	Political Risk	24.8	8
8	Country Promotion and Image	41.3	8
9	Targeted Investment Incentives	34.8	11

IPCTF Nonagon



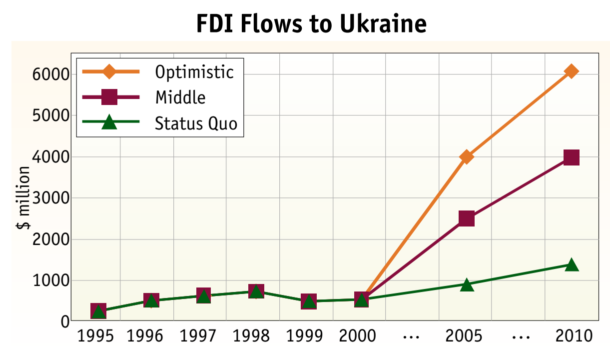
FDI Flows to Ukraine

With the continuation of current policies, FDI flows to Ukraine will increase only slightly from its current levels, reaching $909 million per year in 2005 and $1387 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Ukraine could increase annual FDI flows to about $2500 million per year by 2005 and to $3988 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Ukraine could increase to $4000 million per year by 2005 and to $6082 million by 2010.

FDI Flows to Ukraine



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Uzbekistan

Key Social and Economic Indicators

POVERTY and SOCIAL	Uzbekistan	Same Region/Income Group	
		Europe & Central Asia	Low Income
2000			
Population, mid year (millions)	24.7	475	2459
Urban Population (% of population)	37	67	32
GDP per Capita (Atlas method, $)	620	2010	420
GDP (Atlas method, $ billions)	15.3	956	1030
Average Annual Growth, 1994–2000			
Population (%)	1.6	0.1	1.9
Labor Force (%)	2.7	0.6	2.4
Most Recent Estimates (1994–2000)			
Poverty (% of population below national poverty line)	...	...	...
Life Expectancy at Birth (years)	70	69	...
KEY ECONOMIC RATIOS	1991	1999	2000
GDP (1991=100)	100	95	100
Agriculture (1991=100)	100	...	102
Industry (1991=100)	100	115	122
GDP ($ billions)	...	8.7	15.3
Gross Domestic Investment/GDP	32.2	17.8	11.1
Export of Goods and Services/GDP	28.8	35.8	44.1
Gross Domestic Savings/GDP	13.2	17.3	16.6
Current Account Balance/GDP	...	15.9	13.5
Total Debt/GDP	...	53.1	59.1
Average Annual Growth (%)	1992–2001	1992–1998	1999–2001
GDP	0.4	–2.0	6.1

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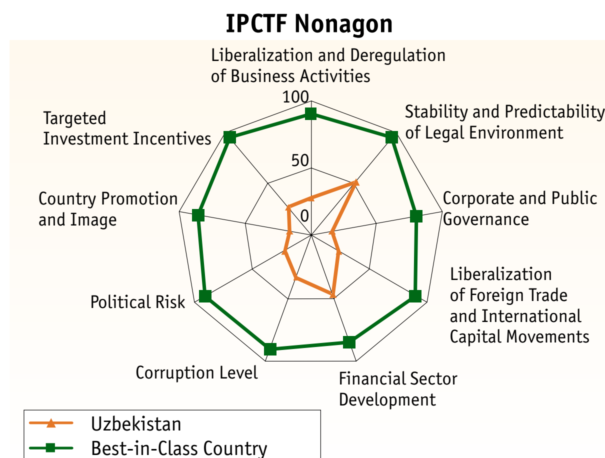
IPCTF Ratings

	POLICY AREA	RATING	RANK
1	Liberalization and Deregulation of Business Activities	27.4	14
2	Stability and Predictability of Legal Environment	51.9	8
3	Corporate and Public Governance	15.8	14
4	Liberalization of Foreign Trade and International Capital Movements	24.2	14
5	Financial Sector Development	47.3	6
6	Corruption Level	33.7	12
7	Political Risk	23.5	9
8	Country Promotion and Image	16.5	13
9	Targeted Investment Incentives	27.0	14

IPCTF Nonagon



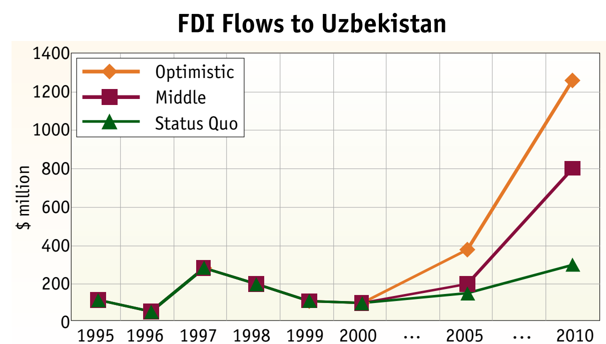
FDI Flows to Uzbekistan

With continuation of current policies, FDI flows to Uzbekistan will increase only slightly from their current levels, reaching approximately $150 million per year in 2005 and $300 million in 2010.

Under a middle scenario, with policy actions to reduce 50% of the policy level differentials with the Best-in-Class Country in five years, Uzbekistan could increase annual FDI flows to about $200 million per year by 2005 and to $800 million by 2010.

Under a more aggressive scenario, with stronger policy actions to reduce 80% of the policy level differential with the Best-in-Class Country in five years, the level of FDI flows to Uzbekistan could increase to $380 million per year by 2005 and to $1260 million by 2010.

FDI Flows to Uzbekistan



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