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This paper focuses on the specific social factors of the classification of farmer priorities for ecological and economic development. This factor is argued as being vital for ensuring that the ecological and economic restructuring of land use in Khorezm is both appropriate to local conditions and reflects locally articulated desires.

This report discusses the findings from a series of farm level and farm management group discussions and interviews. The emphasis was on process-based research, aimed at ensuring the equitable participation of all farmers, representing a cross section of both leaseholders as well as (state directed) Shirkat farms.

ОПРЕДЕЛЕНИЕ ФЕРМЕРСКИХ ПРИОРИТЕТОВ: ВОПРОСЫ И ПОТРЕБНОСТЬ В ИССЛЕДОВАНИИ ХОРЕЗМА, УЗБЕКИСТАН

КАЛЕБ УОЛЛ И ДЖОН ЛАМЕРС

Данный документ сфокусирован на особенных социальных факторах фермерских приоритетов для экологического и экономического развития. Это включает в себя местные ясно выраженные нужды и приоритеты сельской бедноты. Здесь аргументируется, что фермерские приоритеты очень важны для эффективной экологической и экономической реструктуризации землепользования в Хорезме. Включение сельского мнения и перспектив обеспечивает то, что содействие при развитии соответствует местным условиям, а также отражает местные ясно выраженные желания. Более того, это даёт возможность иностранному исследовательскому проекту сконцентрировать свои усилия на самых необходимых нуждах сельской бедноты.

В данном отчёте обсуждаются данные из серий групповых дискуссий и интервью на уровне ферм. Ударение придавалось исследованию, основанному на процессе, целью которого является обеспечение справедливого участия всех фермеров, представляющих поперечное сечение арендаторов, а также (управляемые государством) ширкатных ферм. В частности, данный документ производит анализ барьеров, существующих в технологическом переходе в Хорезме, а также сложных задач в аграрной реформе.

INTRODUCTION

Uzbekistan, especially the Khorezm region, suffers from a range of ecological and economic problems that threaten the livelihoods of all who live there. In order for Uzbekistan to disabuse itself of these ecological and economic problems, assistance in the form of technical solutions is required. However, these technical solutions must be developed in a manner that is cognisant of the specific social context. This requires specific enquiry into both farmer priorities for development as well as the identification of barriers to technological adoption. The preliminary study that this paper reports on sought to identify preliminary issues as well as future research

* Caleb Wall wishes to acknowledge the contribution of Professor John Overton and Professor Marilyn Waring to this research

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needs. It is not claimed that the findings are conclusive; rather this work aims to provide a set of current concerns and focus for future research.

It is vital that the identification of social needs and priorities occurs concomitant with the development of technical solutions. If not, then there is a high risk that the technical solutions will either be inappropriate given local capacity and capabilities, or irrelevant to the needs and desires of the end users. In either case the technical solution will suffer from low adoption rates and poor fulfilment of project objectives. Through the proper use of social development advice, technical solutions can become both more appropriate and acceptable to the end users. In this respect development projects need to stop looking at technology and asking 'what can this do?' but rather need to look at problems and ask 'what technology could help here?' (Norrish, 1998, pp.1).

SAMPLING

Several considerations were made in taking a sample of the population, which included the operational type of the farm, position of the farm relative to irrigation (up or downstream), gender-aspects and pragmatic factors. Provided in Figure 1 is a map of Khorezm, indicating the Rayons (administrative districts) in which the research was conducted. Please note that the Amu-Darya river flows from the South-East towards the North-West, making Gurlen the most downstream Rayon within Khorezm.

Farm types vary in Khorezm. Whilst no private farming exists, there are degrees of operational autonomy. This ranges from devolved state farms, which retain central state ownership (kolkhoz), joint-stock farms with collective ownership (shirkat) and smallholder leased farms (dekhan). Efforts were made to include a representative sample of each farm type, which is detailed in Tables 1 and 2 (p.6).

The typology of upstream and down stream is based on access to irrigation water, assumed to be a key determinate of economic and agricultural affluence. The assumption is that 'upstream' farms that are early in the water distribution cycle have an advantage over 'downstream' farms (which are later in the distribution cycle). Upstream farms have greater security of irrigation supply, as water will flow past them before it arrives at downstream farms. This also has an effect on the salinity of the water available for irrigation, with upstream farms entering saline and other pollutants into the irrigation canals, which is then used by downstream farms. This effect is most profound during the leaching cycle (whereby surface salt is 'leached' away through surface flooding). This report adopts a more sociological definition of up/down stream access. Access to water is typified as having greater control over, ready supply of, and preferable timing for, irrigation water. This can take a variety of forms, but in each instance they describe a "social relationship and expression of power" defining not only "access to a resource, but also a relationship of inclusion and exclusion, and control over decision-making" (Boelens and Hoogendam, 2002, p. ix). This may or may not relate directly to the 'geographical' definition of up/down stream farms. Rather, the social definition of upstream is of farms that have ready access to and availability of irrigation, whereas downstream farms are those, which experience poor access to, and availability of, irrigation

water. In Khorezm, Gurlen is a downstream region, compared to Kazarasp and Bagat which are upstream.

FIGURE 1: MAP OF KHOREZM REGION: ADMINISTRATIVE DISTRICTS



Gender sampling faces serious challenges in the culturally conservative Khorezm region. The revival of Islam in Uzbekistan has seen the growth of traditional notions of women's segregation from certain aspects of society. Husbands and fathers might wish to restrict women's contact with a white, western young male as a researcher. However, working with two female interpreters, and by building rapport through group work, it was possible to access 68 women, 33% of the sample. In the first research period, where mainly group activities were used, women's participation reached 39%. However this was pulled down to 21% representation in the second research period. It would have been preferable to have increased the participation of women. However, the challenge of conducting one on one interviews with women made this very difficult. Where it was possible, there were usually follow-up interviews and longer length discussions, to ensure more equitable representation of opinions.

The two research periods of March 2003 and September to October 2003 constituted slightly different sample groups, and are analysed separately for this reason. The first period (March 2003) is given in Table 1 (p.6) and the second research period (September to October 2003) is provided in Table 2 (p.6). Most of the group based activities were conducted in Phase One (March 2003) which explains the higher number of individuals involved in each farm visit. However there were a greater number of total contacts in the second phase of the research (September - October 2003).

TABLE 1: SAMPLE SIZE, GENDER AND FARM TYPOLOGY: MARCH 2003

Rayon	Farm Type	Up/Down Stream	Men	Women	TOTAL
Khiva	Research Farm	Down	13	6	19
Khiva	Research Farm	Down	0	8	8
Khiva	Research Farm	Up	9	12	21
Yanghibazar	Dekhan	Up	7	2	9
Yanghibazar	Dekhan	Up	4	7	11
Yanghibazar	Dekhan	Up	8	2	10
Yanghibazar	Dekhan	Down	3	5	8
Yanghibazar	Dekhan	Down	8	2	10
Khanka	Shirkat	Up	15	0	15
Khanka	Shirkat	Up	5	3	8
Khanka	Kolkhoz	Up	3	2	5
Khanka	Kolkhoz	Up	4	0	4
Khanka	Kolkhoz	Up	4	4	8
Total - March 2003		70% Upstream 30% Downstream	83 (61%)	53 (39%)	136

TABLE 2: SAMPLE SIZE, GENDER AND FARM TYPOLOGY: SEPTEMBER - OCTOBER 2003

Rayon	Farm Type	Up/Down Stream	Men	Women	TOTAL
Khiva	Dekhan	Down	2	1	3
Yangiaryk	Cattle	n/a	1	1	2
Yangiaryk	Dekhan	Down	1	1	2
Yangiaryk	Dekhan	Down	1	0	1
Yangiaryk	Dekhan	Up	1	0	1
Yangiaryk	Dekhan	Down	1	1	2
Khanka	Fruit Grower	Up	3	0	3
Khanka	Fruit Grower	Down	2	2	4
Yangiaryk	Shirkat	Mixed	14	1	15
Yangiaryk	Dekhan	Up	7	1	8
Yangiaryk	Shirkat	Down	4	0	4
Yanghibazar	Dekhan	Up	3	1	4
Yanghibazar	Dekhan	Down	5	0	5
Yanghibazar	Dekhan	Down	1	0	1
Gurlen	Cattle	n/a	0	1	1
Yanghibazar	Dekhan	Up	3	0	3
Yanghibazar	Dekhan	Up	2	2	4
Yanghibazar	Dekhan	Down	1	0	1
Yanghibazar	Dekhan	Unknown	1	1	2
Khiva	Research Farm	Down	1	1	2
Khiva	Research Farm	Down	1	0	1
Gurlen	Kolkhoz	Up	0	1	1
Gurlen	Kolkhoz	Up	1	0	1
Total Sept. - Oct. 2003		40% Upstream 60% Downstream	56 (79%)	15 (21%)	71

QUALITATIVE METHODS

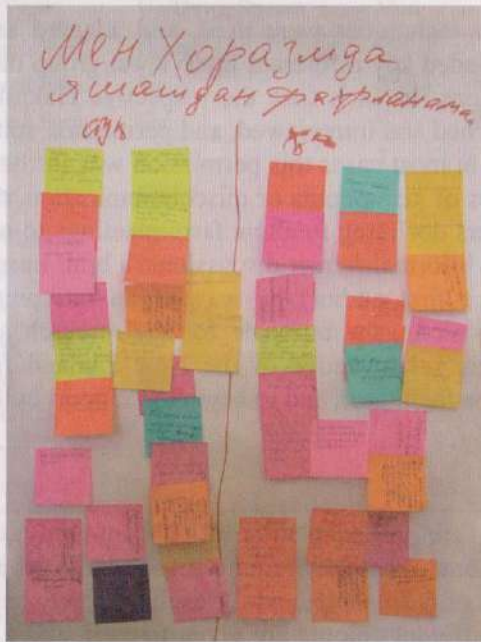
A range of interview techniques were used, and adapted as conditions required. These interviews included key informant interviews, group interviews and informal farmer level discussions. In each case the respective Hakim and/or Shirkat Farm Manager was approached and interviewed, and permission sought for the conduct of farm level meetings. In most cases this permission was forthcoming, however there were limited instances of xenophobia or miscommunication, that led to Hakims and Shirkat Farm managers declining to allow farm meetings to occur. In each instance of farm meetings and informal farmer discussions, a brief introduction was provided by the facilitator (the first author) by way of an interpreter. This introduction covered privacy provisions, the rationale for the research and began by relating some of the facilitator's knowledge of the New Zealand farming systems. This served to introduce the facilitator, and to begin the rapport building process.

Simplified H-forms

Simplified H-Forms are an adaptation of a commonly used tool in guiding participatory discussions. What they require is for a large group of participants to be separated into groups of 6-8 people, and for each person to be given a pad of Post-It notes. Usually five different colours are given to men, and a slightly different five colours to women, however this aspect is not shared with the participants. Each group is then given a large (A1) sheet of paper, with a capital H drawn on it. At the top is a question, written in Uzbek, and a 0 is marked on the left hand intersection and a 10 is marked on the right hand intersection. Participants then write reasons why the status quo is NOT a 0 and NOT a 10, which is done individually. The group then discusses the findings, and collects together common answers on each side, which are ranked vertically (top most important). These grouped Post-Its can be used as a starter for group discussion, as well as taken away for further gender disaggregated analysis. From this a clear idea of local priorities, views on project activities and wider opinions can be gained. It is also useful from a gender standpoint because men's and women's answers can be disaggregated using the colour-coding system. As an ice-breaker activity this process is useful as it gets groups working together, as well as allowing the facilitator time to stand back and observe how groups interact and which individuals hold traditional or existing power over others. These individuals can then be targeted, and their influence can be dissipated through the careful use of 'sabotage management' techniques by the facilitator (see Figure 2).

In total nine H-Forms analyses were undertaken, often with larger groups of individuals. In six cases the groups were divided at random, and in three cases the groups were gender segregated. It was the belief of the researcher that conducting mixed gender groups using the subtle colour coding system was the most useful mechanism for disaggregating responses by gender.

FIGURE 2: PHOTOGRAPH OF A SIMPLIFIED H-FORM



Semi-structured interviews

Otherwise named *Informant Structured Interviews* are an inductive method of research, which begin with a range of information desired, without tying the researcher down to particular question sets or ways of accessing information (Reinharz, 1992, p.18). The advantage of this is that discussions lead towards issues of importance for the participants, which is the key aim of priority setting. In this manner the researcher can access information from different perspectives and the participant feels less like the 'subject' of research and more like a partner in the research process. In this way, rapport is built more easily and the bias of the 'expected' or 'desired' answers by the researcher is less of a distortion to the research. Semi-structured interviews served as one of the most commonly used interview techniques in the second phase of the research. In total sixty seven informant structured interviews were conducted.

Focus groups

This method was used to separate men and women, and to focus on issues of particular importance to each group. The main aim of using smaller focus groups is to encourage more equitable participation. Large groups tend to be dominated by the more eloquent speakers, or those who hold traditional power and authority. In such situations many people, especially the disenfranchised, tend to stay silent rather than risk the rebuke of making a comment. This is especially the case in societies where

men speak 'on behalf' of women (in reality, instead of). Whilst this is not absolutely the case in Uzbekistan, in more traditional rural areas there is certainly a tendency for it. As such, smaller focus groups were established where peers could confidently discuss specific issues with the facilitator. Focus groups were utilised on fourteen occasions.

Household Meetings

This method involved the researcher visiting (by appointment) a series of households, in order to observe the family and discuss household decision-making processes with them. These meetings ideally included the children, as well as the husband, wife and any other members (*i.e.* a widowed mother of either spouse). The conduct of these discussions often followed that of a semi/un-structured interview, and the timing occurred after the initial focus group discussion. In this manner a degree of rapport was already established, and there were always a number of issues arising from prior meetings that benefited from clarification at a household level. Such an example was discussions over vegetable planting decisions, typically a female domain but one many men would claim as their own in front of their male counterparts. The aim of using the household as a unit of analysis is not simply used for convenience, rather it is considered a good method to encourage a synergy of "insights and solutions that would not come about" without the household meeting (Brown et.al, 1989, p. 40; *cited in*; Patton, 2002, p.16). Household meetings were utilised twelve times during the second phase of the research.

Problem Trees

These followed on from the priority ladder exercise (see below 'Quantitative Methods'), taking the top three or four priorities established by the farmers in that activity. The group was then broken up into three to four sub-groups, and each sub-group was given a priority to make into a problem tree. These priorities formed the 'trunk' of the tree. The causes of the problems were listed by participants, and linked to the trunk like roots, indicating how they led to the specific problem. The effects of the problem were then classified as the branches, the visible impacts of the problem. These problem trees were then used as discussion pieces, and were later taken for interpretation and analysis. 'Problem trees' were found instructive in cases where there was a high level of literacy and where participants had a large amount of spare time. In many respects more ethnographic approaches (such as semi-structured interviews) were found more helpful. In total five problem trees were developed by mixed gender groups, all in the first phase of the research.

Sabotage Management

This involved eliminating the influence of overly vocal group members, initially by using body language and directing questions to other group members. In the

extreme situation the saboteur manager, one of the interpreters nominated prior to the meeting, complemented the individual on the degree of their knowledge and requested a one-on-one interview in a separate room, thus eliminating the saboteur. The use of sabotage management was only necessary on two occasions, and in each instance it was possible to continue with the group activity by removing the saboteur. It is necessary to exercise caution in using sabotage management techniques, as it remains a matter of judgement as to what constitutes a saboteur. Excessive use of sabotage management can hinder, and possibly contradict, an ethnographic approach. In spite of this it remains a useful tool to use in extreme situations.

QUANTITATIVE METHODS

In keeping with the ethnographic approach, quantitative methods are not used extensively in this research. Priorities ladders were used, and analysed using non-parametric tools.

Priority Ladders

This is a simplification of Q-sort methodology, devised for psychology and adapted for self-referent social research by Celia Kitzinger (1987), in 'The Social Construction of Lesbianism'. The Q-sort methodology is not externally referenced, so the numbers produced bear no resemblance to factors outside the study, rather it "is fundamentally a means of eliciting subjectivities" (Kitzinger, 1987, p78). The adaptation used in this research involved developing fifteen factors of life in Khorezm, gleaned from the semi-structured interviews and household meetings. A focus group was then presented with each of the factors written on a large piece of card. Each of these was then arranged at random, and the group was asked to rank them in order from highest to lowest priority. Each group member was allowed to move two cards, moving each only one place up or down the 'ladder'. This ensured equitable participation and input by all participants. The ranking of the priorities was then recorded, and analysed. The priority ladder was used initially for staff training and at six farms, during the March 2003 research period. These farms were; Khorezm (1), Khorezm (2), Mustakil, Khamid, Mashrab, Khudaibergam. The priorities used were:

- Fertiliser availability
- Price of vegetables at Bazaar
- Quality of Wheat produced
- Quality of Cotton produced
- Availability of herbicides/pesticides
- Agricultural Engineering
- Seed Quality
- Supply of Machinery and Technology
- Availability of Diesel for Tractors

- Financial Resources
- Soil Quality
- Water Quality
- Water/Irrigation Timing

In an effort to better understand the barriers to technological change that exist in Khorezm, a 'farmer first' approach was adopted. This approach of positioning farmers at the primacy of the research process was of benefit for three key reasons.

Firstly, the farmer first approach enabled the research to take cognisance of the priorities of the rural poor. These priorities, or a conflict between farmer priorities and the economic reality, have the potential to be a major barrier to technology transfer. Thus the first period of research undertaken placed a great emphasis on farmer priority setting. This priority setting contributed to the thesis by positioning further research in light of farmer priorities. This identified aspects of rural life that are often assumed to be important by external development projects, yet which this exercise showed to be of marginal or limited importance to farmers.

Secondly the ethnographic approach of eliciting farmer priorities, made it possible to build the empathy of the researcher towards the participants. In many cases farmers were very honest about their lack of money and their concerns about future harvests. From the outset of this research this enabled the researcher and translation staff to understand the most serious problems facing farmers, as well as being aware of factors that farmers did not consider to be of real concern. A concomitant advantage of priority setting is in improving the efficacy and efficiency of research and technology transfer. Any efforts towards technology transfer must be acceptable to the socio-political context in which they will operate. Most importantly this means that for farmers to adopt new technologies, these technologies must respond to needs that have been identified by farmers themselves. It is not sufficient for external researchers to identify perceived needs and to solve these. Technologies must be appropriate to the needs of the rural community for them to be used.

The third aspect is that of empowerment. By working with farmers to identify their own needs, and then by assisting them in solving these needs, a process of empowerment occurred. Farmers became aware of their needs as legitimate, and ultimately as solvable. Communities and families were encouraged to work collectively towards solving common problems, sharing the strategies for meeting their needs and priorities.

It is hoped that the priority setting exercises, as well as subsequent interviews and group discussions met the three aims of empathy, efficacy and empowerment. Whilst limited in its scope, this research hopefully provides a useful insight into farmer level priorities and a guide for further technology development.

Priority ladder results

Farmer priority setting was informed partially through the use of the 'priority ladder' discussed in the methodology section. Each priority was initially developed

from the earlier discussions held on farms, and was vetted by two trials of the method, before the final list was produced. The results of the priority ladder are given below in Table 3, which provides the final priority from each farm meeting. A '1' indicated primary priority, whilst a '14' indicated lowest priority. Of greater use is the analysis of these results, which is provided in Table 4.

There are a number of interesting results that emerge from this analysis specifically the low importance of 'Price of vegetables at Bazaar', 'Quality of Wheat produced', and 'Quality of Cotton produced'. Equally interesting, and encouraging for the project, is the primacy given to 'Soil Quality', 'Water Quality', 'Financial Resources' and 'Water/Irrigation Timing'. Each of these findings is discussed in the following section and compared to the legal and economic framework analysed in subsequent chapters.

TABLE 3: PRIORITY LADDER RESULTS: BY FARM

Priority	Khorezm (1)	Khorezm (2)	Mustakil	Khanid	Mashrab	Khudalberg
Fertiliser availability	7	9	9	9	2	9
Price of vegetables at Bazaar	11	13	14	14	9	14
Quality of Wheat produced	10	12	12	11	12	11
Quality of Cotton produced	9	11	11	12	13	13
Availability of herbicides/pesticides		10	10	10	6	10
Agricultural Engineering	6	8	7	5	5	8
Seed Quality		7	1	3	11	7
Supply of Machinery and Technology	4	6	5	2	7	2
Availability of Diesel for Tractors	8	5	6	7	10	3
Financial Resources	1	4	4	6	8	1
Soil Quality	2	1	3	1	1	6
Water Quality	3	3	2	8	4	5
Water/Irrigation Timing	5	2	8	4	3	4

Market Price of Vegetables

The fact that 'Price of vegetables at Bazaar' was most commonly the lowest farmer priority is of interest. This could be due to an error in sampling, which may have favoured farmers with allotments that were not focused on vegetable production for sale. However, pursuant research suggested that a sampling error was not to blame. What emerged was that most farmers were self-sufficient in basic foodstuffs and

vegetables. Thus they were not influenced greatly by the market price of crops, as they produced sufficient vegetables for domestic consumption and only infrequently bought vegetables at the bazaar. Vegetables at the bazaar constituted a small part of household expenditure, only increasing during preparations for life cycle ceremonies, especially for weddings which require the host to cater for large numbers of people. In this case there is a significant expenditure on rice, carrots, mutton and cotton seed oil for making *plov*, the national dish, traditionally served at weddings and other life cycle ceremonies. The reverse is true for urban and peri-urban families, who were informally interviewed at various bazaars. These families ranked the cost of staple foodstuffs as amongst their highest household expenditure, and complained about the incessant inflation of prices since Independence.

In the case of farmers who are producing marketable surpluses what emerged from follow-up interviews and focus group discussions was that farmers saw market prices as relatively inflexible.

Female respondent: "The price at the bazaar doesn't change that much"

CW: "Does the price change from year to year?"

FR: "Yes, it goes up all the time - but things are the same compared to other things ... meat always costs more than carrots"

TABLE 4: PRIORITY LADDER RESULTS: ANALYSIS

Rank*	Priority	Median	Mode	Minimum	Maximum
1	Soil Quality	1.5	1	1	6
2	Financial Resources	4	1	1	8
3=	Water Quality	3.5	3	2	8
3=	Supply of Machinery and Technology	4.5	2	2	7
5	Water/Irrigation Timing	4	4	2	8
6	Availability of Diesel for Tractors	6.5	-	3	10
7	Seed Quality	7	7	1	11
8	Agricultural Engineering	6.5	8	5	8
9	Fertiliser availability	9	9	2	9
10	Availability of herbicides/pesticides	10	10	6	10
11	Quality of Cotton produced	11.5	11	9	13
12	Quality of Wheat produced	11.5	12	10	12
13	Price of vegetables at Bazaar	13.5	14	9	14

Whilst price inflation was noted by most farmers and consumers alike, farmers stressed that this increase in market price did not even keep pace with increases in

* The Rank is gained by taking the sum of the median and mode, and then ordering the priorities according to their relative score. The lowest score indicates highest priority.

the cost of agricultural inputs and new forms of expenditure since Independence. For example, schools now charge fees and require students to purchase their own textbooks, whereas all education was basically free during the Soviet period. Despite these complaints, those farmers who do produce marketable surplus saw themselves as price takers, who had little ability to influence the price which they were paid for their goods.

Notably women farmers were observed to place greater emphasis on the market price of vegetables than their male counterparts. During the priority ladder exercise research staff noted that women would often move this item further up the ladder, whilst men left it relatively static or moved it down the ladder. Pursuant interviews suggested that the relatively low income gleaned from the sale of excess vegetables at market is a 'women's activity'. Not only is vegetable production largely in the female domain, but the sale of surpluses at market is usually conducted by the leading woman in the family, usually the mother spouse or mother of the head of the household. These women are then able to retain the profits from this sale, often spend on children's clothing and other large, irregular, expenditures. The fact that the market price of vegetables was considered such a low farmer priority, despite the importance of it to women farmers, possibly suggests a lot about the state of gender equality in rural Khorezm.

This finding does not remove the importance of vegetables and marketable surplus in the rural economy. What it does highlight is the high degree of self-sufficiency in vegetables for most of the rural farming population. This self-sufficiency, combined with the statements about price elasticity, actually confirm the importance of vegetables to rural Uzbekistan. However, the price is an inappropriate measure in determining this priority, and identifies a need for greater clarity in translation between English and Uzbek.

Wheat Quality

The quality of wheat produced, with a median of 11.5, indicates the degree to which the governmental and farm management systems distort the agricultural market. In a competitive environment, quality of produce is usually of primary importance to farmers. In this instance it would appear that state strategic plans, which emphasise only the 'quantity' (*i.e.* weight) produced, do so at the expense of quality control. Wheat became a "strategic crop" under central government planning soon after Independence in 1991. The Uzbek government continues to aim for national self sufficiency in grain, not wanting to rely on imports from Kazakhstan and elsewhere in the world.

Owner of Private Wheat Mill: "We process the wheat, but the quality is not as good as Kazakhstan – if people could afford to they would buy their wheat from Kazakhstan...it is much better to eat and cheaper"

At present approximately 50% of farmer yields are subject to purchase at the 'plan' price, with the remaining 50% theoretically available for sale outside the state

system. This is somewhat illusory as the majority of flour mills are state owned, and operate a protected market. Farmers complain that whilst they only receive 150 sum (Local currency: During the time of the interviews one USD equalled about 1000 sum at the unofficial exchange rate) per kilogram of wheat, they then buy back the milled flour at 300 sum per kilogram. The privatisation of grain processing facilities was underway during this research, and there was evidence of private milling of grain for either a percentage of produce or a set monetary charge.

One family of farmers proudly displayed a home made flour mill - capable of processing several hundred kilograms of wheat per day. The fact that this mill was very small made it difficult for the family to sell their flour at any marketable quantity. However the family reported a ready market of neighbours who were prepared to pay a portion of their harvest to use the mill.

Small-Scale Wheat Threshers: "Our neighbours come and get us to put some of their wheat through...we take about a tenth part, depending on how close they are to us"

CW: "What do you mean by how close?"

SS: "Well, if they are family or good friends then we take less and it all depends on the arrangement"

CW: "What if the Mahalla came to check?"

SS: "Feed him well enough to keep his mouth full – so he can't speak" (laughter)

CW: "Is the grain you process better quality than the state mill?"

SS: "Yes, but only because farmers bring their best wheat to us – the tool is the same quality"

Various women interviewed in household interviews in the environs of the private mill noted a preference for privately milled flour. I was told that the flour from private mills is much easier to make good bread from, and is thought to have improved nutritional qualities. The fact that women think this suggests that the private use of technology is a possible solution to technology change. This demonstrates that it will be important to monitor the impact that privatisation has on the priority accorded to the quality of wheat.

Equally significant, one businessman discussed his ownership of wheat and rice processing equipment, of Russian origin. Purchased using private finances (of unknown origin) this equipment employed several staff, and charged 5 sum per kilogram for rice and 6 sum per kilogram of wheat. Those farmers in the nearby region who availed themselves of this service demonstrated a much higher concern for the quality of their wheat, not just the quantity produced.

It would however be wrong to state that the Uzbek government is solely responsible for the excessive emphasis on weight as the sole indicator of production. Soviet central planning, and the education system that served it, placed undue emphasis on quantification of weight. Whilst this may have aided the analysis of aggregated statistics, it created adverse affects in terms of proper incentives for farmers and indeed other industries. Regrettably the Soviet legacy has been perpetuated by the Uzbek government, which continues to focus, almost

exclusively, on the weight produced. Indeed, the Yangiariq Hakimiyat observed in 2003 had a propaganda billboard, boasting of the tonnes of each commodity produced in the past harvest (Figure 3).

FIGURE 3: PHOTOGRAPH SHOWING TONNES OF PRODUCTION: YANGIARIQ, SEPTEMBER 2003



From my own observations, this problem is exacerbated in the education system that trains agronomists and other agricultural specialists in almost purely quantitative techniques at the expense of qualitative techniques. Many agronomists were visited during the course of the research. Often when the research was explained to them, they eagerly ran off a litany of previous years (probably spurious) production figures. Many would also boast to what extent their region had fulfilled or exceeded the state plan.

The low farmer priority of wheat quality emphasises the impact of negative incentives for constructive farmer behaviour. If the central government continues to measure output using inappropriate, and solely quantitative, tools then farmers will continue to place a low priority on quality factors.

Cotton Quality

The state plan for cotton calls for 100% of the production to be procured at sub-market rates by the government, which is then ginned and sold on the international market. This internal monopoly provides a significant, yet un-quantified, part of the national accounts. Farmers are paid for their cotton according to three or five grades

of quality, averaging a price of 250 sum per kilogram. These quality grades are deceptive for two reasons.

The first is that farmers are not actually paid according to a verifiable quality scheme, rather paid on a calculated figure depending on several factors. These include which picking the cotton is from (the first picking is generally of a superior quality), the variety, and whether it is hand or machine harvested. There is also, apparently, laboratory testing of the quality. However, no information on how this is verified or tested is available. Farmers have little ability to increase the grading of their cotton (except through bribery and inducements) through improved agricultural techniques. Also important to note is that the preference for weight over quality can lead to irrational farming behaviour, such as that observed in September 2003, prior to the cotton harvest. In this instance farmers were seen irrigating their cotton crop during cotton boll development, which would appear unnecessary.

CW: "Why are you irrigating now?"

Male Dekhan Farmer: "We make the cotton wet, because we just get paid by weight ... it is an old trick"

CW: "Does it do anything to the quality of cotton?"

MDF: "I don't really care ... the pay is the same - too low"

The second factor influencing the low priority placed on cotton quality is the limited price differentials along the quality gradient. Farmers are not aware of what price they will receive for their cotton ahead of time, and act as passive price recipients. This system discourages farmers from making future production decisions based on economic logic. Rather, farmers tend to plant crops that have delivered high profits in previous years rather than choosing future production based on anticipated future prices. This retrospective decision making process saw the over-production of rice in 2003, as farmers all strove to produce this (usually high value) crop.

Soil Quality

Farmers interviewed attributed clear importance to soil quality, with a mode of '1' and median of '1.5'. The fact that those interviewed recognised the importance of soil quality means that further research and extension can emphasise the direct relationship between sustainable land use and soil quality. This rates it as the most important priority for local farmers and was thus considered to warrant further research.

In order to provide a more in-depth analysis of farmer priorities for soil quality, a decision tree was completed for five of the interviews. These trees exposed a lack of understanding of the causes of poor soil quality, with farmers focusing on the need for more fertilisers and other inputs. These problem trees also identified the causes of soil salinity and chemical toxicity as being from either the Soviet past, or from a lack of irrigation water. The fact that farmers correlated water shortages with soil quality is of some note, as it is often the excessive application of low quality (rather than low quantity water) that degrades soil quality.

However, those interviewed demonstrated a good understanding of the effects of good and bad soil quality. The fact that fertility, yield and quality of harvest consistently appeared confirmed the importance of soil quality to farmers. There was a significant correlation between priorities identified by farmers in interviews and the effects of bad soil quality noted in the problem trees. For example fertility and yield were frequently cited in both formal and informal farmer meetings, and the connection was often made with soil quality. This reinforced the importance of soil quality, as well as illustrating how degrading soil quality is and will continue to be a key constraint to technology transfer. What it also identifies is that greater levels of education are required, especially in terms of the causes of soil quality, for the project to successfully transfer technologies.

The primacy of soil quality to farmer priorities was confirmed in the H-Form exercise. In each H-Form completed, the most popular grouping of negative responses to "I like Farming in Khorezm" was that of 'ecology'. Within this grouping, popular responses included land salinity, poor soil structure and decreasing yields attributed to generally poor soil quality. Follow-up discussions from the H-Form exercises identified that many farmers not only saw land quality as poor, but that they perceived it to be declining at a rapid rate.

Focus Group Participant 1: "Our land is getting harder to grow crops on ... we used to be able to grow fruit trees but not any more"

FGP 2: "It is very bad for the health of the old and the young – and us working age people get less and less from the land"

The high instance of marginal lands, being those lands where traditional farming methods were not possible due to acute environmental degradation, in Khorezm was also a key priority for farmers. Many farmers when asked about their saline soils which were no longer productive actively sought advice on what to grow on them. This active interest suggests that high saline levels pose a present constraint to technology change in Khorezm.

Water Quality

Water quality ranked third equal in terms of priorities, with a median of 3.5 on the priority ladder. This identified it as an important, though not vital component for those interviewed. When questioned, some farmers identified a decline in water quality over the past ten years, whilst older farmers talked of a high level of water quality in their youth. Notwithstanding the statements made in 'Soil Quality' (above), there seems to be a disconnection between the high priority attached to soil quality, and the relatively low priority attached to water quality. The accepted scientific research on Khorezm indicates poor water quality as the primary cause of degrading soil quality. The high presence of salinity, and persistence of agricultural chemicals, is generally considered by the academic community to be a primary cause of declining soil fertility and quality.

Interestingly, many farmers did not make a significant association between salinity of water and soil salinity. This is surprising, given the logical connection

between saline application and saline residue. Whilst most farmers seemed concerned with a decline in the quantity of water available, there was limited concern with the existence of salt or other pollutants. This may reflect concerns of water scarcity during drought 2000-2002. It also reflects the conventional wisdom that salt can be "leached" away. The twice annual application of water to leach surface salt may be effective in the short term. The long term effects of raising the water table, and increasing the levels of salinity in this water table, are not well acknowledged by farmers. The effects of the saline water table are evident, and include not being able to plant fruit trees on land with a high water table. This finding would tend to suggest that there is a need for farmer education about water quality to enable technology change.

The issue of poor water quality illustrates the dependent nature of Khorezm. As a downstream user of the Amu-Darya, the Khorezm region is subject to the water use of up-stream riparian regions and countries. The water usage of Kyrgyzstan, Tajikistan, Afghanistan, Turkmenistan, as well as significant regions of Uzbekistan, has a profound impact on Khorezm. To a large extent the farmers of Khorezm are unable to control the water use, or polluting, of upstream users. Khorezm is very dependent upon central state, and interstate planning bodies for their water allocation.

Informant Interviewee: "We have no say over the water – it just comes to us and we use what we can when we can ... it is not very good – but what can we do, we are just farmers"

The despondence of many farmers reflects the fact that many are resigned to accepting whatever water arrives, and see no mechanism for ensuring that quality and quantity concerns are met.

Water/Irrigation Timing

This variable ranked much lower than was expected, however is still significant at a median and mode of four. This was possibly due to the fact that whilst water supply had been a problem in the past two drought years, it had not been and farmers did not anticipate it to be a problem in 2003.

Female Focus Group Participant: "We have no problems with water this year ... in past years yes we did – but this year there are no problems"

This may also reflect the formulaic approach to irrigation, which is dictated more by calendar date and rostering, than the actual crop needs. All farmers discussed some short-term lack of supply, but claimed that this was always remedied within an acceptable time span.

Male Informant: "we all need water, so we take turns ... it always works out"

In most cases a "responsible person" (ibid) monitors water use and makes ad hoc rulings on irrigation timing manages water allocation. Given the paucity of metering

or other adequate control mechanisms this would appear to be an effective solution. However, personal interviews identified a high incidence of corruption, and water theft.

Female Informant: "How it works is that if you have money, or are friends with the right people you have water. We are poor. We have no water. Some people take the water when we are not allowed, what else can we do if the crops need water? Everything needs the same amount of water – plants don't know how rich their owner is"

On a macro scale the irrigation of cotton in particular is too infrequent, with many cotton crops being irrigated from one to four times throughout the entire growing cycle. The system of taking turns favours upstream users who will over-irrigate their fields, unsure of their next opportunity to access irrigation water. This produces problems of saline runoff, which is then gathered in collector canals (many of which are old and poorly maintained). Downstream users receive both limited and untimely water access, as well as increased levels of salt in their water.

Of considerable concern is the use of 'emergency' ground water supplies for general crop irrigation. Many farmers discussed using electric or tractor driven pumps to access shallow well water for irrigation, during times when no canal water was available. In doing this farmers are using high saline ground water, which contributes to the already problematic soil salinity.

Family group interviewee 1 (male): "We all use wells and drainage canals if we can – it is water, but it is very sour [salty]"

FGI 2 (female): "It is not very good for humans or animals but it is good for the crops, except for fruits and trees that don't like sour water"

FGI 1: "You have to know what the plants need – I am a farmer and I know what plants need – cotton can have sour water so long as it is old enough, if it is too young it will die"

The use of ground water for irrigation highlights both the relatively low priority farmers attach to water quality as well as the high importance to the project of improving irrigation timing.

Financial Resources

Financial resources are, unsurprisingly, a key concern with a mode of one and a median of four. The reasons for this are two-fold. Firstly the settlement accounts system of Uzbekistan is a significant barrier to accessing financial resources, as well as an inhibitor to rural development. In brief, the majority of transactions must occur through the 'settlement account' of an individual. This includes receiving payment for official crops (cotton, wheat and rice) as well as paying production costs such as for fertilisers and seeds. In most cases men are the legal 'leaseholders' of land and it is their settlement account into which monies are paid. Whilst women are legally entitled to lease land, and some do, this remains a rarity. Similarly, there is no reason why a woman's banking account could not be nominated for receipt of

payments and for expenses. However informal interviews showed that in almost all cases men are both the legal leaseholder and the bank account is in their name. The only common exception is where a widow annexes her husbands lease and bank accounts following his death.

The second reason for the importance of financial resources is the generally high level of poverty in Khorezm, especially in the rural regions. Many families subsist on or below what is colloquially termed 'the poverty line'. Extensive use is made of informal cash income mechanisms, with the black market dominating the rural (and urban) economies. Family focus group discussions exposed that there was an acute lack of cash resources. For example one family noted that they did not have enough cash to bribe their two children into University.

Mother: "I have not been paid as a teacher for the past three months, I should get 30,000 sum [\$30 US] but I get much less than that, if I am lucky enough to get anything at all"

One of the coping mechanisms employed by this family was for the father and eldest son to travel to Karakalpakstan where some extended family lease a farm. The men then harvested rice by hand, in return for a portion of the rice they harvested. During the summer months the mother also bought ice-cream in bulk, and sold it from her front door for a small profit.

What is clear from this research is that farmers are motivated towards gaining cash income, especially if it is outside of the official settlement accounts system. This enables them perfect access to their cash, rather than access only to buy certain inputs from government firms. This preference was evidenced quite clearly in 2003 by farmers stating a preference for rice over cotton, even though the profit was not so great. The advantage of rice was that all the profit was in cash rather than in an inaccessible back account.

SUMMARY AND CONCLUSIONS ON FARMER PRIORITIES AND BARRIERS TO TECHNOLOGICAL CHANGE

What these research findings show is that locally articulated priorities demonstrate that there exists a real impetus for change within rural Khorezm. Whilst the Soviet legacy continues to stifle the development of new agricultural technologies, farmers are interested in improving their land and improving their crop profit. What the farmer priority setting research enables is for this thesis to compare and contrast articulated farmer desires with the opinions of farmers and decision makers on technological change. From a development perspective this is very useful in enabling technological intervention to be properly targeted to meet the needs of the rural poor. Moreover, the farmer priority setting research serves as a useful introduction to the problems of technology transfer in Khorezm.

The first finding from this study is that there is a lack of access to cash resources and that this poses a serious constraint to the adoption of new technologies. This constraint identifies the need for cash generating technologies to ensure successful technology transfer. It is important to note that financial resources kept in banks are

not always accessible, and that new technologies that are promoted through the private sector may be inaccessible to the very poor. This is because the private sector requires cash payment whereas the government managed Machine Tractor Parks accept transfers from the settlement accounting system.

The second issue to note is the level of motivation by farmers for improving both water quality and irrigation timing. Whilst farmers attribute high levels of priority to these factors, they are not as high as would be optimal for technology transfer. A general lack of impetus, at the farmer level, for change can be seen as a serious constraint to technology change. This barrier intersects with the lack of access to cash resources noted above. This is especially true if a lack of cash is shown to be having an adverse effect on farmer level education, as indicated by one family interview. It is the intersection of these two barriers that needs to be analysed jointly, as part of the complex of barriers to technology change.

It is likely that the continued privatisation of agricultural production and post-harvest processing will see a move away from quality focused production, towards quality and quantity focused production. This transition towards the private sector, including the move towards quality focused production, has the potential to exacerbate the problems identified by farmers in this chapter. This privatisation is likely to reinforce problems in the rural community if it does not occur concomitant with a rationalisation of the banking system and improvement in the state of family financial resources.

The priorities of farmers in Khorezm are understandable given the socio-legal context in which they are formed. This study attempts to adopt a farmer first approach, working from the perspective of meeting the articulated needs and priorities of the rural poor. This represents the first step in the process seeking out the priorities of households in rural Khorezm.

CONCLUSIONS

The technologies presently being developed by the ZEF/UNESCO project in Khorezm hold considerable potential for meeting the development needs and priorities of local farmers. In particular, several key conclusions can be made: 'Amount of Rice Produced', 'Price of vegetables at Bazaar', 'Quality of Wheat produced', and 'Quality of Cotton produced' are all of a low priority to farmers in the Khorezm. 'Soil Quality', 'Water Quality', 'Financial Resources' and 'Water/Irrigation Timing' are all of key importance to farmers interviewed. This holds great potential for the project; especially in the introduction of tree fallow and fish farming, as well as improved irrigation and tillage practices.

There exists limited farm decision-making autonomy, which will pose a key constraint to the successful transfer of technologies, however this situation is slowly changing with privatisation.

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IMPLICATIONS OF A MONETARY UNION BETWEEN RUSSIA & KAZAKHSTAN: A HYPOTHETICAL EXAMPLE. SOME ANALYTICAL ISSUES & THOUGHTS

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This paper has investigated the implications of a hypothetical Eurasian Economic Community Common Currency Area, EEECCA, and has asked whether it makes any good economic sense for Kazakhstan and Russia to have separate currencies; do or can they increase their respective welfare when each of them abolishes their respective currencies, and adopts some currency of a wider area? Standard economic theories are used to study the implications of the EEECCA with respect to external demand shocks, differences in preferences for inflation and unemployment rates, differences in labour productivities, differences in economic growth rates, and lastly, differences in fiscal systems and seigniorage problems. It is observed that the member nations in the EEECCA can automatically return back to initial levels provided there are wage flexibility and free mobility of labour from one country to another. Otherwise, the adjustment problem would not vanish and disequilibrium must come exclusively through changes in prices. It is explained that as per the new growth theory, the member nations will experience higher capital stock per capita, and enjoy a permanently higher economic growth path. The member nations with differences in inflation rates can easily set inflation rates equal to each other by fixing the exchange rates without any costs in terms of unemployment while becoming a member of the EEECCA. However, there is a short run cost to EEECCA as the short run Phillips curve is still alive. The EEECCA constrains the member nations in the way they finance their budget deficits. It is argued that a less developed country in the EEC (with higher inflation) planning to join the EEECCA with a developed country (with lower inflation) will have to lower inflation. For a given budget, the less developed country will have to increase taxes, particularly when their fiscal system is underdeveloped or undeveloped. This underdevelopment leads to a welfare cost of the EEECCA, eventually with a common currency, EURASH.

ЗНАЧЕНИЕ ВАЛЮТНОГО СОЮЗА МЕЖДУ РОССИЕЙ И КАЗАХСТАНОМ: ГИПОТЕТИЧЕСКИЙ ПРИМЕР. НЕКОТОРЫЕ АНАЛИТИЧЕСКИЕ ВОПРОСЫ И ВЗГЛЯДЫ

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Данная работа исследует значение гипотетической Единой Валютной Зоны Евразийского Экономического Сообщества (ЕВЗЕврАзЭС), и задается вопросами - есть ли экономическая выгода для Казахстана и Российской Федерации в том, что они имеют различные валюты; смогут ли они улучшить свое благосостояние в случае введения единой валюты, отказавшись при этом от собственных валютных единиц? Стандартные экономические теории исследуют последствия создания ЕВЗЕврАзЭС с точки зрения шока внешнего спроса, различий в предпочтениях между уровнями инфляции и безработицы, производительности труда, экономического роста, а также, фискальных систем и проблем, связанных с сеньоражем. В работе указано, что страны-члены ЕВЗЕврАзЭС могут автоматически вернуться к исходному состоянию, при наличии гибкости заработных плат и свободы перемещения рабочей силы из одной страны в другую. В противном случае, проблема адаптации не будет решена и потеря равновесия произойдет главным образом путем изменения цен. Статья разъясняет, что в соответствии с новой теорией экономического роста, страны-участницы могут испытать более высокий шок капитала на душу населения, и,

вместе с тем, более высокие устойчивые темпы экономического роста. Становясь членами ЕВЗЕврАзЭС, страны-участницы с разными темпами инфляции могут установить одинаковые темпы инфляции путем установления фиксированных обменных курсов без каких-либо издержек с точки зрения занятости. Однако, краткосрочные издержки ЕВЗЕврАзЭС, описываемые краткосрочной кривой Филлипа, все же не теряют своего значения. ЕВЗЕврАзЭС накладывает ограничения на страны-участницы в вопросе финансирования дефицита бюджета. Статья утверждает, что менее развитая страна ЕврАзЭС (с более высокими темпами инфляции), вступающая в ЕВЗЕврАзЭС в союзе с более развитой страной (с низкими темпами инфляции), должна будет понизить у себя темпы инфляции. Для обеспечения бюджета менее развитая страна должна будет повысить налоги, особенно если ее фискальная система не до конца развита или не развита вообще. Эта неразвитость влечет за собой издержки ЕВЗЕврАзЭС с точки зрения благосостояния, что в конечном счете отражается на общей валюте.

