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2008

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MPRA Paper No. 26417, posted 06 Nov 2010 14:04 UTC

Informal Regionalism in Central Asia: Subnational and International Levels

by

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November 2008

While the poor quality of governance is widely accepted as a main factor hampering economic development in Central Asia, one of the main ways to solve this problem is often connected with changing the allocation of authorities, shifting them to the supranational (regional integration) or subnational (decentralization) levels. Both aspects have been widely discussed, but the progress remains extremely limited. This paper claims however, that in spite of deficit of formal institutions, *informal* decentralization and regional integration have been important factors with a profound impact on economic and social development of Central Asia. However, the impact of informal shifts of authority on institutional development is not unambiguous.

The paper was written within the framework of the project “Emerging Market Economies in Central Asia: The Role of Institutional Complementarities in Reform Process”. The paper was presented at the conference of the project in September 2008 in Goettingen. The author thanks the participants for helpful discussion.

1. Introduction

The problem of regional integration and decentralization in Central Asia is relevant at least from two points of view. From the positive perspective, economic and political transition is hardly limited to the clear structure of a nation-state. It is much more often resulting into shifts of authority and economic relations both between and within states (Ananyin, 2005). Regional economic integration and political, administrative and fiscal decentralization represent just individual aspects of these changes. Hence, these shifts may become a crucial factor explaining the outcomes of economic development, and are worth studying. From the normative perspective, both decentralization and international economic integration are often claimed to be able to act as an important trigger to overcome the problems of institutional quality in the region. In the post-Soviet world territorial decentralization of power and devolution of services to municipal self-governance level are often considered as key elements of successful transformation. Though the issue of the regional integration is perceived differently for different regions of the former Soviet Union, the overall consensus is that increasing regional cooperation could be helpful for Central Asia from the point of view of economic development and overcoming common problems (Gleason, 2001).

However, in spite of multitude of projects and initiatives in both fields, both regional integration and decentralization remain mostly a vague collection of “ink on paper”. All countries of the region are highly centralized and do not allow for even limited authority of subnational jurisdictions. Multilateral integration and cooperation virtually does not exist in spite of a multitude of projects in this area. Though, economic opening up may be achieved through unilateral actions, which do not require cooperation, it is however not what one observes in Central Asia: all countries of the region implemented at least some protectionist measures at certain points of time.

This paper, however, aims to consider a different perspective on both problems. It claims that in spite of obvious weakness of the *formal* decentralization and regional integration, *informal* decentralization and regional integration become crucial elements of regional development. From the point of view of decentralization, it is well known that the formal distribution of authorities among levels of government does not necessarily represent the real equilibrium, developed through the interaction of bargaining power (Taylor, 2007). The informal decentralization represents a specific case of authority migration through encroachment, shirking, burden-shifting and other forms of opportunistic behavior (Bednar, 2004). Regional governments are often able to achieve a higher degree of autonomy than specified in the formal constitution; on the other hand, China gives an example when a formal

decentralization is counteracted by informal centralization through control over appointment of regional party secretaries (Landry, 2004; Sheng, 2007). From the point of view of the international integration, the areas of relatively less effective *regionalism* could happen to be quite successful in terms of *regionalization*, i.e. interaction of economic and political actors beyond the formal intergovernmental cooperation across national borders. Main elements of the regionalization usually include stable trade networks, cross-border investments linking the countries through international chains of production and migration. The well-known case of “informal integration” is South East Asia, where foreign direct investments of Japanese corporations and cross-border Chinese ethnic business networks effectively substitute for lack of formal international integration (Peng, 2000; Kawai, 2005). In Africa cross-border trading networks play a similar role: while the official intraregional trade is estimated at the level of 6% of the overall foreign trade of the countries in the region, the informal trade flows not captured by statistics could reach the level of 30-50% (Meager, 1997). Similar processes are observed in Southern Asia, although they seem to be less developed (Taneja, 2001; Rafi Khan, 2007).

The paper is therefore organized as follows. The second and the third sections deal with the informal decentralization and regionalization (two concepts which are unfortunately not entirely symmetric). The fourth section sums up potential institutional implications of both informal processes. The fifth section looks at the interaction of formal and informal changes in spatial governance organization. Finally, the last section concludes. The first two sections are mostly *descriptive*: my aim is basically to focus on the existence of certain phenomena, often neglected in the analysis but potentially important for the regional development. The further sections are *deductive*: basically, they propose a set of hypotheses linking the observed phenomena (informal integration and informal decentralization) with each other and with institutional development. I most certainly understand that this approach is not sufficient to prove the causal claims; but it may at least give some ideas for further research.