1. INTRODUCTION

Realizing the importance of historical and cultural ties, as well as the great potential for intra regional trade among the Central Asian Countries, the first public meeting of the political leaders of these countries took place in Almaty in June 1990. The deepening of interstate cooperation and integration was realized through the interstate treaties on trade, customs, and security. Such a move necessitated the formation of formal regional international organizations. The most of its kind is Inter State Council. Such integration and cooperation, as it is asserted, would reinforce the sovereignty of the individual states in the Central Asia. Efforts were made to abolish tariffs on trade between Kazakhstan and Uzbekistan with the expectation to create a common market by 2000. The agreement provided for freer movement of goods, services, capital and labour between these two countries and coordination of fiscal and customs policies. The president of Kazakhstan termed such agreement as the abolishing of borders between Kazakhstan and Uzbekistan. Later, the president of Kyrgyzstan expressed to join the Central Asian Union. The local press announced that as of February 1, 1994, customs regulation was suspended on common borders in Kazakhstan, Uzbekistan and Kyrgyzstan. The establishment of a Central Asian Union was announced at the summit of Central Asian leaders in July 1994 in Almaty. In December 1994 Belarus, Kazakhstan and Russia announced the creation of a customs union. The agreement came into effect on July 1995 and Kyrgyzstan joined the group in December 1995. The union was widely referred to as the "Big Four Agreement." Belarus, Kazakhstan, Kyrgyzstan and Russia adopted a separate Customs Union Agreement and a treaty on Integration in March 1996. After Tajikistan joined in December 1998, the group became known as the "Big Five Agreement". At the beginning, this union was no more than a pledge of the parties to observe the provisions of the CIS agreements that were already in force. The agreement was further formalized by yet another customs union adopted in February 1999.

Earlier back in 1993, the leaders of the CIS states adopted a declaration to establish an "Economic Union" and signed a corresponding economic union treaty in September 1993. The treaty was designed to foster a free trade area, create a customs union with reduced internal tariffs and a common external tariff, and establish a system of payments and settlements.

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Later in 2000, the presidents of Belarus, Kazakhstan, Kyrgyzstan, Tajikistan and Russia established a Eurasian Economic Community (EEC) to harmonize the customs, taxes and trade policies of these countries. The EEC was designed as the next logical step in an incremental movement towards policy harmonization. The new EEC was seen as a step toward ASEAN or NAFTA style international policy agreements.¹ The EEC framework combines both the functional integration and constitutional approaches. This activity is accompanied by a series of subsidiary agreements and implementation of decrees that address the disagreements among the states with respect to disparities in trans border policies, customs, tariffs, trade policies and security provisions. The agreement also promises to introduce a visa free travel arrangement for citizens of the signatory countries. At the summit meeting on February 23, 2003, the presidents of Belarus, Kazakhstan and Russia decided to make a Monetary Union based on the progress of EEC in five to seven years time. Such a time will be needed to coordinate monetary and currency policies, standardize payment systems, and work out a common approach to social welfare policy.

The purpose of the present paper is neither to critically examine the functioning and the development of the EEC, nor to investigate to what extent the objectives and goals of the EEC have been achieved. Rather, this paper has asked heuristically the following questions: Is there a good economic case for Russia & Kazakhstan, for example, to have separate currencies? Does or can each of these countries increase their respective welfare when each of them abolishes their respective currencies and adopts some currency of a wider area?

While the above countries do not have free trade among themselves, or any effective customs union in between, and not to mention about the common market², the above questions may sound strange at this moment. Given this backdrop, it is hypothesized that Kazakhstan and Russia, as if, have succeeded in all the steps necessary for a common market area, except the stage of a monetary union. Therefore, a discussion on the theory of common currency involving these two countries is important and makes sense, particularly, when one would like to investigate what implications would the monetary union carry on these countries in the adjustment phase, if some of the following things happen. In particular, what costs Russia & Kazakhstan would have to pay for when they are in the monetary union, if there are: (i) demand shocks away from the products from one country to another; (ii) different preferences for inflation and unemployment rates; (iii) differences in labour productivities; (iv) differences in economic growth rates; and lastly, (v) differences in fiscal systems and seigniorage problems. Are there any other alternative views or arguments as far as the costs of monetary union are concerned?

The ultimate goal of the paper is to shed some light on the existing economic theories and to share with the professionals, academicians, and policy makers & government officials across the EEC countries, to create rooms for future research in various dimensions of the issue. I will construct simple arguments based on the

existing macroeconomic and microeconomic theories and other ideas available in the economics literature.

2. ORGANIZATION AND PRESENTATION OF THE PAPER

First, the notion of monetary union or monetary integration is briefly defined and discussed. The economic theories, and empirical evidences countering the scope of such integration are presented next. Then we discuss to what extent the member states in a monetary union suffer in the adjustment phases: when one of them has a positive demand shock away from its partner; when they differ in their preferences for inflation and unemployment rates; when one has higher labour productivity and economic growth than the other member state; and one member state has different fiscal system and seigniorage problem and labour market institutions. Simultaneously, I take cognizance of the credibility of otherwise arguments, available in the literature, against the alleged costs of the monetary union. Then the summary and conclusions of the paper are made followed by the direction of future research.

In section 3.1, I discuss the stabilization powers of Kazakhstan that it sacrifices, and the gains in efficiency and credibility it reaps (through elimination of transaction costs and uncertainty with respect to exchange rates fluctuation), when it becomes a member of the Eurasian Economic Community Common Currency Area, EECCCA. The economy of a member state in the EECCCA with higher capital stock per capita, can move on a permanently higher economic growth path, as per the new growth theory. The member countries with demand shocks away from the other member, face the adjustment problems with their trade balances. In the adjustment phase, the economies can automatically (without resorting to currency devaluation or revaluation) return back to initial levels, provided there is wage flexibility, and free mobility of labour from one member state to another. Otherwise, the adjustment problem will not vanish, and disequilibrium must come exclusively through changes in prices in Russia and Kazakhstan. This is described in section 4.

When member countries in the EECCCA differ in their preferences for inflation, and unemployment rates, there is an asymmetric adjustment phase for the member states: a member state, with initially higher inflation rate, will have to accept lower inflation rate, meaning more unemployment, while its partner country, with initially lower inflation rate, has to accept higher inflation rate with less unemployment. I discuss these in section 5. The dynamic version of the Phillips curve analysis demonstrates that authorities cannot choose any optimal combination of inflation and unemployment rates, when there is a natural rate of unemployment. Therefore, they can easily set inflation rates equal to each other by fixing the exchange rates without any costs in terms of unemployment, while becoming the member of the monetary union. However, there is a short run cost to join a monetary union, as the short run Phillips curve is still alive.

The countries with higher labour productivity, must have higher nominal wage than others. It is argued in section 5. 3 that countries with differences in economic

growth create a trade balance problem for the fast growing nation: a chronic trade deficit for a fast growing nation and a chronic trade surplus for the slow grower. Adjustment problem takes place in the form of deflationary measures (decrease in government expenditures or increase in taxes, such as, income taxes, excise taxes, import tariffs, and other restrictions) in the fast growing nation, implying its terms trade has to decline.

Countries with different fiscal systems lead to use different combinations of debt and monetary financing of the government budget deficits. This is discussed in section 5. 4.

In section 6.1, I revisit the external demand shocks. If the demand shift is of the following nature: importing and exporting, simultaneously, the same types of products, a structure of trade, where most demand shocks would affect these countries in a similar way. Therefore, the most of the demand shocks, instead of being asymmetric, will tend to be symmetric in nature. Economies of scale make the integration of trade possible through concentration of industrial activities.

The effect of economic growth on member state is revisited in section 6. 2. It is argued that a fast growing nation can grow without having any problems in its trade balance. This implies that a fast growing nation can increase its exports at a faster pace without having to resort to real depreciations to solve its trade deficits. The reasons and the underlying process for this to happen are explained. Section 7 draws summaries and conclusions of the paper followed by the direction of future research in section 8.

3. MONETARY UNION

I discuss two important issues: benefits and cost of a nation joining a monetary union. In this context, the role of an independent national central bank in the economic management of the country is briefly discussed. Then I analyze and discuss the theories with examples, and the inconveniences that a member state in the monetary union has to face due to the loss of independence of the national central bank to withstand the external economic shocks. Afterwards, the credibility of the arguments disfavoring the option to joining a monetary union is discussed. Throughout of the analysis, Russia and Kazakhstan are assumed, as test cases, the members of the common currency area, EECCA.

3.1. Monetary Union and Independence of National Central Bank

When Kazakhstan becomes a member of the EECCA, the role of its national central bank (National Bank of Kazakhstan) either ceases to exist or will have no real economic power. In that it means that Kazakhstan joining the monetary union EECCA will not be able any more to change the price of its currency, tenge (through devaluation or revaluation), or, to determine the quantity of tenge in circulation. All these mean that Kazakhstan has to relinquish its national currency,

enge as an instrument of economic policy. Alternatively, it loses the ability to conduct a national monetary policy.³

A framework is needed to systematically analyze the costs of joining a group, EECCA with a mutually fixed exchange rate against its advantages.⁴ Hypothetically, we assume that there exists an Eurasian Economic Community Common Currency Area, EECCA. We need to look at the stabilization powers of Kazakhstan that it sacrifices, and the gains in efficiency and credibility it reaps when it becomes a member of the EECCA. The economic costs and benefits of joining the EECCA and having a common currency, EURASH (an innovative name for an imaginary currency at this stage), depends largely on how well the Kazakhstani economy is integrated with those of its potential partners in the EECCA. Fixed exchange rates, as the theory of common currency areas predicts, are most appropriate which magnifies the monetary efficiency gains, for closely integrated economy through international trade of goods and services, and factor movements such as, free migration of labour and capital. Further, more intensive is cross border trade and factor movement, greater is the gain from a fixed cross border exchange rate.

3.2. Monetary Union and Management of Demand Shocks

If there are simultaneous demand shocks away from both Kazakhstan and EECCA to the outside world, the EEC currency, EURASH will simply depreciate against outside world currency, providing automatic stabilization to Kazakhstan. Kazakhstan would have serious problems had it faced alone the demand shock. For example, if the world demand for Kazakh oil & wheat fell, therefore, Kazakh's exports would fall. In that case, full employment will be restored only after a period of costly slump during which the price of Kazakhstan's goods and wages would fall. Greater is the economic integrity with the EECCA, shallower slump will be, and less costly be the adjustment to the adverse shift in demand. The gain in economic efficiency originates from elimination of transaction costs associated with the exchange of national moneys, and elimination of risk from uncertain future movements of the exchange rates. For examples, individuals, firms, businesses, Governments do not have to convert one currency into another to make the necessary payments for its imports or receive any foreign earnings from its exports and investment income abroad. The agents can make systematic plans of their businesses and investment, when they know for sure the amount they would be making payments for their imports or receiving from exports. Therefore, the uncertainty is completely removed. A well-integrated economy pegging its currency to an area of price stability, (EECCA in our case) imports further an anti-inflationary climate to the domestic economy. Close economic integration leads to international price convergence, and, therefore, lessens the scope for independent variation in the pegging country's (Kazakhstan and Russia, in our example) price level.

back to their initial level without devaluation (in Kazakhstan) and revaluation (in Russia) of their respective currency?

4.2. Automatic Stabilizers

Ideally, there are two mechanisms, which can take these economies automatically back to initial levels. One is based on wage flexibility while the other is based on the mobility of labour.

4.2.1. Automatic Stabilizers - Wage Flexibility

Flexibility of wages means that the unemployed workers in Kazakhstan will reduce their wage claims while the excess demand for labour in Russia will push up the wage rate. The effect of this adjustment is as follows. The reduction in wage rate in Kazakhstan will shift their aggregate supply curve to the right while an increase in wage rate would shift it to the left in Russia. This adjustment process will bring back the equilibrium in both countries: in Kazakhstan, the price of output will fall, and it will increase in Russia. Simultaneously, it improves the current account in Kazakhstan, and reduces the Russia's current account surplus. Further, the second order effects on aggregate demand will also reinforce the equilibrating mechanism. In other words, the wage and price increases in Russia will make Kazakh products more competitive, leading to an upward shift in Kazakh aggregate demand curve. Similarly, the decline in Kazakh costs and prices makes Russian products less competitive, and shifts the Russian aggregate demand curve downward.

4.2.2. Automatic Stabilizers- Mobility of Labour

The Kazakh unemployed labourers move to Russia where there is an excess demand for labour. This movement of labour eliminates the need to let the wage in Kazakhstan to fall while in Russia, it does not let it rise. The unemployment problem in Kazakhstan is solved, while the inflationary wage pressure in Russia vanishes. Simultaneously, the current account problem is also solved.⁹

4.2.3. Lack of Automatic Stabilizers

If none of the above sources, wage flexibility or mobility of labour is possible, the adjustment problem will not vanish. In that case, both countries will stick to the disequilibrium situation. The adjustment to the disequilibrium must now come exclusively through price increases in Russia. The price increases in Russia will make the Kazakh products more competitive, leading to an upward shift in aggregate demand in Kazakhstan. Thus, if wages don't decline in Kazakhstan, the adjustment to disequilibrium in Russia will take the form of inflation.

The above changes put the Russian authorities into dilemma. If they care about inflation, they will want to resist these inflationary pressures through restrictive

monetary or fiscal policies. However, in that case the current account surplus will not disappear. If they want to eliminate it, the Russian authorities will have to accept higher inflation.

One of the solutions of the above dilemma is to revalue ruble against tenge. The revaluation of ruble reduces the aggregate demand in Russia.¹⁰ In Kazakhstan, the opposite would happen. The effect of all these demand shifts is that Kazakhstan solves its unemployment problem, and Russia avoids having to accept inflationary pressures. There will be no more current account surplus in Russia, and no more current account deficit in Kazakhstan. This is all about Mundell's prescription to overcome the situation.

Once they become the members of the EECCEA, both will have to relinquish the control of its exchange rate. Kazakhstan will be saddled with a sustained unemployment problem and a current account deficit, and this can only disappear by deflation in Kazakhstan. This means that a monetary union has a cost to Kazakhstan when faced with a negative demand shock. In Russia, it is costly too, as it will have to accept higher inflation than it would otherwise be.

Is there any other instrument that can solve the above problems in both countries? The Russian authorities could increase taxes in Russia so as to reduce the aggregate demand there. The tax revenues are then transferred to Kazakhstan, where they are spent (the aggregate demand curve shifts upward in Kazakhstan, as a result). Kazakhstan would still have a current account deficit. However, this deficit would be financed out of the transfer from Russia.¹¹

We may, therefore, conclude that member countries of the EECCEA (particularly, where wages are rigid and labour mobility is totally restricted) will find it harder to adjust to any demand shocks than the countries that have maintained their own national currencies, and that can devalue it. The monetary union between two or more countries is optimal if there is sufficient wage flexibility or sufficient mobility of labour.

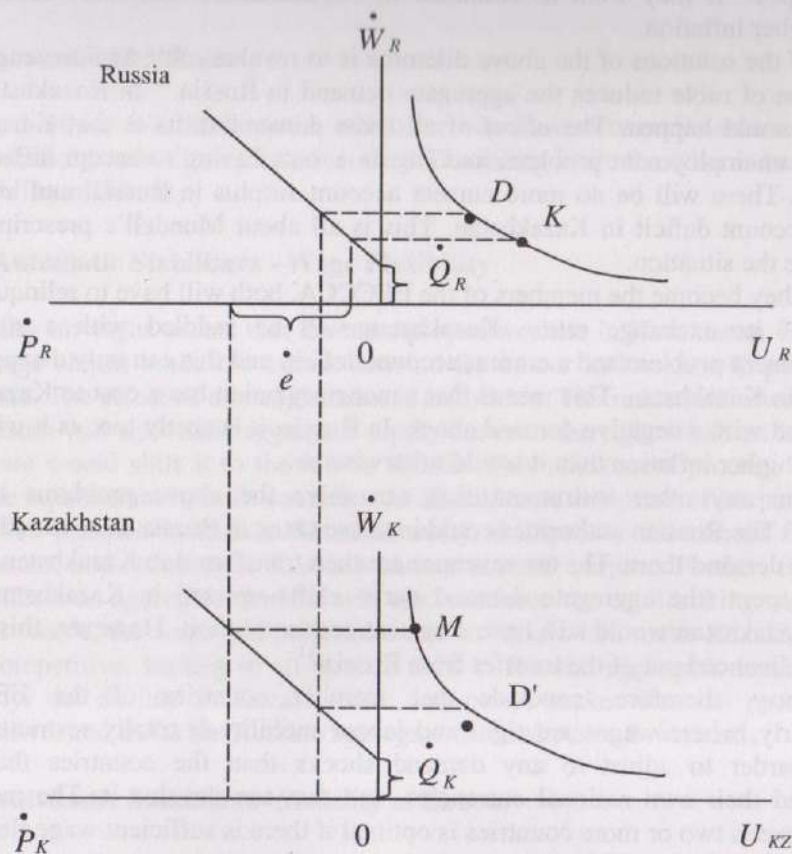
5. COST OF MONETARY UNION WHEN COUNTRIES ARE DIFFERENT

5.1. Countries with different preferences for inflation and unemployment

Corden (1972) and Giersch (1973) observed that when countries have different degrees of tolerance with inflation rates, it makes the introduction of common currency, EURASH, costly.¹² I will make use of De Grauwe (1975) to graphically explain the problems.

We continue our experiments with Kazakhstan and Russia. Suppose Kazakhstan has a relatively higher inflation rate than Russia. In figure 1, the Phillips curves are shown for these two nations.

FIGURE 1: INFLATION AND UNEMPLOYMENT CHOICES (U) IN KAZAKHSTAN AND RUSSIA.



The vertical axis shows the rate of change of the wage rate, the horizontal axis the unemployment rate. The Phillips curves are assumed to be stable, that is, they do not shift as a result of changes in expectations of inflation.¹³ In the left-hand side panels, we represent the relationship between wage changes and price changes. This relationship can be written for Kazakhstan and Russia, as follows:

$$\dot{P}_K = \dot{W}_K - \dot{Q}_K \quad (1)$$

$$\dot{P}_R = \dot{W}_R - \dot{Q}_R \quad (2)$$

where \dot{P}_K and \dot{P}_R are the rates of inflation, \dot{W}_K and \dot{W}_R are the rates of wage increases, and \dot{Q}_K , \dot{Q}_R are the rates of labour productivity respectively in Kazakhstan and Russia. The above two equations define the rate of price changes that keep profits unchanged (as a percentage of value added).¹⁴ The above two equations are represented by the straight lines in the left hand side panels. The two

intercepts are given by \dot{Q}_K and \dot{Q}_R , respectively. When the rate of labour productivity increases in Kazakhstan, one would expect the line shifting upwards. The two countries are linked by relative purchasing power parity as follows:

$$E_K = P_K - P_R \quad (3)$$

where, E_K represents the rate of depreciation of tenge relative to ruble. Equation (3) is an equilibrium condition, which states that if Kazakhstan has a higher rate of inflation than Russia, it will have to depreciate its currency to maintain the competitiveness of its products unchanged. If Kazakhstan and Russia decide to join a monetary union, the exchange rate is fixed: ($E_K = 0$), so that the rates of inflation must be equal. If this is not the case, that is, if inflation in Kazakhstan is higher than in Russia ($P_K > P_R$), Kazakhstan will increasingly lose its competitiveness.

If we assume that Kazakhstan has different preferences for inflation and unemployment rates (with Kazakhstan choosing a point M on its Phillips curve

while Russia point K), it is immediately obvious that a fixed exchange rate ($E_K = 0$) will be unsustainable. The cost of a monetary union, EEECCA (provided both Kazakhstan and Russia agree to have a fixed exchange rate), force them to choose another less preferred point on the Phillips curves, so that both countries will have the same inflation rates. In other words, Kazakhstan will have to accept less inflation rate (meaning more unemployment there, assuming a stable Phillips relationship) while Russia accepts more inflation rate with less unemployment. This outcome is shown by points D & D' on the respective Phillips curves (many other points on the Phillips curves are equally likely with joint inflation rates).

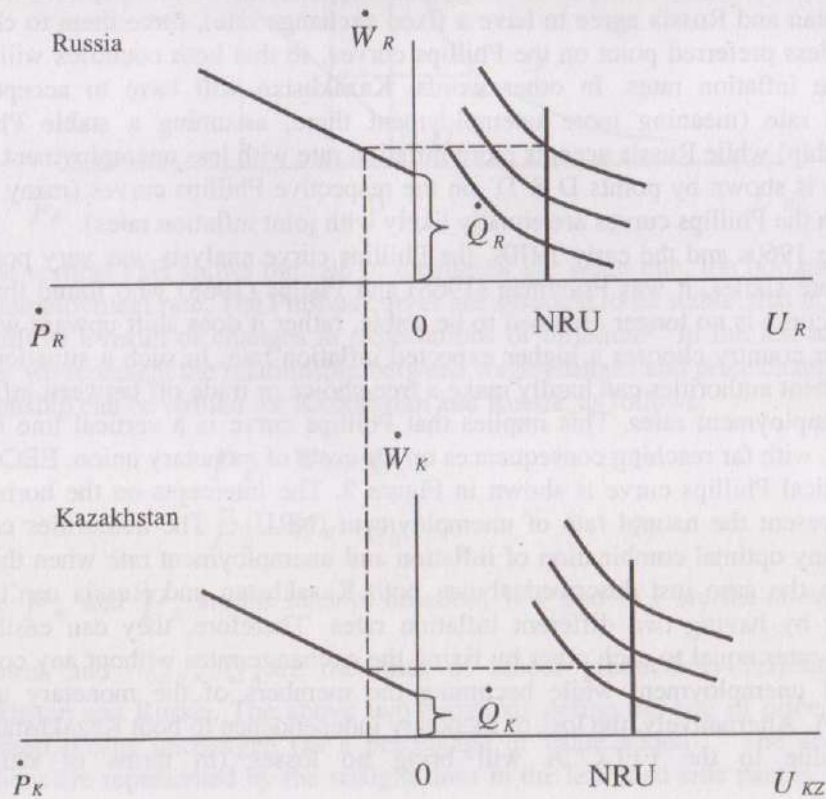
In the 1960s and the early 1970s, the Phillips curve analysis was very popular. But in late sixties, it was Friedman (1968) and Phelps (1968) who found that the Phillips curve is no longer assumed to be stable, rather it does shift upward when a particular country chooses a higher expected inflation rate. In such a situation, the Government authorities can hardly make a free choice or trade off between inflation and unemployment rates. This implies that Phillips curve is a vertical line in the long run, with far reaching consequences on the costs of monetary union, EEECCA. The vertical Phillips curve is shown in Figure 2. The intercepts on the horizontal axis represent the natural rate of unemployment (NRU).¹⁵ The authorities cannot choose any optimal combination of inflation and unemployment rate when there is NRU. In the case just described above, both Kazakhstan and Russia can't gain anything by having two different inflation rates. Therefore, they can easily set inflation rates equal to each other by fixing the exchange rates without any costs in terms of unemployment while becoming the members of the monetary union, EEECCA. Alternatively, the loss of monetary independence to both Kazakhstan and Russia due to the EEECCA will bring no losses (in terms of reducing

unemployment or lowering inflation rate) to each of these countries. However, there is a short run cost to joining the EECCA as the short run Phillips curve is still alive. The countries that want to reduce inflation end up temporarily with higher unemployment.

The relevant question is whether a country with higher inflation rate (Kazakhstan, in our example) planning to join the EECCA, would end up either with a temporary increase or a permanent increase in cost due to higher unemployment. From figure 1, one would observe that by moving inflation rate from point M to point D', Kazakhstan raises its unemployment rate. However, over time as the expected inflation rate tend to be lower in Kazakhstan, one would expect the Phillips curve of it to shift downward (Figure 2). In the mean time, during the transition, Kazakhstan is faced with high unemployment rate, which is not avoidable by any means.

Therefore, one may counter the argument: the cost of disinflating the economy should not necessarily be the cost of the EECCA, as the country would need to reduce it, no matter it is the member of it, or not. An appropriate question one may further pose whether the cost of disinflation would be lower with the EECCA, or doing it alone?

FIGURE 2: MONETARY UNION (EECCA) IN A WORLD OF VERTICAL PHILLIPS CURVE



5.2. Costs of Monetary Union when Labour Productivities are Different

What would the implications be if there were differences in labour productivity between Kazakhstan and Russia? Let us suppose that the labour productivity in Russia, \dot{Q}_R is higher than that of in Kazakhstan, \dot{Q}_K . If two countries decide to form a monetary union, EECCA, this implies that the nominal wage increases in Kazakhstan must be lower than in Russia. This can be seen by setting $E_K = 0$.

Therefore, equation (3) states that $P_K = P_R$. Deducting equation (2) above from equation (1), we get:

$$P_K - P_R = W_K - \dot{Q}_K - W_R + \dot{Q}_R$$

$$0 = W_K - \dot{Q}_K - W_R + \dot{Q}_R$$

$$W_R - \dot{Q}_R = W_K - \dot{Q}_K$$

$$\text{or } W_R - W_K = \dot{Q}_R - \dot{Q}_K$$

After the EECCA, if the labour unions in Kazakhstan and Russia centralize their wage bargaining power and aim for equal nominal wage increases despite their productivity differences, this will create problems. At this point, we conclude that even if countries may be different in their preferences for inflation and unemployment rates across countries, it will not create any formidable obstacles to forming the EECCA if one accepts that countries can't choose optimally a particular point on the Phillips curve. However, the short run cost to disinflation is unavoidable in the transition period.

5.3. Costs of Monetary Union and Differences in Growth Rates

It is obvious that some countries grow faster than others. Such differences in growth rates can lead to problems when countries form a monetary union such as EECCA. We analyze this issue with respect to Kazakhstan and Russia. Suppose Kazakhstan's GDP is growing at the rate of 10% per year while Russia's GDP at 5% per year. Also suppose that the income elasticity of Kazakhstan' imports from Russia is 1, and for Russia, it is also 1 for its imports from Kazakhstan. The Kazakhstan's imports from Russia will grow at the rate of 10% per year, while Russia's imports from Kazakhstan will grow only at the rate of 5% per year. This will create a trade balance problem for the fast growing nation. In Kazakhstan, imports will grow faster than its exports and vice versa for Russia. Therefore, a chronic trade deficit in Kazakhstan and a chronic trade surplus in Russia is eminent.

To avoid such chronic deficits in trade account, Kazakhstan would have to reduce the price of its exports to Russia. This implies Kazakhstan's terms trade must

decline to make its products more competitive. Kazakhstan can perform this job in two ways: a depreciation of tenge against ruble or a lower rate of domestic price increases than in Russia. If both countries become the members of the EECCA, Kazakhstan can only allow its domestic price to decrease without impacting upon its exchange rate with ruble. This means that Kazakhstan would have to adopt deflationary policies (decrease in government expenditures or increase in taxes, such as income taxes, excise taxes, import tariffs and other restrictions), which in turn, will constrain the growth process in Kazakhstan. This means that the monetary union, EECCA, has a cost for a fast growing nation.

5.4. Costs of Monetary Union and Different Fiscal Systems and Seigniorage Problem

This is not surprising that countries do have different fiscal systems. Such differences in fiscal systems lead countries to use different combinations of debt and monetary financing of the government budget deficits. The countries after joining the monetary union, EECCA, will constrain them in the way they finance their budget deficits.¹⁶

The following model is adapted from De Grauwe (1994). Assume the government budget constraint as follows:

$$G - T + rB = dB/dt + dM/dt \quad (4), \text{ where}$$

G: government spending (excluding interest payments on the government debt),

T: tax revenue,

r: is the interest rate on government debt, B,

M: is the level of high-powered money (monetary base)

(G - T): primary budget deficit

rB: interest payment on the government debt

$dB/dt + dM/dt$: represents the financing of budget deficit:

dB/dt : represents financing through issuing of debt over time,

(dM/dt) : use of high powered money over time.

Any rational government will use different sources of revenue so that the marginal costs of raising revenue from different sources are equal.¹⁷ For instance, if marginal cost of raising revenue by increasing taxes exceeds the marginal cost of raising revenue by inflation (seigniorage) it will be optimal to reduce taxes and to increase inflation. This implies that countries will have different optimal inflation rates. For example, countries with under developed tax system will have a tendency and incentive to raise revenue by inflation (seigniorage), as they experience large costs in raising revenue by increasing tax rates. Therefore, it is less costly to increase government revenue by inflation. What implication does it carry for the monetary integration and EECCA in particular?

Any less developed countries in the EECCA such as Kyrgyzstan or Tajikistan (with higher inflation rate, for example) planning to join the EECCA with a

developed country, Russia (with a relatively lower inflation rate, for example), will have to lower inflation. This means that for a given budget, a less developed country will have to increase taxes, particularly when its fiscal system is underdeveloped or undeveloped. Definitely, this is a welfare cost of the monetary union, EECCA.¹⁸

6. COSTS OF MONETARY UNION AND SOME COUNTER ARGUMENTS

The above analyses so far demonstrate that there is a cost for a country joining a monetary union, EECCA. Because there are disturbances and shocks that lead the central bank of the country not to execute its exchange rate policy to solve the problems. Further, different fiscal systems also bear upon extra costs due to the monetary union. The above analyses, known as the theory common currency areas, are being questioned.¹⁹ However, there are criticisms, which fall under several categories. Firstly, do the differences among countries matter? Secondly, exchange rate may not be very effective in correcting for shocks when there are differences between nations. Thirdly, exchange rate may not only be ineffective, it might even cause more harm than good in the hands of politicians.

6.1. Do Demand Shocks Matter?

To what extent the demand shift away from one country to another matters (while they are members of the EECCA) depends on the nature of products being traded? Are these products homogenous or differentiated in nature? Or are these products merely raw materials, or semi finished, or agro based types? If trade is assumed to be created due to the economies of scale and imperfect competition (product differentiation), one would expect the countries importing and exporting the same types of products to each other. This is called an intra industry trade. For instance, if Kazakhstan and Russia import and export simultaneously the same types of products (an empirical question to investigate), have the same structure of trade, most demand shocks would affect these countries in similar way. Therefore, the most of the demand shocks would tend to be symmetric instead of being asymmetric. Should it not mean that Mundell's analysis is totally invalid? Economies of scale make integration of trade possible through concentration of industrial activities.²⁰

6.2. Do Differences in Economic Growth Matter?

It was argued earlier in section 5.3 that the fast growing countries will have trade deficits, and the slow growing countries have trade surpluses. Consequently, a real depreciation of local currency is eminent for the fast growing country to make its trade more competitive. If they join the monetary union, EECCA, such an option is difficult to exercise. There is, however, little support to this fact empirically.

The European Commission (1990) studied the growth rates of EC countries during 1973 - 1988 and the real depreciations (or appreciations). They found that

among the fast growers, there were countries with real appreciation of currencies while in others, there was depreciation. The same thing was observed for slow-growers.

Paul Krugman (1989) revisited this relationship and observed that economic growth had little to do with the static view implicit in the theory. Economic growth implies development of new products or old products with qualitative features. The income elasticity of a fast growing nation is higher than that of a slow grower, but the income elasticity of the export goods of a fast grower will also be higher than that of imports. As a result, the fast grower can grow without having any problems in its trade balance. This implies that a fast growing nation can increase its exports at a fast pace without having to resort to real depreciations.

Further, a fast growing nation will experience higher capital inflow from a slow growing nation because of its higher productivity of capital. Such a capital inflow to a fast grower will finance the current account deficits without any need to devalue its currency. At this point, the counter argument, therefore, is that a fast growing country that joins a monetary union, EECCA, with slow growing countries will find it easier to attract foreign capital. With no exchange rate uncertainty investors from slow growing area may be moving their capital to a fast grower, in order to make larger profit (De Grauwe, 1994). In conclusion, the differences in growth rates among countries of the EEC can't be considered as an obstacle to monetary integration in EECCA.

7. SUMMARY & CONCLUSIONS

This paper has used simple macroeconomic and microeconomic analytics and arguments useful in open economy to investigate the implications of a hypothetical monetary union, EECCA, to its member states Kazakhstan and Russia as an example. It has investigated the following questions: Is there a good economic case for Kazakhstan and Russia to have separate currencies? Does or can each of these countries increase their respective welfare when each of them abolishes their respective currencies and adopts some currency of a wider area? Particular attention was to investigate the implications of the EECCA on these countries in the adjustment phase, particularly when they face the following economic shocks: (i) demand shocks away from the products from one country to another; (ii) different preferences for inflation and unemployment rates; (iii) differences in labour productivities; (iv) differences in economic growth rates; and lastly, (v) differences in fiscal systems and seigniorage problems.

As a member of the EECCA, Kazakhstan (Russia) has to relinquish its national currency, tenge (ruble) as an instrument of economic policy; it loses the ability to conduct a national monetary policy. The stabilization powers of Kazakhstan that it sacrifices, and the gains in efficiency and credibility it reaps (through elimination of transaction costs and uncertainty with respect to exchange rates fluctuation) need to be compared when it is a member of the Eurasian Economic Common Currency Area, EECCA. The importance of the monetary union, EECCA, in economic

growth is investigated. It is observed that the economy of a member state (either Kazakhstan or Russia) in the EECCA with higher capital stock per capita would move on a permanently higher economic growth path.

I discuss the nature of adjustment problems that a member state in a monetary union faces in its trade balances due to demand shocks. It has been found that the economies can automatically (without resorting to currency devaluation or revaluation) return back to initial levels provided there is wage flexibility and free mobility of labour from one country to another. Otherwise, the adjustment problem would not vanish and disequilibrium must now come exclusively through changes in prices.

However, countries importing and exporting the same types of products to each other, for example, if Kazakhstan and Russia import and export simultaneously the same types of products, a structure of trade where most demand shocks would affect these countries in similar way. Therefore, the most of the demand shocks will tend to be symmetric in nature instead of being asymmetric.

If the member countries in a common currency area, EECCA, differ in their preferences for inflation and unemployment rates, the adjustment would be to choose a less preferred inflation rates: Kazakhstan, for instance (initially assumed with higher inflation rate), will have to accept less inflation rate (meaning more unemployment) while its partner, Russia, (initially assumed with lower inflation rate) will have to accept more inflation with less unemployment. The dynamic version of the Phillips curve analysis, however, demonstrates that authorities cannot choose any optimal combination of inflation and unemployment rate when there is a natural rate of unemployment. Therefore, they can easily set inflation rates equal to each other by fixing the exchange rates without any costs in terms of unemployment while becoming the member of the monetary union, EECCA. However, there is a short run cost to joining the EECCA as the short run Phillips curve is still alive.

Countries with differences in economic growth create a trade balance problem, especially, for the fast growing nation: a chronic trade deficit in Kazakhstan (a fast growing nation, in our example) and a chronic trade surplus in Russia (a slow growing nation). Adjustment problem takes place in the form of deflationary measures (decrease in government expenditures or increase in taxes, such as income taxes, excise taxes, import tariffs and other restrictions) in Kazakhstan, implying Kazakhstan's terms trade must decline. As with the monetary union, EECCA, Kazakhstan can only allow its domestic price to decrease without impacting upon its exchange rate with ruble. This in turn will constrain the growth process in Kazakhstan.

However, the counter argument is that economic growth implies development of new products or old products with qualitative features. The income elasticity of a typical fast grower is typically higher than that of a slow grower, but the income elasticity of the export goods of a fast grower will also be higher than income elasticity of its imports. As a result, the fast grower can grow without having any problems in its trade balance. This implies that a fast growing nation can increase its exports at a fast pace without having to resort to real depreciations to solve trade

deficits. This is because a fast growing nation will experience higher capital inflow from a slow growing nation because of its higher productivity of capital. This will finance the current account deficits without any need to devalue its currency. The counter argument, therefore, is that a fast growing country that joins the monetary union, EECCA with slow growing countries, can find it easier to attract foreign capital. With no exchange rate uncertainty investors from slow growing area may be moving their capital to a fast grower in order to make larger profit.

Countries with different fiscal systems lead to use different combinations of monetary financing of the government budget deficits and debt. The countries after joining a monetary union will constrain themselves in the way they finance their budget deficits. This implies that countries will have different optimal inflation rates. For example, countries with under developed tax system (Kazakhstan, for example) will have a tendency and incentive to raise revenue by inflation (seigniorage) as they experience large costs in raising revenue by increasing tax rates. Therefore, it is less costly to increase government revenue by inflation.

Any less developed countries in the Eurasian Economic Community (with a relatively higher inflation rate), therefore, planning to join the monetary union, EECCA, with a developed country (with a relatively lower inflation rate) will have to lower its inflation rate. This means that for a given budget the less developed country will have to increase taxes, particularly when their fiscal system is underdeveloped or undeveloped. Definitely, this is a welfare cost of the monetary union, EECCA.

Whatever arguments made and conclusions drawn in the paper, they are equally applicable to any other member nations of the EEC: Tajikistan, Kyrgyzstan and Belarus. The conclusions drawn in the paper should be taken rather cautiously as they don't necessarily reflect the reality. Changes in the initial circumstances and endowments of respective member countries of the EECCA under consideration would grossly change the above conclusions. But nonetheless, the analyses and theoretical constructs drawn in this paper will help to shed some lights on the subject. Heuristically, Kazakhstan and Russia have been considered as potential members of the EECCA with no sound economic reasoning.

Finally, the present paper was not planned to critically examine the functioning and development of the Eurasian Economic Community; neither, the paper investigated to what extent the objectives and goals of the EEC and the initiatives taken so far have been achieved. Further, this paper was not planned to explain the steps necessary to operate and maintain any Exchange Rate Mechanisms (the European ERM type) among the EEC member states, and neither the paper has tried to explain to what extent the EEC countries are even ready to be the members of the Exchange Rate Mechanisms before these countries could eventually qualify themselves to be the potential members of the monetary union, EECCA, and will eventually have EURASH as their common currency.

8. DIRECTION OF FUTURE RESEARCH

The management of external demand shocks (for member countries in the EECCA) dictates the importance of wage flexibility and free movement of labour (and perhaps, other factors as well). One may therefore, investigate more carefully the extent of relative wage flexibility and labour mobility across the member states of the EEC. Comparative studies may further be conducted to assess the progress made in the process of economic integration, particularly in the flows of good and services, factor movements, and lastly, in the evolution of trade policies of the respective member countries of the EEC. Hence, a comparative analysis of trade policies and actual trade taking place among the EEC countries over time would determine whether the political initiatives for a greater economic integration are at default or whether they are sufficiently congruent. Such a study would also assess the preparedness of these countries towards the steps for monetary integration.

It was asserted in the paper that a fast growing nation joining a monetary union, EECCA, with slow growing nations would find it easier to attract foreign capital from the later. Consequently it was argued that the differences in growth rates of countries couldn't be considered an obstacle to monetary integration. Future studies may be conducted among the EEC member countries to ascertain the above assertion, and a broad based research plan may be developed.

It was also shown in the paper that differences in the ability to finance government budget deficits among countries either through fiscal policy or monetary policy or a combination of both lead to differences in the per unit cost of generating a certain amount of revenue. All these have implications for a potential entrance in the EECCA. Therefore, it is pertinent to carefully study and compare the fiscal system of the EEC member countries, particularly to examine their relative efficacies and efficiencies (in terms of costs and benefits) in raising necessary government revenues, to finance the budget deficits and debts. In particular, (i) the relative ease of various fiscal measures: (a) the nature of government expenditures in various sectors of the economy (priority areas); (b) different types of tax policies in practice determining the relative tax elasticity to revenue generation (a comparison across EEC member countries); (ii) the nature of monetary policies, addressing (a) the frequency of money supply process and their implications on inflation rates, long run interest rates and exchange rates; (b) the exchange rate policies; (c) the interest rate policies, and (d) the desired level of unemployment rates and the tolerance for inflation rates, interest rates and exchange rates across EEC member states.

Any research studies in the above areas, would assess the degrees of difficulties and ease to which the member states of the EEC will be able to harmonize their respective fiscal policies (taxes and other instruments, for example) and monetary policies (exchange rate policies, interest rate policies, desired inflation rate, and etc) before they allow themselves to be members of any kind of Exchange Rate Mechanisms (ERM as in Europe) with the ultimate objective to form the Eurasian Economic Community Common Currency Area, EECCA, and eventually, have EURASH as their common currency.

ENDNOTES

1. The new EEC is designed to function as a regional international organization, and it will be recognized as such by the United Nations. The EEC did not intend to limit the sovereignty of the member states, but it does provide for the delegation to the EEC some negotiating responsibilities within the international organizations. The EEC will be managed through an Inter-State Council, an Integration Committee, an Inter-Parliament Assembly, and a EEC court. The EEC differs from its predecessors as it will have greater enforcement powers than the current customs union. For example, a member state that refuses to abide by the EEC rules can be excluded from the union. The EEC arrangements include a weighted voting and financing scheme. Russia will exercise 40% of the voting rights and be responsible for meeting 40% financing of the organization's operating expenses. Belarus and Kazakhstan each have 20% of the shares. Kyrgyzstan and Tajikistan each have 10% share. The EEC Charter specifies that vote on major policy issues will require two-thirds agreement. This formula would imply that, on any given major policy issue, Russia would have to have at least two other states supporting it to win a vote. On the other hand, it also implies that Russia will exercise veto power on major policy issues (for more, see Zhalimbetova and Gleason, 2001).
2. In reality these countries have highly protected trade barriers of goods and services, and continuously increasing barriers on the movement of factors of production: labour & capital. Ideally, the central Asian countries have import-substitution trade policies; trade barriers have been artificially increased in order to gain benefits (political) from the producers' interest groups. Higher barriers on the movement of labor started due to the popular counter-terrorism measures of the Russian Government, especially actions of the Moscow Government, that were awarded as the Runner-up for **the Most Inexplicably Stupid Award** by the Privacy International. Such popular measures were retaliated by the other CIS countries, by building their own barriers on labor-movement on the excuse that they are taking care of their own security; the momentum of building such barriers by others made the situation even worse.
3. The link between monetary policy and the exchange rate works through the interest parity condition, which states that the difference in interest rates across countries must equal the expected rate of depreciation of their bilateral exchange rate in order to avoid unexploited profit opportunities from arising. Therefore, interest rates must be equal across countries in an exchange rate regime where exchange rates are credibly fixed, and the expected rate of depreciation is zero. Theoretically, fiscal policy could be employed in addition to monetary policy or even instead of it to set interest rates and maintain fixed exchange rates. In practice, however, monetary policy is more quickly and easily altered than fiscal policy, and therefore, it is the tool with which authorities directly influence exchange rates.
4. There were strong arguments to support joining the European Monetary Union (EMU) while there were negative views as well. The negative views of EMU stem from concerns about the political implications of a surrender of national sovereignty as well as concerns about economic costs of a common currency. The critics argued that the EMU arrangement is ill-suited, its people may increasingly resent hardships they perceive to be caused by European integration. For more see, Feldstein (1997) & Obstfeld (1997).
5. For surveys of this literature, see Tower and Willett (1976).
6. See Dornbusch & Fischer (2000) or Parkin (2003) or any standard macroeconomics textbook.
7. Current account = domestic output – domestic spending
8. Assuming that the social security system automatically pays unemployment benefits, and as such the disposable income does not fall to the same extent as output falls in Kazakhstan.
9. The reason is that the Kazakh unemployed workers were spending earlier on goods and services without producing anything. This problem tends to disappear with the emigration of the Kazakh workers to Russia.
10. The revaluation of ruble makes the value of imports from Kazakhstan cheaper while the value of exports to Kazakhstan from Russia expensive. As a result, the value of net exports in Russia falls and that reduces the aggregate demand in Russia. Net export is one of the important components of aggregate demand. For simplicity, the Marshall Lerner condition is assumed to hold. In other words, there is a complete exchange rate pass through implying that the real exchange rate depreciates (appreciates) in Kazakhstan (Russia) at the rate of an increase (decrease) in nominal exchange rate there, respectively.
One may, however, question the feedback effects of exchange rate depreciation (appreciation). For instance, devaluation of tenge would raise the cost of production directly provided the imported inputs from Russia constitute a major share of total costs in Kazakhstan. This will raise the price level in Kazakhstan, and an increase in nominal wage is required to pay to the labourer there for the compensation of purchasing power. All these mean that the aggregate supply curve would fall in Kazakhstan shifting it to the left. As a result, price would increase and output will decrease. The price increases would then feed back into the wage formation process, and lead further upward movements of the aggregate supply curve. The final equilibrium will be somewhat different than discussed above. All these mean that the initial favourable effect would tend to disappear over time. Such possibilities have been ignored in the above analysis.
11. It may be difficult though to contemplate such a transfer between sovereign nations (Kazakhstan & Russia) since the transfer would have to be repeated every year if the demand shift so started is a permanent one. This kind of solution is usually observed within a sovereign state, where the poorer regions are financed out of the transfers from richer regions, coordinated through the central government of the country. Many countries have either implicit or explicit redistribution scheme of social security benefits through the centralized federal budget. The European Monetary System (EMS), for instance, developed generous safety provisions for the extension of credit from stringer to weak currency members; e.g., if French franc depreciates too far against German deutschmark, Germany's Central Bank, will be expected to lend to the Bank of France necessary deutschmarks that could be solved for francs in the foreign exchange market.
12. It is pertinent to state that the Maastricht treaty specifies European union member countries to satisfy several macroeconomic convergence criteria before they be admitted to European monetary union (in order to avoid costs once they become the members of the EMU). These are: (i) inflation rate must be no more than 1.5% above the average of three EU member states with lowest inflation; (ii) member countries must maintain a stable exchange rate within the Exchange Rate Management without devaluing on its own initiative; (iii) the country must have a public sector deficit no higher than 3% of its GDP (except in exceptional circumstances); and (iv) the country must have a public debt that is below or approaching a reference level of 60% of its GDP.

The treaty provides a monitoring device and a room for levying penalty on countries that violate the fiscal rules: (iii) and (iv) above, and don't correct excessive deficits and debts (Krugman & Obstfeld, 2003).

13. The reality is not so ideal. We ask the reader to wait until next section.
14. An example will clarify this: suppose wage increases by 8%, and the rate of growth in labour productivity increases by 5% in Kazakhstan. Then the rate of price increase that maintains the share of profits in total value added unchanged is 3%.

Further assume a perfectly competitive environment. Then the profit maximization would imply that $W/P = \delta X/\delta L$, where X is the level of production, L is the number of labour. If production function is Cobb-Douglas, $W/P = \alpha X/L$, where α is the labour share in the value added. Taking rates of change yields: $\dot{W}_K - \dot{P}_K = \dot{Q}_K$ (assuming a constant α).

15. Natural rate of unemployment (NRU) consists of seasonal, structural and frictional unemployment. The NRU rate is independent of the inflation rate. The cyclical portion of total unemployment is not part of NRU. The cyclical unemployment can be reduced to a desired level through discretionary fiscal and monetary policies of the government.
16. In endnote (12) it was mentioned that before a country is admitted into the European Monetary Union (EMU) must have (i) inflation rates no more than 1.5% above the average of three EMU members with the lowest inflation rates, (ii) a stable exchange rate, (iii) a public sector deficit no more than 3% of GDP, and (iv) a debt level not more than 60% of GDP. Any violator would be penalized for violating (iii) and (iv) above. This arrangement put constraints on fiscal powers of the national governments, e.g., a highly indebted EMU country having a national recession, might be unable to use expansionary fiscal policy for fear of breaching the Maastricht limits, a loss of monetary autonomy (because of lacking a discretionary national monetary policy). Another implication of Stability and Growth Pact under the Maastricht Treaty obliges the countries to set out a medium term objective close to balance or in surplus. It also sets out a time frame for the imposition of financial penalties on countries that fail to correct situations of excessive deficits and debt promptly.
17. Stanley Fischer (1982) and Grilli (1989)
18. It is pertinent to refer the problems in the transition and adjustment phase towards EMU, as an example. Before signing the Maastricht Treaty, low inflation Germany wanted the European Monetary System (EMS) partners to learn to prefer an environment of low inflation and fiscal restraints, otherwise, Euro might be a weak currency falling prey to the types of policies that have fueled French, Italian, Portuguese, Spanish and UK inflation rates at various points since early 1970s. Further, the architects of Maastricht Treaty also feared that high public debts or deficits would put pressure on European central bank to purchase government debt directly, thereby, fueling the money supply growth and inflation. It may be pointed out here that EMS began in 1979 with eight of the nine members of the European community (except Great Britain). At that time, differences in inflation rates across members of the Exchange Rate Mechanism (ERM) were as large as 10 percentage points. These inflation differentials made it difficult to maintain stability in the ERM since with fixed exchange rates, differences in inflation are translated directly into changes in relative prices, which shift competitiveness across countries. Eleven realignments in exchange rate took place in the EMS between 1979 and 1987 in an effort to offset ongoing inflation differentials. The down side of realignment is that it leads to destabilization of

international capital flows as investors speculate against a potentially weakening currency. (Klein, 1998)

19. See European Commission (1990) and Gros and Thygesen (1991)
20. An old idea was developed earlier by Myrdal (1957) and Kaldor (1966) and has recently been written by Krugman (1991)

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This study aims at outlining the primary characteristics of foreign trade in Georgia, drawing upon a variety of data¹ to analyze the key components of the nation's balance of payment, namely its monetary inflows (export & FDI in Georgia), and monetary outflows (import expenditures). The research shows that Georgia has been experiencing trade deficits since 1993, due in large part to heavy dependence on foreign countries for industrial products and energy (i.e. natural gas, petrol and electricity). Most of its exports are non-industrial goods such as mineral and vegetable products (manganese & copper ore, and tea, fruits and wine) and scrap metal. However, with the exception of wine, its export products are not as competitive. The amount of foreign investment in Georgia is fairly low, and remains focused on sectors like communications with a high return to the investor. As such, foreign investments do not significantly contribute to the economy, i.e. not offering so many job opportunities for indigenous people nor stimulating the creation of new industries. Tourism is a resource that also remains largely untapped, though certain foreign-funded programs are attempting to restructure the tourism industry to increase its potential. Unlike neighboring Azerbaijan and Turkmenistan, whose foreign trade heavily centers around natural gas and oil, Georgia lacks abundant natural resources. Therefore, the study suggests that if Georgia is to increase international investment and maintain its foreign trade balance, the government must modernize the nation's industries through both its own efforts and through partnerships with foreign companies. This process should begin as soon as possible, following the Japanese model of producing industrialized products to become more competitive in the global market.

ОБЩИЙ ОБЗОР ГРУЗИНСКОЙ ВНЕШНЕЙ ТОРГОВЛИ

ШЕРКАН ЯЛЬЧИН

Настоящее исследование стремится описать главные характеристики внешней торговли Грузии, опираясь на различные данные для анализа ключевых компонентов государственного платежного баланса, а именно, приток денег (экспорт и прямые иностранные инвестиции в Грузию), и отток денег (затраты на импорт). Исследование показывает, что Грузия испытывает торговый дефицит с 1993 года главным образом из-за сильной зависимости от зарубежных стран в плане промышленной продукции и энергии (т.е. газ, нефть и электричество). Большая часть ее экспорта – это непромышленная продукция, такая как минералы и сельхоз. продукция (марганцевая и медная руды, чай, фрукты и вино). Однако, за исключением вина, экспортная продукция Грузии неконкурентоспособна. В Грузию вкладывают довольно мало иностранных инвестиций, и они, главным образом, сконцентрированы в таких отраслях, как коммуникации, в которых обеспечена высокая прибыль для самих инвесторов. Сами по себе, иностранные инвестиции не приносят заметной пользы для экономики страны; то есть, они не участвуют ни в создании большего количества рабочих мест для местного населения, ни в развитии новых отраслей промышленности. Туризм в целом так же остается недоиспользованным ресурсом, хотя некоторые программы, финансируемые из-за рубежа, пытаются реструктурировать туристическую индустрию с целью повышения ее потенциала. В отличие от соседних Азербайджана и Туркменистана, чья внешняя торговля сконцентрирована главным образом вокруг нефти и газа, у Грузии нет богатых природных ресурсов. Поэтому, исследование утверждает, что для того, чтобы в Грузии повысился уровень международных инвестиций и восстановился внешнеторговый баланс, правительство должно модернизировать промышленность страны, как собственными усилиями, так и в сотрудничестве с иностранными компаниями. Этот процесс должен начаться как можно скорее и следовать японской модели производства индустриальной продукции, чтобы повысить конкурентоспособность на мировом рынке.

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1. INTRODUCTION

In addition to funding from global institutions such as United Nations, IMF and World Bank, foreign trade, and especially foreign investment play a significant role in the growth and development of the economies of poor nations. Research shows that foreign investment has a considerable impact on development and tends to provide a catalyst for economic growth in newly industrializing/independent countries (NICs) (Markusen & Venables 1997; Walkenhorst 2000; Buckley *et al.* 2002). Since becoming a NIC with its independence in 1991, Georgia has been trying to adapt its policies to suit the global market economy. However, this transition has been impeded by internal conflict. Following the nation's independence, the regions of Abkhazia and Tskhinvali (South Ossetia) attempted to secede from the Tbilisi government. Not only did this lead to civil war in these areas, law and order began to break down throughout Georgia as well (Georgia Country Commercial Guide, 2001). Also, the high level of corruption² and a thriving black market economy pose additional obstacles to economic development in Georgia. As illustrated by corruption statistics (see appendix), the rates of corruption in the Commonwealth of Independent States (CIS) are very high (Transparency International, 1999 & 2000). During the Soviet era, Georgia was infamous for its shadow economy because under the state-controlled economic system, the black market was the sole outlet for private entrepreneurship. The strength of the black market economy, coupled with civil strife and political liberalization, resulted in a turbulent and rapid decline of economic activity until 1995 (Georgian State of Environment). The dismal situation was illustrated as follows: "...output has dropped by 60 % in the past two years, inflation is running at more than 1,500 %, and the budget deficit last year was about 30 % of the estimated GDP. There is a war in Abkhazia, in the north-west of the country, which is blocking the main trade route from Russia..." (The Economist). Also, due to the civil war, the economic infrastructure was almost completely destroyed, and rampant crime ensued. The total number of crimes reported was 19,711 and 15,735 in 1990 and 1995, respectively (State Department for Statistics of Georgia). This lawless economic climate posed a further hindrance to the flow of foreign investment into the country. Therefore, the Georgian economy experienced a deep depression in the years 1992-1995 (Georgian State of Environment). As demonstrated by this analysis, Georgia had severe difficulty obtaining economic and political stability in the four years following independence.

After 1995, Georgia began to recover with the introduction of policies that restored political stability by strengthening the power of the central government. Crime decreased, having a positive effect on the economy. Foreign capital began to flow into the country, and many of the inefficient state-run sectors were privatized. In addition to these efforts, the introduction of a national currency, the Lari, put into circulation in 1995, significantly revived the consumer market and stimulated economic recovery. Finally, the growth rate of the Georgian economy began to increase; GDP growth rates were 2.4 % in 1995, 11.4 % in 1996, and 11.2 % in

1997 (State Department for Statistics of Georgia). However, Georgia still faced many formidable problems. "The Georgia National Assessment Report for Sustainable Growth" outlines several of Georgia's current challenges: establishing a stable, legitimate government; implementing structural and institutional reforms; and transitioning to a market economy (United Nations Development Program, 2002).

For countries that are transitioning from a command economy that had not permitted foreign investment, adapting to a market economy and cultivating effective trading relationships is neither a simple nor a rapid process. During this stage, foreign trade plays a key role, especially for NICs, as previously stated. As one of the NICs, Georgia has been evolving in this way since independence. This study investigates Georgia's efforts to adapt to foreign trade in this critical transition period by focusing on key balance of payments items- monetary inflow and monetary outflow. "Income from exported goods", and "investment from foreign sources" (*i.e.* foreign direct investment in Georgia), are considered monetary inflow; "Payment for imported goods" is classified as monetary outflow. The analysis focuses on development in the years 1995-2002, due to a lack of data for the 1991-1995 period. As stated above, due to the economical and political crises and civil war, there was little foreign trade before 1995. However, the study does attempt to explore this period, inasmuch as relevant data can be found.

2. FOREIGN TRADE

The term "foreign trade", or "balance of payments," covers all inward and outward moneymaking transactions and activities that take place across national borders. This includes all types of current capital (goods, services, income, and current transfers) and financial accounts (direct investment, portfolio investment, other investments, and reserve assets), as seen in Table 1.

2.1. Balance of Payments

A lack of detailed information on all Georgian balance of payments items prevents one from conducting an exhaustive analysis. Thus, the analysis in this section focuses only on the major components: monetary inflow (export & FDI) and monetary outflow (import expenditures).

2.2. Monetary Inflows

Monetary inflow items include:

- Water/Irrigation
- Income from exported goods
- Income from foreign investment in Georgia
- Other monetary inflows

TABLE 1: GEORGIAN BALANCE OF PAYMENTS (IN MILLION \$USD)

	1997	1998	1999	2000
Current Account	-513.8	-275.6	-199.5	-268.9
A. Goods	-786.3	-694.5	-533.8	-511.4
B. Services	-51.3	19.8	-8.4	-9.8
C. Income	127.4	190.8	146.9	117.4
D. Current transfers	196.3	208.2	195.7	134.8
Capital Account	-6.4	-6.0	-7.0	-4.7
Financial Account	379.8	466.7	244.7	71.3
A. Direct investment	242.6	265.3	81.2	131.7
To abroad	-	-	-0.9	0.4
From abroad	242.5	265.3	82.3	131.1
B. Portfolio investment	2.4	-	0.006	2.7
C. Other investment	148.8	128.6	159.9	-83.2
D. Reserve assets	-14	72.6	3.5	20
Net Errors & Omissions	140.5	-184.9	-38	202.4

Source: State Department for Statistics of Georgia

2.2.1. Income from Exported Goods

Georgian export volume in general, as shown in Table 2, has increased from 1995 to 2002, disregarding some small decreases during the period.

TABLE 2: GEORGIAN EXPORT FIGURES

YEARS	EXPORT REVENUE (IN MILLION \$USD)
2002	325
2001	320
2000	329.9
1999	238.2
1998	192.3
1997	239.8
1996	193.3
1995	154.4
1994 ³	86.80
1993 ³	466
1992 ³	465

Source: State Department for Statistics of Georgia

Georgian government information sources (e.g. State Department for Statistics of Georgia and the Georgian Export Promotion Agency) have released no data on Georgian exports pre-1995, but the U.S. Department of State does provide such information. An analysis regarding Georgian export figures shows that Georgia has seen a 59% increase in its exports from the 1995-1999 period to the 2000-2002 period.

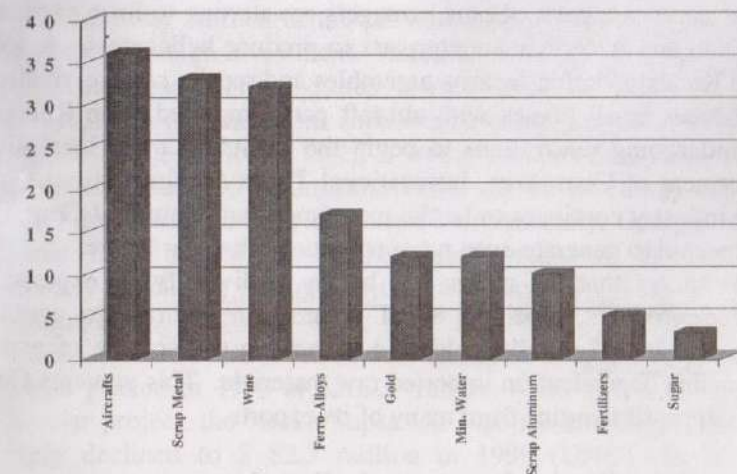
TABLE 3. MAJOR EXPORT ITEMS OF GEORGIA⁴ (IN MILLION \$USD)

	1997	1998	1999	2000
A	51.5	31.7	38.9	58.8
B	30.5	30.9	34.0	34.5
C	49.6	0.9	55.9	81.1
D	47.7	37.6	30.7	57.5
E	24.8	26.7	17.6	32.1
F	11.7	38.5	12.8	26.1

- A. Mineral Products
- B. Vegetable Products
- C. Basic metals and related products
- D. Edible goods, beverages, spirits and vinegar, tobacco and manufactured tobacco substitutes
- E. Chemicals and other related products
- F. Machinery and equipment and parts thereof; sound recorders and reproducers, television recorders and reproducers, and parts and accessories of such articles

Source: State Department for Statistics of Georgia

FIGURE 1: MAJOR EXPORT ITEMS OF GEORGIA⁵, 2001 & 2002 (IN MILLION \$USD)



Source: Georgian Export Promotion Agency (GEPA)

In the year 2000, scrap metal (item C), wine and vegetable products (including various fruits and nuts, items D & B), and precious metals and mineral products (item A), such as manganese concentrate and copper ore, were major export products. In 2001 and 2002, these products still played a significant role in Georgian export. Ten major export items and their primary destination countries in 2001-2002 are as follows:

- Aircrafts: Turkmenistan (79.5%)
- Scrap metal: Turkey (81.6%), Spain (3.5%), Italy (3.1%);
- Wine: Russia (68.1%), Ukraine (11.5%), USA (5.6%), Kazakhstan (7%);
- Ferro-alloys: Turkey (41.9%), Russia (33.4%), USA (19%);
- Scrap aluminum: Turkey (52.5%), India (18.9);
- Gold: UK (100%);
- Mineral water: Russia (79.6%), Ukraine (8.7%);
- Electricity: Turkey (98%);
- Nuts: Germany (25%), Italy (24.9%), Russia (22%);
- Copper ore: Switzerland (99.5%)

(Source: Georgian Export Promotion Agency)

In 2001 and 2002, aircrafts became a major export item (see Figure 1). Although Georgia does not produce airplanes in large quantities, its airplane and airplane parts export volume in 2001 and 2002, (\$36 million in both years) was higher than all other export items. This represents a dramatic increase from the year 2000, in which aircraft exports brought in a mere \$8 million in 2000 (Georgian Export Promotion Agency). In fact, aircraft manufacture is one of the oldest industries in Georgia. Tbiliviamsheni, the Tbilisi aviation factory, was established in 1941, producing military aircrafts for the Soviet Union. Aircraft models included: Lagg 3, Yak 3-15-17-23, Mig 15-17-21 and Su 25-25UB. The factory continues to produce these planes and spare parts. Some managers are starting to form partnerships with their Canadian and American counterparts to produce helicopters. A second plane factory, the Kutaisi aviation factory, assembles and repairs small civil aircrafts. The factory produces small planes with aircraft parts imported from Russia, and it is currently undergoing renovations to begin the manufacture of local aircraft parts (U.S Department of Commerce, International Trade Administration). In this way, the aircraft industry continues to be the most important feature of Georgian exports, and it is expected to generate even more revenue in the near future.

Analysis shows that the nation has begun to diversify its exports, producing industrialized products, albeit in small volume, in addition to agricultural and mineral ones. One of the difficulties in increasing the volume of exports is that Georgia remains dependent on imported raw materials. This prevents Georgia from attaining high profit margins from many of its exports.

2.2.2. Income from Foreign Investment in Georgia

In 1991, Georgia passed the first law regarding foreign investment, The Law of the Republic of Georgia "On Investment Activity," (Georgian Supreme

Council's Gazette, Art. 588, No. 8, 1991) and then the second, entitled "On Foreign Investments" in 1995 (Parliamentary Gazette, Art. 654, NN. 27-30, 1995). However, these laws became invalid with the ratification of a third law in 1996, "The Law of Georgia on Investment Activity Promotion and Guarantees." In this manner, Georgia has paid close attention to promoting foreign investment ever since independence. The new law states that the rights and guarantees of foreign investors are the same as those granted to Georgian citizens. The law also secured the right to repatriate profit and capital: "... the Law on Promotion and Guarantees of Investment Activities grants foreign investors unlimited rights to convert profit (revenue) and other funds received from investment at the market rate of Georgian banking institutions and transfer these abroad freely and without delay." The law also established the "Georgian Investment Center" under the Ministry of Trade and Foreign Economic Relations (Article 6 of the law on "Promotion and Guarantees" of Investment Activities).

The new law established the following incentives for foreign investors:

- Exemption / Reduction of import duty and custom taxes on capital goods by foreign investors
- No antidumping duty
- Tax benefits: No VAT in most areas; enterprise property tax holiday for the first year of operations, and 50 % reduced tax the next two years

As this shows, the Georgian government tries to encourage foreign investment in different ways. However, the current level of foreign investment is still low (see Table 4). The inefficiency of state-owned sectors, lack of adequate infrastructure and energy, excessive economic regulations, and prevalent corruption constitute the main roadblocks to foreign investment in Georgia and damage the foreign investment climate in general (U.S Department of Commerce, International Trade Administration). Infrastructure development is included as critical aspect of encouraging foreign investment. Research demonstrates that the effective execution of business operations requires infrastructural facilities (i. e. roads, harbors, railways, telecommunications capabilities, energy supplies, banking services *etc.*) to be at least at a sufficient level, if not at an excellent level (Tu & Schive 1995; Broadman & Sun 1997; Kinoshita 1998). As for its energy capabilities, Georgia is heavily dependent on other countries; Unfortunately, Georgia still imports all of its organic fuel (natural gas & petroleum products), making the energy sector extremely dependent on supplier countries' requests (United Nations Development Program, 2002).

Table 4 shows the level of foreign direct investment. Foreign investment in Georgia peaked in 1998 at \$265.3 million. This spike was primarily due to one particular project, the "Baku-Supsa Oil Pipeline and Supsa Terminal." The figure sharply declined to \$ 82.3 million in 1999 (UNCTAD, 2002). The Russian economic crisis in 1998 played a major role in this decrease. During 1991-1994, the average FDI flow to Georgia was \$2 million, whereas this rate dramatically rose to \$103 million during 1995-1998 (UNCTAD, 2000).

TABLE 4. FOREIGN INVESTMENT IN GEORGIA

YEARS	FOREIGN DIRECT INVESTMENT (IN MILLION \$USD)
2002	146
2001	159.6
2000	131.1
1999	82.3
1998	265.3
1997	242.5
1991- 1996 (average)	19

Source: UNCTAD, 2003

Table 5 shows the percentage of foreign direct investment made by major countries and lending institutions. England invested the greatest amount in 1995; Germany in 1996; England in 1997; USA in 1998 and 1999 (disregarding the World Bank); and Turkey in 2000. For 1995-2000, the average percentage figures of foreign direct investment by these countries are as follows: England 17.2 %, USA 16.1 %, World Bank 14.7 %, Turkey 9.4 %, Switzerland 7.8 %, and Germany 6.1 %. This shows that England and USA are the two principle foreign investors in the Georgian economy.

TABLE 5. MAJOR FOREIGN DIRECT INVESTMENT SOURCES (%)

	1995	1996	1997	1998	1999	2000	2001	2002
U.S.A	1.1	2.1	16.1	32.7	24.2	20.6	N/A	N/A
Turkey	0.3	9.7	5.4	6.6	4.5	29.8	N/A	N/A
Russia	-	0.9	3.7	6.5	4.9	-	N/A	N/A
U.K.	58	3.8	18.9	12.9	9.9	0.02	N/A	N/A
Switzerland	12.4	22	11.9	0.4	-	0.08	N/A	N/A
Germany	-	25.8	6.2	4.3	0.02	0.6	N/A	N/A
World Bank	22.7	9.3	2.5	11.3	31.3	11.4	N/A	N/A
European Bank	-	16.5	-	3	-	1.2	N/A	N/A

Source: Based on State Department for Statistics of Georgia data

The distribution of foreign capital flows by sector (see Table 6) shows that more than half of foreign capital (67.9 % in 1998 and 55 % in 1999) goes to industries related to transportation, storage and communication. The second major industry attracting foreign investment is "electricity and gas," which is one of the weakest sectors, as evidenced by Georgia's high dependence on foreign countries for energy. Most of Georgia's energy comes from other countries: Russia exports electricity, Azerbaijan and Turkey export fuel oil, and Turkmenistan supplies natural gas. As a result, Georgia is in debt to foreign governments for providing its electricity (U.S. Department of Commerce, International Trade Administration).

TABLE 6. FOREIGN DIRECT INVESTMENTS ITEMIZED BY INDUSTRY (%)

INDUSTRY	1998	1999
Agriculture, hunting, and forestry	-	3.6
Mining and quarrying	0.5	1.2
Manufacturing	8.8	6.0
Supply of electricity, gas, and water	18.1	29.3
Construction	0.5	-
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	2.1	0.2
Hotels and restaurants	1.5	3.2
Transport, storage and communication	67.9	55.0
Real estate, renting and business activities	-	-
Public administration and defense; compulsory social security	0.5	0.6
Education	-	0.9
Health and Social Work	-	-
Other community, social, and personal service activities	0.1	-

Source: State Department for Statistics of Georgia

2.2.3. Other Monetary Inflows

For many NICs, a major asset in addition to its exports and ability to attract foreign investment is "tourist income." During Soviet times, Georgia was a major vacation destination, offering many recreational activities. Unfortunately, after independence the tourism sector fell upon hard times due to the unstable political and economic climate and the civil war (Georgian Investment Centre). However, the number of tourists is steadily increasing, as measured by the number of non-resident arrivals: 85,000 people in 1995, 117,000 in 1996, 313,000 in 1997, and 400,000 people in 1998. Of these people, 44.2 %, 50.8 %, 51.0 %, and 50.4 %, respectively, visited Georgia for pleasure (Georgian Department of Tourism). The potential of the sector is very high, and it is expected to grow in coming years. The cultural and geographic variety of Georgia offers many leisure activities for tourists. Competition among tourist-oriented enterprises is slated to increase with the implementation of several programs, including the Black Sea Environmental Program (BSEP) funded by the Global Environmental Facility (GEF) and the European Union, and the Black Sea Sustainable Tourism Regional Program (BSSTP) funded by European Union and TACIS (U.S. Department of Commerce, National Trade Data Bank). However, in its current state, the tourism sector does not bring much foreign currency into the country.

2.3. Monetary Outflows

The monetary outflows will be examined through "payments for imported goods"

2.3.1. Payments for Imported Goods

Like most NICs, Georgia depends on foreign products because of its inability to produce industrialized products. This predicament is further worsened by demand for foreign energy supplies. This heavy dependence prevents Georgia from generating high profit margins on its balance of trade. The following section "Discussion of Findings" examines this issue. Table 7 shows Georgian import figures, and Table 8 shows the primary import items.

TABLE 7. GEORGIAN IMPORT FIGURES

YEAR	IMPORT COST (MILLION US \$)
2002	720
2001	684.1
2000	650.7
1999	601.9
1998	884.3
1997	943.5
1996	686
1995	647
1994 ⁶	739
1993 ⁶	795
1992 ⁶	183.2

Source: State Department for Statistics of Georgia

TABLE 8. MAJOR IMPORT ITEMS OF GEORGIA (IN MILLION \$USD)

	1997	1998	1999	2000
A	267.7	226.6	141.9	141.6
B	113.6	81.6	45.2	53.2
C	39.05	69.6	17.7	29.3
D	186.1	48.8	67.9	75.5
E	78.57	60.06	57.1	57.8
F	100.9	169.7	90.1	127.5

A. Mineral Products
B. Vegetable Products
C. Basic metals and related products
D. Edible goods, beverages, spirits and vinegar, tobacco and manufactured tobacco substitutes
E. Chemicals and other related products
F. Machinery and equipment and parts thereof; sound recorders and reproducers, television recorders and reproducers, and parts and accessories of such articles

Source: State Department for Statistics of Georgia

One major category of Georgian imports is "natural gas and petroleum." Since its independence, Georgia has been striving to find ways to meet its energy demand, yet it continues to remain utterly dependent on other nations. One of the main

causes of the economic crisis that occurred after independence was related to this insufficient production of energy. The majority of Georgia's electricity is imported. Russia exports electricity, Azerbaijan and Turkey export fuel oil, and Turkmenistan supplies natural gas. Because of this, Georgia has amassed a large debt to foreign governments for its electricity; it owes over US \$1 billion to neighboring nations for post-independence electricity delivery. For example: in 1994, \$380 million was owed to Turkmenistan and \$71 million to Russia; 83 % of total import expenditures in 1993 included energy products, and 52% of all imports came from Turkmenistan (U.S. Department of Commerce, International Trade Administration). These figures underline the heavy burden Georgia is facing to provide electricity.

TABLE 9: MAJOR IMPORT SOURCES OF GEORGIA (%)

	1997	1998	1999	2000
U.S.A	7.4	8.5	11.9	5.4
Turkey	12.4	11.1	12.1	15.9
Russia	13.2	14.7	19.2	14.1
U.K.	4.4	7.7	3.5	3.5
Germany	4.3	9.3	7.3	7.7
Azerbaijan	12.3	8.3	6.9	8.5

Source: State Department for Statistics of Georgia

Besides gas and petroleum, machinery and equipment is another primary import of Georgia. Other import items are as follows:

- Sugar (5%, primarily from Ukraine);
- Dairy products (4 % primarily from Turkey, Ukraine, and Russia);
- Wheat (1 % from Turkey, USA, Kazakhstan);
- Flour (1 % from Kazakhstan, Turkey, USA);
- Others (6 %) Practically all the pharmaceutical products consumed in Georgia are imported.

(Source: State Department for Statistics of Georgia)

3. DISCUSSION OF FINDINGS

This section compares the monetary inflow and outflow of Georgia. As seen in Table 10, Georgia has been experiencing a trade deficit since 1993. This shows the effect of Georgia's dependence on foreign products as well as its insufficient amount of exports compared to its imports.

These trade deficits are a main source of Georgia's foreign debt: \$ 1,5 billion in 1997, \$ 1,6 billion in 1998, \$ 1,6 billion in 1999, \$ 1,5 billion in 2000, and \$ 1,6 billion in 2001 (U.S. Department of Commerce, International Trade Administration). Moreover, the volume of Georgian exports remains quite small in terms of the GDP: 7.8% in 2000 and 10% in 2001. None of Georgia's foreign direct investment takes place outside of Georgia's borders (except \$0.4 million in 2000).

TABLE 10: TRADE BALANCE OF GEORGIA (IN MILLION \$USD)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	
Exports	465	466	87	154	193	239	192	238	238	320	325	
Imports	183	795	739	647	686	943	884	602	650	684	720	
Balance	282	(329)	(652)	(493)	(493)	(704)	(692)	(364)	(412)	(364)	(395)	
FDI	19	(average)					242.5	265.3	82.3	131.1	159.6	146
GDP	N/A	N/A	1,300	2,400	3,600	3,573	3,622	2,836	3,023	3,184	N/A	

Source: Based on State Department for Statistics of Georgia data,
(Source of data related to 1992, 1993, and 1994: U.S. Department of State)

Foreign investment in Georgia primarily occurs in high return areas, namely in the communications (IT) sector, in which most venture capital has been invested throughout the world. For instance, 91 % of venture capital dollars goes to technology-based companies (Grassroots Venture Capital Inc.). So, although Georgia has adopted internationally accepted foreign trade standards and has offered various incentives to foreign investors, it still cannot attract foreign investment to many areas, particularly the manufacturing and constructing sectors. These two sectors receive very little foreign investment, though it would be advantageous if they did. Foreign investment in these sectors would both revitalize domestic economic activity and allow foreign investors to lend their expertise to Georgian companies, the latter being one of the most transformative effects of foreign investment. A second major area receiving foreign investment is electricity and gas. In this respect, foreign companies are profiting from Georgia's weakness in this area. As such, the foreign investment in this sector does not contribute much to the Georgian economy because Georgia currently spends more money than is invested in the country. Both the communications and energy sectors experience this paradoxical dilemma, being high return industries.

Another problem related to foreign investment is that due to cultural differences, foreign investors may experience difficulties in their personal dealings with Georgian managers, entrepreneurs and state officials. Since Georgian businessmen have very different backgrounds from their counterparts in the West, they often do not share the same understanding of business concepts and practices (e.g. they may not consider written contracts as binding as is commonly accepted in the West). Many of the managers who control the newly privatized enterprises were previously managers of Soviet enterprises and may have retain the values and attitudes that characterized that period, such as lack of transparency in company practices and an unwillingness to divulge relevant information. Frequently, Georgian managers expect to attract investment or advice from a foreign investor without providing the necessary information or ceding any of their control (U.S. Department of Commerce, International Trade Administration). Regarding this issue, a study comparing British managers to Lithuanian, Ukrainian and Georgian managers found that the managers from the FSU are more suspicious of new ideas and unfamiliar

people than their British counterparts (Cook *et al.*, 1998). Because of this, Georgian businessmen can be slow to acquire the necessary business skills and outlook to adapt to the market economy.

4. CONCLUSION AND SUGGESTIONS

Results showed that since Georgia's independence in 1991, it has developed a trade deficit mostly caused by its heavy dependence on foreign sources for its energy (*i.e.* natural gas, petrol, and electricity) and industrialized products (see the amount of these products, "A" and "F" items, in Table 8). Because of such weaknesses, Georgia has acquired a foreign debt of \$1.5 billion since 1997; the average Georgian GDP in 1997-2001 was \$3.2 billion (State Department for Statistics of Georgia). In this manner, one can clearly see the burden on the Georgian economy caused by foreign debt. Georgia has few lucrative prospects for export, except for wine. Most export items are non-technical products: mineral and vegetable products (manganese and copper ore, tea, fruits and wine) as well as various types of scrap metal. The volume of foreign investment in Georgia is not high either, and it tends to center on high return areas like communication, so, foreign investments in Georgia do not significantly contribute to the economy, not offering lots of job opportunities nor stimulating new industries. Tourism also brings in an inadequate amount of revenue, though the tourist industry is being restructured through various programs funded by foreign institutions, which shall hopefully help the sector reach its potential.

This analysis concludes that the general outlook for foreign trade in Georgian is rather grim. The study offers several suggestions. First, Georgia needs to find better ways to attract foreign investment to sectors other than communication, electricity and gas supply. For example, the aviation industry has started to form joint ventures with foreign partners. Other domestic companies can follow this example to forge international partnerships so that foreign companies have the opportunity to become acquainted with the Georgian market. Second, Georgian policy makers and businessmen need to move beyond their antiquated mindsets and adopt contemporary relationships with foreign companies, developing business practices based on openness and trust. If negative perceptions about the country's business practices continue to persist, foreign investors will become increasingly hesitant about dealing with Georgian companies. Finally, since Georgia does not have rich natural resources like the natural gas and oil of Azerbaijan and Turkmenistan, it must pursue alternate means of developing its economy. It needs to modernize its industries through internal reform as well as through partnerships formed with foreign companies. This process should begin as soon as possible, to begin producing industrialized products that will give Georgian products a competitive edge. Georgia should follow the example of the Asian Tigers, who achieved a high degree of economic prosperity thanks to their ability to attract foreign investment.

ENDNOTES

1. One of major difficulties of this research is related to availability and correctness of data. Regarding availability, major local information sources, e.g. State Department for Statistics of Georgia, Georgian Export Promotion Agency and Ministry of Foreign Trade, do not reveal complete data. As to correctness, different sources have different information concerning the same subject. In order to offset this discrepancy, major local information sources (Georgian ministries and Georgian Export Promotion Agency) and well-known worldwide institutions (United Nations Conference on Trade and Development, U.S. Department of Commerce, U.S. Small Business Administration, World Bank, World Trade Organization etc.) were taken as information sources.
2. See the corruption figures and corruption map of the world in the appendix.
3. Source of these data: U.S. Department of State, 1994 Country Reports on Economic Policy and Trade Practices, Bureau of Economic and Business Affairs
4. The State Department for Statistics of Georgia does not give detailed export items information belonging to 1995 and 1996 nor to 2001 and 2002
5. The State Department for Statistics of Georgia does not provide information regarding exports in 2001-2002. Rather, the Georgian Export Promotion Agency (GEP) released such information, and the export figures in 2001 and 2002 are virtually the same. For this reason, they are shown in a single graph. The total export revenue in 2001 and 2002 was \$ 320 and \$ 325 million, respectively, as shown in the Table 1.
6. Source of these data: U.S. Department of State, 1994 Country Reports on Economic Policy and Trade Practices, Bureau of Economic and Business Affairs

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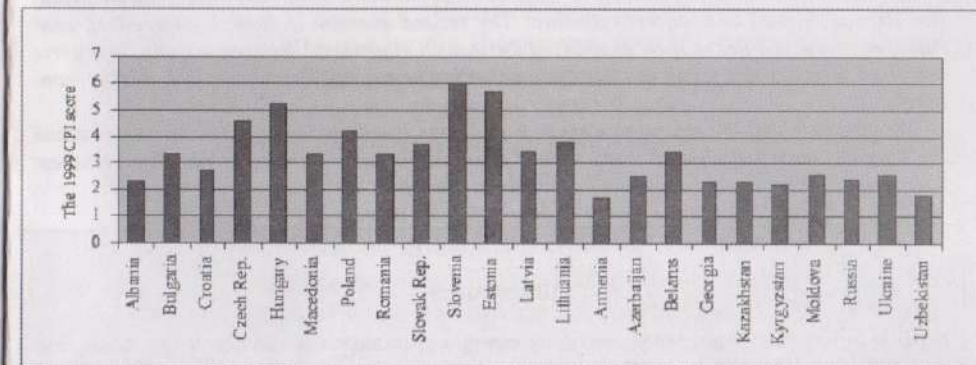
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APPENDIX

THE LEVEL OF PERCEIVED CORRUPTION



Source: The Corruption Perception Index (CPI), Transparency International (1999), www.transparency.de

THE TRANSPARENCY INTERNATIONAL BRIBERY SURVEY



Source: Transparency International, The Transparency International Bribery Survey, Transparency International Releases, The Year 2000 Corruption Index Survey, new release, September 13, 2000, www.transparency.de

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Transition from planned to a market economy is an evolutionary process. Evolutions do not have finite beginning and ending points. We may look to the beginning of transition in 1991 when the Soviet Union broke up, or we may see it as beginning earlier, when the Soviet Union began to allow its firms to engage in private sales of output that exceeded state plans and to independently take part in international trade agreements. At what point do we say that transition is complete? Hence, it is quite difficult to say when any country begins and completes its transition.

The United States and the European Union have categorized Kazakhstan differently with regard to its degree of transition. The United States removed "non market economy" status from Kazakhstan, whereas the EU gave Kazakhstan an intermediate status. The first question that this work asks is how do these political bodies rank a country's market orientation, and how did they arrive at different conclusions?

These results are then compared to what transitional economists have to say on the evolution from a planned to a market economy. The second question is, how do theoretical, academic economists differ in their analysis of the transition process? By creating unique criteria sets from several papers, can one say that, according to any set, Kazakhstan is a market economy?

We conclude that the reform process in Kazakhstan is still underway. The government and the economy have experienced many radical reforms, but none completely satisfies the necessary conditions for being categorized as a market economy.

КАЗАХСТАНСКИЙ ПОДХОД К РЫНОЧНОЙ ЭКОНОМИКЕ

ШЭРЭН АЙКЕР

Переход от плановой к рыночной экономике является эволюционным процессом. Эволюция, как известно, не имеет конкретных дат ее начала и завершения. Мы можем рассматривать в качестве начала переходного периода 1991 год, когда распался Советский Союз, или более ранний период, когда фирмы в Советском Союзе получили разрешение на частную продажу продукции, превышающей госплан, и на самостоятельное участие в международных торговых соглашениях. На каком этапе мы можем говорить о завершении переходного периода? Очень сложно дать ответ на вопрос, когда та или иная страна вступает в переходный период или завершает его.

Соединенные Штаты и Европейский Союз отнесли Казахстан к разным категориям в плане перехода к рыночной экономике. Соединенные Штаты сняли с Казахстана статус страны с «не рыночной экономикой», тогда как ЕС присудил Казахстану промежуточный статус.

Первым вопросом настоящей статьи является то, как эти политические акторы оценивают рыночную ориентацию страны и каким образом они пришли к разным мнениям на этот счет?

После этого приводится сравнение результатов настоящего анализа с мнениями экономистов по поводу эволюции плановой экономики в рыночную. Второй вопрос – как теоретики, академические экономисты различаются в подходах к анализу переходного процесса? Собрав уникальные наборы критериев из нескольких работ, возможно ли утверждать, что, в соответствии с каким-либо набором критериев, Казахстан является страной с рыночной экономикой?

Статья приходит к выводу, что процесс реформирования Казахстана все еще не завершён. Правительство и народное хозяйство страны испытали много радикальных перемен, но ни одна из них не удовлетворяет полностью необходимым условиям для того, чтобы отнести страну к категории стран с рыночной экономикой.

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There are some transition economies, which everyone agrees have enjoyed great success in reverting to a market economy, such as Slovenia. Other countries, such as Turkmenistan, everyone agrees is neither a market economy nor a democracy. Other countries, such as Kazakhstan, are much more difficult to gauge. This paper looks at the conclusions from the USA, the EU, and work by theoretical economists, to answer whether Kazakhstan has become a market economy, as the U.S. government has declared it has. The conclusion is that it is "getting warmer," but it cannot be said to satisfy the criteria sets for a market economy.

Kazakhstan began its gradual reform process in 1992. In many areas, such as its pension reform, which created a pay-as-you-go system, or in the development of its banking sector, Kazakhstan appears to be a model transition economy. Kazakhstan plans to privatize all land in 2007. However, an EU document states also that "structural and fiscal reform are still very much lagging behind, while corruption continues to be widespread."¹

There is a difference between the criteria sets and the conclusions by the United States and by the European Union on Kazakhstan's market status. To the EU, Kazakhstan improved from non-market economy to "special status" (still not a market economy) in 2000. In 2002, Kazakhstan officially became a market economy, according to the American government.

Oddly enough, it is not economists, but politicians who make a decision about which country is, and which country is not, a market economy.² The Department of Commerce in the United States labels economies as "market economy" or "not market economy." The European Union assigns to a country "market economy status" when it publishes lists of those countries accused of permitting dumping.

In 2001, President Bush made the recommendation to Congress that Kazakhstan be taken off the Jackson Vanik List. In March 2002, the U.S. Department of Commerce officially revoked Kazakhstan's non-market economy status. Its finding was that Kazakhstan had been effectively a market economy since October 2001.³

In 1998, Kazakhstan is grouped with non-market economy countries in an EU regulation. Along with Kazakhstan were Albania, Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, North Korea, Kyrgyzstan, Moldavia, Mongolia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan, and Vietnam.

Within two years, this status changed. The EU has recognized that while Kazakhstan may not yet be a "market economy," it has made significant progress:

The process of reform in the Ukraine, Vietnam and Kazakhstan has fundamentally altered the economies of those countries and has led to the emergence of firms for which market-economy conditions prevail. These three countries have as a result moved away from the economic circumstances that inspired the use of the analogue-country method.⁴

Kazakhstan was granted a "special market economy status" by the EU in 2000.⁵ This was an intermediate category in between market economy and non-market economy status. Kyrgyzstan also received this special status.

In its August 2002 report on Bilateral Trade Relations,⁶ the EU still considered Kazakhstan to be a "non-market economy regime."

These events beg two questions:

- Firstly, How is it that the USA and the EU have not come to the same conclusion regarding Kazakhstan's progress towards a market economy?
- Secondly, since it is political organizations, not economic ones, that assign "market economy" status, is Kazakhstan a market economy according to economists?

ANALYSIS OF TRANSITION ECONOMY STATUS

Countries do not actually have to be market economies to be awarded market-economy status. What they must do is to demonstrate that significant progress has been made and that the country's economy is following the path towards inevitably becoming a market economy.

In 2001, the official Department of Commerce view was that Kazakhstan was becoming a market economy:

Kazakhstan is continuing its transition to a market economy. Key reforms underway include completing Kazakhstan's privatization program, nurturing the nascent securities market, consolidating gains in pension reform and the banking sector, improving the investment climate and continuing to modify the trade regime as part of Kazakhstan's efforts to join the World Trade Organization (WTO).⁷

That is not to say that the EU and the USA lack any set of criteria. There are conditions that must be met before a country is called a market economy by either.

TABLE 1: POLITICAL CLASSIFICATION

	European Union Criteria	U.S. Department of Commerce Criteria
Market-determined prices	State interference must be minor.	Wage rates are established by the labour market.
Control of resources	Disappearance of undue state control over resources and production decisions. Law is transparent and non-discriminatory.	State-ownership of resources is minimal.
Accounting standards	International standards are followed. There are no holdovers from planned economy payment of debts, such as write-offs, barter, or payment through compensation of debts.	
Property Rights	Law is transparent and effective. Insolvent firms are forced into bankruptcy.	
Exchange Rates	Exchange rates are not fixed.	Currency is convertible.
Foreign Investment		There is potential for foreign investment.

Criteria set by the EU seem more restrictive than those of the USA. The former emphasizes liberalization of all prices, not just wages. Much is made of accounting standards, which do not appear to be emphasized by the USA. The EU underscores property rights, whereas the USA puts emphasis on opportunities for FDI. Both sets place stress upon removing currency controls and both emphasize private use of resources.

Many transition economies also wish to join the European Union, or have recently done so. For these countries, there are additional requirements.⁸ Democratic institutions, including the rule of law, respect for human rights, and protection of minorities, must be supported. The country must be willing to support the political, economic, and monetary aims of the union. The economy should be able to cope with added competition pressures that EU membership will bring. For those European countries such as Poland, Slovenia, Croatia, Latvia, etc. that hope for full integration into Europe's markets, political and economic requirements are stricter.