2. Informal decentralization

2.1. Post-Soviet experience of informal decentralization

The problem of substantial differences between de-facto and de-jure decentralization is not unique for Central Asia and is present in most post-Soviet countries. In the Soviet Union relations between different tiers of governance were threefold. First, the country was officially organized as a multi-level asymmetric federation. Secondly, the formal

decentralization was in fact part of a strictly hierarchical political system with absolute dominance of the central government; the Soviet Union thus was a “super-unitary” state. However, thirdly, the Soviet hierarchy evolved from the 1950s on into a system of multi-level bargaining between different power centers with informal property rights over their assets and territories, often exchanging the formal loyalty for quasi-autonomy (typical for the Southern republics of the Soviet Union). This system of informal bargaining is often referred to as the “administrative market” (Kordonskiy, 1995).

The collapse of the Soviet Union shifted the power balance in the administrative market. Formally, most post-Soviet de-jure allowed different forms of administrative, but not political decentralization, establishing a clear hierarchy between the central and the regional authority (with the only exception of Russia as a formally federal country, as well as Ukraine, Moldova and Georgia with autonomous territories). Even Russia established in 1994 a highly centralized structure of fiscal federalism with relatively limited authority of the regions; in fact, differences between de-jure federal Russia and de-jure unitary Ukraine, Belarus or Kazakhstan are smaller than one would expect, though present (Dabla-Norris, 2000; Lavrov, 2004). However, the development of de-facto decentralization varied more significantly. While several new independent states were too small to experience any significant decentralization, faced too strong external challenges (like Armenia) or developed a highly autocratic political system even exceeding that of the late Soviet period (like Turkmenistan), several larger republics with relatively weak central government experienced the *de facto devolution*: the regional governments were able to seize significant power and became influential players. The classical example is that of the Russian Federation with its asymmetric federalism of the 1990s: even after establishment of the formal rules of a highly centralized federation in 1994 regional governments continued gaining independence through the quasi-constitutional system of power sharing treaties and unilateral actions like strategic tax collection and “war of laws” (Litwak, 2002; Libman and Feld, 2008). In Ukraine regional governments led by the presidents of regional councils (*oblastnoi sovet*) became influential players in the political system, and the Autonomous Republic of Crimea followed the Russian path of unilateral devolution (Turovskiy, 1999); the resulting “decentralized influence over revenue policy” seemed to be much higher than formal structures would suggest (Way, 2002).

However, the informal nature of the decentralization made it vulnerable to power shifts (Bahry, 2003); the evolution of the post-Soviet regimes, on the other hand, dictated the consolidation of power on the central level (Furman, 2007). Hence, most post-Soviet countries which became informally decentralized in the 1990s, switched to increasing

centralization when the regional semi-autocracies managed to gain power. In Russia the centralization stage replaced informal decentralization in the 1990s after the power shift from Yeltsin to Putin; nevertheless, even the first term of Putin (2000-2004) and, according to certain claims, the first wave of gubernatorial appointments at the beginning of the second term, were characterized by relatively high informal autonomy of regional governments and persistent informal decentralization (cf. Chebankova, 2008). In Ukraine the shift to centralization occurred earlier under the administration of Kuchma based on successful manipulation of regional elites, which, however, also tolerated informal autonomy of the regions for a relatively long period of time (Turovskiy, 1999; Sasse, 2001). Since the Ukraine, unlike Russia, is economically decentralized (in spite of economic dependence of individual regions from the center), the regions still continue playing an important role in the political processes in the country, and the political struggles after the Orange Revolution lead to repeated discussion of the federalization idea. Nevertheless, the general logic of predominance of informal decentralization depending upon the power balance at the central level remains valid: the informality of decentralization makes it sustainable only if the central authority is weak.

The informality of decentralization fits quite well in the model of semi-authoritarian hybrid regimes and the “hostage taking” as an instrument of control typical for many post-Soviet countries. In fact, the attempts of the central government to establish control over secessionist territories by force in the former Soviet Union failed (and resulted into emergence of non-recognized states), while the temporary retreat and acceptance of informal decentralization allowed the re-centralization in the future (Ukraine does not fit this pattern, but its current political system is also quite different from the post-Soviet standard).¹ The mechanism of is very similar to that of control over private business: since decentralization is informal, it may be removed by applying perfectly legal instruments; their selective application may be used as an instrument of control over regional elites. As the previous section claimed, semi-authoritarian regimes have an extremely negative impact on public administration. It will be shown that the same is true for the devolution in semi-authoritarian environment.

2.2. Specifics of Central Asia

¹ The only exception is the Chechen Republic, where Russia actually enforces the regime of very high informal autonomy.