Economists have created conditions for accessing countries' progress towards becoming market economies and for comparing the progress of transition economies. The well-known Hungarian, author of *Hiways and Byways*, Kornai (2000) is one.⁹ Svejnar (2002) is another.¹⁰ Also considered are Melo *et al* (1996),¹¹ Lavigne (1999),¹² and Frydman & Rapaczynski (1994).¹³

Kornai's conditions compare the differences between socialism and capitalism. They include factors such as state control of property and resources, as did the American and European criteria sets. However, Kornai also looks at political party attitudes and whether producers or consumers dominate the economic system.

TABLE 2: KORNAI'S CLASSIFICATION

	SOCIALISM	CAPITALISM
1: Political Control	Central Party	Pro-private property party
2: Economic Control	State dominates the economy.	Private property interests dominate the economy.
3: Economic Coordination	Bureaucratic organization and coordination	Allocation and production decisions are market-based.
4: Resource Efficiencies	Soft budget constraints	Hard budget constraints
5: Market Efficiencies	Sellers market; goods' shortages; and labor short-age	Buyers' Market; no shortages, and unemployment

Kornai emphasized points 1-3: private property is protected and dominates the economy and private parties control resources. When this occurs, according to Kornai, transition is mostly complete.

Neoclassical economists, who advised transition economy leaders in the early 1990's, believed that market activity would spontaneously occur, once controls were lifted. Kornai also felt that by removing state controls, the barriers to capitalism were removed. So removal of politically created, economic barriers is a major component of transition.

Kornai does not argue that democracy is a necessary condition for capitalism, but that capitalism is a necessary condition for democracy.

Using Kornai's classification for what makes a "capitalist" economy, we see that efficiency is not a necessary condition. On the other hand, private property rights and price-coordination are. This is an institutionalist approach. In another piece by Kornai, he writes that, "the transition from socialism to capitalism has to be an organic development. It cannot be done otherwise. It is a curious amalgam of revolution and evolution."¹⁴ The revolution began in force in 1991, when the Soviet Union dissolved. The evolution has been occurring since then.

Let us examine how well Kazakhstan has satisfied Kornai's criteria.

- Does the dominant political party protect property rights? Kazakhstan has privatized most property except for rural land. There is currently a problematic land reform plan that is scheduled to begin in 2007. Bankruptcy and property laws exist. However, problems in clarifying the legal code and high corruption cannot ensure the sanctity of property rights. Kazakhstan has mostly, but not fully, satisfied Kornai's first criterion.
- Is the state's role in resource management and production decisions minimal? The largest sector in the Kazakhstani economy is oil and gas. The government controls oil and gas resources, and investment in this sector has led to the development of *new* large state-enterprises.

The share of state-owned industrial production as a percentage of the total fell from 74.6 to 2.5 percent¹⁵ between 1992 and 2000. However, 33.5 percent of farms were private, and 18.9 percent of rural land was privately owned in 2000.¹⁶ (This is soon to be changed in 2007.)

Kazakhstan plans to liberalize control of land resources, but there are no plans for liberalizing oil and gas resources.

- Who or what coordinates economic decisions? Decisions on what to produce and how to produce are mostly independent of government control. One key exception is restrictive labor laws making it difficult to import specialized workers. There is also no "national treatment," as unofficially, foreign firms must make "local content" contributions. Another is the state control of oil and gas resources.
- Hard budget constraints appear to have replaced soft, thus satisfying the third criterion.
- The fourth issue is whether resources are allocated efficiently? Labor and capital markets are independent of government intervention. There appears to be little state-directed investment, and the minimum wage is so low as to be non-binding upon employers.¹⁷ Land allocation will be changing in 2007.
- Is the economy efficient? Efficiency is usually indicated by normalization of prices. This is not the case in Kazakhstan, even within the same area. Inadequate infrastructure, especially in the rural sector, creates problems for rural producers.

There is low official unemployment (10-11 percent), but high under-employment. Government salaries and pensions are very low. This results in talented people leaving the public sector and encourages state capture.

A strong indicator of economic efficiency, when governance issues are factored in, is the Index of Economic Freedom, which ranks countries from 1 (best) to 5 (worst). Kazakhstan began in 1998 with a rating of 4.28.¹⁸ It has improved its ranking to 3.70 in 2002 and 2004 (economic freedom worsened in 2003). Kazakhstan was downgraded for its barriers to capital flows. The low fiscal burden of the government, price and wage liberalization, and low government intervention were the country's best attributes that contributed to market efficiency.

Kornai's criteria require that a country has moved from the planned system to the market system, minimally with respect to points 1 to 3 in the table above. Point 3 is satisfied, but Kazakhstan has not yet moved from the planned to the market system particularly with respect to point 2. Kazakhstan is not yet a market economy.

Svejnar looks at three classes of variables in comparing the success of transition economies: macroeconomic stabilization; microeconomic restructuring; and social indicators.¹⁹ Judging success requires a somewhat deeper mode of analysis than deciding if an economy is or is not a market one. The analysis has changed from being bimodal to qualitative.

The argument is that market economies are Pareto superior to planned economies, because they can improve quality of life the more greatly. Since all transition economies are moving in the direction of, or have already become, market systems, those that are more successful should be more market-oriented. Anecdotal evidence supports this. Life in reformed Poland and Slovenia is significantly better than life in Russia which is comparatively less market oriented, which is still better than life in reform-resistant countries like Turkmenistan.

Svejnar judges that transition is complete when government monopoly ceases and economic growth is evident. "I would define the end of transition as a state when these economies replace central planning by a functioning market system and when they generate rapid and sustained rates of economic growth that enable them to interact with the more advanced market economies without major forms of protection."²⁰ In this 2002 work, Svejnar did not categorize FSU countries as nearly market economies, but did comment favorably upon Estonia, Poland, the Czech Republic, Hungary, Slovenia, and the Slovak Republic.

Can Kazakhstan satisfy Svejnar's standards?

- Has the macroeconomy stabilized? Kazakhstan has high growth in GDP, which is currently about 10 percent per annum. Growth rates increased between 1998 and 2000, from 5.1 to 14.9 to 18.8 percent.²¹ However, growth in the Kazakhstani economy is more of a function of oil and gas prices, than it is of increased output. Inflation in the 2000's is in the teens. The government has done much, spending and investing little and saving much, to pay debts and maintain fiscal surpluses. The economy in 2004 appears to be continuing its trend of healthy growth.

- Have firms been restructured? Firms are mostly privately owned and are undergoing restructuring. Officially published statistics state that in 2001, 16.1 percent of all firms were still state-owned.²²

State-owned firms are still most common for large-size firms (59%). Eighty-one percent of small-size firms are privately owned.²³

Foreign investment is permitted and encouraged. Foreigners must control less than 50 percent of a firm, or a resident may create a local, Kazakhstani corporation. FDI in Kazakhstan is predominantly in the oil and gas sector.

From 1993 to 1999 Kazakhstan received almost 10 billion USD in direct investment from foreign investors. Total FDI per capita for 2000 was 2.75 billion USD of which 71 percent was in the "Mining Sector" (oil and gas).²⁴

Rural privatization through the Land Code was proposed in 2002, and approved by the Parliament in March 2003. This plan called for the privatization of 90 million hectares of land and for sales to be limited to citizens of Kazakhstan.²⁵ The program begins in 2007, when hectares of land will be sold at fixed prices: \$100 to \$400 per hectare of arable land and \$400 to \$1,600 per hectare of the best arable land.

How are social indicators in Kazakhstan? Below are statistics from 1995 and 2001. Deaths are down moderately. Infant mortality and homicide statistics have been greatly improved. Both marriage and divorce rates decreased. The birth rate is down substantially. The third Svejnar criterion is the existence of favorable social measurements, as indicators of institutional development. From these indicators, there is room for progress, but life appears to be improving.

TABLE 3: SOCIAL INDICATORS

Year	Births/ 1000	Deaths/ 1000	Infant Mortal- ity/1000 Births	Homi- cide/10000 0	Suicide/ 100000	Marriage/ 1000	Divorce/ 1000
1995	17,5	10,2	25,4	20,3	29,9	7,3	2,4
2001	14,6	10,0	19,6	15,6	29,7	6,3	2,0
95-01 Change	↓16, 6%	↓2, 3%	↓22, 8%	↓23, 2%	↓0, 7%	↓13, 7%	↓16, 7%

Source: Statistical Agency of the Republic of Kazakhstan (1999, 2002)

The World Bank reported that longevity in Kazakhstan was the lowest among all transition countries.²⁶ The statistics from the Statistical Agency of Kazakhstan generally point in the direction of improved living standards, yet longevity remains low. The most recent statistic was 71.1 years for women and 60.2 years (less than the age of retirement) for men.²⁷ It is not known to what degree economic conditions (and the stress of change, unemployment, and poverty) and to what degree Kazakhstan's environmental problems²⁸ are at fault. Otherwise, the only possible negative indicators were the rural fertility rate, that fell substantially, and a slightly lower number of per capita marriages.

Using Svejnar's criteria of macroeconomic stabilization, microeconomic restructuring, and social, health indicators, suggests that Kazakhstan is, or is nearly, a market economy. The economy is growing and macroeconomic variables are about where expected. Inflation rates are high, but not excessively. Microeconomic restructuring results are mixed. Privatization has been limited thus far. There is a large discrepancy in incomes following independence. Unemployment and underemployment remain high. Kazakhstani firms in general are not attracting much foreign investment; FDI is concentrated in the oil and gas sector. Indicators of health have nearly all improved in recent years. Longevity statistics still hold Kazakhstan down. Kazakhstan does not satisfy Svejnar's criteria perfectly, but it seems on the threshold of doing so.

Another well-known paper on the process of reform in transition countries is de Melo *et al* (1996).²⁹ This paper contrasts the economic differences between the planned, Soviet system and the transition stage. This is followed by the author's expected results after the transitional period has been completed and a nascent market economy is firmly in place.

TABLE 4.1: DE MELO *ET AL*'S CHANGES FROM PLANNED TO TRANSITIONAL ECONOMIES

	Planned System	Transitional Period
Macroeconomic balances	Balances are achieved through direct government supervision.	Destabilized.
Economic, political, and social decision-making	These are coordinated through the Party.	Coordinating mechanisms are disrupted.
Private ownership	Minimal.	Growth of private sector.
Relative prices	Distorted.	Structural reallocation of resources.

Let us pursue this evolution, to results that are expected when transition is completed, or mostly completed. We use de Melo *et al*'s conditions during reform to predict expected results when a country has evolved from a non-market to a market economy. Instabilities are replaced by the relative stability of a market economy. Ignorance of market operations is replaced with sufficient understanding to make seemingly rational decisions. Not only does private property exist, but these rights are also protected by law and a registration system that is efficient and fair.

TABLE 4.2: RESULTS OF CHANGES WHEN TRANSITION IS COMPLETE

	Transition is complete
Macroeconomic balances	Changes in GDP are not erratic; inflation and unemployment are within the bounds of a similar, non-transition economy.
Economic, political, and social decision-making	Private interests, rather than politicians, direct changes in the society. Citizens have an understanding of how markets work, so that rational decisions can be made.
Private ownership	Registration of property is clear and rights are effectively, not nominally, protected by a court of law.
Relative prices	Market mechanisms are mostly able to prevent shortages and surpluses and information is available, so that relative prices are correct.

Whether an economy is, or is not, a market economy does not depend on proclamations that private enterprise will happen, or by privatization, or by regaining lost output. Institutional development is necessary or a country will remain a transition economy and never fully mature. Changes in macroeconomic indicators will be erratic; decision making is impaired; property rights are not truly secure; and prices remain distorted. It is evident in Kazakhstan today that although it may be a "market economy" according to the USA, that it has not completed its transition, if one follows these criteria. Something more is needed than simply stabilization, privatization and the recovery of growth rates. It requires basic economic literacy and savvy and decision making that is nearly free of political considerations.

Lavigne (1999) goes so far as to write that when we are no longer recognize that we are in what was once a planned economy, then transition is complete. Using these criteria, few FSU countries would pass this test though countries such as Slovenia would easily pass them. Lavigne also uses EU accession eligibility for European transition economies as a robust test for completion of a country's transition.

Frydman & Rapaczynski (1994)³⁰ described "transition" as a period of state withdrawal from its central position. Following this line of thought, we can conclude that transition is complete when the government no longer sets prices and controls resources.

In Kazakhstan, government mostly does not set prices, although its national wealth of oil and gas reserves are controlled by the government. This, however, is not dissimilar to many socialist, developed countries. Investment in oil and gas has even encouraged many large, new state enterprises to be created. It is not clear, precisely how much the government,³¹ which is largely controlled by a strong president, has withdrawn from economic decision-making.

However, Frydman & Rapaczynski also point out that market decisions are frequently made through institutions, such as corporations, rather than individuals making independent decisions. The processes of obtaining information, dissemination, analysis, and decision-making are created by cooperating individuals. Managers control the flow of information while government regulators maintain the interests of the general society. Managers must understand market signals, know where to find information, and how to respond to it. If this is absent, then command-and-control management could be more efficient than private management.

It is clear in Kazakhstan that dissemination of information is a mess. This is particularly the case when it comes to governance issues. The rules are quite strict, but how to adhere to the rules is not commonly known, which create obstacles to entrepreneurial activity and opportunities for corruption. Laws are not well understood and courts implement them in an ad hoc manner. Statistical data for the republic are quite good. Little is known about households and consumer demand.

As has been suggested here, institutions are needed to support a fair and efficient economic system. These institutions are partly cultural. Fair market practices may be understood, but completely ignored, because the culture does not yet support them. In other cases, market economic behavior is learned, and people are learning this more slowly than foreign economists originally imagined.

Linz (2000) asked, "are Russians really ready for capitalism?" She found deviations in Russian students' attitudes from American ones, which she felt would undermine market development. So long as the beliefs necessary for market institutions are weak, those market institutions cannot exist. So long as necessary economic institutions are absent, transition cannot be complete.

Without survey data, it is difficult to answer if Kazakhstanis are ready for capitalism. It seems that they are certainly ready for the wealth that foreign investment and exploitation of natural resources have delivered, not to mention rent-seeking activities in the early years of independence. However, many people look fondly upon the days of Soviet order and egalitarianism. What is also evident is that Kazakhstanis are not ready in the sense that basic understanding is lacking of such issues as supply-and-demand, service-mentality, and the sanctity of contracts.

CONCLUSION

The initial questions were: how did the USA and the EU arrive at different decisions concerning Kazakhstan's market status and do analyses by economists differ from the findings of the EU and USA?

The answers to these questions lie partly in the nature of the criteria set and partly in the fact that political agencies, as opposed to academic economists, are making these decisions. Independent economists are less likely to be swayed by political considerations, such as a gratitude for Kazakhstan's giving up nuclear weapons or the desire for Kazakhstan's oil and gas reserves, or for its pro-western stance in international politics. Secondly, we see that both criteria sets are limited, the USA's more so than the EU's. Their criteria are mostly binomial: yes or no. Those of economists are more qualitative. Svejnar includes welfare factors; Lavigne includes perceptions. Here we also emphasize knowledge of basic business and economics by the citizenry, the rapid evolution of which was taken for granted in the early 1990's.

Having discussed several academic works on the subject, we see that Kazakhstan is not yet a market economy. This conclusion is based upon the fact that it does not fully satisfy either the EU's criteria or any of the criteria sets that can be created from the work of theoretical economists. Kazakhstan does, however, satisfy many criteria in these sets. Hence, it is more likely that most economists would be more in agreement with the conclusions of the EU than with the U.S. Department of Commerce.

ENDNOTES

1. European Union (2001).
2. When the U.S. declared Russia to be a market economy, there was much speculation in the press that this result was politically-motivated.
3. United States Department of Commerce (Office of Public Affairs) (2002).
4. Vedrine, H., President of the EU Council (2000).

5. Source is Tatiana Romon, of the European Union's Delegation of the European Commission in Kazakhstan.
6. European Union (2002, 2000).
7. United States Trade Representative (2001).
8. European Union (2002e).
9. Kornai, J. (2000a): 27-42.
10. Svejnar, J. (2002): 3-28.
11. De Melo, M.; Denizer, C.; & Gelb, A. (1996).
12. Lavigne, M. (1999): 276.
13. Frydman, R. & Rapaczynski, A. (1994).
14. Kornai, J. (2000b).
15. Statistical Agency of the Republic of Kazakhstan (2001): 248.
16. *Ibid*: 255.
17. Minimum wage-earners are usually civil servants. For example, \$50 is about the lowest wage for an unskilled worker who is privately hired. Public employees are often paid the legal minimum wage, which is less (\$36 in March 2004).
18. Miles, M., Feulner, Jr., E. & O'Grady, M. (2004): 247. For comparison, this is the same rating that Bangladesh and Yemen received.
19. Svejnar's criteria are almost exactly those suggested by the IMF (2000). The IMF's criteria include (i) liberalization; (ii) stabilization; (iii) restructuring of firms; and (iv) legal and institutional reform.
20. Svejnar, J. (2002): 26.
21. *Ibid*: 10.
22. Statistical Agency of the Republic of Kazakhstan (2001).
23. *Ibid*.
24. *Ibid*.
25. Konstantinov, A. (2003):2.
26. World Bank (2003).
27. Statistical Agency of Kazakhstan (2001).
28. Kazakhstan has non-economic conditions that will decrease lifespan: urban pollution, Aral Sea environmental degradation, and radiation from former Soviet nuclear testing.
29. De Melo, M.; Denizer, C.; & Gelb, A. (1996).
30. Frydman, R. & Rapaczynski, A. (1994).
31. The government consists of a strong president who dominates the courts and Parliament. Government is still centralized with local government leaders answering to those in the capital of Astana.

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INFORMAL COSTS OF DOING BUSINESS: THE CASE STUDY OF THE REGISTRATION AND REGULATION OF FIRMS IN THE KYRGYZ REPUBLIC*

MAKSAT KOBONBAYEV**

The Kyrgyz government has made positive steps in terms of introducing and simplifying the formal laws and regulations to provide incentives for firms to do business according to the formal rules of the game. However, despite the presence of simple and cost-effective formal laws and regulations, firms continue to resort to informal arrangements, incurring additional costs in money and time, which far exceed the legal (official) limits. Moreover, the government bureaucrats continue to reap rents, intervening informally in the economic activities of firms, and discouraging firms from working legally. Thus, the government-business transactions are in the equilibrium point that sustains informal ways of doing business. However, informal ways of doing business are not cost-free. There are long-term effects, associated with uncertainty and externalities, as well as short-term costs associated with bribes and other informal dealings. The paper briefly discusses the possible long-term effects and documents in detail, the short-term costs due to corruption in the areas of registration, and regulation of firms.

НЕФОРМАЛЬНЫЕ ИЗДЕРЖКИ ВЕДЕНИЯ БИЗНЕСА: НА ПРИМЕРЕ РЕГИСТРАЦИИ И РЕГУЛИРОВАНИЯ ФИРМ В КЫРГЫЗСКОЙ РЕСПУБЛИКЕ

МАКСАТ КОБОНБАЕВ

Правительство Кыргызской Республики провело законодательную реформу в сфере регистрации и регулирования частного бизнеса, чтобы стимулировать фирмы работать в соответствии с официальными (формальными) правилами предпринимательской деятельности. Однако, несмотря на наличие государственных законов создающих благоприятные условия для предпринимательской деятельности, фирмы продолжают прибегать к нелегальным способам ведения бизнеса. Это приводит к дополнительной затрате времени и финансовых расходов, которые далеко превышают официальные рамки.

Кроме того, государственные чиновники продолжают неформально вмешиваться в деятельность частных предприятий, вымогая взятки и тем самым поощряя теневую экономику. Таким образом, неформальное государственное вмешательство в частный сектор способствует тому, что фирмы продолжают вести нелегальную предпринимательскую деятельность. Многие бизнесмены не осознают, что они теряют гораздо больше, чем выигрывают от уклонения от законов не только в долгосрочном, но и в краткосрочном периоде. Фирмы несут долгосрочные расходы из-за побочных эффектов и инвестиционной неопределенности и краткосрочные расходы из-за наличия коррупции, связанной с регистрацией и регулированием фирм. Основная цель данного исследования состоит в том, чтобы теоретически обосновать долгосрочные издержки и подсчитать краткосрочные издержки, исходящие от неформального ведения бизнеса.

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"Laws like cobwebs, entangle the weak, but are broken by the strong"
Ascribed to Solon c.575 B.C.

The advocates of radical reforms and advisors to post-communist governments such as Jeffrey Sachs and David Lipton (Sachs and Lipton 1990) and Anders Aslund (Aslund 1999; 2000) have argued that the Kyrgyz Republic¹, being an island of democracy and economic liberty, would become one of the fastest growing economies among other post-Soviet countries. They even predicted that necessary institutions² would emerge naturally adjusting to the radical market reforms. Having witnessed the failure of radical reforms to create the institutional environment conducive to the formation of the market economy, policymakers finally began to pay attention to the role of institutions.

Two distinct but related fields have increasingly begun to explore the role of law and regulations in providing incentives for firms to operate in a market economy (Stone, Levy and Paredes 1996; De Soto 1989). The field of Law and Development takes a very formalistic approach, arguing that economic growth depends on a system of formal laws and regulations consistent with the market economy. Hernando De Soto (De Soto 1989; 2000), Kenneth Karst and Keith Rosenn (Karst and Rosenn 1975) argue that cumbersome formal institutions are the root causes of the formation of the shadow economy, which negatively affects the overall economic development. They prescribe that the road to success is possible by nurturing transparent and simple laws along with providing consistent enforcement mechanisms.

The field of New Institutional Economics (NIE) also pays much attention to formal laws and regulations but its frontiers go far beyond formal institutions to explore all sets of institutional arrangements on the basis of their empirical impact on economic transactions and performance. Indeed, there are several strands of NIE. The transaction cost economics strand of NIE led by Ronald Coase (Coase 1937; 1960) stresses the importance of proper definition of property rights and emphasizes the impact of institutions on transaction costs. Oliver Williamson (Williamson 2000) argues further that formal laws and regulations are necessary but not sufficient to prevent opportunistic behavior by firms. Douglass North (North 1990) argues persuasively that informal institutions matter as much as formal laws and regulations in determining the costs of doing business. North has showed cogently that the same formal rules imposed on different societies produce different patterns of development depending on informal norms (societal values, cultural heritage, historical experience, past polities, *etc.*).

It is no longer a question whether institutions shape economic performance. The NIE literature provides vast empirical evidence in favor of institutions. The question is whether the presence of formal institutions consistent with the market economy is sufficient for efficient business operations as the Law and Development literature contends or indeed the mixture of formal and informal institutions help us better

understand the processes shaping the costs of business transactions as NIE claims. The purpose of this paper is to contribute to the understanding of this puzzle.

I have chosen the Kyrgyz Republic because it has simplified the laws, governing business registrations and regulations, and officially prohibited the random involvement by bureaucrats in the activities of the private sector. Furthermore, the Kyrgyz government has minimized the costs and time associated with the government regulations of businesses. Thus, the formal costs in money and time to commence and conduct business in the Kyrgyz Republic are low. According to the Law and Development School of Thought, firms should start up new businesses and run existing firms according to formal rules of the game because they are simple and cost-effective. The paper examines the results of the Regulatory and Business Environment Survey (RBES) conducted in the Kyrgyz Republic after the simplification and introduction of laws that govern: (1) registration of new businesses (entry mechanism), (2) regulation of businesses, and (3) government intervention.

The survey results demonstrate that the mere presence of formal institutions necessary to provide favorable incentives for firms to engage in business activities does not mean that these formal institutions naturally become effective. For example, formally great strides have been made in simplifying the regulations for starting up and conducting business, but, as a matter of fact, the costs and time far exceed the legal (official) limits. Moreover, the government bureaucrats continue to impose burdensome regulations and informally intervene in the economic activities of firms, discouraging them from working legally and making long-term investment commitments.

It is important to note that statistics employed in this paper is mainly descriptive rather than causal and there is the degrees of freedom problem of using only one case study. Thus, the external validity (generalizability) of this study is limited. Therefore, I do not intend to generalize the results to other formerly communist countries.³ However, I briefly compare the results of the cross-country survey, the Business Environment and the Enterprise Performance Survey (BEEPS), conducted to analyze the government-business relations in the twenty formerly communist countries, to test the consistency of the RBES data and, more importantly, to examine whether the firms' informal costs due to corruption are only specific to the Kyrgyz Republic or a part of larger trend in the formerly communist countries.

The results of the BEEPS survey are consistent with the results of the RBES survey, showing the pervasiveness of corruption in the Kyrgyz Republic. Furthermore, the BEEPS results illustrate that the informal costs of corruption are not specific to the Kyrgyz Republic. The BEEPS survey reveals that most firms in all of the formerly communist countries pay bribes without exclusion. The firms resort to informal means to survive the pressure by the government bureaucrats in spite of their increasing appreciation of the formal rules of the game. However, there is a regional variation, showing that firms in Central Asia and Caucasus rank higher than their counterparts in Eastern Europe on the corruption continuum.

THEORETICAL ANALYSIS

The formerly communist countries⁴ present a fascinating laboratory for testing theories of new institutional economics (NIE). The theories of NIE in their turn offer unconventional explanations of the complex processes taking place in these countries. One of these complex processes is the formation of the market economy. To understand it, we, at least, need to understand some of its fundamental components. One of the fundamental components of the market economy is, undoubtedly, the existence of the private sector. The formation of the private sector in the formerly communist countries has seemed a deceptively simple process – radical transformation of the state owned firms into privately owned firms (privatization).

However, the radical nature of privatization during the early stages of the reforms, and the absence of robust formal institutions consistent with the market economy reinforced and created informal norms of doing business, including rent seeking, bribery, tax evasion, patronage and other forms of corruption. This outcome is consistent with the argument that in the absence of well-enforced rules of the game (formal and informal), firms tend to engage in opportunistic economic activities (Williamson 1996; North 1990). It is also argued that in the presence of burdensome formal rules of the game, firms resort to informal ways of doing business (De Soto 1989; 2000). The logic is that when the government imposes onerous regulations, it becomes costly for firms to engage in business activities. Hence, there is no incentive for firms to abide by these regulations.

Overall, in the absence of well defined and in the presence of cumbersome rules of the game, firms tend to resort to informal arrangements of doing business. Unfortunately, informal arrangements become deeply ingrained in the government-business exchange, forming the shadow economy equal to or even exceeding the formal economy.⁵ However, informal arrangements are not cost-free. There are long-term costs, associated with uncertainty and externalities and short-term costs associated with bribes and other informal dealings. Let's firstly focus on the long-term costs.

Firms often evade the rules of the game to benefit in the short run. But it is hard for firms to plan ahead and make long term oriented business commitments in a corrupt and unpredictable environment. Individual entrepreneurs make investments if only they have a certain degree of predictability of future events. In other words, they calculate within their capacity the costs and benefits of investing in certain types of business opportunities. When only there are pay-offs, they may decide to invest. The degree of predictability increases in the presence of simple, transparent and enforced formal rules of the game. Informal arrangements are inherently unpredictable and discriminatory. Although informal arrangements can be efficiency enhancing in the short term,⁶ in the long run they will have perverse effects such as externalities, third party effects, *etc.* As the economy gets more complex and impersonal, the formal rules become necessary.

Comparing a predictable game (skiing) to an unpredictable one (gambling) can be illustrative. For instance, in downhill skiing, a skier understands the rules of the game; the fastest skier is the winner. There is a predictability component in the game because if a skier loses the game, the skier understands that the faster one skies the more chances there are to win the next time. Thus, skiers can train more to ski faster to win. However, gambling entails an unpredictability component. A player is not certain on how to win because gambling is based on luck and randomness but not on rational calculations.

Some players indeed try to use rationality by cheating to win the game but they are not certain if they will succeed in doing so all the time. Which game do firms prefer to play? It depends on the situation. If a firm is able to evade the rules and benefit much from it, it is likely to prefer gambling to skiing (just like a player who is able to gamble). But even in this case, the firm is not certain if it is able to evade the rules in the same way all the time. It becomes more uncertain for the firm to do business when the government officials start favoring one firm to another (if you gamble, you do not probably want a croupier to participate in the plot with another player against you). What if one does not like gambling at all?

If a firm wants to compete and grow, it is most likely to prefer skiing. The firm wants to be certain that the efforts it puts into the game will "pay off". For instance, it may make a long-term investment if only it has a certain degree of confidence that, even if the game is not fair, it is at least predictable. In the absence of the fair and predictable game, the firm is unwilling to take a risk. Given that the government complicates the rules of the game to make firms dependent upon it, there are no fair rules of the game and given that, bureaucrats change constantly and depend on super-ordinates in the higher ladder of the government pyramid, the rules of the game become unpredictable.

Evidently, the evasion from the rules of the game can be costly for firms and for the overall economy. Nonetheless, there is a tendency to think that firms benefit from noncompliance in the short-run. The overall perception is that things can be done faster and cheaper through informal arrangements and dealings. But informal arrangements are not cost free in the short run either. There are costs of giving money (bribes), spending time, searching information, and so on. The informal costs can often be higher than the official costs, increasing the opportunity cost of productive activity and generating inefficiencies in the entire economy. The following examination of the results of the regulatory business survey attempts to document the informal costs of doing business in the short run.

ANALYSIS OF THE RESULTS OF RBES SURVEY

Pr. Vitaly Nishanov, Associate Professor at the American University in Central Asia and Director of the Professional-Manager Consulting (PMC) kindly provided the Regulatory and Business Environment Survey (RBES), which was conducted at the request of ARD/Chechi and the USAID Regulatory Reform Project in 2000. The survey involved one thousand small and medium-sized enterprises and included

both legal entities (69 percent) and individual entrepreneurs (31 percent). Participants were selected from every major city and business sector in the Kyrgyz Republic (for distribution of respondents by regions and sectors and for other methodological issues, see RBES 2000).

The purpose of the survey was to measure the extent to which government regulations on the activities of businesses impact the start-up and development of business initiatives. These regulations include business registration requirements, licenses, permits, certificates and business inspections. Besides, researchers asked additional questions to evaluate the overall state intervention in the private sector (RBES 2000).

THE START UP OF A NEW BUSINESS

Registration is an entry mechanism for individuals or legal entities to start up a new business. Simple registration process is essential for providing incentives for starting up and expanding business activities. In contrast, a complex, costly and time-consuming registration process discourages entrepreneurs from starting up and conducting their business activities. De Soto's famous experiment to set up a small garment firm on the outskirts of Lima following all the complex legal procedures is a case in point. It took De Soto's team two hundred eighty nine days to fulfill eleven requirements and US\$194 direct costs including two bribes they were obliged to pay to fulfill the task (Stone, Levy and Paredes 1996, 105).

Under the pressure of international donors the Kyrgyz government has made great strides in improving the formal registration process for firms and individual entrepreneurs. In the Kyrgyz Republic, the formal time to register a business should not exceed ten days. The survey shows that around 70 percent of individual entrepreneurs were able to register their businesses in two weeks (see Figure 1, Appendix). It took longer to register legal entities because they had to go through the one more government agency to receive a registration certificate (the Ministry of Justice). On average, it took 15 days to register business in the Kyrgyz Republic.

The formal costs of registering a business are also nominal. Individual entrepreneurs can officially register at the State Statistics Committee (US\$2.93),⁷ the State Tax Inspectorate (US\$1.26) and the Social Fund (free of charge). Legal entities follow the same registration requirements, but first are required to register at the Ministry of Justice, (free of charge) which is obliged to provide a registration certificate within ten days of receipt of all required documents. This is also supposed to be done free of charge (RBES 2000, 10).

Evidently, the formal registration process is fairly inexpensive and prompt. However, formal rules are only part of the story. North (North 1990) reminds us of the importance of informal institutions that frequently shape the actual costs of business transactions. The survey results show that in reality the costs of registration are much higher than they are written in the laws. According to Figure 2, the registration costs including both official and unofficial payments far exceeded the official costs. For example, 31 percent of individual entrepreneurs and 32 percent of

legal entities paid around US\$20 (around 1000 Kyrgyz soms) to register their businesses, which is five times higher than the official cost (US\$4.19). About seven percent of individual entrepreneurs overpaid the official costs 50 times (US\$209) to set up their business activities.

TABLE A. FORMAL VS. INFORMAL TIME AND COST OF REGISTRATION

	Total Official	Average Official and Unofficial
Cost of Registering (U.S. \$)	US\$4.17	US\$59.12
Time to Register (days)	No more than ten days	15 days

Although the actual duration of registration was only slightly longer than the official duration, the actual costs of registering a business far exceeded the official costs. According to Table A, firms on average spent about 14 times higher than the official costs, indicating a high degree of rent seeking among registration authorities. About 27 percent of respondents admitted they were forced to make unofficial payments to registration authorities in the form of bribes, gifts and rendering other services along with official registration payments (RBES 2000, 13). Interestingly enough, the highest average costs were in the retail trade (US\$72.46), transportation (US\$67.99) and wholesale trade (US\$67.4) in which individual entrepreneurs predominate (see Figure 3). The lowest average costs were in consulting and construction. The same sectors that spent more money, also spent more time to commence their businesses (compare Figures 3 and 4).

Moreover, the lack of information on the cost, time and procedures of registration can explain the difference between formal and informal payments. The survey respondents pointed out that they were not well informed about the registration process or considered it perplexing. Of the total number of businesses, only 29 percent were fully aware of the registration procedures while 39 percent had insufficient information, and the remainder knew nothing about registration process (RBES 2000, 10).

REGULATION OF BUSINESSES

Stone, Levy and Paredes argue that regulation and bureaucratic red tape are one of the main obstacles to economic efficiency. They stated, that "excessive regulation may create a generalized drag on all businesses or may favor some kinds of businesses over others, either as an integral consequence of implementation or as a result of the structure of costs imposed by regulations" (Stone, Levy and Paredes 1996, 106). Regulation can take different forms in different countries. In the Kyrgyz Republic, the main forms of regulations are licenses, permits, certificates, business inspections and other forms of government intervention.

Licenses are required for certain businesses to legally commence their operations in certain activities. These activities are listed in the Law of the Kyrgyz Republic

"On Licensing," which was just amended on January 18, 2001. The new Law on Licensing reduces the number of activities subject to licensing from 62 to 29 (RBES 2000, 16). By the time the survey was conducted, the previous law was in effect, meaning there were 62 activities subject to licensing. The survey revealed that licensing was a pervasive requirement for many business activities. Over 60 percent of respondents indicated that they had to receive a license or licenses for the type of business activity they conducted. Some respondents indicated that, by law they were required to receive it but found it more expedient to continue working without a license by bribing supervisory government bodies. Researchers excluded these respondents from the analysis and examined those respondents who were directly involved in the process of obtaining a license or licenses (RBES 2000, 16).

Nearly 60 percent of licensed businesses considered the requirements and procedures of licensing the most difficult problem, followed by the cost, time and renewal of licenses (RBES 2000). The average time for obtaining a license was 21 days and the average cost was about US\$76 with the most expensive licenses in transport, construction, manufacturing and food processing sectors. In the construction and transport sectors more than 25 percent of respondents paid above US\$160 to obtain licenses (RBES 2000). In addition to these formal payments, 42 percent of respondents admitted that they were required to make non-official payments, while almost 20 percent of them admitted they directly paid officials who were in charge of issuing licenses. It was mainly because entrepreneurs preferred paying bribes to going through complicated procedures each time when the licenses could only be issued for a short period of time (Figure 5 shows that 74 percent of respondents had a license or licenses only for a year).

Overall, obtaining licenses in the Kyrgyz Republic is more problematic than the registration process. The registration agencies and procedures are clearly identified as well as the cost and time of registration are fixed. In contrast, each licensing agency determines separately the costs of licenses. Some licensing bodies have fixed costs while others require applicants to receive the approval of on-site inspections, experts' opinions, different signatures, *etc.* In other words, the licensing is highly uncoordinated providing incentives for each agency to compete for rents by creating onerous regulations and obligations to be able to collect as much rents as possible.

Certification is another form of the government regulation. Certification requirements encompass a host of imported and exported goods and services. The main certifying body is Kyrgyzstandard (formerly Gosstandard). Kyrgyzstandard can also accredit other government agencies to perform certifying functions. According to the survey, almost 49 percent of respondents were required to obtain certificates from various state bodies and almost half of all respondents were required to obtain from one to four certificates with the average of six (RBES 2000, 22). Officially, certificates could be received less than in one week but in many instances it took from one to four months. The average cost of certification was around 80 percent. The highest costs were in the transportation (US\$160) and wholesaling (US\$110) sectors (see Figure 6). Moreover, certificates were given for

a short period of time meaning that businesses had to repeat the process regularly, which increased the opportunities for certifying agencies to engage in rent seeking and provided incentives for businesses to bribe certifying agencies. The RBES (2000, 27) concludes that, although certification is a necessary mechanism to protect health and safety of citizens, it is complex and expensive (for the most difficult aspects of certification process, see Figure 7). Furthermore, certification serves no useful purpose if there are ways of overcoming them. If the goods do not comply with the required standards, entrepreneurs pay bribes to overcome this obstacle. 40 percent of respondents paid unofficial costs to obtain certificates and in many cases simply avoided them altogether by paying bribes to certifying agencies.

In addition to licenses and certificates, there are other government requirements such as health and sanitary permits, fire permits, architecture and construction permits, land use permits and a variety of other regulation requirements (RBES 2000, 28). These government requirements are often not included in official normative documents and thus create additional uncertainties for entrepreneurs. The most difficult permits to obtain are those issued by the Sanitary and Epidemiological Stations (SES) and Kyrgyzzalko (agency regulating businesses that produce or distribute alcohol beverages) (RBES 2000). Both the SES and Kyrgyzzalko are considered to be the most corrupt agencies. Interestingly enough, businesses required to obtain permits from the SES and Kyrgyzzalko are also considered to be as the most corrupt. Overall, the average cost of permits was around US\$77. The process of issuing was non-transparent and in many cases arbitrary in its application. It is no wonder therefore, that about half of the respondents admitted that they made unofficial payments to receive permits.

GOVERNMENT INTERVENTION

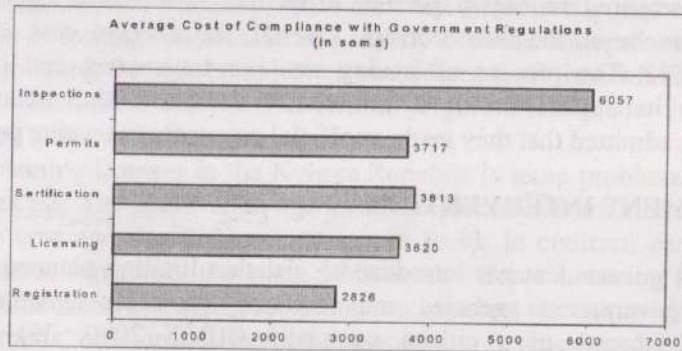
The Kyrgyz government has introduced legislation limiting planned inspections to only five government agencies and requiring all other agencies to conduct inspections in case of a citizen complaint (RBES 2000, 35). The National Commission for the Protection and Development of Competition (CPDC) is established to issue an inspection permit for government agencies. Besides, inspecting agencies are forbidden to conduct more than one inspection per year on a single business entity. This formal regulation aims at limiting government intervention and is supposed to be enforced by the introduction of an Inspection Logbook that each agency or inspector is obliged to complete after the inspection (RBES 2000).

Although formally the rules of inspection are fair enough, in reality inspections are very onerous. In particular, respondents were concerned with the taxation and SES inspectors who were also the most frequent visitors (see Figure 8). The average costs spent in six months for inspections by firms were around US\$126, with the most expensive payments made by entrepreneurs in the transport sector (amounting to US\$400 on average). Although legally inspectors are obliged to receive permission from the CPDC, inspectors conduct inspections without permission all

the time. The presence of the CPDC seems nominal from the results of the survey. Most respondents simply did not know about this procedure and never asked inspectors if they had the permission to inspect. 39 percent of the respondents knew nothing about the CPDC and 29 percent were pessimistic about proving anything. 42 percent of businessmen did not appeal unjustified decisions because they were afraid of negative consequences, and the other 42 percent were concerned about large court expenses and did not trust courts at all. Those, who appealed to courts, were unsuccessful in any way (RBES 2000). Because inspectors can easily impose very high transaction costs, entrepreneurs pay bribes regularly and try to establish relationships with the inspectors.

In addition to inspections, the government officials intervene in the private sector in many other ways. Professor Nishanov calls them – “informal or subtle forms of intervention” (RBES 2000). Despite the fact that formal inspections on each business entity can be done only once a year, they are done once every three weeks on average (see Figure 9). Not surprisingly, the tax inspectors have the highest rate of visits. 52.7 percent of respondents considered tax inspections as the most disruptive form of interference, followed by permits (43.8 percent) (See Figure 10).

FIGURE A. COSTS OF DIFFERENT FORMS OF BUSINESS REGULATIONS



Source: Regulatory and Business Environment Survey 2000.
Note: 47.8 Kyrgyz soms equal to US\$1 (exchange rate in 2000).

According to Figure A, firms incurred the highest costs from inspections. On average entrepreneurs spent around US\$419 to comply with government regulations. This does not include the opportunity costs spent by businesses in terms of human resources allocated on recurring permit and certification costs. It is important to note that more than US\$400 dollars a year spent by small enterprises may easily drive them out of business or push them to operate in the shadow economy (RBES 2000). Thus, the potential costs placed on small sized enterprises are high. The costs are especially high when entrepreneurs deal with inspections and permits.

COMPARATIVE SURVEY: COUNTRIES IN TRANSITION

Joel Hellman, Geraint Jones, Daniel Kaufmann and Mark Schankerman (Hellman, Jones, Kaufmann, and Schankerman 2000) summarize the results of the Business Environment and Enterprise Performance Survey (BEEPS)⁸ across 20 transition economies,⁹ assessing governance and corruption from the perspective of firms. The survey was extensively piloted in each of the countries to ensure that respondents understood the questions correctly.¹⁰ Researchers selected firms randomly from business directories and conducted the initial screener questionnaire by telephone to identify firms fulfilling the quota restrictions (for quota restrictions, see Hellman *et al.* 2000, 4). They also made all efforts to include different types of firms including ex-state firms, new-private firms, firms with foreign direct investment and firms from different regions (for the sample composition and other methodological issues, see Hellman *et al.* 2000).

I use the results of this survey for a comparative purpose to test for validity of the RBES survey results and generalize the findings to other post-Soviet countries. The survey questions have two parts: (1) questions related to institutions and policies at the macro level; and (2) questions related to bureaucracy, state intervention and corruption at the micro level. The focus of this paper is on the interaction of the state with firms at the micro level. However, let's briefly describe the interaction between the state and firms at the macro level.

Firstly, the BEEPS results verify the proposition that firms participate in corrupt activities all the time in the post-Soviet societies.¹¹ Secondly, the BEEPS show that firms prefer the rule of law to uncertainty and corruption.¹² Thirdly, firms view the government as the main obstacle for doing business.¹³ It is also clear that the state and firms view differently the role of market institutions and rules. The state is reluctant to change the existing status quo, but firms want to work on different modus operandi. Unfortunately, the legacy of the power of the state in all of the formerly communist countries makes the desire of the firms to change the status quo almost impossible, or, at least, incremental at this point. However, the change in the perception of the firms to value the rule of law is a positive trend.

John Nye, Professor of Economics at Washington University in St Louis, reminds us of the importance of the micro-level analysis for understanding broad issues such as corruption (Nye 2003). In verification of Pr. Nye's words, the analysis of the RBES survey has showed that the microanalysis of separate forms of interaction of government agencies with the private sector through registration, regulation and government intervention has allowed us to examine the variation of corruption from one area to another, which we could in no way capture by looking at the macro level data such as a corruption index or a composite of corruption indexes, *etc.* Indeed, the question is no longer about whether corruption exists or not, but it is about the magnitude of corruption, and only the questions asked at the micro level can capture this magnitude.

The RBES has already showed that individual entrepreneurs and legal entities face the problem of incomplete information on registration process and government

regulations. The BEEPS results confirm that 40 percent of firms in the Kyrgyz Republic agreed that it was hard to obtain information, while only 11 percent of firms agreed that they could obtain information easily (see Figure 14). The Kyrgyz Republic is ranked third in terms of the lack of information on government regulations. In other formerly communist countries less than 40 percent of firms agreed that information was lacking (except Lithuania and Ukraine).

The RBES has showed that in the Kyrgyz Republic, the state intervention is one of the major obstacles to the operation of the private sector. In particular, the government inspections, permits, licenses and certifications were the most onerous. Hellman *et al* (2000, 32) notes, that the opportunity cost is high for senior managers in spending their time dealing with government agencies because the time can otherwise be allocated to productive activity. Figure 15 shows that the Kyrgyz Republic is ranked seventh after Ukraine (1), Kazakhstan (2), Moldova (3), Russia (4), Lithuania (5), and Uzbekistan (6) in terms of the average percentage of time spent dealing with government officials. The situation is better in Eastern Europe and the Baltic States (except Lithuania) than in Central Asia.

The RBES has also provided evidence that in the Kyrgyz Republic unofficial payments are high in the areas of inspections and permits. The BEEPS demonstrates that in the Kyrgyz Republic, firms spent 53.5 percent of the proportion of bribes on tax inspections plus 7.4 percent on health and fire inspections. The procedures on licenses were simplified and, therefore, in the Kyrgyz Republic firms paid fewer bribes on licenses than firms in Kazakhstan and Uzbekistan (see Table 2).

TABLE B: THE AVERAGE PROPORTION OF BRIBES SPENT ON EACH SERVICE

Regions	Licenses	Taxes	Contracts	Courts	Legislation Influence
Central Asia	18.8	33.9	9.1	7.5	1.1
Eastern Europe	26.6	8.6	23.1	8.16	3.3

Note: for detailed information, see Table 2.

The problem of corruption is pervasive in the government-business interactions in the formerly communist countries. Figure 16 illustrates, that most of the time firms paid bribes to government officials. Overall, most firms in all of the formerly communist countries paid bribes without exclusion, Central Asia and Caucasus, ranking the highest and Eastern Europe, ranking the lowest on the corruption continuum. The Central Asian countries, in general, paid more bribes on taxes, while Eastern European countries spent fewer bribes on taxes but more bribes on courts, legislation influence and licenses (see Table B above). The economic backwardness of the Central Asian countries may partially be due to the inability of the governments to establish the transparent and effective tax system which could generate revenues for the government to invest in physical, human and institutional capital of the countries.

CONCLUSION

The survey results show that the mere presence of formal laws and regulations are only a part of the story in understanding the business-government transaction costs. It is obvious that informal constraints determine the bulk of costs on entrepreneurs in the Kyrgyz Republic. However, it is still unclear whether the full enforcement of formal regulations can reduce the level of corruption but it is obvious that it is too costly to enforce all formal institutions and indeed the informal norms or internalization of these norms should accompany formal institutional reforms.

In spite of the existence of the simple formal rules and regulations in certain areas such as registration, entrepreneurs resorted to informal arrangements especially in making payments. However, the registration process was the fastest and the least burdensome among other forms of the government business relations. Indeed, the mixture of cumbersome regulations, uncoordinated regulatory activities with opportunities for rent seeking, especially in such areas as tax inspections and permit issuance, increased substantially the costs and time of doing business. Thus, the relationship between simplicity and inefficiency can be spurious because the lack of transparency and availability of formal rules undermine the effectiveness of simple formal rules and regulations. In a corrupt environment it is unclear whether the simplification of rules decreases the actual costs in government business interactions but it can at least speed up the process as it is the case in registering businesses in the Kyrgyz Republic. Overall, the combination of simple, transparent, available (accessible) and enforced formal rules and regulations seem to decrease the costs of doing business.

Obviously, the state plays a crucial role in institutional change by enforcing simple, transparent, and accessible formal institutions as long as these institutions become dominant modes of political, social and economic activity. However, the state should be exempt from corruption and rent seeking itself before it enforces formal rules on others. Unfortunately, corruption and rent seeking are deeply ingrained in the higher echelons of the government pyramid in the Kyrgyz Republic. The state is a political organization that can create institutions and enforce rules of the game. However, it is costly for the state to enforce all the rules of the game. In fact, in advanced capitalist societies, firms comply with most of the rules even if the government does not control, forming a favorable and transparent informal institutional environment. This indicates that the pure formalistic approach offered by the Law and Development literature is not a guarantee of efficient business transactions. Indeed, the role of informal norms is significant according to the survey results.

Firms should view compliance with the rules more beneficial in the long run. This is not the case in the Kyrgyz Republic. Even if the simple and well understood formal rules exist, the government bureaucrats complicate the rules to seek rent and exercise their power over firms. Although the formal rules have become more or less consistent with the market economy, the informal state interventions and

regulations make firms evade the rules and involve in different types of corrupt activities.

Therefore, under this noncompliant system, the shadow economy is the main way of economic life; and unpredictability, favoritism, and instability are norms rather than exceptions. Overall, the noncompliant system has more costs than benefits on all members of the society. Unfortunately, the incentive structure that fosters noncompliant behaviors continues to dominate in the Kyrgyz Republic, resulting in lost output and a growing disparity in wealth. The prevalence of predatory activities is the main obstacle to the healthy functioning of the private sector. When the main custodians of law such as the government officials and lawyers constantly engage in non-compliant behaviors, the system becomes unpredictable and unstable. They take it as it is and if possible participate in the creation of new mechanisms of noncompliance. This is a self-sustaining system that ensures the survival of those who are part of this predatory environment. Thus, the both the state and firms are in "vicious circle".

ENDNOTES

1. For a detailed description of the Kyrgyz Republic, see Appendix, Map 1 and Table 1.
2. Institutions in a society provide the rules of the game that shape the incentives for individuals to engage in productive or destructive activities. Institutions can be formal and informal. Formal institutions are written or codified rules and informal constraints are unwritten norms of conduct. In other words, formal institutions are rules that humans devise to provide a framework within which human interactions take place. Informal constraints are norms and codes of behavior that humans naturally follow - North (1990).
3. The World Bank and the Office of the Chief Economist at the EBRD jointly developed the BEEPS questionnaire for the transition economies - Hellman *et al.* (2000): 4.
4. By the formerly communist countries, I mean the formerly socialist countries of Eastern Europe and the U.S.S.R. By the post-Soviet countries I mean specifically the former countries of the U.S.S.R.
5. De Soto (2000) calls the shadow economy an extralegal sector that constitutes a major bulk of the GDP in most developing countries. He reports that the extralegal market in Russia and Ukraine accounts for 50 percent of GDP and 62 percent in Georgia. There is no exact data on the extralegal market in the Kyrgyz Republic but if one walks down the streets of the Bishkek city, capital of the Kyrgyz Republic, one cannot avoid seeing extralegal cafes, shops and other services. To see the representation of extralegality in its full fashion, one should visit the "Osh bazaar" (the biggest market in the capital city). Thus, it will be no surprise if the extralegal sector in the Kyrgyz Republic approximates or exceeds those of Russia, Ukraine or Georgia.
6. Leitzel (1997) reminds us that the violation of rules which constraint the voluntary exchange in the absence of negative third party effects may actually have positive economic effects. For example, some scholars argue that corruption can be efficiency enhancing. They argue that corruption allows firms to avoid burdensome regulations or confiscatory tax rates and thus decreases the transaction costs for the firms that bribe. The problem is that it does not take it into account the long-term effects that the practice of corruption can have on the broader reforms. For instance, in most cases corruption

has third party effects such as the costs can fall disproportionately on smaller firms and externalities far exceed the benefits in the long run. Firms may also choose to evade both cumbersome and good regulations, causing a shift of economic activity from the formal into informal sector - World Bank (1997).

7. According to the National Bank of the Kyrgyz Republic the average exchange rate of Kyrgyz som/\$US during the year 2000 was 47.8. However, it is important to note that the purchasing power parity is not considered and thus the value of a dollar is higher than it may seem in the paper.
8. The World Bank and the Office of the Chief Economist at the EBRD jointly developed the BEEPS questionnaire for the transition economies - Hellman *et al.* (2000): 4.
9. The survey examines the following countries: Armenia, Azerbaijan, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, The Kyrgyz Republic, Lithuania, Moldova, Poland, Romania, the Russian Federation, the Slovak Republic, Slovenia, Ukraine and Uzbekistan.
10. A sub-sample of respondents was telephoned on the following day and the responses to key questions checked for consistency as a quality-control measure - Hellman *et al.* (2000): 4-5.
11. For the first time, the survey measures grand corruption defined as "private payments to public officials to influence the content of the basic rules of the game (*i.e.* legislation, rules, laws or decrees" - Hellman *et al.* (2000): 19. Figure 11 shows the degree of sale of parliamentary votes on laws and presidential decrees to private interests. The presence of this practice is an indication of grand corruption. Obviously, grand corruption is present in all transition countries with particularly high indication in Azerbaijan and Ukraine.
12. Figure 12 indicates the desire of firms to eliminate corruption, crime and regulations in almost all of the transitional countries. It means that firms want to operate under transparent formal rules rather than under corruption, crime and excessive bureaucratic regulations. Hellman *et al.* (2000) admit that the responses to the question in Figure 16 in reality underestimate the true costs imposed on firms by the institutional failures.
13. Figure 13 also illustrates the general dissatisfaction of firms with the central government. For instance, about 85 percent of the firms in the Kyrgyz Republic consider the central state very unhelpful, 25 percent consider mildly unhelpful in comparison with about 9 percent that think that the central government is helpful and less than two percent that consider it very helpful. It is evident that the central government poses a huge hindrance to firms.

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APPENDIX

MAP 1. THE KYRGYZ REPUBLIC



Source: Comprehensive Development Framework of the Kyrgyz Republic to 2010: National Strategy. The Report Conducted in Direct Contact of Many International Donors such as the WB, IMF, ADB, EBRD and others, 2001.

TABLE 1. THE KYRGYZ REPUBLIC AT A GLANCE

Geographic, Natural and Climate conditions	
Location	North-Eastern part of Central Asia
Neighboring countries	Kazakhstan, Uzbekistan, Tajikistan and China
Total surface area	199 900 square km
Physical geography	90% of the territory is located 1500 meters above sea level. Mountains divide the country into Northern and Southern zones
Use of land	53.9% is agricultural land, of which 12.7% is arable, 5.1% - forests, 4.3% - water, 36.7% - others
Population	
Population, mid-year	4907.6 thousand
Population density	24 persons per 1 square meter
Population growth rate	0.8 % average per annum
Ethnic composition	64.8% Kyrgyz, 13.8% Uzbek, 12.5% Russian and 8.9% others
Language	State language - Kyrgyz, official - Russian

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TABLE 1. THE KYRGYZ REPUBLIC AT A GLANCE (CONTINUED)

Structure of State	
Establishment of statehood	Independent state since 1991. Constitution adopted in May 1993.
Head of state	President (general and direct elections for 5 years)
Legislative power	Bicameral Parliament – Jogorku Kenesh of the Kyrgyz Republic of 105 MPs elected for 5 years. Legislative Assembly of 60 MPs, 15 places given to political parties. People's Representatives Assembly of 45 MPs
Executive power	Government of the Kyrgyz Republic Head of the Government – Prime Minister of the Kyrgyz Republic appointed by the President of the Kyrgyz Republic with the consent of the People's Representatives Assembly of Jogorku Kenesh
Judiciary	Constitutional Court of the Kyrgyz Republic, Supreme Court of the Kyrgyz Republic, Superior Arbitrary Court of the Kyrgyz Republic, Local courts
Bilateral and multilateral relations	The Kyrgyz Republic is a member to UN, CIS, OSCE, WTO, WB, IMF, ADB, EBRD, IDB and other international organizations and maintains diplomatic relations with 67 countries.

Source: Comprehensive Development Framework of the Kyrgyz Republic to 2010: National Strategy. The Report Conducted in Direct Contact of Many International Donors such as the WB, IMF, ADB, EBRD and others, 2001.

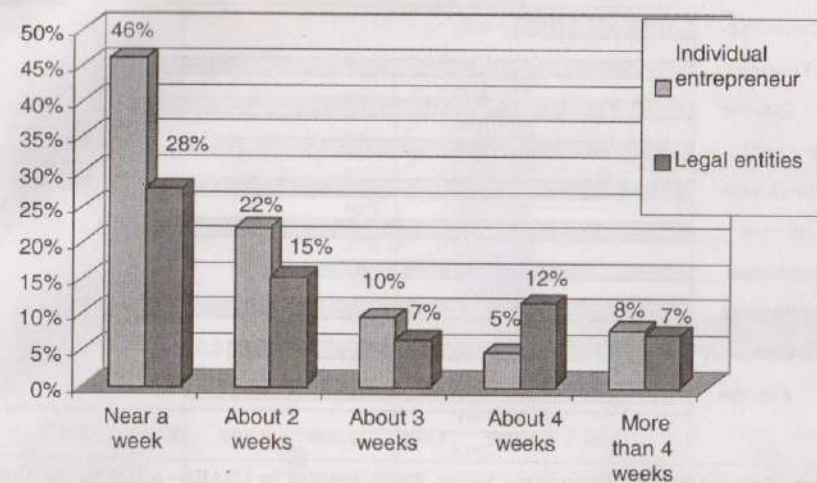
TABLE 2: THE AVERAGE PROPORTION OF BRIBES SPENT ON EACH "SERVICE"

Country	Public Service	License	Tax	Contract	Custom	Court	Health/ Fire Inspector	Influence legislation	Other
Armenia	11	10	31	6	14	5	3	3	18
Azerbaijan	9	20	32	17	9	6	4	2	0
Belarus	10	30	28	7	7	4	14	0	0
Bulgaria	18	23	14	7	12	14	8	3	3
Croatia	9	7	7	45	11	9	4	4	5
Czech-Rep	8	16	7	43	6	7	9	2	2
Estonia	2	27	6	35	15	3	4	6	3
Georgia	11	18	29	4	10	11	10	7	0
Hungary	7	44	11	11	14	3	3	1	5
Kazakhstan	11	23	20	5	14	13	10	1	3
Kyrgyzstan	5	15	54	7	7	5	7	1	0
Lithuania	14	9	16	5	15	9	18	4	11
Moldova	15	30	21	4	10	9	7	2	2
Poland	7	26	9	18	16	10	6	4	4
Romania	16	40	6	8	15	5	6	3	1
Russia	12	20	19	11	9	11	12	3	4
Slovakia	6	33	10	18	12	13	4	1	3
Slovenia	7	25	4	36	9	5	6	8	0
Ukraine	10	21	26	10	12	7	10	3	1
Uzbekistan	9	18	28	15	11	5	12	1	1
Overall	11	22	19	15	12	8	8	3	3

Note: Numbers are rounded to the nearest tenth.

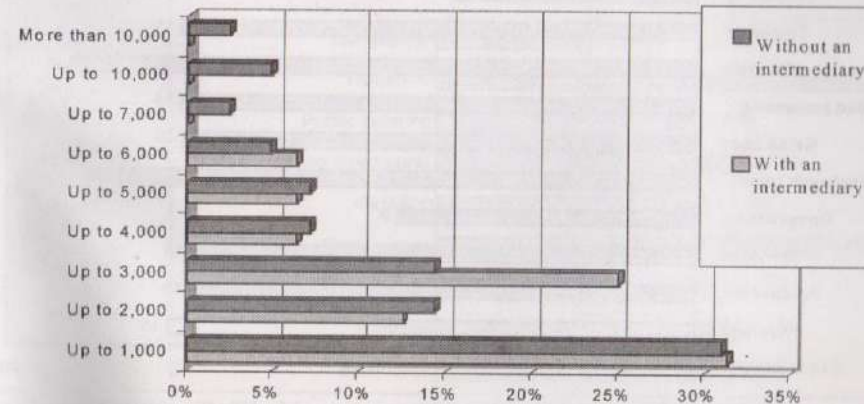
Source: Hellman Joel, Jones Geraint, Kaufmann, Daniel, and Schankerman, Mark. Measuring Governance, Corruption, and State Capture: How Firms and Bureaucrats Shape the Business Environment in Transition Economies. The World Bank Policy Research Working Paper 2312, 2000.

FIGURE 1. TIME OF REGISTRATION



Source: Regulatory and Business Environment Survey. Report prepared for USAID – ARD/Checchi. Conducted by Vitaly Nishanov 2000.

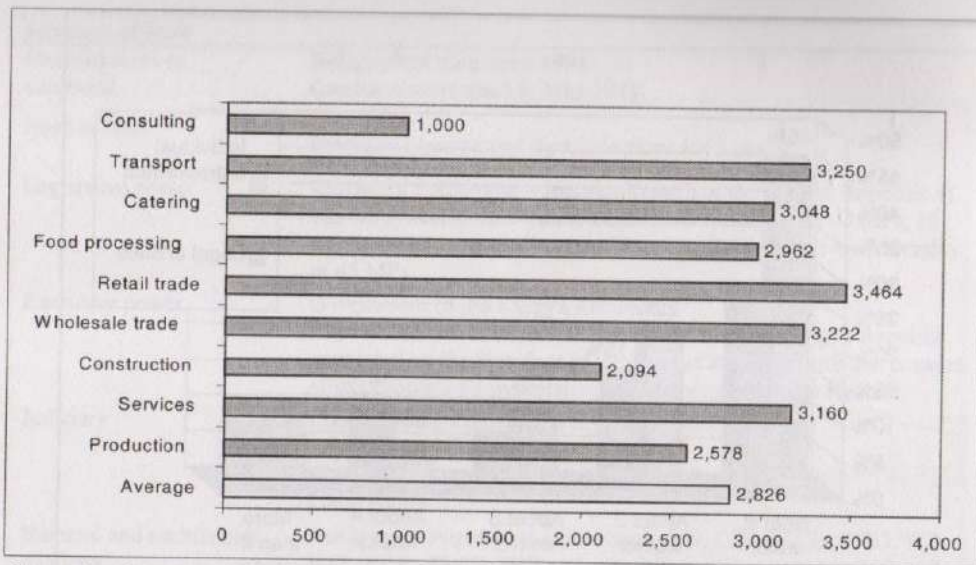
FIGURE 2. COST OF REGISTRATION (INCLUDING OFFICIAL AND UNOFFICIAL PAYMENTS IN SOMs)



Note: According to the National Bank of the Kyrgyz Republic the average exchange rate of Kyrgyz som/\$US during the year 2000 was 47.8. However, it is important to note that the purchasing power parity was no considered and thus the value of dollars indeed have much higher value than they may seem in the paper.

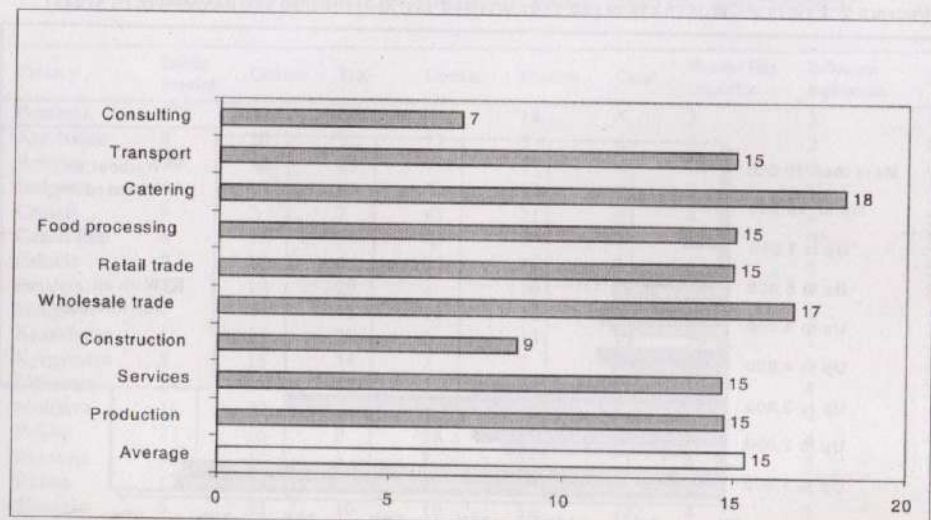
Source: Regulatory and Business Environment Survey. Report prepared for USAID – ARD/Checchi. Conducted by Vitaly Nishanov 2000.

FIGURE 3. AVERAGE COST OF REGISTRATION BY SECTOR (IN SOMS)



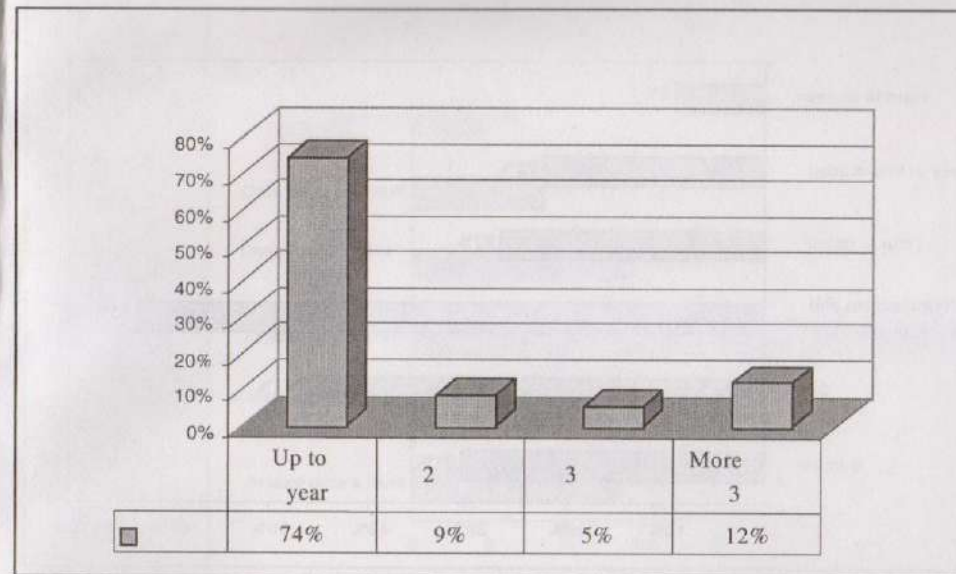
Source: Regulatory and Business Environment Survey. Report prepared for USAID – ARD/Checchi. Conducted by Vitaly Nishanov 2000.

FIGURE 4. TIME OF REGISTRATION BY SECTOR (IN DAYS)



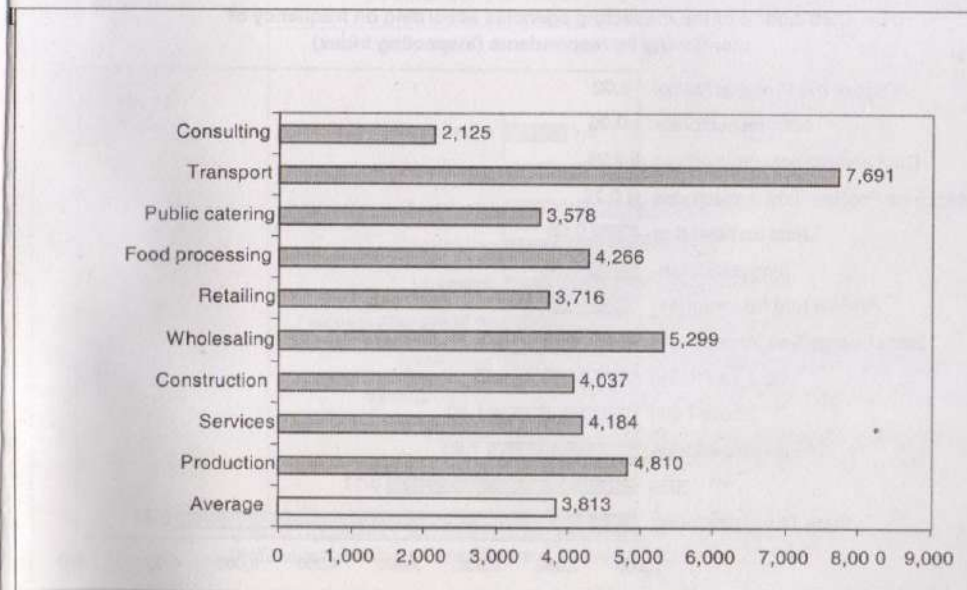
Source: Regulatory and Business Environment Survey. Report prepared for USAID – ARD/Checchi. Conducted by Vitaly Nishanov 2000.

FIGURE 5. AVERAGE VALIDITY OF LICENSES



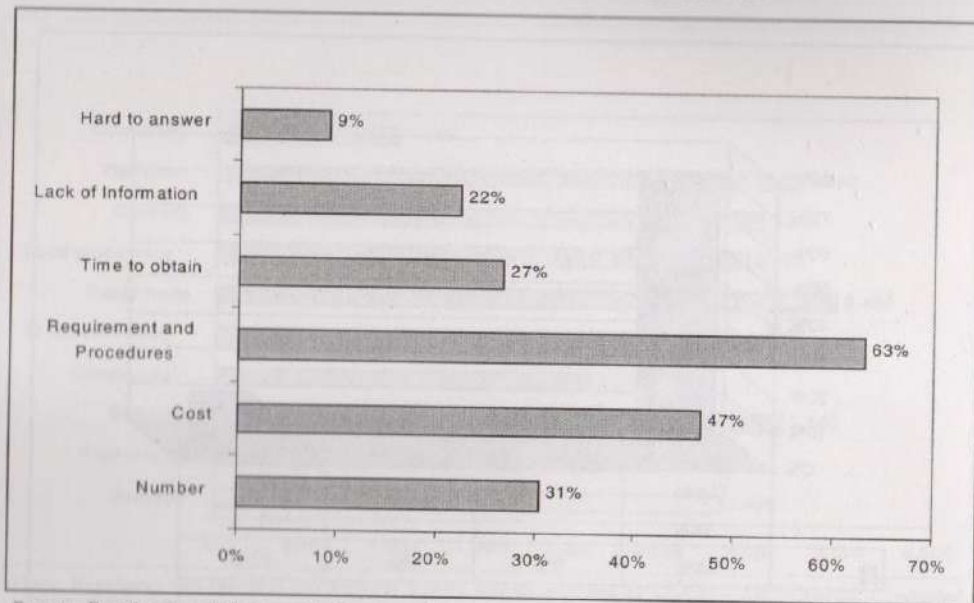
Source: Regulatory and Business Environment Survey. Report prepared for USAID – ARD/Checchi. Conducted by Vitaly Nishanov 2000.

FIGURE 6. AVERAGE COST OF CERTIFICATES BY SECTOR (IN SOMS)



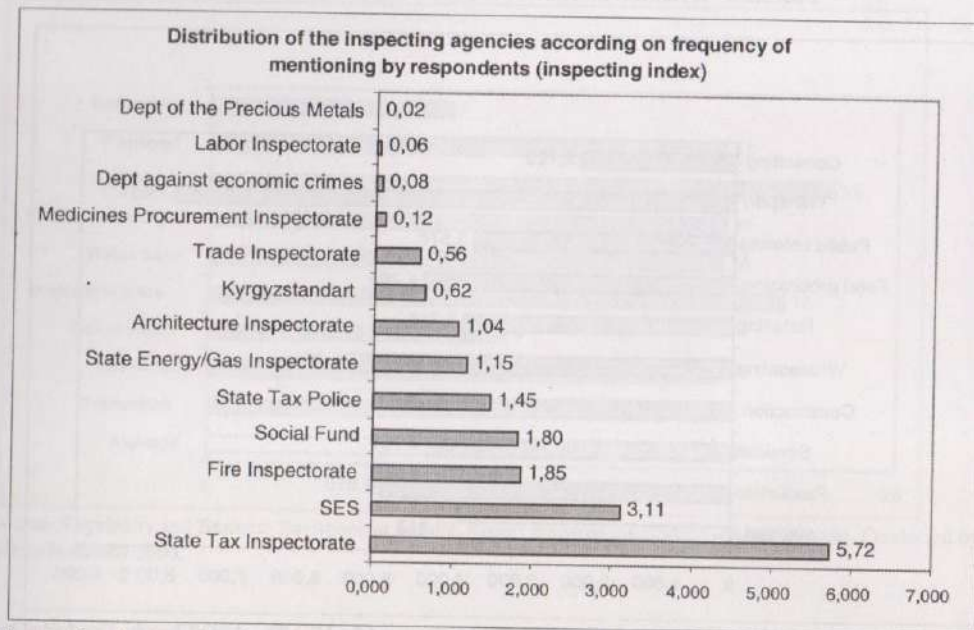
Source: Regulatory and Business Environment Survey. Report prepared for USAID – ARD/Checchi. Conducted by Vitaly Nishanov 2000.

FIGURE 7. PROBLEMS WITH OBTAINING CERTIFICATES



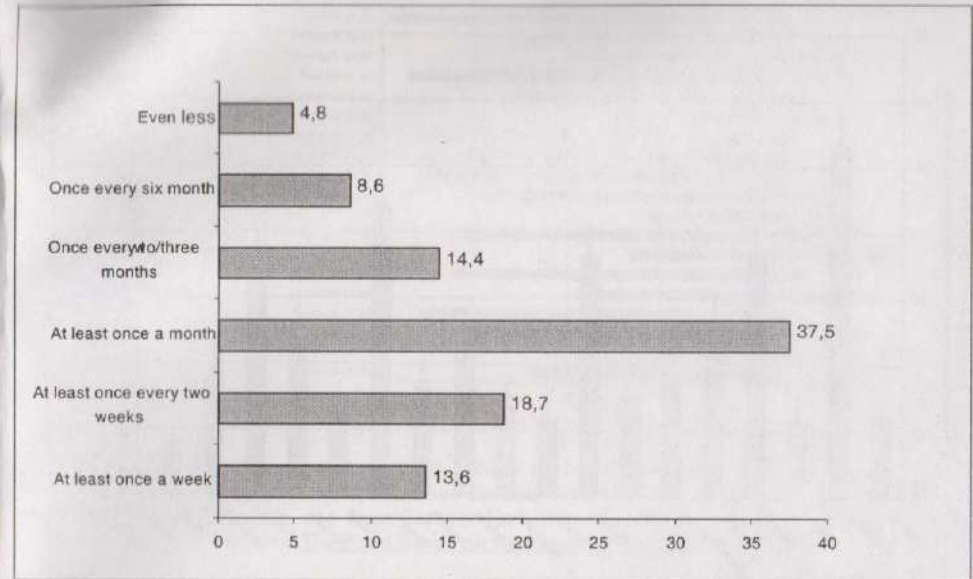
Source: Regulatory and Business Environment Survey. Report prepared for USAID – ARD/Checchi. Conducted by Vitaly Nishanov 2000.

FIGURE 8. THE MOST FREQUENT INSPECTING AGENCIES



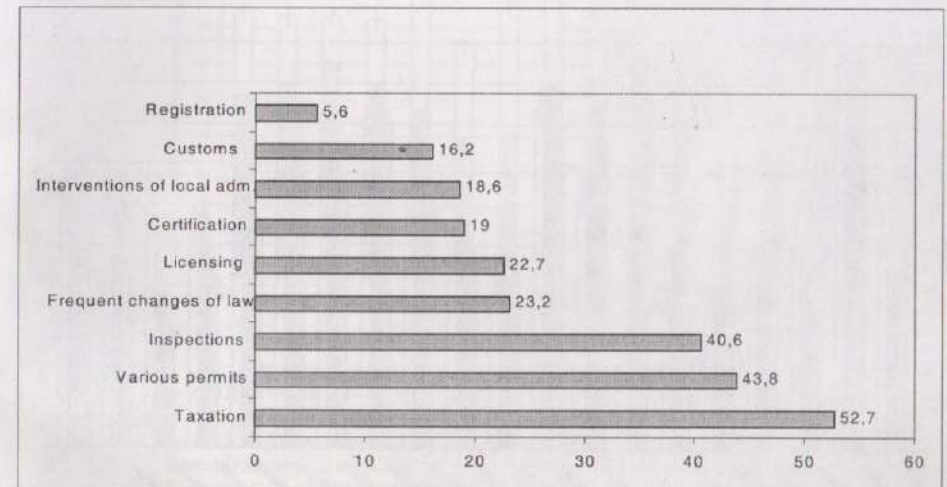
Source: Regulatory and Business Environment Survey. Report prepared for USAID – ARD/Checchi. Conducted by Vitaly Nishanov 2000.

FIGURE 9. GOVERNMENT INTERFERENCE/CONTACT WITH GOVERNMENT OFFICIALS



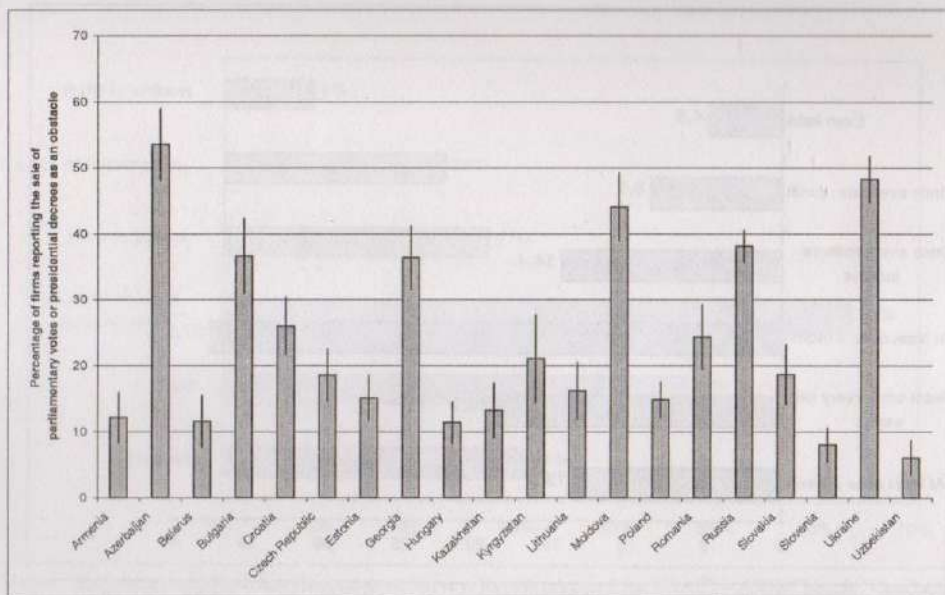
Source: Regulatory and Business Environment Survey. Report prepared for USAID – ARD/Checchi. Conducted by Professional Manager Consulting and Edited by Vitaly Nishanov 2000.

FIGURE 10. THE MOST DISRUPTIVE FORMS OF GOVERNMENT INTERFERENCE



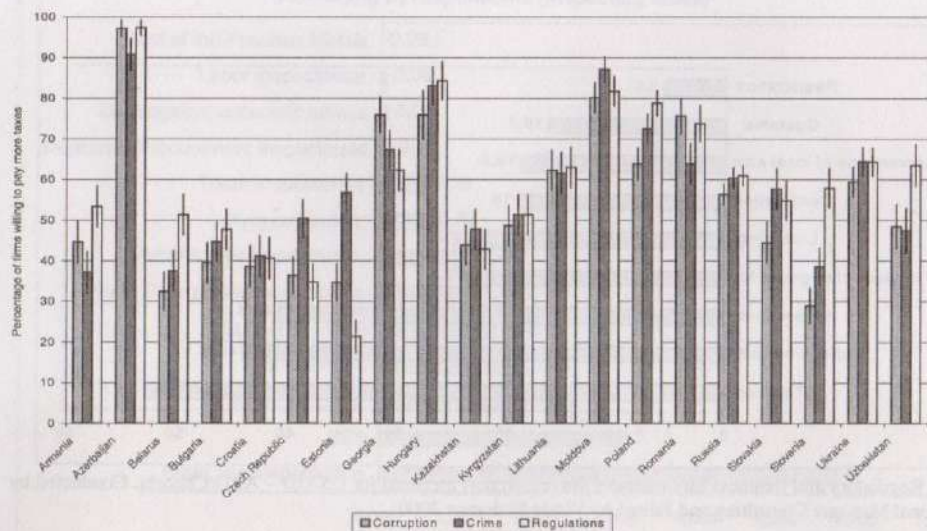
Source: Regulatory and Business Environment Survey. Report prepared for USAID – ARD/Checchi. Conducted by Professional Manager Consulting and Edited by Vitaly Nishanov 2000.

FIGURE 11. GRAND CORRUPTION (COMPOSITE INDEX OF STATE CAPTURE)



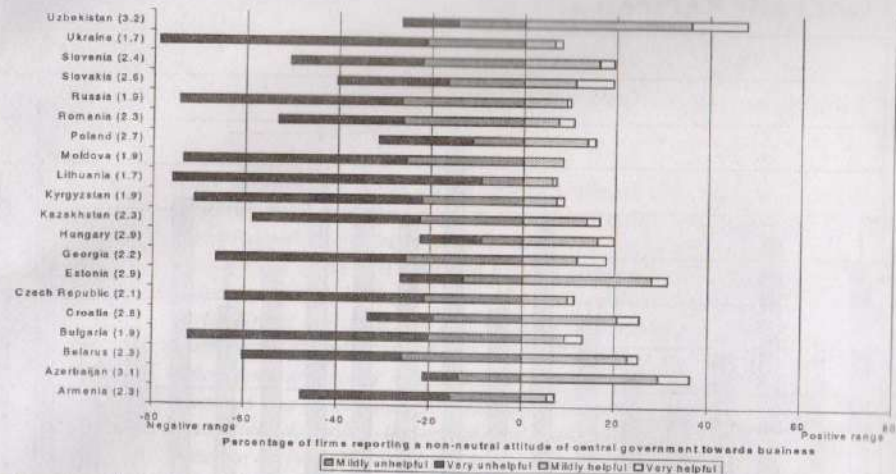
Source: Hellman Joel, Jones Geraint, Kaufmann, Daniel, and Schankerman, Mark. Measuring Governance, Corruption, and State Capture: How Firms and Bureaucrats Shape the Business Environment in Transition Economies. *The World Bank Policy Research Working Paper 2312*, 2000.

FIGURE 12. THE DESIRE OF FIRMS TO STRUGGLE WITH CORRUPTION



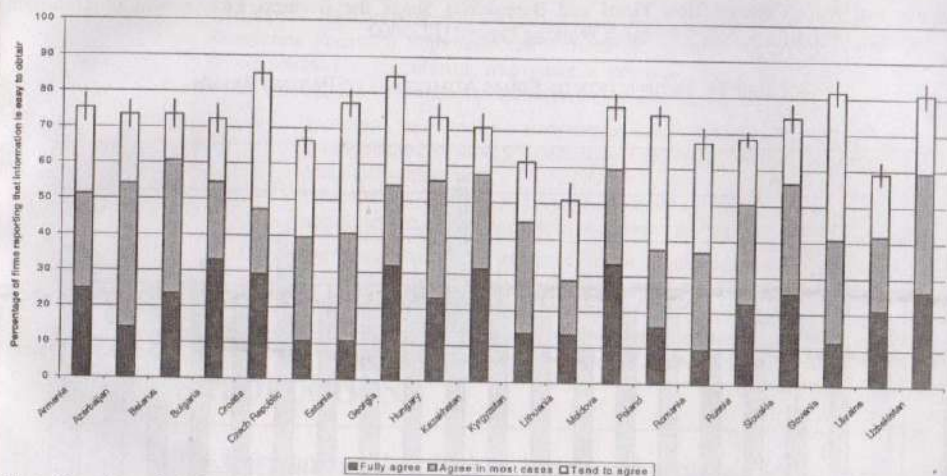
Note: Question asked: Would you pay additional taxes to eliminate corruption, crime and excessive regulations?
 Source: Hellman Joel, Jones Geraint, Kaufmann, Daniel, and Schankerman, Mark. Measuring Governance, Corruption, and State Capture: How Firms and Bureaucrats Shape the Business Environment in Transition Economies. *The World Bank Policy Research Working Paper 2312*, 2000.

FIGURE 13. THE FIRMS' PERSPECTIVE ON THE CENTRAL GOVERNMENT



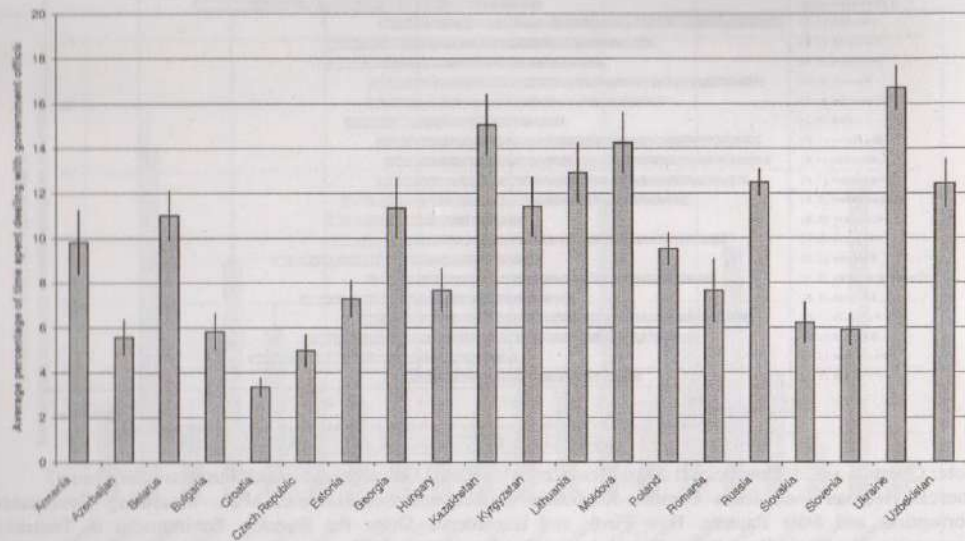
Note: Question asked: How helpful do you find Central/National Government towards businesses like yours?
 Source: Hellman Joel, Jones Geraint, Kaufmann, Daniel, and Schankerman, Mark. Measuring Governance, Corruption, and State Capture: How Firms and Bureaucrats Shape the Business Environment in Transition Economies. *The World Bank Policy Research Working Paper 2312*, 2000.

FIGURE 14. INFORMATION THAT FIRMS POSSESS ON GOVERNMENT REGULATIONS



Note: Question asked: To what degree do you agree with this statement? "Information on the laws and regulations affecting my firm is easy to obtain"
 Source: Hellman Joel, Jones Geraint, Kaufmann, Daniel, and Schankerman, Mark. Measuring Governance, Corruption, and State Capture: How Firms and Bureaucrats Shape the Business Environment in Transition Economies. *The World Bank Policy Research Working Paper 2312*, 2000.

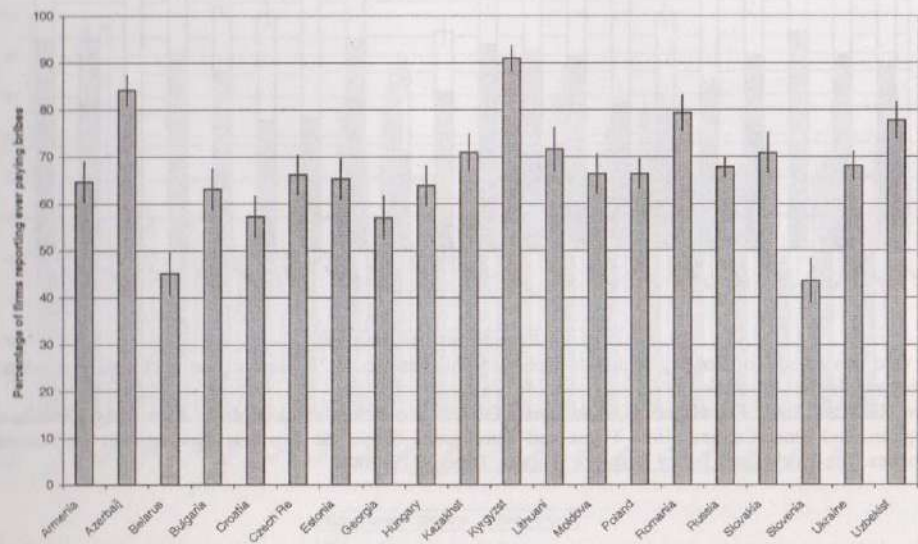
FIGURE 15. AVERAGE PERCENTAGE OF TIME SPENT DEALING WITH GOVERNMENT OFFICIALS



Note: Question asked: What percentage of senior management's time per year is spent in dealing with government officials about the application and interpretation of laws and regulations?

Source: Hellman Joel, Jones Geraint, Kaufmann, Daniel, and Schankerman, Mark. Measuring Governance, Corruption, and State Capture: How Firms and Bureaucrats Shape the Business Environment in Transition Economies. *The World Bank Policy Research Working Paper 2312*, 2000.

FIGURE 16. PROPORTION OF FIRMS ADMITTING TO PAYING BRIBES



Note: Question asked: Proportion of firms admitting to paying bribes?

Source: Hellman Joel, Jones Geraint, Kaufmann, Daniel, and Schankerman, Mark. Measuring Governance, Corruption, and State Capture: How Firms and Bureaucrats Shape the Business Environment in Transition Economies. *The World Bank Policy Research Working Paper 2312*, 2000.

KAZAKHSTAN AND THE CASPIAN SEA LEGAL DISPUTE

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Since the disintegration of the Soviet Union in 1991 led to the independence of three new countries bordering the Caspian, the littoral states - Azerbaijan, Iran, Kazakhstan, Russia, and Turkmenistan - have been unable to agree on a legal framework governing the use and development of the Sea's oil and natural gas reserves. From a legal perspective, the key issues include: whether, in the absence of a new legal convention, treaties signed between the former Soviet Union and Iran are still in force and thereby govern current development rights; and whether the Caspian is a body of water covered by UN Convention on the Law of the Sea, which does not cover inland lakes. The main difference of opinions among the five littoral countries lies in the uneven distribution of potential oil and natural gas riches in the region. The article describes the complex negotiations that have taken place among Caspian states since the early 1990s, focusing on Kazakhstan's strategy.

КАЗАХСТАН И ЮРИДИЧЕСКИЕ РАЗНОГЛАСИЯ В ОТНОШЕНИИ КАСПИЙСКОГО МОРЯ

ЭМАНУЭЛЬ КАРАГИАНИС И УСЕН СУЛЕЙМЕНОВ

С тех пор, как распад Советского Союза в 1991 году ознаменовал независимость трех новых государств, имеющих доступ к Каспийскому морю, прибрежные государства - Азербайджан, Иран, Казахстан, Россия и Туркменистан - были не способны прийти к единому мнению по вопросу использования и разработки нефтяных и газовых ресурсов Каспийского моря. С юридической точки зрения, следующие вопросы являются основными:

- принимая во внимание отсутствие новых законных конвенций, действуют ли прежние договоренности между Советским Союзом и Ираном и определяют ли они настоящие права на разработку;
- является ли Каспий водоемом, подпадающим под юрисдикцию Конвенции ООН по морскому праву, которая не оговаривает внутренних озер.

Основное различие во мнениях пяти прибрежных государств касается неравного распределения нефтяных и газовых богатств региона. Статья описывает сложный переговорный процесс, происходивший между каспийскими государствами с начала 1990-х годов и концентрирует свое внимание на казахстанской стратегии.

INTRODUCTION

The Caspian is a landlocked inland sea with no natural outlet to any other sea or ocean. As a result of the break-up of the Soviet Union in 1991, five littoral states now border the sea: Russia, Kazakhstan, Turkmenistan, Iran, and Azerbaijan. In recent years the Caspian region has taken a special place on the world arena. The September 11 events and the war against international terrorism added to the strategic importance of the Caspian Sea, which is in proximity to Iraq and Afgha-

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nistan, the two main theatres of operations. Also, the Caspian is at the center of the Eurasian transport corridor linking Europe with Central Asia and China.

Since the discovery of substantial oil resources in the North Sea a few decades ago, no new world-class oil deposits had been found. However, this changed in the early 1990s with a renewed assessment of Caspian Sea's energy resources. The Caspian has been seen as a new significant additional source of oil; its proven crude oil reserves are 17-33 billion barrels, while its proven natural gas reserves are estimated at 232 trillion cubic feet (Energy Information Agency, 2003). Kazakhstan sits astride the northeast portion of the Caspian Sea and claims most of the sea's biggest known oil fields. Kazakhstan's combined onshore and offshore proven hydrocarbon reserves have been estimated to be between 9 and 17.6 billion barrels (Energy Information Agency, 2003). Although only a minor world oil exporter in 2003, Kazakhstan is poised to become a more significant player in world oil markets over the next decade.

Not surprisingly, the region has attracted the attention of leading world powers. Imports from the Caspian Sea could diversify the supply of oil which would help to maintain energy security and bring the benefits of increased competition to the consumer. Diversification of supply could decrease the possibility that a political upheaval in one country/region will significantly affect oil supplies and possibly bring about a global economic crisis. Moreover, Caspian oil is 'non-OPEC oil', meaning that supplies from this region are less likely to be affected by the price and supply policies applied by the oil-exporting cartel. Flows of large volumes of Caspian oil through non-OPEC lands would erode the power of OPEC, as well as its ability to maintain high oil prices and to use oil as a mode of political blackmail. In order for the Caspian region to realize its full oil and gas potential, however, the littoral states must first agree on the legal status of the sea. The continuing unresolved status of the Caspian has hindered further development of its oil and gas resources, as well as the construction of potential export pipelines from the region.

Over the past twelve years, diplomatic negotiations and developments on the ground have centered on two issues. First, should the Caspian Sea be delineated into national sectors, drawn equidistant from coast lines, or alternatively, be subject to a condominium arrangement? Second, should states divide completely the Caspian into national sectors or the division be limited only to subsea resources, with joint management governing the water column (*i.e.*, fishing, navigation and environment)? Although relevant literature seems to be abundant, in reality it is general rather than specific.¹ The main aim of the present article is to examine the Kazakhstani strategy towards the Caspian legal dispute.

In the beginning, this article will attempt to describe briefly the legal history of the Caspian Sea. Then, it examines the international practice of dispute resolution on boundary waters between states in other parts of the world, while analyzing the implications for Kazakhstan. Finally, it analyses the negotiation process among littoral states since 1991, focusing on the Kazakhstan's strategy.

LEGAL HISTORY OF THE CASPIAN SEA BEFORE 1991

The Caspian has been described as both the largest lake and one of the smallest seas in the world. It is 436,000 square kilometers in size, 1440 km long and an average of 278 km wide. The Caspian Sea is 980 meters deep at its deepest, contains approximately 77,000 cubic km of water, and has an average salinity of 13,000 ppm, or roughly one-third that of the ocean. (Micklin 2001, 44).

The history of the evolution and development of the legal status of the Caspian before 1991 could conveniently be divided into two periods. The first is the pre-Soviet period. In 1722, Peter the Great made the famous Persian expedition; as a result, in 1723, the St. Petersburg Treaty was signed, according to which only Russia could have its fleet on the Caspian Sea. The Russian-Persian wars of the 19th century resulted in the conclusion of two treaties, which, in addition to fixing the Russo-Persian land borders, regulated shipping rights in the Caspian. The first of these treaties, the Golestan Treaty of 1813, barred Persia from deploying its naval forces in the Caspian. The Turkmenchai Treaty, concluded in 1828 reiterated these limitations on Persian shipping. In 1907, an Anglo-Russian Convention on Afghanistan, Persian and Tibet divided Persia into a northern zone passed to Russian influence and a southern zone passed to British influence. The Convention reinforced Russia's hegemony in the Caspian Sea.

The legal regime of the Caspian Sea remained unchanged until after the Russian Revolution of 1917. The second period started when the 1921 Treaty of Friendship between Iran and Russia abrogated all prior treaties and restored Iranian shipping rights in the Caspian. Moreover, the treaty provided that Iranian crews may not include citizens from third countries using their service aboard vessels under the Iranian flag for purposes unfriendly towards the Soviet Union. Under the Treaty of Establishment, Commerce and Navigation concluded by the two states on August 25, 1935, each party 'reserves to vessels flying its own flag the right to fish in its coastal waters up to a limit of ten nautical miles' (Mehdiyoum, 2000).

The two countries reaffirmed the 10-mile fishing zone in the Treaty of Commerce and Navigation on March 25, 1940. Beyond the 10-mile zone, fishing was allowed only to Soviet and Iranian nationals. Exchanges of notes attached to Soviet-Iranian treaties of 1935 and 1940 declared that the Caspian 'is regarded by the two governments as a Soviet and Iranian sea' and that the 'parties hold the Caspian to belong to Iran and to the Soviet Union' respectively (Clagett, 1995). The meaning of these provisions in the two exchanges of notes was, plainly, that no third state had any rights in the sea, including the right of navigation.

Before the 1940s, the Caspian Sea was known primarily for its fish stock and as a part of the Russian and later the Soviet navigational network. It has been possible, since the 1880s, to travel from the Caspian Sea to the Baltic Sea via a system of rivers and canals. In 1952, after the completion of the Volga-Don Canal, it became also feasible to travel from the Caspian Sea to the Azov and Black Seas. However, one ambiguity about these treaties is that nothing was mentioned about the seabed resources. The implementation of oil drilling off the coast of Azerbaijan in 1949 meant that the Caspian Sea became an important source of petroleum.

Since the early 1990s, there has been a debate about whether the Caspian Sea is a sea or a lake, and what is the appropriate legal regime for its division. Geologists do not agree on the precise difference between seas and lakes. Characteristics that have been cited as relevant to the determination of whether a body of water is a sea or a lake include size, salt content, depth, life span, method of formation and the existence of a continental shelf. Therefore, it has been argued that the Caspian Sea is a saltwater lake rather than a sea because of certain geological characteristics.

The 1982 UN Convention on the Law of the Sea applies to all seas and oceans. Pursuant to the Convention, coastal states are entitled to the following rights to the adjacent sea and its resources: (i) a territorial sea, over which the coastal state exercises sovereignty (Article 2); (ii) an exclusive economic zone, in which the coastal state has 'sovereign rights for the purpose of exploiting, conserving and managing the natural resources . . . of the waters superjacent to the seabed and of the seabed and its subsoil' (Article 56); and (iii) a continental shelf, over which the coastal state exercises 'sovereign rights for the purpose of exploring and exploiting the natural resources' (Article 77). The rights of a coastal state over its continental shelf do not extend to the superjacent waters or the air space above those waters (Article 78). A territorial sea can extend up to 12 nautical miles from the coastal state's shoreline. The exclusive economic zone extends beyond and adjacent to the territorial sea, up to 200 nautical miles from coastal state's shoreline. The continental shelf extends throughout the natural prolongation of a coastal state's land territory, or for 200 nautical miles where the outer edge of the continental shelf does not extend up to that distance.

The Convention contains specific provisions governing enclosed seas. An enclosed sea is defined as 'a gulf, basin or a sea surrounded by two or more states and connected to another sea or ocean by a narrow outlet or consisting entirely or primarily of the territorial seas and exclusive economic zones of two or more coastal states' (Article 122). The Convention provides that states that border on enclosed seas should cooperate with each other in the exercise of their rights and in the performance of their duties under the Convention, as described above. If the Caspian Sea is considered to be an enclosed sea, then, under the Convention, it should be divided into the territorial sea, the exclusive economic zone and the continental shelf of each coastal state, to the extent possible and without infringing on the rights of the other coastal states.

If it is not possible for the states around an enclosed sea to fully exercise the rights granted to them under the Convention, because doing so would overlap with the rights granted to other coastal states, then the states must cooperate to reach another solution. Under Article 15 of the Convention, which discusses the delimitation of the territorial sea between states with opposite or adjacent coasts, the solution suggested is that the states extend their territorial seas to the 'median line every point of which is equidistant from the nearest points on the baseline from which the breadth of the territorial seas of each of the two states is measured'.

Articles 74 and 83 of the Convention provide that a state, that cannot fully exercise its rights to an exclusive economic zone or a continental shelf without impinging on the rights of another state, shall define these rights by agreement with the other state and that this agreement must be based upon international law, as defined in Article 38 of the Statute of the International Court of Justice.

Examples of past practice in which coastal states divided enclosed seas into national sectors include the Black Sea, which has been effectively divided into the territorial seas of Ukraine, Russia, Romania, Bulgaria, Turkey and Georgia by bilateral treaties and the Dead Sea, which has been divided between Israel and Jordan by treaty. In both examples, the seas were divided by extending the land borders between the coastal states, rather than at the midpoint of the sea.

If it is determined that the Caspian Sea is not a sea but a lake, then the Convention would not apply to it. There are about a hundred inland bodies of water whose coast is shared by two or more countries. Under international law, as reflected in the past practice, lakes that are bordered by more than one state could be divided between the states by agreement, and either in accordance with the borders of the states as they intersect the lakes or at the midpoint of the lake.

The regimen has been followed with regard for example to Lake Victoria, which was divided by former colonial powers into what is now Ugandan, Tanzanian and Kenyan territory. The boundaries are now accepted as legitimate by the three states and have been recognized by the international community. Each country is entitled to exploit the resources of its section of the lake, including subsea resources, subject only to the limitation that certain environmental issues are subject to the oversight of a consultative body. In Europe, Lake Geneva is divided into Swiss and French territory, Lake Constance is divided into Swiss and German territory, and Lake Lugano and Lake Maggiore are divided into Swiss and Italian territory. In all cases, each of littoral states is free to exploit any resources which are found on its side of the lake. In North America, Lakes Superior, Erie, Huron and Ontario were divided into U.S. and Canadian territory by the Peace Treaty between the United States and the UK on September 3, 1783. In Latin America, the five lakes which border on both Argentina and Chile have been divided between the two countries.

On the other hand, Lake Titicaca, under the 1997 treaty between Peru and Bolivia, is shared and collectively utilized by the littoral states. However, border lakes are as a rule divided by national borders. There are three ways to divide the Caspian:

1. *Dividing the Caspian Sea into equal parts.* According to this view, the sea should be equally shared by the littoral states, in a way that each of them own 20 percent of the Caspian. This method, supported by Iran, is based on the 1921 and 1940 treaties because according to them the Caspian Sea had been considered an Iranian-Soviet sea and used equally by both countries. Therefore, any future agreement should provide to each country an equal share of the sea.
2. *Dividing the Caspian Sea based on the hypothetical line of Astara-Hosseingholi and the interior divisions formerly used in the USSR.* This

method, promoted by Azerbaijan, suggests that the Caspian Sea was divided in the past and no further division is required. It holds that the sea borderline between Iran and the Soviet Union before 1991 was clear and the line extending along the two countries' borderlines from the city of Astara in the west to the Hosseingholi gulf in the east formed the border. With respect to the sea borders of the newly independent states, it is argued that the Soviet government determined the sea border for each republic in 1970 and the same borderlines are still applicable. Kazakhstan's share of the Caspian was 113,000 square kilometers. The shares of the other republics were as follows: Russia, 64,000 sq. km; Azerbaijan, 80,000 sq. km, Turkmenistan, 80,000 sq. km.

3. *Dividing the Caspian Sea according to the median line.* According to this method, the sea should be divided along the median line, which has the same distance from both opposite shores. Should this method be adopted, Kazakhstan's share of the Caspian Sea would be 29 percent, while Iran's would receive 13.4 percent, Azerbaijan 19 percent, Russia 19 percent and Turkmenistan 18.6 percent.

Thus, two variants of solution of the Caspian Sea legal status problem are possible. Under the first, the Caspian can be considered as an enclosed sea, and in this case the provisions of the UN Convention on the Law of the Sea governing the legal regime of enclosed seas are applicable to it. Under the second, the Caspian is a lake, and is subject to the international legal regime governing lakes. In either case, the result is some type of division of the sea between the littoral states, rather than a common ownership of the Caspian.

THE NEGOTIATION PROCESS AND THE KAZAKHSTANI STRATEGY

With so many other priorities requiring attention at the time of the USSR's disintegration, resolution of the Caspian legal issue was low on the regional political agenda. When Western oil companies rushed to the region with far-reaching, ambitious oil and gas production projects, the legal debate gained momentum. Since then, the positions of the littoral states have been shifting with the evolution of their domestic politics, their economic situation, their foreign policies and the international environment.

The first serious attempt to tackle the issue was made on October 15, 1993, when the prime ministers of Azerbaijan, Kazakhstan, Russia and Turkmenistan met in Astrakhan to discuss the legal status of the Caspian Sea. The official position of the Russian Federation was that, due to natural characteristics, the Caspian should be considered a closed lake, and the 1982 United Nations Convention on the Law of the Sea was not applicable to the states bordering the sea. According to the Soviet-Iranian treaties on the status of the Caspian Sea, the states had sovereign rights over the water up to 10 miles away from their coast. Because none of the treaties contained any provision for formal delimitation of the Caspian, Russia claimed legal justification of its argument for a joint sovereignty settlement. Moreover, the Alma

Ata Declaration of December 1991 (which was signed by Kazakhstan, Russia, Azerbaijan, Turkmenistan and other former Soviet republics) included a provision recognizing the validity of all treaties and agreements signed by the USSR. There is, therefore, a case for keeping the treaties between the Soviet Union and Iran in force.

Azerbaijan claimed that the division of the sea among the littoral states is supported by international practice and rules of international law. The water, as well as the seabed, must be divided by means of an equidistant line. From the Azerbaijani point of view, the Soviet-Iranian treaties of 1921 and 1940 regulate only navigation, fishing, and border-guard practices and are inapplicable to the mining regime. Azerbaijanis also argue that the history of state practice prior to 1991 supports their position for the division of the Caspian into national zones. Turkmenistan, which had hitherto favored common development of resources in the Caspian, in 1997 began considering the prospect of division.

From the Iranian perspective, the Caspian has unique geographical characteristics, which distinguish it from similar bodies of water. Therefore, the international law of the sea is not applicable to it. Instead, until the five littoral states jointly devise a new legal regime for the Caspian, the Soviet-Iranian Treaties of 1921 and 1940 must govern the sea. The silence of these treaties on mining rights must be seen in the light of the inadequacy of offshore mining technology at the time. Tehran originally insisted that the new legal regime of the Caspian should be based on the condominium solution. Recently, however, the Islamic Republic's official position is that it would accept the division of the Caspian Sea, so long as it receives a 20 percent share, and that both the seabed and surface are divided. As a result, the Iranian government has rejected as invalid all unilateral and bilateral agreements on the utilization of the Caspian Sea. This fact was brought to the forefront when Iranian gunboats confronted a British Petroleum's research vessel in the Azerbaijani sector of the Caspian Sea in July 2001 (Iskenderov, 2001).

To Kazakhstan, as a littoral state, the legal status of the Caspian has been a foreign policy priority. Initially, Kazakhstan simply claimed that previous agreements on the Caspian had become invalid in the post-Soviet era and a new legal status for the sea should be defined. The Kazakhstani government claimed that the UN Convention on the Law of the Sea should apply because the Caspian is connected to the high seas through the Volga-Don and Volga-Baltic river systems. But should the UN Convention be applied to the Caspian, the two channels will have the status as international waterways, which is unacceptable to Russia.

On July 19, 1994 Kazakhstan sent a draft 'Convention on the Legal Status of the Caspian Sea' to the other littoral states. The draft was based on the concept of a landlocked sea, and attempted to apply the provisions of the UN Convention on the Law of the Sea to the Caspian. It envisaged delimiting the coastal states' borders on the Caspian, including territorial waters and exclusive economic zones, as well as determining each state's continental shelf. Coastal states were to possess national jurisdiction and exclusive rights to explore and exploit the mineral resources in their sector of the seabed. Moreover, Almaty immediately began to form a coalition with Azerbaijan and Turkmenistan to counter the Russian demands. On the other hand,

the draft contained some provisions favoring the Russian position. It recognized the need for unhampered navigation and fishing, each state's ecological responsibility, and need for a coordinating body, which would ensure a balance between the interests of all the littoral states.

Another important element of Kazakhstan's diplomatic tactics was the internationalization of the Caspian Sea dispute by involving in it other powerful players, such as the United States and European countries, that were likely to support the Kazakhstani position. Almaty began actively seeking foreign investment in its oil and gas industry immediately after independence. In May 1992, during Nazarbayev's visit to the United States, a contract was signed with Chevron Oil to develop the Tengiz oil field. In July 1992 British Gas and the Italian oil company Agip bid successfully to exploit the Karachaganak oil and gas field. On February 13, 1993 the Kazakhstankaspiyshelf State Company was formed, for the purpose of exploring for oil and gas in the Caspian Sea. On December 3, 1993 a consortium of Western companies signed an agreement with Kazakhstan to explore the geological, geophysical and ecological features of the Kazakhstani section of the Caspian shelf. The consortium, formed in June 1993, included seven companies - Agip, British Gas, British Petroleum and Statoil (Norway), Mobil Oil (United States), Shell (Holland/UK) and Total (France). The project was to be coordinated by the Kazakhstankaspiyshelf State Company. In addition, Azerbaijan signed its 'Contract of the Century' with foreign oil companies in September 1994.

Not surprisingly, Azerbaijan's and Kazakhstan's moves caused irritation in Moscow. At a UN meeting in October 1994 the Russian government circulated a paper which stated that it 'reserved the right to take appropriate measures' against Caspian states that unilaterally begin exploring the seabed. Such a formulation meant nothing short of a direct threat to use direct force (Croissant 1998, 56). Release of the document preceded the opening on October 11 of a two-day conference in Moscow of the five Caspian littoral states, called to discuss the establishment of a joint legal body on the Caspian Sea. At this meeting Iran put forward the idea of establishing a regional organization and submitted a draft treaty. The Russian side suggested the signing of separate agreements on different kinds of activities (navigation, fishing, etc.), which consequently could create the skeleton of the future convention. However, it became obvious that the Kremlin was trying to shelve the signing of treaty and to 'pull through' significant elements of the status of the sea into agreements on separate kinds of activities and, thus predetermine the legal status of the Caspian as whole.

In May 1995, there was a second meeting of deputy foreign ministers of the Caspian littoral states in Almaty. On the initiative of Kazakhstan the parties reached an agreement on creation of a standing negotiation mechanism on the level of heads of legal departments of the ministries of foreign affairs. The Almaty meeting was the starting point of an abrupt intensification of the negotiation process which acquired a more organized character. Indeed, in 1995, heads of legal departments held two meetings - one in Tehran in July and another in Almaty in September.

At the Tehran meeting the sides discussed various elements of the future legal status of the Caspian Sea, such as navigation, utilization of bioresources, environment, utilization of mineral resources, and definition of limits of jurisdiction of littoral states. An important result of the Tehran meeting was that participants reached an agreement on that the legal status of the Caspian must be fixed in one document, on the basis of which other agreements would regulate different kinds of activities. This meant the failure of the Russian tactics to predetermine the legal status by signing separate agreements on individual activities.

A major shift in Kazakhstan's position occurred at the conference of heads of legal departments of the Caspian states' foreign ministries, held in Almaty on September 26, 1995. Realizing that its initial stance was difficult to defend, the Kazakhstani government dropped its insistence on application of the Law of the Sea to the Caspian and agreed to regard it as a lake. During the negotiations, Kazakhstan submitted a new version of a draft Convention on the Caspian Sea's legal status. Despite the change in Kazakhstan's position, Almaty still insisted that territorial waters, subsea resource rights and fishing zones should be awarded to coastal states, on the grounds that the idea of general ownership of the Caspian would not appeal to foreign investors who have already signed contracts with two of the five coastal states (*i.e.* Azerbaijan and Kazakhstan).

During the Almaty meeting, the parties also accepted seven basic principles of activities on the Caspian Sea which must become an important constituent of convention on the legal status of the Caspian Sea.² Among them was agreed the principle of demilitarization of the Caspian Sea which is significant for facilitation of peace and stability in the region. It should be noted that representatives of Russia did not take part in the Almaty meeting; at the last moment they informed the hosting country that they do not believe in the success of the meeting without additional political impulse.

The Caspian legal problem was also discussed by the heads of littoral states. In April 1996, the Presidents of Kazakhstan and Russia, Nursultan Nazarbayev and Boris Yeltsin, signed a joint statement on the Caspian legal issue in Almaty. For the first time the Russian side, on the highest governmental level, recognized the right of Kazakhstan to carry works on exploration and development of oil and gas resources in the Caspian Sea and expressed readiness to cooperation in this field. It meant that the Kremlin had accepted that actions of Kazakhstan on northern Caspian were legal. The Russian government recognized, perhaps with some reluctance, the need for dialogue and mutual cooperation with Kazakhstan, if long-term stability and sustainable development was to be achieved. But as expected the statement did not lead to any breakthrough in determining the Caspian Sea legal regime. Two meetings of the five Caspian states, in Teheran on October 24, 1996, and in Ashgabat on November 12, 1996 produced no noticeable results.

In the second half of 1997, diplomatic struggle around the Caspian Sea issue substantially intensified. It was the result of growing American involvement in the region. During Nazarbayev's visit to Washington on November 17-18, 1997, the issue of Caspian energy development was discussed extensively in several meetings,

including with President Clinton. Washington fully supported Kazakhstan's position on dividing the Caspian Sea into national sectors as a counter to Russian-Iranian advocacy of the 'common use' principle. The joint statement by Clinton and Nazarbayev especially emphasized the 'need to adopt a Caspian Sea legal regime that establishes a clear division of property rights based on the division of seabed resources' (Office of Press Secretary, 1997).

From the U.S. point of view, the availability of Caspian reserves comes at a time when world demand for energy is growing rapidly, many are questioning the reliability of supplies from the Middle East, and Washington is encouraging the diversification of supply to ensure U.S. and global energy security. It is the policy of the United States to diversify world sources of oil, not only for itself but also for other oil importers. Since Western countries depend on oil supplies from the Gulf, it is in the USA's interest that the Caspian region emerges as a distinct oil market between the oil producing and exporting networks of the Middle East and the Russian Federation. The oil from the Caspian Sea is looked upon by Western countries as a strategic priority for four additional reasons:

- The proven and projected reserves of Azerbaijan, Kazakhstan and Turkmenistan will be crucial to meeting the expected demand for oil in the next years.
- The oil of this region is considered to be of good quality.
- The biggest part of this oil is intended for export, since the needs of Caspian producers are relatively low and are expected to remain low.
- The fact that the regional governments lack the capital and the technology to proceed independently to the development of these oil fields offers Western corporations considerable investment opportunities. Unlike the majority of the Middle East's proved oil reserves, these resources are available for exploitation by foreign companies. In fact, Western firms have a strong presence in the region as they have poured many billion dollars into oil and gas exploration, betting on a future payoff.

In the absence of a formal agreement among the five countries on the legal status of the Caspian, several countries have negotiated bilateral agreements to clarify their positions. In 1997, Kazakhstan and Azerbaijan agreed to adhere to the borders of the sectors along the median line until a convention on the legal status of the Caspian is signed. In 1997, also, Kazakhstan signed a declaration with Turkmenistan pledging to divide their sections of the Caspian along the geographical median line, based upon Soviet-era divisions, until the littoral states agreed upon a new status for the Caspian. The median line approach allocates each state a share of the sea's seabed resources in proportion to their share of the coastline, while leaving the surface of sea as a common area.

Being devoted to the idea of a consensus, Moscow started looking for a compromise that would bring together two opposite positions: that of a condominium and that of dividing the sea into national sectors. In July 1998, Kazakhstan unexpectedly signed a bilateral agreement with Russia dividing the

northern Caspian seabed along the modified median line between the two countries, with the waters (covering issues such as shipping, fishing, and environment) remaining under joint ownership.³ Under this accord, Soviet agreements with Iran on the division of the Caspian would remain valid until an overall agreement is reached among all Caspian littoral states.

FIGURE 1: CASPIAN DIVISION MEDIAN LINES



What was the payoff to Russia? First, the agreement would enable Russian oil and gas companies to develop rich hydrocarbon deposits in the north of the Caspian and bring them to the market. In addition, the Russian government has opposed the construction of a trans-Caspian pipeline to join Kazakhstan and Azerbaijan on the grounds that it would pose an environmental risk. The shared control of the water would allow Russia to block such a pipeline. Moreover, Russia's interests in the sea are not limited to economic benefits. Its unwillingness to divide the surface and the water stems from its fear of losing military control over the Caspian and of allowing Turkey and the United States to fill the vacuum.

The implementation of the Kazakhstani-Russian agreement proved more difficult than its conclusion. After nearly four years of negotiation, in May 2002, a

supplementary protocol to the 1998 agreement was signed by both states which called for joint development of three disputed oil fields located on the median line, including the Khvalynskoye deposit and Central structure in Russia and the Kurmangazy structure in Kazakhstan.⁴ The 1998 agreement was ratified by the parliament of Kazakhstan in October 2002 and the Russian Duma in March 2003.

In May 2003, another round of Caspian Sea talks took place in Almaty, involving officials from all five regional countries, but once again there was no progress towards a pact defining the Caspian's legal status. Tehran insisted that the sea be divided into equal 20 percent shares, while Baku, Moscow and Astana supported a median line principle that would leave the five countries with differing shares. Following the Caspian talks, Azerbaijan, Russia and Kazakhstan signed a trilateral pact demarcating the seabed. According to the agreement, Kazakhstan received a 29 percent share, while Russia and Azerbaijan each obtained a 19 share. It appears that there is an emerging element of coincidence in the approaches of Russia, Kazakhstan and Azerbaijan toward settlement of the legal status of the Caspian.

CONCLUSION

The Caspian legal dispute has been the subject of intensive and rather complicated negotiations among the littoral states. The results of these negotiations will eventually determine whether the Caspian will be a sea of peace and cooperation or become 'an apple of discord', that could plunge into an abyss of bloody conflicts. There is no doubt that the Caspian problem has many dimensions. There are issues of navigation, fishing and the use of biological resources, and of ensuring the ecological security of the sea. But the most important issue is the exploration and exploitation of the seabed of the Caspian, which is rich in hydrocarbons. Negotiations between the littoral states have made slow progress in ironing out differences: while Russia, Azerbaijan, and Kazakhstan have agreed on dividing the sea by a modified median line principle, Iran insists on an equal division of the sea, and Turkmenistan's position is continuing to evolve.

Resolution of the legal status of the Caspian Sea is an important issue affecting the sovereignty of the Caspian states and the pace of private sector investment in regional energy development. The Kazakhstani government has turned to the energy sector as the major lever for economic restructuring, industrial modernization and national independence. It appears that Kazakhstan has come to understand that Caspian energy development, at least in its own case, is not feasible without Russian consent. For Kazakhstan the only real choice has been between finding a compromise with Moscow and having no oil profits at all. However, without a final agreement on the division of the Caspian international financiers and multilateral development banks could withhold financing on grounds that property rights are in dispute.

Today the most viable option is to divide the Caspian seabed regardless of legal regime of surface waters, shipping, navigation, fishing and protection of

bioresources. The bilateral agreements between Russia, Kazakhstan and Azerbaijan on the delimitation of the seabed can be the first step for coastal states to reach a consensus on the legal status of the sea. The rules of international law and practice in delimitation of bodies of water could be highly instrumental in working out a mutually acceptable solution.

ENDNOTES

1. See for example Oxman Bernard, 'Caspian Sea or Lake: What Difference does it Make?', *Caspian Crossroads*, 1(4); Center for Foreign Policy and Analysis (2002). *Kazakhstan in Focus: Ten Years of Independence*, Almaty: CFP; Ebel Robert and Menon Rajan (2000). *Energy and Conflict in Central Asia and the Caucasus*, New York: Rowman & Littlefield Publishers.
2. The other six principles were the following: acceptance of UN Chapter; transformation of the Caspian Sea into a zone of peace and settlement of disputes arising around it in a peaceful way; environmental protection and prevention of Caspian pollution; maintenance and efficient use of Caspian biological resources; liabilities of Caspian states for environmental damage due to the development and use of the Caspian Sea; free and safe commercial navigation (Center for Foreign Policy and Analysis 2002, 187).
3. A modified median line is based on the equidistant principle, but is comprised of segments connecting points whose position is not strictly equidistant from the baselines from which the breadth of the territorial seas of each of the two states is measured. The reason for this can be islands, reefs, low-tide elevations, etc. Therefore, the final border may substantially deviate from the actual median line.
4. According to the term of the protocol, the Kurmangazy and Central structures are to be split 50-50, although 25 percent of the Russian share at Kurmangazy and 25 percent of the Kazakhstani share at Central are to be reserved as an option that will be exploited by companies from the two states on a commercial basis. The division of the Khvalynskoye deposit will be determined at a later date by the two parties.

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**"NEGATIVE PHENOMENA":
SOVIET PRESS COVERAGE OF THE
DECEMBER 1986 ALMA-ATA EVENTS**

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*This article examines the Alma-Ata** events of December 17-19, 1986 as presented within the pages of the main organs of the Soviet press, Pravda and Izvestiia, between December 1986 and March 1987. In addition, analysis of coverage from four Russian-language Central Asian newspapers, Kommunist Tadzhikistana, Pravda vostoka, Sovetskaiia Kirgizia, and Turkmenskaia Iskra is included. The Kremlin's response to the events of Alma-Ata, though ultimately ineffectual, revealed both the waxing influence of Mikhail Gorbachev's new policy of glasnost and a continued reliance on traditional Soviet propaganda techniques. Thus, the demonstrations were reported promptly in the Soviet press, but Moscow also saw to it that only the Party's version of events was presented, labeling the demonstrations as little more than the drunken rampages of students who had been duped by various unsavory elements of the population. Soviet press coverage also reveals that the Kremlin was deeply concerned about nationalism and Islam in Central Asia.*

НЕГАТИВНЫЕ ЯВЛЕНИЯ: ОСВЕЩЕНИЕ АЛМА-АТИНСКИХ СОБЫТИЙ
ДЕКАБРЯ 1986 ГОДА В СОВЕТСКОЙ ПРЕССЕ

МАЙКЛ СТЕФАНИ

Эта статья рассматривает события, происходившие в Алма-Ате 17-19 декабря 1986 года, в интерпретации основных органов Советской печати, «Правды» и «Известий», в период между декабрем 1986 и мартом 1987 гг. В дополнение к этому, представлен анализ публикаций четырех русскоязычных среднеазиатских газет, «Коммунист Таджикистана», «Правда Востока», «Советская Киргизия» и «Туркменская Искра». Ответ Кремля на события в Алма-Ате, хотя и безрезультатный, раскрыл не только нарастающее воздействие новой политики гласности Михаила Горбачева, но и продолжающуюся зависимость от традиционной Советской техники пропаганды. Так, демонстрации были тут же освещены в Советской прессе; однако, Москва позаботилась о том, чтобы отразить только партийную версию событий, клеймя демонстрации как ничто иное, чем пьяное буйство студентов, обманутых увещаниями различных неблагонадежных членов общества. Кроме того, публикации в Советской прессе показывают то, насколько в Кремле были обеспокоены вопросом национализма и ислама в Средней Азии.

INITIAL COVERAGE

The Alma-Ata demonstrations were a clear signal of the failure of Soviet nationalities policy, and thus, of the Soviet Union itself. They also constituted the first of several ethnic flare-ups that would shake the Gorbachev regime to its very core. Soviet press reaction to the events of December in the main Soviet and Central Asian dailies graphically illustrated not only how far the Party had come since the advent of the Gorbachev era, but also how far it still had to go in pursuing the goals of peaceful interethnic relations and individual human rights. On the evening of

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** The city is presently called Almaty

December 18, TASS announced that a nationalist uprising had occurred in Alma-Ata. On December 19, the Soviet Ministry of Foreign Affairs held a press conference that provided official information about the riots.¹ US diplomats described the seemingly candid nature of Soviet admissions as "extraordinary," and the "frank" reporting on the riots was interpreted by many Western observers as "another sign of Mikhail Gorbachev's campaign for *glasnost*."²

The decision that provided the pretext for the demonstrations—to retire First Secretary of the Communist Party of Kazakhstan (CPK) Dinmukhamed Kunaev and replace him with Gennadi Kolbin, an outsider and ethnic Russian—and the occurrence of the demonstrations December 17-18 were reported fairly promptly, not only in the main Soviet dailies of *Pravda* and *Izvestiia*, but also in the major non-Kazakh Central Asian newspapers.³ The latter papers, which were all published in the capital cities of their respective republics, included *Kommunist Tadzhikistana*, published in Dushanbe; *Pravda vostoka*, published in Tashkent; *Sovetskaia Kirgizia*, published in Frunze (now Bishkek); and *Turkmenskaia Iskra*, published in Ashkhabad. All of these papers were dailies of three to four pages in length and were read by the Russian-speaking native populations along with *Pravda* and *Izvestiia*, which were larger (six to eight pages) in length.

Although the timely Soviet reporting of the Alma-Ata demonstrations was certainly a novelty, as will be shown, the Soviet press—both in Moscow and in Central Asia—also fell back on tried-and-true methods of propaganda and/or outright deception in its coverage of events. From its inception in 1917, the Bolshevik regime had always, to quote Soviet press scholar John Murray, "understood the value of the newspaper as a means of schooling the public in the basics of Marxist ideology and ...of casting in a favorable light selected government policies."⁴ The complete control of the Soviet press by the Communist Party (CPSU) ensured not only a "patronizing, teacher-pupil relationship" between newspapers and their readers, but also a preponderance of rambling, ideologically slanted columns with little coverage of "fresh news" for fear of "causing sensation."⁵ Thus, even though the up-to-date coverage of the Alma-Ata events seems to have violated the above-mentioned restriction on reporting breaking news, during the weeks following the disturbances, Soviet officials concerned about nationalism and interethnic relations resorted to three basic strategies for dealing with the political and ethnic fallout of Alma-Ata. These strategies included attempts to discredit the demonstrators and the Kunaev-era leadership, pass Kolbin off as a principled reformer, and extol the virtues of Soviet "internationalism" while denigrating potential counter-forces such as nationalism and Islam.

STRATEGY I: BLAME "HOOLIGANS" FOR THE DISTURBANCES

The first strategy used by Soviet leaders and the new government of Kazakhstan was an attempt to discredit the demonstrators (and hence, the demonstrations) by writing off participants as hooligans, drunks, drug addicts, or impressionable students unwittingly manipulated by the former unsavory elements. Thus, the initial

image of the demonstrations portrayed by *Pravda*, *Izvestiia* and the Central Asian dailies was as follows: On December 17 a group of "youths" (*molodezhi*), instigated by "nationalistic elements" (*natsionalisticheskimi elementami*) took to the streets protesting the decision to retire Kunaev. The resulting disorder was then taken advantage of by "hooliganistic" (*khuliganstvuiushchie*), "parasitical" (*paraziticheskie*) and other "antisocial individuals" (*antiobshchestvennye litsa*), who set fire to a grocery store and several private automobiles. "Order" (*poriadka*) was being restored, various groups of respectable individuals had come out in favor of the decision to retire Kunaev, and "decided measures" (*reshitel'nye mery*) were being taken against hooliganism. There was, of course, no discussion regarding whether or not the grievances of the young protestors were actually legitimate.⁶

According to information that was later given to the Shakhanov Commission by Alma-Ata city and *oblast* medical institutions, no new cases of alcoholism or drug addiction were registered during December 17-19, and the city's "drying out tanks" did not treat a single individual who had been involved in the demonstrations.⁷ This fact, however, did little to stop rumors on the part of the media and high officials that alcohol and drugs had played a major role in inciting the students during the Alma-Ata disturbances. On December 24, *Pravda* published an article about the CPK entitled *Protiv negativnykh iavlenii*. The article, which was subsequently run in *Izvestiia* and three of the Central Asian dailies, spoke of the struggle for "discipline and order" being waged by the CPK against "drunkenness" (*pianstva*), "alcoholism" (*alkogolizma*) and other "antisocial manifestations" (*antiobshchestvennykh proiavlenii*).⁸ A similar article on December 28, again published in *Pravda*, then *Izvestiia* and three of the Central Asian papers, spoke of the formation of a "coordinating council" that was assigned the specific task of waging a struggle against "crime," "alcoholism," and "drug addiction."⁹ Indeed, this aspect of the Party's smear campaign was so effective that the heading of an article in the *Washington Post* on December 22 blared: Soviet Rioters Got Vodka, Drugs, Witnesses Report.¹⁰ Even after the dust had settled in Alma-Ata, the Soviet press continued to return to the theme of the nefarious effects of drugs and narcotics. An *Izvestiia* article published on January 15 mentioned that Kolbin had identified the struggle with alcoholism and other "negative phenomena" as being "among the main tasks" faced by the CPK.¹¹ On February 3, *Turkmenskaia Iskra* devoted an entire article, penned by the Deputy Procurator of the Republic, to the subject of narcotics.¹² On March 14, an article published in *Izvestiia* and subsequently republished in *Pravda vostoka* and *Sovetskaia Kirgizia* was devoted to the strengthening of "socialist legality" in Alma-Ata. The piece mentioned that there was still "insufficient coordination" between the actions of law enforcement organs and the military in the Kazakh Soviet Socialist Republic (KSSR), but also observed that the organs of internal affairs had "noticeably intensified" the "struggle with crime, alcoholism, and drug abuse."¹³

The second broad strategy employed by the CPSU was another standard Soviet propaganda ploy dating back to the 1930s (and perhaps even earlier). This approach consisted of an attempt to set Kazakhs against the former leadership of the republic by discrediting Kunaev and his colleagues while simultaneously drumming up support for the new regime by presenting Kolbin as an honest reformer. On January 10, in a halfhearted attempt to placate Kazakh national feeling, Moscow replaced the Russian Second Secretary of the CPK, Oleg Miroshkhin, with S. Kubashev, a native Kazakh.¹⁴ This conciliatory move came, however, amidst a flood of criticism of CPK higher-ups—mostly Kazakhs—who had served under Kunaev. In addition to alcoholism and drug abuse, *Pravda's* December 28 article announcing the decisive struggle with "negative phenomena" also listed "protectionism" (*proteksionizm*), "nepotism" (*kumovstvo*), "ethnic connections" (*zemliachestvo*), "bribery" (*vziatochnichestvo*) and "official abuses" (*sluzhebnie zloupotreblenii*) as shortcomings to be dealt with.¹⁵

On January 12, *Izvestiia* ran a story that gave highlights of Kolbin's speech at a plenum of the Central Committee of the CPK two days earlier. Kolbin voiced the need to institute economic and political reforms called for by the 27th Party Congress of the CPSU (February 1986), and also mentioned the need to eradicate the "utilization of official positions for personal ends."¹⁶ The most negative attacks against the Kunaev leadership were confined to *Pravda* and *Izvestiia*, as opposed to the Central Asian dailies. A lone *Izvestiia* correspondent, E. Matskevich, spearheaded press attacks against Kunaev-era officials in two investigative pieces that were published only in *Izvestiia*. In his original article of February 14 and follow-up report, which was published on March 15, Matskevich lauded the Presidium of the Supreme Soviet of the KSSR for its decision to confiscate dozens of hostels, cottages, hunting lodges and luxury apartments—worth hundreds of thousands of rubles—previously owned by Kunaev higher-ups. According to the articles, the confiscated, ill-gotten gains were to be turned into kindergartens, camps for young Pioneers, and other, more socially constructive projects.¹⁷

On March 9, *Pravda* published an article under the heady-sounding title, Greater adherence to principle: The truth has come out. What is to be done about it?

The piece, attributed to Kolbin himself, listed the former members of Kunaev's government who apparently had not been acting in accordance with correct Party codes of conduct. Individuals who had been penalized by the new regime included the First Secretary of the Central Committee of the CPK, D. Bekezhanov (criticized); the First Secretary of the Alma-Ata oblast committee, K. Aukhadieva (relieved of office); the First Secretary of the Chimkent *obkom*, A. Askarov (dismissed from the Party); the Dean of the faculty of Journalism at Kazakh State University (KazGU), T. Kozhakeev (dismissed from the Party); and the Minister of Automobile Transport for the KSSR, A. Karavaeva (also dismissed from the Party).¹⁸

In the aftermath of the riots Kolbin and his Muscovite guest, Party Control Commission Chairman M.C. Solomentsev, mounted a major publicity campaign, ostensibly for the purpose of winning back the support of the Kazakh people. On December 20, *Pravda* and *Izvestiia* printed an article announcing that Kolbin and the newly-arrived Solomentsev had visited a machine-building factory and cotton combine in Alma-Ata on December 18, and had become acquainted with various production enterprises in the area. This article was subsequently reprinted in all four of the Central Asian papers.¹⁹ On December 21 and 22, respectively, *Pravda* and *Izvestiia* reported a visit by Solomentsev and Kolbin to Alma-Ata's central *kolkhoz* market, where the Soviet officials familiarized themselves with commodities as well as vendors, salespeople, and other workers from the village cooperative.²⁰ Finally, on December 22, *Pravda* published an account of an address given by Solomentsev and Kolbin to an expanded session of the Council of Ministers of the KSSR. According to the article, which was reprinted in all four of the Central Asian dailies, special attention was focused on the "elimination of shortcomings in the social-economic development of the republic." Solomentsev and Kolbin particularly singled out deficiencies in the production of sugar beets, cattle, and raw cotton.²¹ Solomentsev and Kolbin's overemphasis on raising Kazakhstan's food and crop production even led one astute observer to conclude "food shortages may have played a part in fuelling the riots."²²

Besides attempting to rectify the agricultural and food production deficiencies of the republic, the Kolbin government also tried to win support from the Kazakh population by appearing to push for more responsiveness in local government and an end to the KSSR's chronic housing shortage. Thus, a widely printed article covering the December 23 session of the Bureau of the Central Committee of the CPK mentioned that republican Party organizations had turned to the practical task of fostering "criticism and self-criticism, democratic norms and *glasnost*."²³ In a similar piece, which was disseminated in *Pravda*, *Izvestiia* and *Pravda vostoka*, Solomentsev and Kolbin called for putting an end to "elements of stagnation and inertia" in the republican leadership.²⁴ A few days later, yet another article spoke of Kolbin's determination to "more fully protect the population from criminal, hooliganistic and parasitic elements."²⁵

Finally, on January 23, *Izvestiia* and *Pravda vostoka* published an account of Kolbin's determination to alleviate a problem very near and dear to the inhabitants of most of the USSR's urban areas during the late Soviet period—the shortage of suitable domiciles. "Party plans call for the provisioning of every family in need with a well-equipped apartment or house by the year 2000," the article trumpeted.²⁶ Thus, by January Moscow's handpicked successor to Kunaev had begun to sound more like a Western electoral candidate facing an uphill campaign than a Soviet quasi-dictator. Kolbin's concerted attempt to win the trust of native Kazakhs not only revealed how far the CPSU had come since the days of Stalinism, but also attested to the increased political clout of a nationality that Moscow had previously felt it could ignore.

The last strategy of the CPSU with regard to Alma-Ata and the nationalities problem that was reflected in the Soviet press consisted of both positive and negative elements. While emphasizing the fraternal unity and brotherhood of the Soviet peoples, the Soviet and Central Asian dailies also ran articles critical of cultural and political forces—including nationalism and Islam—that were perceived as inherently threatening to Soviet *edinstvo*. In addition, a string of articles emphasizing the need to improve “internationalist education” among Soviet youth testified to the jarring psychological impact Alma-Ata had on Moscow’s orientation towards the Soviet nationalities. The term, of course, signified little more than a thinly disguised attempt at political indoctrination by the central government, with the goal of replacing loyalty to region and nationality with loyalty to the Soviet State.²⁷

On December 28, *Pravda* carried a front-page article entitled, In a single Soviet family. The piece emphasized correct training of Party cadres in order to point people away from a “localistic,” “departmentalistic,” or “nationalistic” mindset.²⁸ On December 30, *Kommunist Tadzhikistana* ran its own version of *Pravda*’s “friendship article.” The front-page report, written to commemorate the 30th anniversary of the opening of the first all-Soviet congress of the USSR, spoke of the contributions made by each republic to the strengthening of the “social administrative complex” of the USSR. The article identified the “greatest tasks” of the Party to be “the deepening and consolidation of the process of the socialist building of inter-relationships between peoples” and the “formation in every citizen of a feeling of Soviet patriotism and Party internationalism.”²⁹ Finally, on January 10, *Izvestiia* editor of the letters department Vladimir Nadein published a column that discussed readers’ letters regarding Alma-Ata. Waxing eloquent, Nadein noted: “Literally in every one of the letters one is able to find persuasive evidence of the pure, sincere friendship of the peoples of our country, examples of the type that humanity has formerly never known.” According to the author, readers attempting to explain the Alma-Ata demonstrations pointed to “formalism,” “isolation from real life” and the “activities of internationalist politics,” as well as “shortcomings in the sphere of Party educational work.”³⁰

According to Taras Kuzio, the Alma-Ata events invariably led to “many re-evaluations of Soviet nationality policy.”³¹ Indeed, Mikhail Gorbachev testified to this fact when he addressed a plenary meeting of the CPSU Central Committee on January 27. “It is clear already today,” the Soviet leader noted:

that what has happened [in Alma-Ata] should compel not only Communists in Kazakhstan, but all Party organizations and their committees to face up to the problems of the further development of national relations, of enhancing internationalist education. It is especially important to save the rising generation from the demoralizing effects of nationalism.³²

Thus, the CPSU embarked on a campaign to foster internationalist education among the young, and internationalism became a positive catchword in the Soviet press just as drunkenness, corruption, and provincialism became “negative phenomena.”

The first mention of the need to better pursue internationalist education came in the *Pravda* and *Izvestiia* articles of December 21 and 22, mentioned earlier, which reported the meetings between Solomentsev, Kolbin, and laborers and professionals of Alma-Ata on December 20.³³ On December 23, *Pravda* reported discussions which had taken place the previous day between Solomentsev, Kolbin, and the Komsomol *aktiv* of Alma-Ata. The report, which was reprinted in *Izvestiia* and three of the Central Asian dailies, mentioned that the meeting highlighted “serious deficiencies” in the Komsomol organization and emphasized the difficulty of reconciling such shortcomings with “internationalism and an ideological-moral upbringing.”³⁴ The theme of internationalist education also cropped up in an *Izvestiia* article of January 2, which subsequently appeared in *Pravda vostoka*, *Sovetskaia Kirgizia*, and *Turkmenkaia Iskra*. The article, which chronicled highlights of a meeting between Kolbin and Kazakh writers on December 31, spoke of the responsibility of the Soviet press and Soviet publishers for the “ideological-moral and internationalist upbringing of workers, especially the youth,” and for the “truthful representation of reality.”³⁵

The campaign to foster correct internationalist education was apparently deemed so important that the Soviet press continued to harp on this theme throughout the months of January, February and March.³⁶ On January 15, *Izvestiia* published an account of Kolbin’s address, two days earlier, to a conference of *aktivs*. Again, Kolbin listed as a main goal the “improvement of internationalist and patriotic education.”³⁷ Even the Kazakh press received a dressing-down for “having failed to put in place systems for covering questions of internationalist education” in a particularly critical article that appeared in *Pravda* on February 11.³⁸ In a corresponding report for *Pravda vostoka* on March 17, T. Novozhenina wrote about the responsibility of publishers and the press, in the wake of Alma-Ata, to “instill in young people” the “highest feeling of internationalism and Soviet patriotism.”³⁹ In the Kirgiz SSR, an entire republican Party *aktiv* was devoted to the theme of bringing up good internationalists. The proceedings of the *aktiv*, which was held in Frunze on February 21, were given extended coverage within the pages of *Sovetskaia Kirgizia* on February 24 and 25.⁴⁰

Perhaps the most distinctive feature of relevant articles in the Central Asian press in the wake of Alma-Ata was an intense campaign against both nationalism and Islam. Although such efforts in part reflected ongoing CPSU nervousness about the political and social effects of the conflict in Afghanistan, Alma-Ata certainly did not help matters. Moscow’s tremendous sensitivity toward any hint of nationalism in Central Asia was vividly illustrated by an article published in *Sovetskaia Kirgizia* on the day of Kunaev’s dismissal. The piece pointed out the important role played by “Western propaganda” in the realization of the geopolitical designs of “Imperialism” in Central Asia: namely, to “mislead” the Central Asian republics,

undermine the "brotherly friendship and unity of the Soviet peoples," and then foment a "revolutionary transformation in the newly-independent countries."⁴¹ Thus, the CPSU presented nationalism and regionalism as little more than tools in the West's divide-and-conquer strategy vis-à-vis the USSR and hinted that Central Asians who were too proud of their cultural heritage risked being duped by the "Imperialists."

On January 7 and 8, respectively, *Kommunist Tadzhikistana* and *Sovetskaia Kirgizia* ran a report of Sikh violence in the Indian state of Punjab entitled, The poisonous idea of separatism, and on January 22, *Turkmenskaia Iskra* printed a similarly negative-sounding book review entitled, Nationalism in the service of imperialism.⁴²

A somewhat more positive, but no less propagandistic piece appeared in *Kommunist Tadzhikistana* on February 20 in a column entitled, We are internationalists. The article related the story of native Tadzhik Ibođu Sharipov who, despite losing both legs in the service of his country in Afghanistan in 1984, later managed to realize his life-long dream of "becoming a member of Lenin's party."⁴³

Finally, Alma-Ata seems to have at least partially energized the CPSU propaganda drive against Islam. In Afghanistan, the Soviets had recognized a clear connection between Islam and strong nationalistic sentiment. Thus, Moscow attempted to nip any Soviet Central Asian variants of this phenomenon in the bud. In January, three major articles directed against the Islamic faith appeared in the pages of *Pravda*, *Pravda vostoka*, and *Kommunist Tadzhikistana*. "It is not possible to agree...with Muslim ideologues' defining of their faith as a 'civilizing religion,'" Dr. A. Tursunov asserted in *Pravda*. The author then proceeded to damn Muslims for implanting Islam in Central Asia "by fire and sword" in the 16th century, and causing the region (including Afghanistan) to "lag behind in its development" by enveloping it in a "thick fog of superstition,"⁴⁴ while somewhat less confrontational in tone, Khasym Shadiev's article, which appeared in the January 10 editions of *Izvestiia* and *Pravda vostoka*, also took aim at Islam by tying it to anti-Soviet propaganda in connection with the struggle in Afghanistan.⁴⁵ V. Rabiev's article in the January 31 edition of *Kommunist Tadzhikistana* was also anti-Islam in tone. Rabiev reported the antics of "mullah-pretenders" in the republic, pointing to them as examples of the threat to societal order posed by "religious fanaticism." Moreover, the author also equated traditional Islamic religious teaching with pedagogy.⁴⁶

CONCLUSION

Because the CPSU exercised final control over the contents of the Soviet press, the way in which Alma-Ata was treated within the pages of *Pravda*, *Izvestiia* and the Central Asian dailies provides something of a written snapshot of the Soviet leadership during the early *glasnost* period, identifying the key concerns, fears, and political tactics of Moscow in the waning days of the Soviet empire. Certainly one

of the most obvious conclusions that can be reached from the available evidence is that press reaction to the Alma-Ata events revealed the Soviet leadership to be in an early transitional stage between the Stalinist-type authoritarianism of the past (or Brezhnev era stagnation, for that matter), and the emphasis on human rights and democratic norms that characterized the late Gorbachev period. Thus, while coverage of the riots may have been biased and propagandistic, the occurrence of the demonstrations was, nevertheless, reported promptly.

It is also possible to conclude that at least at the time—late 1986 to early 1987—the Soviet leadership took very seriously the threat posed to the Soviet political system by republican-level nationalism (not to mention Islam) among Central Asia's rapidly rising, youthful population. The thorough and continuous press coverage of Moscow's political-ideological campaign to foster internationalist education undeniably testifies to this fact. In addition, the fact that the CPSU chose to attack the Kunaev leadership within the pages of *Pravda* and *Izvestiia* while focusing mainly on internationalism and the positive aspects of Kolbin's program in the other Central Asian dailies seems to attest to Moscow's wish to incite as little ethnic unrest in the region as possible.⁴⁷ When the Soviet press did run negative articles in the Central Asian dailies, as has been shown, vehement criticism was directed mainly against the clear and present threats of nationalism, separatism, and the Islamic faith.

Considering the attempts to placate the population that were widely advertised in the Soviet press, one can also conclude that the new First Secretary and the CPSU were experiencing a "hard sell" when it came to convincing the majority of Kazakhs of their version of the riots; in effect that Alma-Ata was nothing more than a selfish tantrum thrown by drunken young hooligans. Though the December events did result in the "general re-imposition of political conformity" in the KSSR in the short term, by 1989 democratic reform was beginning to penetrate the republic and Gorbachev felt compelled to oust Kolbin in favor of the Kazakh Nursultan Nazarbayev.⁴⁸ On June 26, 1989, the USSR Supreme Soviet appointed the Shakhanov Commission to "bring full glasnost" to the Alma-Ata events.⁴⁹ Finally, on May 21, 1990, the Central Committee of the CPSU formally rescinded its resolution of July 1987 that had branded the demonstrations as specifically anti-Russian, nationalistic phenomena.⁵⁰

Thus, when Soviet press coverage of the Alma-Ata riots is examined in historical context, the most glaring conclusion is simply that all of the various strategies employed by the Soviet leadership to keep Kazakhs (and all Central Asians) quiescent eventually proved ineffectual. Moreover, such heavy-handedness on the Kremlin's part only added to the list of ethnic grievances—or post-Cold War political baggage—that are now an integral part of present-day Russo-Kazakh relations. After taking all of the above into consideration, then, it also seems reasonable to conclude that it was the long history of Soviet repression in Kazakhstan which encapsulated the real "negative phenomena."

1. Conflict in the Soviet Union: The Untold Story of the Clashes in Kazakhstan. (1990). New York: Human Rights Watch, p. 38.
2. Keller, Bill. (December 20, 1986). Soviet Says Hundreds Were Involved in Riot. New York Times, p. 5; and Jackson, James. (March 2, 1987). What Really Happened in Alma-Ata. Time, p. 25; see also Kuzio, Taras. (1988). Nationalist Riots in Kazakhstan. Central Asian Survey 7, p. 79.
3. Plenum TsK Kompartii Kazakhstana [Plenum of the Central Committee of the CPK]. (December 17, 1986). Pravda, p. 2; Izvestiia, p. 2; Pravda vostoka, p. 2; Turkmenskaia Iskra, p. 1; (December 18, 1986). Sovietskaia Kirgizia, p. 2; Soobshchenie iz Alma-Aty [Report from Alma-Ata]. (December 19, 1986). Pravda, p. 6; Turkmenskaia Iskra, p. 2; (December 20, 1986). Izvestiia, p. 6; Pravda vostoka, p. 4; Sovietskaia Kirgizia, p. 4; (December 21, 1986). Kommunist Tadzhikistana, p. 2.
4. Murray, John. (1994). The Russian Press from Brezhnev to Yeltsin: Behind the Paper Curtain. Brookfield, Vermont: Edward Elgar Publishing Co., p. 87.
5. *Ibid*, p. 93.
6. Soobshchenie iz Alma-Aty. Pravda, p. 6.
7. See, A Report by Mukhtar Shakhanov, Commission Co-Chairman, USSR Supreme Soviet Member and USSR's People's Deputy, Alma-Ata, November 14, 1989, Appendix A, Conflict in the Soviet Union, p. 59.
8. Protiv negativnykh iavlenii [Against negative phenomena]. (December 24, 1986). Pravda, p. 2; (December 25, 1986). Izvestiia, p. 2; Pravda vostoka, p. 1; Sovietskaia Kirgizia, p. 1; (December 26, 1986). Turkmenskaia Iskra, p. 1.
9. Reshitel'no borot'sia s negativnymi iavleniiami [To decisively struggle with negative phenomena]. (December 28, 1986). Pravda, p. 2; (December 29, 1986). Izvestiia, p. 2; (December 30, 1986). Kommunist Tadzhikistana, p. 3; Pravda vostoka, p. 3; Turkmenskaia Iskra, p. 2.
10. Lee, Gary. (December 22, 1986). Soviet Rioters Got Vodka, Drugs, Witnesses Report. Washington Post, pp. A1, and A6. An article later published by the Post carried the subtitle, [Soviet] Account Says Drunken Youths Carried Iron Rods, Marble Chunks. See, Bohlen, Celestine. (January 11, 1987). Soviet Press Details Kazakhstan Riot. Washington Post, p. A28.
11. Rabotat' tselestremennnee, s bol'shei otachei [To work more purposefully, with greater reward]. (January 15, 1987). Izvestiia, p. 3.
12. See, Begniiazov, O. (February 3, 1987). Narkoticheskoe bezumie [Drug-induced insanity]. Turkmenskaia Iskra, p. 3.
13. Ukrepiat' sotsialisticheskuiu zakonnost' [To strengthen socialist legality]. (March 14, 1987). Izvestiia, p. 4; (March 15, 1987). Pravda vostoka, p. 3; Sovietskaia Kirgizia, p. 3.
14. Bohlen. Washington Post, p. A28; and Communiqué on the Plenary Session of the Kazakhstan Communist Party Central Committee. Kazakhstanskaia pravda, p. 1. Translated and condensed in Current Digest of the Soviet Press 39, 2 (February 11, 1987), pp. 10-11.
15. Reshitel'no borot'sia s negativnymi iavleniiami. Pravda, p. 3.
16. Bol'she produktsii zhivonovodstva [Greater production in animal husbandry]. (January 12, 1987). Izvestiia, p. 2; (January 13, 1987). Sovietskaia Kirgizia, p. 2.
17. Matskevich, E. (February 14, 1987). Khorishie budut detskie sady [They will be better as kindergartens]. Izvestiia, p. 2; (March 15, 1987). Eshche raz o 'khitrykh' osobniakakh [Once more about 'clever' mansions]. Izvestiia, p. 3.
18. Kolbin, Gennadi. (March 9, 1987). Bol'she printsipial'nosti [Greater adherence to principles]. Pravda, pp. 1, and 3. Interestingly, though Kunaev himself escaped any sort of arrest or imprisonment he was "retired" from his position on the Soviet Politburo on January 28. This was reported by all six newspapers. See, Informatsionnoe soobshchenie o Plenum Tsentralnogo Komiteta Kommunisticheskoi partii Sovetskogo Soiuzu [Informational report of the Plenum of the Central Committee of the CPSU]. (January 29, 1987). Izvestiia, p. 1; Kommunist Tadzhikistana, p. 1; Pravda, p. 1; Pravda vostoka, p. 1; Sovietskaia Kirgizia, p. 1; Turkmenskaia Iskra, p. 1.
19. Prebyvanie v Alma-Ata [Stay in Alma-Ata]. (December 20, 1986). Pravda, p. 2; (December 21, 1986). Izvestiia, p. 2; Kommunist Tadzhikistana, p. 2; Pravda vostoka, p. 1; Sovietskaia Kirgizia, p. 1; Turkmenskaia Iskra, p. 1.
20. Vstrechi s trudiashchimisia Alma-Aty [Meetings with workers of Alma-Ata]. (December 21, 1986). Pravda, p. 2; (December 22, 1986). Izvestiia, p. 2.
21. Kursom uskoreniia [In the course of acceleration]. (December 22, 1986). Pravda, p. 2; Kursom perestroiki i uskoreniia [In the course of perestroika and acceleration]. (December 23, 1986). Kommunist Tadzhikistana, p. 2; Pravda vostoka, p. 3; Sovietskaia Kirgizia, p. 1; Turkmenskaia Iskra, p. 1. (The article is the same in all papers despite the slight difference in title.)
22. Kuzio. Nationalist Riots, p. 88.
23. Protiv negativnykh iavlenii. Pravda, p. 2.
24. Nauchnomu potentsialu—effektivnoe ispol'zovanie [To effectively utilize scientific potential]. (December 25, 1986). Pravda, p. 2; Pravda vostoka, p. 1; (December 26, 1986). Izvestiia, p. 2.
25. Reshitel'no borot'sia. Pravda, p. 2.
26. Zhilishchnoi probleme—skoreishee reshenie [Quicker resolution to the housing problem]. (January 23, 1987). Izvestiia, p. 2; Pravda vostoka, p. 2.
27. Kuzio equates internationalist education with "thinly disguised Russification." See, Kuzio. Nationalist Riots, p. 100.
28. V edinoi sovetsoi sem'e [In a single Soviet family]. (December 28, 1986). Pravda, p. 1.
29. Sil'ny druzhboi [Strong friendships]. (December 30, 1986). Kommunist Tadzhikistana, p. 1.
30. Nadein, Vladimir. (January 10, 1987). Chitaia pochtu: svoe suzhdenie imet' [Reading the mail: to make my own judgement]. Izvestiia, p. 3.
31. Kuzio. Nationalist Riots, p. 92.
32. Gorbachev, Mikhail. (January 27, 1987). On Restructuring the Party's Personnel Policy: Report to the Plenary Meeting of the CPSU Central Committee. In Speeches and Writings, vol. 2. New York: Pergamon, p. 129.
33. See, Vstrechi s trudiashchimisia Alma-Aty. Pravda, p. 2.
34. Sovershenstvovat' vospitatel'nuu rabotu [To improve educational work]. (December 23, 1986). Pravda, p. 2; (December 24, 1986). Izvestiia, p. 2; Pravda vostoka, p. 1; Sovietskaia Kirgizia, p. 1; Turkmenskaia Iskra, p. 1.
35. Vysokoe prizvanie pisatelei [The highest calling of writers]. (January 2, 1987). Izvestiia, p. 2; (January 3, 1987). Pravda vostoka, p. 2; Turkmenskaia Iskra, p. 3; Vysokoe prizvanie pisatel'ia [The highest calling of a writer]. (January 3, 1987). Sovietskaia Kirgizia, p. 2. (The article is the same.)

36. Another interesting aspect of this campaign had to do with attempts in the Soviet press to tout Russian as the language of inter-republic communication. See, Bromlei, Iu. (February 13, 1987). *Natsional'nye protsessy v SSSR: dostizheniia i problemy* [National processes in the USSR: achievements and problems]. *Pravda*, pp. 2-3; and Nurpeisov, Abdizhamil. (March 5, 1987). *Vozvyshaia nashi sviatyni* [Elevating our sacred values]. *Pravda*, p. 2.
37. *Rabotat' tselestremennee, s bol'shei otdachei* [To work more purposefully, with greater reward]. (January 15, 1987). *Izvestiia*, p. 3.
38. Esil'baev, T. (February 11, 1987). *Tsena samoliubovaniia* [The price of arrogance]. (February 11, 1987). *Pravda*, p. 2.
39. Novozhenina, T. (March 17, 1987). *Za internatsionalizm na dele* [For internationalism in practice]. (March 17, 1987). *Pravda vostoka*, p. 2.
40. See, *Sobranie respublikanskogo partiinogo aktiva: vospityvat' patriotov-internatsionalistov* [Meeting of the republican Party aktiv: to bring up patriots and internationalists]. (February 24, 1987). *Sovetskaia Kirgizia*, pp. 3-4; and *Sobranie respublikanskogo partiinogo aktiva: byt' vernymi printsipam internatsionalizma* [Meeting of the republican party aktiv: to be true to the principals of internationalism]. (February 25, 1987). *Sovetskaia Kirgizia*, pp. 3-4.
41. Stroilov, L. *Islam v oboime antisovetizma* [Islam in the arsenal of antisovietism]. (December 16, 1986). *Sovetskaia Kirgizia*, p. 3.
42. *Iadovitye idei separatizma* [The poisonous idea of separatism]. (January 7, 1987). *Kommunist Tadzhikistana*, p. 3; (January 8, 1987). *Sovetskaia Kirgizia*, p. 3; and Iordan, M. & Khydyrov, T. (January 22, 1987). *Natsionalizm na vooruzheni imperializma* [Nationalism in the service of imperialism]. *Turkmenskaia Iskra*, p. 3.
43. Khetagurova, T. (February 20, 1987). *A zhizn prodolzhaetsia* [And life goes on]. *Kommunist Tadzhikistana*, p. 2.
44. Tursunov, A. *Voprosii teorii: ateizm i kul'tura* [Questions of theory: atheism and culture]. (January 16, 1987). *Pravda*, pp. 2-3.
45. Shadiev, Khasym. (January 10, 1987). *Musul'mane v SSR: domysly i fakty* [Muslims in the USSR: Suppositions and facts]. *Pravda vostoka*, p. 3; *Turkmenskaia Iskra*, p. 3. (The latter newspaper article lacks a paragraph, but is otherwise identical.)
46. Rabiev, V. (January 31, 1987). *Na ateisticheskie temy: v klass s Koranom?* [On the subject of atheism: in class with the Koran?]. *Kommunist Tadzhikistana*, p. 2.
47. The lack of articles lambasting the Kunaev leadership in the Central Asian dailies may also have been due to their smaller size (hence, less space for articles).
48. Akiner, Shirin. (1995). *The Formation of Kazakh Identity*. Washington, D.C.: Brookings Institution Press, p. 56.
49. *Kazakhstanskaia Pravda*. (July 29, 1989). Cited in Brown, Bess. (February 9, 1990). *The Alma-Ata Events of 1986 Reexamined*. *Report on the USSR* 2, 6, p. 25.
50. *Conflict in the Soviet Union*, p. 1.

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Gender inequality in non-standard work arrangements is considered. The causes and consequences of the emergence and the growth of non-standard employment are discussed. Existing research in this field is examined and policy impacts are investigated. The introduction of equality policies in the labor market and their impact on social and economic status of women is analyzed. It is shown that labor market trends, women status in non-standard work arrangements and policy implications are similar in different countries, including Kazakhstan.

ГЕНДЕРНОЕ НЕРАВЕНСТВО ПРИ НЕСТАНДАРТНЫХ УСЛОВИЯХ ТРУДА

АЖАР БАЙСАКАЛОВА

В работе рассматривается существование гендерного неравенства на рынке труда в нестандартных условиях в зарубежных странах и в Казахстане. Под гендерным равенством понимается не только формальное равенство перед законом, равные возможности и равные отношения, но также ясное осознание гендерных различий и принятие их во внимание при разработке и осуществлении государственной политики и государственных программ. Под нестандартными условиями подразумеваются те виды занятости, которые предполагают выход за рамки нормативной продолжительности рабочего времени и традиционных требований к рабочему месту. Обсуждаются причины и следствия существования гендерного неравенства на рынке труда. Приводится обзор существующих исследований в данной области, а также государственной политики, проводимой в разных странах с целью устранения гендерного неравенства на рынке труда. Анализируется опыт осуществления различных государственных программ на рынке труда и их воздействие на социальное и экономическое положение женщин. Показано, что современные тенденции развития рынка труда, положение женщин, работающих в нестандартных условиях, и государственные программы, необходимые для устранения гендерного неравенства, имеют много общего как в развитых, так и в развивающихся странах. Особое внимание уделяется обсуждению основных направлений государственной политики в области обеспечения гендерного равенства на рынке труда в Казахстане.

INTRODUCTION

Gender equality is an important development problem. Gender equality is understood not only as "formal" equality before law, equal opportunities and equal treatment, but also as the recognition of gender differences and taking them into account in formulating and implementing public policies and programs. The concept of gender equality implies that social arrangements rather than biological differences lead to inequality, and that these are changeable over time and different between cultures (Human Resource Development Canada: 2002). In recent years, many countries, including Kazakhstan, have joined the Convention on the Eradication of All Forms of Discrimination Against Women (1979) and have thereby shown there is international support for the Beijing Platform for Action, adopted at the Fourth UN World Conference on Women in 1995.

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During the last few decades, new trends in the labor market have been observed. The review of local, national and international literature shows that globalization and technological development have led to the emergence and the growth of employment in non-standard work arrangements in both developed and developing countries. The move from the traditional employment pattern – full-time work with one employer from the start till the end of the job career – to part-time, "contingent" or non-standard work is becoming a wide-spread phenomenon.

This paper presents a literature review on the subject of gender inequality in non-standard work arrangements. It suggests that non-standard work arrangements can lead to both positive and negative consequences for workers, employers and the national economies in both the short and long terms. It aims to examine alternative employment arrangements and identify negative aspects of those arrangements, in terms of wages, job security and other benefits. The most disadvantaged in non-standard work arrangements are women, who are more likely to be employed in non-standard jobs. As a result, in addition to a lack of economic stability and autonomy, they do not have access to social support programs, benefits and pension plans. The paper also aims to suggest future policy directions to help reduce the significant gaps in wages and other benefits between alternative employment arrangements and traditional employment arrangements. In doing so, the following questions are addressed:

- What are the general trends in the labor market?
- What are the characteristics of employment in non-standard work arrangements?
- What are the reasons for the emergence and growth of the non-standard work force?
- What are the consequences of the growth of non-standard work arrangements for workers, employers and the economy?
- How are women in the labor market affected by globalization?
- How can relevant policies and programs improve the economic status of women and their families?
- Why does gender inequality exist in labor markets?
- Is the gender wage gap and its relation to the income gap due to gender-specific factors, such as occupational segregation and discriminatory practices, or to broader factors such as wage structure, minimum wage and union density, among others?
- What are possible ways in which equality can be realized in practice?

A fuller understanding of how different policies impact on employers, employees, and the economy will help to work out and implement gender-based policies aimed at mitigating the negative consequences of non-standard employment.

Kazakhstan, the second largest of the former Soviet republics in territory, is characterized by great natural wealth. Under centrally planned economy prior to independence in 1991, relatively good social indicators characterized Kazakhstan as well as most of the former Soviet Union countries, demonstrating the strong achievements in the field of human development.

As Rutkowski (1995) notes, central planning system presented a blend of rigid planning and soft budget constraints with the main features as follows:

- high participation rate, especially among women: the legal requirement of full employment of both women and men,
- large size enterprises and collective farms,
- small wages and income differentials,
- high degree of job security: job is guaranteed until workers wish to leave,
- strong legal system: it is difficult to dismiss employees for redundancy or incompetence; some vulnerable groups, such as older workers, pregnant women, the handicapped, are legally protected against dismissal,
- full pay, state subsidies for workers, and universal access to education and healthcare,
- guaranteed pensions with retirement age of 55 for women and 60 for men,
- generous system of sick pay and family benefits, long maternity leaves: full job security allowed working mothers to stay at home (for three years) without losing their claim on their job and while receiving an allowance,
- low level of inequality,
- relatively low poverty rate, and
- huge labor hoarding, which was in management's interest because few penalties were imposed on enterprises that had cost overruns or failed to meet net profit targets, and the extra resources could be used to meet plan targets.

The break up of the Soviet Union caused the centrally planning system to collapse, and in the early 1990s Kazakhstan began the transition to market economy. In the process of economic and financial reforms the social indicators drastically deteriorated, showing increased unemployment, reduced public expenditures on social protection, differentiated incomes, increased poverty and worsened demographic characteristics. Transition economies removed one of the key characteristics of the socialist system - job security, as the state gave up its role as a guardian and provider of jobs, and workers were allowed to be laid off, and enterprises to fail. Reforms also changed the wage determination system: from an administrative base to a market base (Haltiwanger and Vodopivec: 2003). Many people were sent on unpaid leave. However, labor hoarding was still observed in both the remaining state firms and those either privatized or in the process of privatization (Rutkowski: 1995).

A growing incapacity of the Government to mobilize resources resulted in the reduction of revenues and public expenditures on social protection (pensions, unemployment benefits, family allowances, sick pay, maternity benefits, and local social assistance) from about 39 percent and 11.2 percent of GDP in 1992 to 24 percent and 6.6 percent of GDP in 1996, respectively. The steepest annual decline of economy was in 1994, when minimum wage and social benefits fell to about one-fourth of 1991 levels; as much as 20 percent of the population could be in serious poverty. The decline in output in Kazakhstan since 1990 was about 44 percent by 1995, particularly after the ruble zone collapsed and the Government of Kazakhstan forced to implement policies to combat hyperinflation. Real wages fell by over 50 percent, with serious implications for household income and consumption (Kazakhstan: 1998).

After declining continuously for five years the economy began to grow in 1996, but remained below 60 percent of pre-independence levels. In 1995-1997 the pace of the government program of economic reform and privatization quickened, resulting in a substantial shifting of assets into the private sector.

Kazakhstan's economy turned downward in 1998 with a 2.5% decline in GDP growth due to slumping oil prices and the August financial crisis in Russia. The exchange rate of US dollar increased from six to 24 rubles in less than six weeks. Prices for consumer goods increased four - six times with the salaries increased only on 20-30 percent.¹

As Ohno and Zhakparova (1999) put it: "Kazakhstan's tradable sector lost price competitiveness and export markets, as a result, its balance of payment worsened, downward pressure on the tenge mounted, and the Kazakh economy started to contract. The government adopted appropriate policies to offset shock and avoid an uncontrollable collapse of the tenge and inflationary resurgence. Due to sustained tight macroeconomic stance, price deflation and non-liquidity at small and medium enterprises intensified. Small businesses were almost devastated."

At the beginning of 1999 the National Bank of Kazakhstan abolished its peg to the ruble and shifted to a floating rate regime. In 1999 GDP increased by 2.7 percent due to the recovery of international oil prices, which, combined with well-timed tenge devaluation and a good grain harvest, pulled the economy out of recession². In 2001 the GDP increased by 13.5 percent, and in 2002 by 9.5 percent, measured relative to the previous year (Women and Men of Kazakhstan: 2003).

The impact of transition on men and women in the labor market was different. Prior to transition employment was viewed as both a right and as a duty for women and men. State enterprises provided 95 percent of employment before independence and one-half of the work force was female².

The processes of privatization, downsizing and re-organization resulted in the loss of jobs for many men and women. However, they hit women harder than men due to the structure of their employment by sector, and by concentration of women's jobs in clerical positions in industrial enterprises, which were first to be cut. Once the transition began, traditional views of women's primary role of care taker in the home revived in society and coupled with a preference for male labor, crowding

women out into the informal sector and increasing women's unemployment rate (Sasser: 2001).

By the end of 1994 the number of employed people had declined about 8.9 percent to about 6.1 million. This drop was caused in part by the privatization of Kazakhstan's economy, but it also reflected growing unemployment and underemployment. In January 1995, there were 85,700 officially registered unemployed people in the republic, up from 4,000 in 1992.²

During 1996-2000 labor resources reduced by 18.5 percent. Workers were dislocated from public to private sector, from productive to non-productive sphere, from rural to urban area. The reduction of employment in economy was accompanied by the increase in non-registered employment and hidden unemployment. About 600-650 thousands of employees were on forced leave (in most cases without pay), reduced hours or delayed wage-payment schedules (Sarykulova: 2000).

Women in Kazakhstan, as in many other countries, are more likely to withdraw from the labor force than men. It is more difficult for women to find a job: in 1999 among women applying to employment agencies only every sixth women got a job (Shokamanov: 2000).

The main factors explaining the reduction in women labor force participation in Kazakhstan (Sasser: 2001; Kazakhstan: 1998):

- the general growth of tension in the labor market,
- low demand for female labor; many women were concentrated in semi-skilled jobs, especially in social services (canteens, health posts, clinics, kindergartens): many of these facilities have been subject to closures and the predominantly female workforce laid off,
- imbalance between demand and supply: mismatched jobs and workforce structure: female jobs cuts in industry were related to the restructuring of light industries and due to the shedding of clerical positions in industrial enterprises,
- participation was unusually high during the Soviet period: many women may have withdrawn in the face of a reduced imperative to work,
- reduction in the provision of childcare may have had a negative impact on the ability of women to work; about a half of the unemployed women had children under the age of 16 years,
- the departure of many ethnic Russian after independence would have lowered participation rates because of the traditionally higher participation among Russian women, and
- market policy: a remedy for massive male unemployment and cuts in childcare provided by the state.

During the last few decades, considerable changes have been observed in the labor market: the female labor participation rate has increased dramatically, especially in alternative or non-standard work arrangements characterized by poor job quality.

In Kazakhstan the share of employees in standard jobs reduced from 95.8 percent in 1991 to 54.5 percent in 2002 (Human Development in Kazakhstan: 2003). Women's unemployment increased till 1996 then gradually decreased (Meldakhanova: 2001). It was the initial stage of transition when most of women lost their jobs being laid off. Some women from medium- and high-income families chose home making, and they did not want to register as unemployed because of the existing societal prejudice. At the same time the women's employment increased in the informal sector, especially in petty trading, suitcase trading and small-scale craftsmen activity, which often occurs on the margins of legality and without sufficient income to secure a livelihood². In 2002 the women unemployment rate was 11.2 percent, men's - 7.5 percent. Most of unemployed women are in their workable age from 25 to 54 and have higher educational attainment in relation to unemployed men. In 2002 among unemployed women 59.6 percent had university education, 67.2 percent - secondary professional, 52.9 percent - elementary professional and 57.2 percent - general secondary education (Women and Men of Kazakhstan: 2003).

Contingent work has becoming a common phenomenon in the fields of production, services and communications. According to Human Resource Development Canada (2002), roughly 30 percent of US workers today do not have permanent, full-time jobs, and a growing proportion of Canadian men are either unemployed, involuntarily employed part-time, or hold non-permanent employment.

The new trends in the labor market are closely related to such new phenomena as globalization, technological development and reforms in both the public and private sectors, such as cutbacks, downsizing or restructuring. With these changes there has been a move toward deregulation of labor markets, as well as a corresponding increase in flexible forms of labor. Stephenson and Emery (2003) explain the changing nature of the labor market in large part by globalization, along with a greatly increased reliance on the contingent work force. Welfare reforms moved large numbers of welfare recipients into the non-standard workforce.

The changes in the labor market can have negative impacts on the overall socio-economic well being of countries and on the individuals within them. Burke and Shields (1999) argue that in Canada this increasing impoverishment and exclusion of workers from the mainstream, with the concomitant loss of potential social and economic well-being, creates social alienation and poverty. Structural economic changes, globalization, and technological development have essentially changed the composition of traditionally male occupations and made the ability of a single male wage earner to earn enough to support his family questionable. As a result, in many cases women have to join the workforce.

Women present the most vulnerable group in the economy. It is widely recognized that "the dramatic increase in female employment over the last thirty years has not been matched, in any country, by an equally dramatic reallocation of domestic duties between men and women. Women, regardless of their labor market status, continue to bear the primary responsibilities for dependent care and

household work in all industrialized countries" (Human Resource Development Canada: 2002). They have to work less than full-time or full year because they have young children. Many women who work outside the home are now confronting the "double day", combining their job responsibilities with family responsibilities (Kalleberg *et al.* 1997). Thirty one percent of employment growth from 1976 to 1997 has been in the form of self-employment and women were over-represented among low-paid, contingent workers (Human Resource Development Canada: 2002).

Stephenson and Emery (2003) also emphasize the negative impacts of the structural, technological and organizational shifts in the economy on women, including the lack of opportunity for more flexible work, along with the disappearance of many jobs that typically provided full-time work for women. Over the 1976 to 2000 period, in Canada the women in part-time employment started at a 24 percent share of all employment, rising to 28 to 29 percent during the late 1990s. Self-employment for women has increased from about nine percent of all women's employment in 1976 to a 12 to 13 percent share by the late 1990s.

From 1998 to 2002 in Kazakhstan the number of women in non-standard work arrangements and standard employment increased by about 20 percent and 11.4 percent, respectively, while the number of men increased only by 8.9 percent and 2.8 percent, respectively (Women and Men of Kazakhstan: 2003). In 2002 self-employed women constituted 40.5 percent, while men only 34.8 percent. Among the reasons for the rapid expansion of female employment demographic changes, lower birthrates, rising divorce rates, and delays in marriage and childrearing, as well as other developments such as women's rising education levels, changes in social attitudes, and a growing demand for women's labor in an expanding service sector, can be emphasized.

According to Human Resource Development Canada (2002), economic restructuring involves growing wage polarization and increase in non-standard employment due to the growth of the service sector, the decline of the public sector and the rise in self-employment. All these trends have important implications for women's labor market position. As it is well established, the service sector typically provides less job security, lower pay, and fewer fringe benefits. Other factors are smaller firm size, fewer liquid assets, less managerial experience, and an unproven track record.

In 2002 58.8 percent of Kazakhstan workers in the service sector were women. The majority of the assets from the privatization process fell into the hands of men. Though privatization opened new job opportunities related to entrepreneurship and the development of the private sector, women faced serious difficulties due to the lack of capital and access to credit. Self-employed women are usually concentrated in the sectors, such as food and beverage, retail trade, and other services, that have significantly lower rates in comparison with the sectors, such as finance, mining, transportation and communication, and construction (Women and Men of Kazakhstan: 2003).

Statistics Canada reports that the most common occupations for self-employed women are childcare, sales, and hairdressing, all of which are at the lower end of the labor market with relatively poor wages and insecure work. Thus, the gender gap in earnings is significantly explained by segregation by occupation and industry (Kalleberg *et al.*: 1997).

Segregation by occupation and industry also takes place in Kazakhstan (Women and Men in Kazakhstan: 2003). In 2002 the share of women in education was 73 percent, in healthcare and social services -79 percent, in finance - 61 percent and in trade - 59 percent. Women's earnings are lower than men's: in 1998 the average ratio of women's wage to men's one was 75.7 percent, in 2000 it fell to 58.7 percent and in 2002 it slightly went up to 61.7 percent. This is explained not only by women being concentrated in sectors of economy with lower salaries, but also with the fact that salaries are less than those of men in these sectors of economy are. In 2002 in industry the wage ratio was 68.6 percent, in agriculture 74.9 percent, in transport and communications 74.9 percent, in education 85.9 percent and in healthcare and social services - 81.6 percent.

As can be seen, there are many negative aspects of non-standard work arrangements, although there are some authors who emphasize their positive aspects. In this context, Ahn (2002) argues that there is a mess in defining which employment arrangements are non-standard. He shows that there are a large number of workers who are classified as contingent workers although their actual employment conditions are similar to those of regular workers. As a result they often face unfair treatment in terms of wages and benefits. Therefore, it seems reasonable to clarify the terms and concepts defining non-standard work arrangements.

CHARACTERISTICS OF EMPLOYMENT IN NON-STANDARD WORK ARRANGEMENTS

Two types of employment in the labor market are standard and non-standard employment. Standard jobs are defined as full-time, full-year employment with a single employer on a long-term basis. Non-standard employment has four dimensions, which are not mutually exclusive: work for fewer hours than normal schedule or part-time work (less than 35 hrs/week); temporary or contingent work of finite duration; *i.e.*, a time beyond which there is no implied employer obligation to continue the employment relationship (temporary direct hires, temporary help agency employees and day laborers); use of outside workers where the employer directing the content of the work (the client employer) is not the employer who hires and pays these workers (leased employees, contract workers and temporary health agency employees); and self employment (incorporated, unincorporated and independent contractors) (Vroman: 1998). Non-standard jobs also include on-call work, seasonal, and multiple jobs with a series of employers.

Temporary workers are supplied by a temporary help agency to companies on an as-needed basis, primarily for short-term assignments. Most jobs are long-term assignments within the company, weekly or monthly rather than day to day.³

Day laborers are employed on a day-to-day basis, which may or may not last for many days at one particular work site. There are two types of day labor work: a) the workers seek employment through a day labor agency (middle-man); b) without a middle-man – employees and employers find each other in designated areas, which can range anywhere from informal specific areas on streets to more formalized hiring halls (NTIC: 2002).

Contract workers provide a product or service and obtain customers on their own initiative. Contract workers range from a worker on a wage or salary with a single employer at a time to a worker managing multiple contracts. Contract workers include independent contractor, own account worker, consultant, freelancer and self-employed. Self-employed workers include those who provide a service or a product and obtain customer on their own, such as shop or restaurant owners. On-call workers are called to work only as needed and this category can include several days or week of work, such as a substitute teacher or construction workers supplied by a union hall. Seasonal workers are hired for work that is available during a specific time of the year and are laid off at the end of the "season". Multiple job-holders have more than one job.³

Non-standard workers are defined as "individuals whose employment is arranged through an employment intermediary such as a temporary help firm, or individuals whose place, time, and quantity of work are potentially unpredictable" (Polivka: 1996). According to Hudson (1997), "non-standard work differs from full-time jobs by (a) the absence of employer, as in self-employment and independent contracting; (b) a distinction between the organization that employs the worker and the one for whom the person works, as in contract and temp work; or (c) the temporal instability of the job, characteristic of temporary, day labor, on-call, and some forms of contract work."

Contingent workers are persons who do not expect their jobs to last or who report their jobs are temporary. Contingent workers are those who do not have an implicit or explicit contract for ongoing employment (The U.S. Department of Labor: 2001). Contingent work is usually defined as short-term work; this term is also often used together with non-standard work to define all jobs that are not permanent and full-time (Report and Statistical Compilation: 1999). Kalleberg *et al.* (1997) note that job quality in standard and non-standard jobs differ in terms of wages, fringe benefits, and job security.

Blau *et al.* (2002) argue, "The proportion of workers in non-standard employment is rather large, especially among women, often homemakers; young people, often students; and older people, often retired or in transition to retirement". In 1999 in the United States the proportion of women in non-standard employment was 56.8 percent.

REASONS FOR EMERGENCE AND GROWTH OF NON-STANDARD WORK ARRANGEMENTS

There are a lot of debates on whether the emergence and the growth of non-standard work arrangements are caused by increased demand on the part of employers or an increase in supply of workers who prefer such arrangements. Ahn (2002) argues that the increase in the number of contingent workers can largely be explained by demand factors of the labor market: the labor market today increasingly appears to be an employers' market. On the one hand, significant increases in benefit costs made employers express a preference for contingent workers over regular full-time workers, to hold down labor costs. On the other, soaring unemployment, the fear of long-term unemployment and the reduction in labor demand weakened the bargaining power of workers in negotiations on wages and working conditions, pressuring workers to accept alternative employment arrangements. The reasons for the emergence and the growth of non-standard work arrangements are discussed here from the employee's and employer's points of view.

According to Report and Statistical Compilation (1999), in 1998 30 percent of the Washington State's workforce held either temporary or part-time jobs for the following reasons. These employees had to satisfy personal, family, or economic needs; however, the vast majority (81 percent) of adult workers was unable to find full-time jobs and would prefer permanent or full-time employment given the opportunity. Among the reasons given for working as day labor, 49 percent of employees noted that it was the only type of work they could find and 24.3 percent found it attractive to be paid daily (NTIC: 2002).

Although critics usually fail to acknowledge the advantages of alternative employment arrangements, Blau *et al.* (2002) argue that the growing movement of women into self-employment does represent a desirable expansion in their opportunities, being an adequate solution to the conflicting demands of work and family. Rothstein (1996) concludes that life events, such as marriage, divorce, and child-birth, are correlated with significant differences in employment status for women, but not for men: among dual-earner couples, women are much more likely than men to alter their employment pattern when they have children. Rather than leaving the labor market *altogether*, many women opt for part-time employment. Non-standard work arrangements are considered as a strategy for creating work/family balance (The New Paradigm Symposia series: 1999). They may also benefit workers by offering greater flexibility as to when and where to work. Kalleberg *et al.* (1997) explain the growth of married women and single-parent families in the labor force by changes in workers' preferences.

Stephenson and Emery (2003) argue that a lack of access to child care and the inadequate salaries made the "trade-off" between the job and the loss of the benefits available to income assistance recipients a difficult choice. Most felt full-time work would be essential, but those with younger children felt that permanent part-time work would be an appealing option.

Townson (March 2003) considers the alternative employment as the means for combining paid employment with further education, and the way to provide caring for children because of the lack of childcare arrangements. She argues that older women may turn to self-employment, as a way of easing into retirement. For highly educated and professional women who leave well-paid positions in order to head their own businesses, self-employment is frequently a response to the "glass ceiling."

For many people, these changes in the employment pattern have meant greater flexibility in combining other activities with employment or increased satisfaction in using skills in their own business. For many others, non-standard work patterns are involuntary and insufficient to meet their needs: many people would prefer to be in traditional full-time employment but move to self-employment when they are unable to find employment. Today the reality is that in most cases workers accept alternative employment arrangements not as a matter of choice, but as an economic necessity.

Employers contribute to the growth of non-standard work arrangements by reducing organization size and introducing flexible staffing arrangements. They find alternative arrangements more advantageous for a number of reasons: there are minimal benefits for part-time workers and these workers have no rights to sick leave or leave for family emergencies; workers are hired at relatively low costs and employers have labor flexibility to meet demand fluctuations (Stephenson and Emery: 2003). In addition, the workers involved in alternative employment are usually non-unionized and outside the scope of coverage of collective bargaining agreements; employing non-standard workers allows employers to avoid paying the same level of wages and benefits as paid to regular employees (HRDC: 2002). Many employers use non-standard jobs to screen future employees (Bellman and Golden: 2000, Autor: 2000).

Blau *et al.* (2002) note that employers can benefit (cut costs, downsize, pay relatively low wages or reduced benefits) from contracted services in specialized areas, if skills are needed only occasionally (e.g., computer programming), production nature – peak and off-peak periods: dispense with the need to carry surplus workers in slow times and avoid the costs of repeatedly hiring and firing workers. The authors explain a large part of increase in non-standard work arrangements by the change in hiring behavior of firms rather than disproportionate increase in the size of industries where they are more common as well as by an increase in the number of small firms, that are the most likely to benefit from the purchase of specialized skills from outside sources.

In Kazakhstan, small and medium-sized enterprises play a much less important role compared to developed or advanced transition economies. This is in part due to occasional criminal network activity, as well as tax evasion schemes that have led many small-scale businesses to operate only in the informal economy.¹

Slamkulova (2001) indicates the following peculiarities of the labor market in Kazakhstan:

- economic restructuring changed demand for labor force both by professional orientation and qualifications leading to imbalance between demand and supply,

- real sector of economy changed greatly reducing the number of jobs, and
- self-employed workers and informal sector of economy emerged.

As Sasser (2001) states: "Informal labor market and entrepreneurship were seen as issues within the labor market that were specifically relevant to women. Women predominate in the informal sector, they bear the "costs" of working in this sector, and they face the barriers and have opportunities in entrepreneurship. For many women the phenomenon of transition and economic globalization is not necessarily generating employment, but rather shifting their work into the informal and casual sectors. Unemployment is rather high among women, they have to work part-time, have low pay positions and low quality jobs. Women state the major reasons for moving into home-based work and informal work in general as being unable to find work in the formal sector and facing mobility constraints due to care obligations in the home."

During the transition period Kazakhstani women were more aggressive than men were. They adapted to market changes much quicker. Women's self-employment was higher than men's, e.g., in 2002 it was 52.6 percent for women and 47.4 percent for men (Women and Men in Kazakhstan: 2003). Many women rushed in suitcase trading, traveling to neighboring countries to purchase consumer goods and to sell them in home markets. Other types of informal work are subcontract workers and own account workers at home, and market vendors, among others. Sasser (2001) emphasizes high costs associated with informal work, which include, very long work hours; harsh competition – there is always someone willing to sell or perform cheaper; lack of insurance; and lack of security; maintenance costs, gas, electricity being transferred to the household.

Karagusova (2001) notes that in Kazakhstan the formation of the two-sector employment results in crowding out of women into the secondary sector. High salary positions, good labor conditions, promotion prospects, fringe benefits, job security, long-term employment guarantee, training and retraining at the expense of the employer characterize jobs in the primary sector. The secondary sector provides low pay, bad conditions, high turnover rate, poor promotion prospects, and dependence on willful and inconstant relations with top administration.

Although employment in the informal sector is hard to quantify, there is strong evidence of rapid informal sector growth, especially in the Kazakhstan's oblast centers. Serious cutbacks in social expenditures, especially in health and education, resulted in the elimination of jobs in these sectors and decreased access to, and use of, the services provided by them. Gender discrimination in hiring practices is a serious problem in the transition countries, *i.e.* employers would not hire women who were visibly pregnant, or would only offer non-contractual employment without any benefits or security (Rutkowski: 1995).

CONSEQUENCES OF THE GROWTH OF NON-STANDARD WORK ARRANGEMENTS

This section presents a discussion of the positive and negative consequences of non-standard work arrangements for employees, employers and the economy. The focus is on the status of women in the labor market. The literature shows that the effect of

alternative employment on wages and benefits differs by job type, industry, occupation and gender. Employee benefits, such as employer health plan, educational assistance, child care subsidies, paid vacation and sick leave, retirement benefits and unionization are all more common among full-time, full employment status worker than among any of the part-time or contingent categories (Kalleberg *et al.*: 1997, The New Paradigm Symposia series: 1999, Report and Statistical Compilation: 1999).

Blau *et al.* (2002) also confirm that workers in non-standard work arrangements have less job security, lower wages, fewer benefits (sick pay, holidays, health insurance, and unemployment coverage), and fewer social security benefits. They receive less training as well as fewer promotions. They lack the protection provided by labor unions and do not accumulate pension rights. The authors conclude that in the long run the negative consequences emerge as a discontinuous labor market history, the lack of funds for education expenses for children, occasional medical emergencies, and retirement in poverty.

Considering the increase in the availability of flexible jobs (*i.e.* temporary contract and part-time work) in the European Union, Bettio *et al.* (2000) note that these arrangements reproduce familiar gender asymmetry. They point out that female labor, rather than male labor, tends to be associated with non-standard employment.

Davis *et al.* (2001) argue that a sex-segregated labor market and the lack of a universal child-care system pose additional hurdles to women as they strive to provide for their families. They note that employment insurance and maternity benefits are hardly applicable to the economic security of low-income women because of their weak attachment to the labor force, including their segregation in low-paying, irregular and part-time jobs.

Governments in many countries, including Kazakhstan, make efforts to encourage people to start their own businesses as a way of stimulating the growth of the middle class, promoting political stability, economic independence and job growth. However, public policies and programs do not generally achieve high female participation rates due to their poor implementation. In fact, these programs and policies benefit men more than women. One of the main problems is women's lack of access to credit. Other problems of self-employed women are related to the need to fund their own benefits. Self-employed women typically earn less than both their paid worker counterparts and self-employed men, and receive fewer benefits. According to gender statistics (Women and Men in Kazakhstan: 2003), in 2002 women's average monthly salary constituted only 61.7 percent of men's average monthly salary.

Blau and Kahn (2000) note that labor market discrimination may also affect women's wages and occupations due to the discriminatory tastes of employers, co-workers, or customers, average differences between the two groups in the expected value of productivity and the discriminatory exclusion of women from "male" jobs, which can result in an excess supply of labor in "female" occupations, depressing wages there for otherwise equally productive workers. They also emphasize discrimination with respect to placement, promotion, movement to full-time

positions and the allocation of additional hours. As an example, the authors give evidence about a role of discrimination in academia. They found that controlling for quality of Ph.D. training, publishing productivity, major field of specialization, current placement in a distinguished department, age and post-Ph.D. experience, female economists were still less likely to be promoted from assistant to associate and from associate to full professor. There are gender differences not simply in salary but also in space, awards, resources and responses to outside offers. Although in Kazakhstan there are more women with higher education (59.4 percent) than men, they are also concentrated in lower positions. Only 10 percent of women hold doctoral degree, and 38 percent hold candidate of science degree (Beckturganov: 2001).

Hudson (1997) indicates some positive consequences of alternative arrangements for those who prefer such arrangements. He argues that contract workers and independent contractors have higher wages than similar workers in traditional arrangements; they are more likely to be covered by health insurance and pensions. In non-standard work arrangements, students can explore career opportunities and adults can re-enter the labor market. Homemakers in need of flexibility because of family responsibilities and older people in transition to retirement can also take advantages of such arrangements. Hudson notes that sometimes employers pay higher wages to compensate for uncertainty and lower benefits.

Considering negative consequences of non-standard jobs, Hudson (1997) notes that they usually:

- pay less than regular full-time jobs with similar characteristics and educational qualifications,
- provide little or no job security, and are more likely to be of limited duration,
- do not ensure access to public programs, such as employment insurance, health insurance, public pensions, or child care arrangements,
- have limited training and promotion opportunities,
- receive few if any benefits.

He concludes that non-standard work arrangements continue to be of low quality. At the same time, employers enjoy reduced costs as they pay less, and do not contribute to benefit packages or public income support programs, such as unemployment insurance or public pensions (Townson: 2003).

Rutkowski (1995) examines positive aspects of the transition and concludes that though women are afforded the opportunity to start their own businesses, they are constrained by the lack of capital and access to credit, the "traditional" roles women play, and lack of information and knowledge on how to start a business - all hindrances to women's participation in entrepreneurial activities. Among negative aspects of the transition process the author notes higher levels of unemployment, barriers to private entrepreneurial activities and decreased social assistance provisions from the state, among other fall-outs. Laid off women have to search jobs in non-standard work arrangements working involuntarily part-time, occupying low paid positions in low quality jobs.

In Kazakhstan women working in informal labor market do not have contributions to the Accumulative Pension Funds and do not pay income taxes. Out of seven and a half millions of economically active population five millions have individual social codes and only 2.2 millions people provide regular monthly payments to Accumulative Pension Funds (Chulanova: 2003). These figures give information about the size of not-registered employment in the labor market. As a result the employees are not protected by the legislative system and are not covered by the social security system because their labor activities are not registered anywhere. In addition, many working women are now confronting the "double day." They experience significant time pressures as they attempt to combine work and family responsibilities.

Beckmukhambetova (2001) argues women having small children or large families are disadvantaged in the labor market. As women workforce requires additional social expenses, employers do not want to bear costs. Women are the first to lose their jobs in downsizing in spite of their generally high educational and often professional level. Non-standard employment implies for women, in addition to lower earnings, fewer benefits, less job security, and fewer opportunities for promotion, solving the work-family conflict by perpetuating traditional gender roles. Under new economic conditions women are less competitive as compared to men and less socially protected.

In spite of the presence of the legislative framework on gender equality, Kazakhstani women often have difficulties in finding jobs, have lower than men pay for comparable work, and they are subject to occupational segregation. The factors leading to gender pay differential are imbalance and distortion of the sector employment structure resulting in women's employment predominantly in the sectors with low pay levels; professional segregation resulting in women employment in low qualification jobs and constraining their access to decision-making positions; the formation of the two sector employment model and crowding out women into the secondary sector (Human Development in Kazakhstan: 2003).

The study of the impact of non-standard jobs on the economy and companies' profitability and productivity deserves serious consideration in both the short and in the long term. Shaidildinova (2003) draws attention to the key problems in Kazakhstan's labor market, such as:

- prevalence of non-effective employment (low productivity, hidden non-taxed employment, noncompliance of labor terms and conditions to existing standards),
- loss of labor potential (long unemployment duration),
- noncompliance of workforce training to economic needs,
- difficulties in finding jobs for some population groups (women, young people, elderly people in the pre-retirement period, disabled),
- large differences in regional labor markets (high unemployment rate in depressed regions, labor surplus in agricultural regions and small towns),
- inappropriate qualification and professional structure of labor demand and supply,
- illegal labor flow from neighboring countries.

Timely policy responses to the above-mentioned issues are absolutely necessary to provide economic growth to the country and to ensure a decent standard of living for its citizens.

POLICY IMPLICATIONS

The emergence and the growth of employment in non-standard arrangements require the development of the appropriate policies. As Townson (1997) notes, the changes in the labor market, such as increasing non-standard work, mean traditional policies to promote women's economic equality may no longer be appropriate. She argues that new initiatives should be undertaken to promote gender equality. Policy implications range from pension policy, employment standards, and how to address pay and employment inequities and discrimination. Hudson (1997) suggests that policy should ensure that workers receive fair pay and benefits regardless of their work arrangements – whether standard or not. Stephenson and Emery (2003) conclude "there must be a clear understanding and acceptance, nation-wide, of the fact that the organization of work has changed permanently to the increasing prevalence of contingent, non-standard, often poorly paid jobs."

Ahn (2002) suggests that the focus of labor laws and regulations should move away from regular workers employed under traditional employment arrangements in order to reflect the changes in industrial structure and labor market and the rights and interests of workers employed under different employment arrangements. If workers are to be protected, current labor laws need to be modernized (NTIC: 2002).

Five important categories of policy/program initiatives are as follows (Human Resources Development Canada: 2002):

- 1) In many countries there are no employment standards designed to protect workers from possible exploitation through unregulated labor markets. Employment standards governing wages and benefits, working conditions, leave entitlement and vacations can help to protect women from unjust dismissal. They may be set out in legislation, in collective bargaining agreements, or through voluntary codes of conduct.
- 2) Most nations have formal equality and sex discrimination legislation, however, in reality it does not work. Strict enforcement of this legislation can help to improve women's opportunities in recruitment, training, and promotion.
- 3) Policies that affect pay, such as equal pay for work of equal value and pay equity, as well as an introduction of the principle of equal pay for work of comparable worth, where it is possible, can help to reduce the gender pay gap. As Baker (1994) put it, enforceable legislation should require that employers base wages on comparable worth rather than gender, marital status or family status.
- 4) In many countries, income support is increasingly contingent on participation in employment and training programs. It is suggested that

training should be tailored to individual needs and circumstances in order to improve the job prospects and earning potential of unemployed or underemployed individuals by developing their human capital.

- 5) Policies to reconcile work and family responsibilities in order to help women balance work and family duties with greater ease, or to facilitate the reallocation of some of the responsibility for unpaid work to men. The policy challenge is to facilitate a work-family balance for all employees, not just for women. These include policies for maternity or parental leave, childcare policies, and flexible work arrangements.

Researchers and policy analysts broadly debate the last initiative. Blau and Kahn (2000) suggest that policies facilitating the integration of work and family responsibilities should be implemented voluntarily and/or mandated by government. Davis *et al.* (2001) argue that there is an indisputable need for a national child-care system. They suggest that child-care centers should provide transportation, while workplaces and educational institutions should receive incentives to implement on-site day-care centers. Stephenson and Emery (2003) note that government-supported systems must allow the mothers to "hold" the places for their children when the mother may be unemployed or underemployed and not need the services to the same degree. This does not mean that unused places remain vacant, but when the mother returns to employment, or when her employment time increases for a limited period of time she should have an opportunity to use the same place for her child. As described in one of several international comparisons provided by Baker (1994), Sweden has been very successful in keeping families with children out of poverty because its government has promoted a policy of full employment, focused on employment equity, and provided subsidized child-care services for working parents.

Flexible work arrangements are frequently promoted as beneficial to both employer and employee. Flexible work arrangements can either restructure or reduce employees' work time. Bettio *et al.* (2000) propose alternatives to three labor flexibility strategies: employer friendly flexibility, flexibility over the life cycle, and working time reduction. Current policy can be revised by shifting the focus of labor flexibility arrangements toward an employee friendly flexibility orientation. At the same time, it should also seek to harmonize the interests of both workers and employers to minimize the conflicts of interests between them.

Today in Kazakhstan there is the legislation on the gender equality in all fields. At the same time there is a wide recognition of existing gender inequality in the society. According to the RK Constitution women and men have equal rights in political, economic and social life. The RK Constitution guarantees citizens the right to work and forbids discrimination based on geographic origin, gender, race, nationality, religious or political belief, and language. In practice, social opinion tends to associate women in the workplace with the abuses of the Soviet past. The early 1990s saw the loss of more than 100,000 day-care spaces, and public opinion

strongly favors returning primary responsibility for the rearing and educating of children to mothers.²

In 1998 Kazakhstan joined the UN Convention "On the Eradication of All Forms of Discrimination Against Women". The Government takes efforts to mainstream gender into its programs and policies. For the first time in the history of Kazakhstan the Indicative Plan for Social and Economic Development in 2001-2005 included the section on the women's participation in development. It offers taking specific measures and achieving certain gender indicators to improve the status of family and women in Kazakhstan. Family policy should support women, who involuntarily left labor market to take care about children and help women to adapt, when they return back to the labor market. Employers should be encouraged to hire women for part-time work with a flexible schedule using special legal measures, economic incentives and allowances (Beckmukhambetova: 2001). One way of ensuring this is using engendered budgets as a tool to assist in gender mainstreaming and to ensure government accountability and financial transparency (Sasser: 2001). Gender indicators are also included in the RK Government Program for 2003-2006 and the RK Strategic Development Plan till 2010.

Rutkowski (1995) suggests to undertake active labor market policies - defined as any measure other than unemployment benefits and early retirement - to help workers adjust to change by increasing their productivity (with retraining), improving matching between jobs and workers (with job search assistance and retraining), maintaining their labor force attachment (with retraining and public works), and increasing demand for labor (with wage subsidies, business startup schemes, and public sector employment).

To cope with gender problems the National Commission on Family and Women Affairs under the President of the Republic of Kazakhstan (NCFWA) was established in 1998. The NCFWA is vested with a wide range of rights and powers. In particular, it has the right to demand from the relevant public agencies to control and officially investigate cases of breaching the legislation regarding family, women and children. The NCFWA in cooperation with public agencies, NGOs and international organizations developed the National Action Plan on Improving the Status of Women in the Republic of Kazakhstan, which was put in force in 1999 (Samakova: 2001). Its priorities include the poverty reduction by increasing the general level of payment for labor, legalization of all incomes and increasing salaries for civil service agencies, where women predominate, and where salary level is lower than an average salary level in the country. A micro credit program for lowest income population is to be expanded in order to provide self-employment to population and development of entrepreneurship (Shokamanov: 2000).

The basic directions of gender policy are formulated in the Concept of Gender Policy in the Republic of Kazakhstan authorized by the Decision of the Government in 2003 (The Concept of Gender Policy in the Republic of Kazakhstan: 2003). They are aimed at providing equal opportunities in the labor market and increasing women employment by increasing demand for women labor force and its competitiveness in the labor market. The Concept envisages implementing

programs (a) to raise competitiveness of women in the labor market by providing the provision of access to consulting services, education and job search information; (b) to promote a further development of entrepreneurship and self-employment opportunities among women; (c) to provide professional retraining and delivering business administration and management skills focused on raising women's self-confidence and competence. It is also planned to establish centers for economic education of women in order to help them in developing small and medium-sized businesses by providing financial support to women entrepreneurs as well as consulting and marketing services. According to the Law "On Micro credit Organizations", financial assistance will be provided to the population in all oblasts of Kazakhstan. A special attention will be paid to the expansion of women's employment in agriculture, in particular in its produce processing. The establishment of public and private pre-school institutions, which provide both childcare service and jobs, will be encouraged.

The Government of Kazakhstan recently developed the Employment Program for 2005-2007, aimed at achieving effective employment, reducing the unemployment rate, improving job quality and providing territorial/geographical redistribution of the workforce in order to avoid demand/ supply imbalance (Shaidildinova: 2003). It is planned to create a comprehensive data basis about available vacancies and to ensure strict enforcement of labor legislation so that to prevent any discrimination in the labor market; to expand public works; to provide professional training and re-training for unemployed population in compliance with existing demand; and to support self-employment through the implementation of micro-credit programs.

A special attention is given to the further development of small and medium business. As Sasser (2001) notes, several barriers hinder women's entrepreneurial activities: a lack of confidence in oneself and in the ability to start one's own business; societal and cultural biases against women as business owners; lack of access to networks such as chamber of commerce and 'old boy' networks; a lack of access to credit due to inability to meet collateral requirements and because of discrimination in lending practices; and finally because of a lack of knowledge of how to start a business and the skills needed to run it. The State also imposes burdens that hinder women's opportunities such as the imposition of user fees and taxes that they are unable to pay; lengthy application procedures; and the time taken away from home and productive activities by the need to travel in attending to these procedures. All of these things limit women's participation in entrepreneurial activities. The author suggests easing the constraints facing women by ensuring equal access to credit. This includes gender awareness training for lenders, decreased legal, regulatory and bureaucratic barriers, increased knowledge on the part of women of programs and resources, and allowance of alternative forms of collateral. Additionally, there needs to be increased training for women in business skills as well as in increased confidence.

The territorial redistribution of the workforce within Kazakhstan requires the development of the voluntary labor migration – the transfer of the labor force from

the labor-excessive regions to industrial centers and the newly developing regions, such as the Caspian shelf. The territorial non-uniformity of the allocation of industrial and agricultural entities as well as a high concentration of population in some regions results in different demand for labor. While population reproduction rate is high in rural areas, labor demand is higher in urban areas and in the regions with developed infrastructure. Low mobility of labor force results in high unemployment in these regions and creates obstacles for work force involvement into production in the regions of economic growth (Human Development in Kazakhstan: 2003).

Rutkowski (1995) notes that transitions call for geographical movement of workers across different localities. Reforms should include new types of labor contracts, building the institutions and regulations of a modern dynamic housing market, encouraging migration by providing mobility grants and creating incentives for firms to locate a new plant or undertake new investment in depressed regions. At the same time the author warns that it may not be cost-effective to pursue the recovery of depressed areas with mobility grants or regional investment subsidies. Therefore, there is a need in removing barriers to spontaneous mobility and ensuring that public expenditures on transport and infrastructure are spread evenly around the country.

Most of the measures reviewed in this study require fairly significant public expenditure and regulation of the economy (Stephenson and Emery: 2003). Strong legislation clearly stating the type and magnitude of the changes expected, including timetables for their achievement and specifying the penalties accruing to organizations that fail to comply with the legislation enforcement, can greatly improve the status of employees with non-standard working arrangements.

While an achievement of these goals would help improve the situation in the labor market as a whole, special attention should be given to the economic security of women working in non-standard jobs. Efforts should be made to examine the issue of contingent work and the implications for women's equality of the trend to increasing use of non-standard work arrangements. Such a research is of great importance as Kazakhstan is restructuring its economy and preparing to join the World Trade Organization.

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“ECONOMETRICS”

Textbook by Kairat T. Mynbaev and Alan Lemos

Rio de Janeiro: Editora FGV, 2004. ISBN 85-225-0459-8

REVIEWED BY SABIT KHAKIMZHANOV

This is a authorized translation of “Econometrics” by K.T. Mynbaev and A. Lemos originally published in Brazil last year. It is one of the few advanced graduate textbooks in econometrics to appear in Russian.

The textbook’s treatment of econometric methods emphasizes deep understanding of the statistical concepts underlying regression analysis. Its no-compromise treatment of the basic techniques is a good preparation for independent research and development of econometric methods. To achieve that worthy goal, the book provides both geometric explanations and mathematically rigorous proofs of the key results.

The first part is a useful and convenient one-stop reference on a number of subjects necessary for the correct application of the econometric methods of the second part. These include necessary topics from higher mathematics, statistics and economic theory. The subject areas common both to statistics and econometrics include multiple regression analysis under classical assumptions, interval estimation and hypothesis testing are also included.

The second part targets more advanced students and could be used in the second semester of a graduate course in econometrics. It brings together the models and methods based on the asymptotical theory: large sample properties, seemingly unrelated regressions, autoregressive models and the theory of simultaneous equations, including the instrumental variables method, 2SLS and 3SLS. The maximum likelihood and Monte-Carlo methods are also considered. Unlike many texts in econometrics, this text includes the proofs of the central results rather than references them.

The book contains more than 100 exercises, with solutions in the end. The exercises and the illustrations are made in Excel, a purposeful choice of a general package with low fixed costs of learning yet more instructive than many high-end specialized packages. The appendices supply the necessary material from the probabilities theory, asymptotical theory, and VAR. In general, the book is self-contained and reduces the need of the reader to consult with other sources. It is a valuable addition to the library of any econometrician and an excellent choice for an advanced two-semester course in econometrics. This book should be recommended as a graduate level textbook for students of econometrics.

By **Svetlana Tsalik**

New York: Caspian Revenue Watch (2003)

REVIEWED BY REGAN SILVESTRI

From the callous question asked in the title, we know at the onset that this book will put forward factual evidence concerning the questionable use of oil revenues in Caspian states. Such is what author Svetlana Tsalik, Director of the Caspian Revenue Watch, endeavors and endeavors successfully.

“Caspian Oil Windfalls: Who Will Benefit?” has been published by the Caspian Revenue Watch, a new program of the Open Society Institute’s Central Eurasia Project. “The Caspian Revenue Watch hopes to ensure that existing and future revenue funds in the region be invested and expended for the benefit of the public, such as poverty reduction, education, and public health - through the promotion of transparency, civic involvement, and government accountability.” (1)

The book is authored by Svetlana Tsalik and edited by Robert Ebel, and it includes three chapters contributed by other scholars. Notably, the book contains a foreword by Joseph E. Stiglitz, Nobel Prize winner in economics and professor of economics and finance at Columbia University.

Author Svetlana Tsalik questions why the majority of the Kazakhstani population remains at sub-standard living levels while Kazakhstan is growing to be one of the richest oil producing and exporting countries outside of the Middle East. “Azerbaijan and Kazakhstan urgently need measures that guarantee accountability, transparency, and public oversight in their oil industries. Only then will the two countries stand a chance of using oil and natural gas revenues to raise living standards for their people and lay the basis for healthy, long-term economic growth” (p. 212.)

The book is divided into logical chapters, each of which could stand-alone on its particular topic. Throughout the book, we are provided with background information so that we may understand the current state of affairs appropriately. The book begins with a few chapters comparing and contrasting the situation with petroleum revenues in Kazakhstan and Azerbaijan to other regions. The authors offer knowledge from lessons learned in Alaska and Norway, and their application to Kazakhstan and Azerbaijan. We can infer from the text that many aspects of the Norwegian model can not be applied to Kazakhstan and Azerbaijan. As a conclusion, it is advised not to duplicate exactly Norway’s National Fund, but to build certain applicable attributes of the Norwegian Fund into the Kazakhstani and Azerbaijani Funds. With questions of separation of powers, transparency and accountability hovering over the Kazakhstani and Azerbaijani Funds, operation of the Kazakhstani and Azerbaijani Funds does not enjoy the advantages held by the Norwegian National Fund.

Kazakhstan, being a less developed country than Norway, could make use of money from the national fund for health care and education. Kazakhstan, a country where the majority of the population does not enjoy healthy living-standards, could

even consider distribution of profits from the national fund to the population -as occurs with the Alaskan Fund.

The most interesting parts of the book are Chapter 5 "State Oil Fund of the Azerbaijan Republic" and Chapter 6 "National Fund of the Republic of Kazakhstan," which may be considered the 'heart' of the book.

In the chapter "National Fund of the Republic of Kazakhstan," author Svetlana Tsalik asserts that the Kazakhstan National Fund is failing. The broad reason given as the cause for the failure of the current Kazakhstan National Fund is centralization of power and rule by presidential decrees. Regarding centralization of power, the President of the Republic of Kazakhstan himself has exclusive power to make and change rules of the National Fund, and the President also has exclusive power to authorize purposed expenditures from the National Fund. Regarding the predisposition in Kazakhstan for governing by presidential decrees "...increasingly, rules governing hydrocarbon development...are promulgated by presidential decree rather than legislative act" (pp. 153-154.)

Author Svetlana Tsalik examines the very creation of the national fund in Kazakhstan, and how the creation of the national fund was linked to the discovery by a U.S. Justice Department investigation of Swiss bank accounts in the names of senior officials of the Kazakhstani government. "In August 2000, a presidential decree officially created the National Fund of the Republic of Kazakhstan... The creation of the BDK [Budget for Development of Kazakhstan] became moot when state revenues dropped precipitously following the East Asian financial crisis that led to a sharp decline in oil process, and the ruble devaluation in the late 1990s. Nevertheless, oil money was set aside in a secret Swiss bank account tied to President Nazarbayev. The account was opened in 1996 with about \$1 billion in proceeds from the sale of 20 percent of the Tengiz oil field to Mobile. In his revelation to parliament in April 2000 about the existence of this account, Prime Minister Tasmagambetov reported that its purpose was to prevent inflation... He also admitted that other foreign bank accounts in the president's name existed. In 2000, when oil prices surged to \$28 a barrel (bbl), the problem of what to do with this sudden windfall became urgent. Additionally, investigations by the U.S. Justice Department into the role of an American, James Giffen, in transferring payments from oil companies to Swiss bank accounts tied to senior officials in the Kazakh government created an incentive to move the money back into Kazakhstan... The president issued his decree in August 2000 and regulations specifying the fund's functions followed in January 2001" (pp. 145-146.)

As can be seen from this excerpt, "Caspian Oil Windfalls: Who Will Benefit?" is filled with factual information addressing who, what, when, where, and how much. The book is well researched, and the sources of the information are meticulously referenced. It is written much in the style of investigative journalism: stating facts and sources of information. Presently, very little information on the topic of Caspian oil revenues is easily accessible, and here it is all collected and neatly organized.

Further, the book offers recommendations for promoting revenue accountability. These recommendations could be the only weakness of the text, as they are made strictly from a western viewpoint and do not take into consideration the local cultural context. "Caspian Oil Windfalls: Who Will Benefit?" is clearly written for an audience of western ('international') readers, who will certainly be outraged at the abuses of power by the governments of the Caspian basin states. However, it is problematic to propose that western solutions can be properly applied to problems in post-Soviet space. In his novel "Dead Souls," Nikolai Gogol long ago documented a

mentality predisposed towards 'trickery' as a means to succeed in business with the story of a man and his deceitful plan to get rich by dealing in dead peasant souls. This mentality and its impact on business operations in the region, documented with the publication in of "Dead Souls" in 1842 long before the establishment of the Soviet Union, has survived the Soviet Union and persists yet today in the New Independent States. If there is one criticism of "Caspian Oil Windfalls" it is that western solutions to the problems of revenue accountability are not likely to be applied properly with any level of success in the local cultural context of the post-Soviet Union.

In conclusion, the book "Caspian Oil Windfalls: Who Will Benefit?" never directly answers the question put forth in the title, but the implication is clear. The book offers factual information from recent history, and allows the reader to draw inferences himself and reach a conclusion from the facts presented.

The authors and publishers of "Caspian Oil Windfalls: Who Will Benefit?" have undertaken and subjugated a topic which many authors fear to touch. The value of this book is that an author has shown the courage to not be silent, and that a publisher has shown the courage to publish the work. We applaud this work, and look forward to the next effort from the Caspian Revenue Watch.

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"POST-SOVIET CHAOS VIOLENCE AND DISPOSSESSION IN KAZAKHSTAN"

By Joma Nazpary

London: Pluto Press 2002. ISBN 0 7453 1503 8

REVIEWED BY JAN TOMCZYK

This book is a valuable contribution to the understanding of the current social and personal economic situation that many people face in Kazakhstan. It is not an economic history of the collapse of the Soviet Union. Despite the authors hope that some people will take up the struggle against global capitalism it is nevertheless a sympathetic, thoughtful and thought provoking description of the social and personal economic hardships and challenges that many people in Kazakhstan are facing as part of the stark reality of their everyday lives. Joma Nazpary succeeds in never being patronising nor aloof. This is not surprising as the author spent time in Kazakhstan amongst the different segments of Kazakh society that are the subject of the research. The author never condemns the roles and personal opinions of the people who have provided an insight into their survival mechanisms and behaviour.

The book is an academic study sponsored by the Royal Anthropological Institute as a result of a grant from the Leach/ RAI fellowship. Joma Nazpary is a member of the Department of Social Anthropology at the University of Edinburgh in Scotland.

According to the author as a result of the Post Soviet chaos Kazakh society has developed five main characteristics or behavioral patterns: "Bardak" (a mess), networking as a response to the chaos, violence and stigma towards women and developed pathologies of sexualised strategies, the construction of the alien and simmering ethnic tension.

In addition, the author provides some related issues that support the books thesis. For example there is a short section on the use of the Kazakh language that explains the reasons that prevent the widespread use of the Kazakh language in all spheres of society: the lack of the necessary infrastructure, the lack of economic incentives and political resistance.

Using several selected academic sources rather than relying upon the international banking and international think tank and donor agency reports and findings together with the anecdotal evidence collected during meetings in Kazakhstan, the book provides what can be described as a lucid but alternative description and explanation as to how the dispossessed have been created. The result is the provision of a classification of the population of Kazakhstan into 8 main segments: from garbage seekers to the new rich.

The author provides a concise and interesting first Chapter that describes how the chaos occurred by using sources that some readers may not be aware off: such as Tickin, Dittman, Diugai, Wurrzel, Castells, Humphrey and Olcott to name a few. The central thesis is well documented, but it is the conclusion that seems at times to wander off the central track of the argument? The author offers questions as to what extent is the present situation in Kazakhstan a legacy of the Soviet era and to what extent is it a product of the new liberal reforms imposed by the U.S, the World Bank and the IMF? The author tends to the later argument. The support that we are offered is the results of the works by Gowan, Kagarlitsky, Burgess and Chossudovsky. The final summary is interesting but it is another argument that is another road that would require another book.

"ENERGY AND CONFLICT IN CENTRAL ASIA AND THE CAUCASUS"

Edited by Robert Ebel and Rajan Menon

Lanham: Rowman & Littlefield 2001. ISBN 0 7425 0063 2

REVIEWED BY JAN TOMCZYK

The book is a collection of 12 essays written by energy and international relation experts and brought together by the editors and The National Bureau of Asian Research (NBR). Robert Ebel on of the editors is Director of the Energy and National Strategic Security program at the Center for Strategic and International Studies. Authors of some of the essays include Pauline Jones Luong, Nancy Lubin, and Terry Lynn Karl to name a few. This should be sufficient recommendation but the broad coverage and serious research and analysis are also good reasons to read this book.

Pauline Jones Luong's comprehensive essay "Kazakhstan: The Long Term Costs of Short Term Gains" (p. 79-106) will probably become standard reading in embassies, boardrooms and classrooms. The essay describes the oil and gas investment frenzy, the distortion that such rapid and large investment can cause, the tendency for rent extraction, the failure of the oil and gas revenues to benefit the majority of the population, and the stable investment climate. The author provides insights and explanations concerning the short term effects of privatisation as well as the long term effects. In conclusion this detailed essay recommends a moderate flow of oil revenues and that the perception that oil and foreign investment can act as a panacea for the country's social and economic ills should be eliminated. Instead, the author recommends that Government officials should focus their efforts on securing domestic sources of present and future revenue streams and securing investment to develop them. These efforts should also include building state institutions that have the capacity to prescribe and collect taxes.

Amongst a list of conclusions the essay also recommends that both the Kazakhstani and U.S. governments should encourage greater development in the manufacturing and agricultural sectors, and that Kazakhstan should resist the temptation to close its borders to free trade. The author suggests that recent research demonstrates that those countries rich in natural resources that have maintained a commitment to free trade have also been the most successful economically – because open borders encouraged them to develop competitive manufacturing sectors. The supportive evidence is attributed to the work undertaken by Jeffrey D. Sachs and Andrew M. Warner and published in "Natural Resource Abundance and Economic Growth: Working Paper 5398, National Bureau of Economic Research, December 1995. This is an interesting comment since Kazakhstan is currently developing a new Customs Code that is scheduled to be implemented on January 1st 2003 and that Kazakhstan is in the process of accession to the World Trade Organisation.

The collection of essays is not limited to Kazakhstan as the book provides an accessible and a high level of information concerning Azerbaijan and Turkmenistan and also describes the U.S. and Iranian relationship. Scholars, company directors, diplomats and policy advisers should have this work on their bookshelves if they do not have it already.

"THE POLITICS OF CASPIAN OIL: BATTLE OF THE BLACK GOLD"

Edited by Bulent Gokay

Palgrave Publishers 2001, ISBN 0-333-73973-6

REVIEWED BY JAN TOMCZYK

Bulent Gokay is the Director of the European Studies Programme and Lecturer in International Relations at Keele University, Staffordshire, UK, and he has brought together seven essays that serve to act as a reference to the understanding of the politics of the Caspian Sea.

Bulent's opening chapter provides some interesting information on Caspian Oil under Soviet control: "Although petroleum exploration was energetic and greatly successful. However, it lacked much of the modern instrumentation. Efforts were held back by the inappropriateness, on occasion, of Soviet technology and the lack of an incentive system."

Other characteristics of Soviet control according to Bulent include:

- Scarcity of large capital expenditures for pumping equipment and drilling more wells (Goldman, *The Enigma of Soviet Petroleum*, George Allen and Unwin, pp. 35-54)
- Recording equipment was poor and depth penetration rarely exceeded 1500 to 3000 metres
- Common-depth-point shooting was largely experimental in most regions
- As a whole the Soviet oil industry was 10 to 25 years behind US technology
- During the 1960's and the 1970's there was a combination of problems: inadequate capacity to manufacture sufficient quantities of such indispensable equipment as compressors, large pipe and electronic equipment; laggard technology; and bureaucratic inflexibility.
- In the late 1980's Soviet technology seriously lagged behind that of the West
- Drill pipe was too weak to withstand the torque for rotary drilling
- Labour productivity was about 40 per cent of the US level
- There was extremely backward and inflexible infrastructure in industry.

The chapter also provides for the interested reader on oil and gas in the former Soviet Union several sources for further study such as A. A Meyerhoff's "Soviet Petroleum History, Technology, Geology, Reserves, Potential and Policy", in R.G Jensen, T. Shabad and A.W. Wright (eds), "Soviet Natural Resources in the Worlds Economy," University of Chicago Press, 1983.

The other six chapters deal with the geopolitics, management of transboundary energy resources, Azerbaijan's energy policy, private and national interests, the Nagorno-Karabakh conflict and the role of oil in the Russian Chechen war.

Serious students, academics but more important diplomats, policy influencers, company directors and managers who need to have an explanation as to what is happening with a lucid analysis as to why events are complex and seemingly without resolve in the Caspian Sea region should read this book.

"KAZAKHSTAN OIL AND GAS REPORT"

By Trade Partners, UK, and the British Embassy,
Almaty

AUGUST 2002: www.tradepartners.gov.uk

REVIEWED BY JAN TOMCZYK

The Commercial team located in the British Embassy in Almaty has produced the Report. It is the result of much desk research, accumulated knowledge and input from visits to the fields.

The report is a benchmark. It is useful and doubtless much appreciated by the British operators, contractors and suppliers for whom it was written. The depth and range of information is detailed and covers the issues and the exploration and production projects that are of keen interest to UK companies planning to market goods and services in Kazakhstan.

The report describes the need for due diligence and the need for local content. Legal and Tax due diligence needs to be undertaken by contractors and suppliers before they win a tender and not after. One of the most important issues for foreign contractors and suppliers who decide to create a legal entity in Kazakhstan is to create the right corporate structure. The corporate structure should balance the UK and Kazakhstan tax obligations. The potential contractor and supplier should realise that tax planning may be misconstrued as tax avoidance. Local content does not mean employing local personnel, even in large numbers. The Government wants to see the maximum benefit from the revenues of oil and gas and the participation and development of Kazakhstan industry is part of the solution. As a result local content should figure in the plans of future contractors and suppliers.

Foreign suppliers should not plan to endlessly supply the Kazakhstan market from factories located in other parts of the world. Setting up part assembly or manufacturing outlets and creating Joint Ventures may be some of the solutions. Some of the major oil and gas operators have relaxed their insistence on 50-50 per cent joint venture. Suppliers should check with the operators if commission agents are acceptable parties for procurement.

A great deal of procurement is and will be undertaken outside of the country as the major construction projects underway in Kazakhstan involve high technology. The local business associations recognise this fact and as a result want to win an increasing share of the low technology tenders. Some of the local companies that are members of the Manufacturers and Subcontractors Associations may be worthwhile contacts for foreign contractors and suppliers.

The Report describes the major consortiums and outlines their projects and construction schedules and lists some of the contractors that are currently working in Kazakhstan. The Annexes includes an invaluable list of contacts (company as well as Akim) and provides information that will help contractors and suppliers thinking of working in Kazakhstan to prepare marketing and business plans. The Report should be standard reading for all UK companies planning to access this market.

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The **Central Asian Journal** welcomes articles on issues relevant to management, economics and social research in Central Asia. Scholars from Central Asia, as well as from all other parts of the world are welcome to submit their articles. While articles directly pertaining to Central Asia are particularly welcome, more general analytical and empirical articles on issues of relevance and studies on other countries that might hold lessons or insights for Central Asia will also be considered. In addition, the journal also publishes a few review articles (such as commentaries on contemporary issues and surveys on recent developments, including those in econometric techniques for applied researchers) and book reviews.

Contributors should submit their articles in English. The articles submitted should be *original contributions* and *should not be under consideration for any other publication at the same time*. Please submit three hard copies and a soft copy of manuscripts, a cover page stating the author's background and affiliation, full address and an abstract of about 150-200 words (in English and Russian). The authors whose articles are accepted are also requested to provide a Russian translation of the final version of their article which will be placed on our website.

The next issue (Volume 5) of Central Asian Journal is due for publication in summer 2005. We invite scholars to submit their papers for this issue. The papers for the next issue are being accepted from now until March 1, 2004.

Please send your submissions to:

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How much transaction costs the EECCA member states as a whole, could save due to monetary integration is essentially an empirical question? The European commission estimated the savings in transaction costs between 13 to 20 billions ECUs per year (EC Commission, 1990). However, the savings in transaction costs would mean a fall in earnings of the banking system. Survey in banks across Europe found that 5% of the bank's revenue originates from commissions paid to the banks in exchange of national currencies. The bank revenues of such magnitude would disappear once the monetary union, EECCA is in place. It is an empirical question to find out how much profits in the banking systems would be reduced after the monetary union in the EECCA.

The indirect effect of eliminating transaction costs can make the price discrimination difficult. Elimination of exchange related risks reduces uncertainties, and improves national welfare (for more details, see De Grauwe, 1994).

3.3. Monetary Union and Economic Growth

The elimination of exchange risk also leads to an increase in economic growth. It reduces the systematic risk so that the real interest rate declines. The reduction of the risk-adjusted rate of discount for future consumption leads to higher investment and output with greater accumulation of capital, and an increase in economic growth rate: output per worker and capital stock in new equilibrium increase. Eventually, the growth rate returns back to its initial level as the technological change and the rate of population growth are assumed to be exogenous and constant in the static neo-classical model. Therefore, it is asserted that through monetary union, temporary economic growth can take place. However, in the dynamic version of the model explaining economies of scale, the growth process tends to be endogenous, and has permanent effects on output growth. In this model, the increase in productivity of capital is assumed to be increasing with the accumulation of capital stock, and also because of learning effects as additional knowledge is accumulated over time and becomes available to the public at large. In the process, this increases the productivity of labour over time. Thus, in the new growth theory with higher capital stock per capita, the economy can move on a permanently higher economic growth path.

4. THE COSTS OF MONETARY UNION

The pioneering work on the "Theory of Common Currency Areas" by Mundell (1961) and McKinnon (1963) and Kenen (1969) basically concentrated on the cost side of the cost benefit analysis of a monetary union.⁵ The classical view is that a country joining an exchange rate of EECCA area gives up its ability to use exchange rate and monetary policy for the purposes of stabilizing output and employment. This is called economic stability loss. It depends on the level of economic integration of the country. For example, when an economy is disturbed by a change in output market (due to shift in demand), a floating exchange rate has an

advantage over a fixed rate; it automatically cushions the economy's output and employment by allowing an immediate change in the relative price of domestic and foreign goods. Therefore, the extra instability caused by the fixed exchange rate in a common currency area, EECCA, is the economic stability loss. The following example will further illustrate the matter.

Think of Kazakhstan fixing its exchange rate against the EECCA allowing its currency, tenge, to float against non-EEC currencies, still Kazakhstan is able to keep some monetary independence. This intuition is surprisingly wrong. An independent money supply in Kazakhstan would put pressure on Kazakh interest rates, and thus on tenge/EURASH exchange rate. So after pegging tenge to a single currency, EURASH, it will completely surrender its monetary control.

As soon as Kazakhstan unilaterally pegs the tenge to EURASH, domestic money market disturbances will no longer affect domestic output despite the continuing float against non-EEC currencies. As Kazakhstan's interest rate must equal EECCA interest rate, any pure shock disturbing the asset market equilibrium in either direction will result in an immediate reserve inflows or outflows keeping Kazakh interest rate unchanged. Thus a tenge/EURASH peg alone is enough to provide automatic stability in the face of any monetary shocks that disturb the asset market equilibrium in either direction.

4.1. Monetary Union & Shifts in Demand

This section has been adapted from Mundell (1961). As mentioned earlier Kazakhstan and Russia are contemplating to be the members of the EECCA. Suppose a demand shock when the consumers shift their preferences from Kazakh-made products to Russian-made products. Using the standard aggregate demand and supply curves in an open economy as shown in most macroeconomic textbooks⁶, we may analyze the effect of such move. The demand shift is represented by an upward shift of the demand curve in Russia and by a downward shift in Kazakhstan. Such shifts in aggregate demand lead to a fall in real output in Kazakhstan, and an increase in Russia. Consequently, one may notice an additional unemployment in Kazakhstan due to fall in real output and a decline of it in Russia. The effect on current account⁷ is also well evident. In Kazakhstan, the value of domestic output has declined while it has increased in Russia. If spending by Kazakhstan residents does not decline by the same amount, it will have a current account deficit.⁸ In Russia the reverse will happen; there the value of output will increase. Assuming that the spending in Russia will not increase as much as output increases, people would tend to save, and therefore, one would expect a current account surplus in Russia.

Both countries will now face adjustment problems: Kazakhstan with current account deficit and unemployment, and Russia with current account surplus and over employment. Russia experiences boom, while Kazakhstan is in recession. Is there any automatic equilibrating force that would take these countries to return