The development of Central Asian countries to certain extent reflects these general trends, but there are important differences between countries. Melvin (2001) claims that in the Central Asian countries sub-national units inherited substantial de-facto autonomy through patron-client relations and economic networks, which could be used in the bargaining process. **Kazakhstan**, as the largest country of the region, resembles the pattern of the informal decentralization-recentralization dynamics of Russia and Ukraine pretty closely. In the first half of the 1990s the country experienced a severe economic crisis, leading the regional governors to develop their own policies partly deviating from the central ones. Moreover, the concentration of FDI inflow in the oil-rich Western part of the country also increased the bargaining power of local elites, able to influence the appointment of governors (akims). The economically successful regions received a higher portion of tax revenue generated from their territory. The results and the mechanisms of informal decentralization in Kazakhstan were very similar to those observed in Russia: capture of local tax authorities, tax exemptions for companies for donations and inconsistent application of central regulations. Hence, the informal decentralization thrived in Kazakhstan as well as in other large countries of the CIS. The main difference was probably the higher concern of the central government for secession threats of the Northern territories with a significant share of the ethnically Russian population and traditional economic ties to Siberia. In fact, the potential of internal separatism belongs to the factors making Kazakhstan supportive of the post-Soviet integration.

Since 1999 economic boom and completion of the power concentration at the central level made the policy of recentralization possible. As in Ukraine, the formal appointment of akims by the central government made the personnel selection schemes the main instrument of recentralization: former members of the central government were appointed as akims. Furthermore, the central government re-established control over oil and gas resources of the regions through the newly established KazMunaiGas. Territorial shifts of regional borders and removal of the capital from the Southern Almaty to Astana in the center of the country also contributed to the reduction of political de-facto autonomy of governors (Cummings, 2000; Melvin, 2001; Jones Luong, 2004; Paarmann, 2007). Increasing transfers from the center increase the dependence of regions from the center (Ufer and Troschke, 2006). Interestingly enough, success of de-facto re-centralization seems to support the desire of the central government to experiment with different forms of self-governance at the regional level. In 2001 president Nazarbaev allowed the pilot elections of heads of rural administrations (a practice resembling the rural elections in China, see Thurston, 1998); however, the experiment was ceased in 2003 and was heavily criticized for non-democratic practices and

limited authorities of newly elected officials. As mentioned, local governments still own about 80% of public enterprises, but the authorities are not clearly separated and the degree of autonomy is in fact very limited (Gutovnik, 2006). Thus modern Kazakhstan turned into a de-facto and de-jure highly centralized political entity.

Other countries do not really follow the devolution-recentralization dynamics like Kazakhstan. The regime of Akaev in the **Kyrgyz Republic** with the strong division between the northern and the southern part basically focused on incorporation of regional elites and increasing interdependence of regional and central government (Melvin, 2001). Political turbulences in the second half of the 2000s gave rise to development of informal devolution. In **Tajikistan** civil war obviously led to the vacuum of power; the positions of local authorities differed substantially during the civil war; nevertheless, there has been a strong convergence trend after 1997 (Olimov and Olimova, 2001). Currently the increasing political stability seems to support the re-centralization trend, limiting the power of regional elites: so, one may say, the country also experienced the “decentralization-recentralization” cycle, but in the extreme form of the civil war. In **Uzbekistan**, unlike Kyrgyz Republic, the regime of Karimov was able to restrict power of local networks and thus develop a highly centralized political system based on omnipresent central control (Melvin, 2001). **Turkmenistan** is probably the most centralized country in the region; governors are dismissed in short intervals and without any reasonable explanation (Leschenko and Troschke, 2006) – once again, due to the very high power concentration at the central level.

There is, however, yet another perspective on Kazakhstan, Kyrgyz Republic and Uzbekistan, discussed by Jones Luong (2000). Regardless of the degree of de-facto decentralization she documents the strong development of *regional interests* and *political identities* in the political and economic elites, which manifest themselves in the decision-making at the central level.² A similar concept in the theory of decentralization is the “constitutional decentralization”, i.e. the ability of regions to influence national decisions; in the case of the Central Asian countries it is obviously necessary to refer to an “informal constitution” as system of rules governing relations within the elite as the basic concept. The rise of regional political identities seems to be stronger than the development of tribal and local interests as an unexpected result of the Soviet heritage. Regional political interests are very important for the Kyrgyzstan with its model of “incorporation” of regional elites. The

² These practices resemble the importance of regional interests in Ukraine, where the centralization is also often perceived as collusion of the center with individual regions (Solnick, 2002) and the current politics is strongly divided along regional lines, although the mechanism of formation of regional interests may be different.

civil war in Tajikistan can be perceived as war between regions (Olcott, 2005: 146). It is questionable whether the “public manifestations” of regional political identities survived the consolidation of power in Uzbekistan and Tajikistan in the mid-2000s. However, from this point of view one could actually claim, that the very nature of *any* central-level politics in Central Asia is to a certain extent related to the competition of *regional* clans (Starr, 2006); therefore even the re-centralization can be viewed as a success of a particular regional interest.³

3. Informal regional integration

3.1. Post-Soviet experience of informal integration

Once again, informality of regional integration is not a specific feature of Central Asia and is present in the post-Soviet world in general. There are good reasons to claim, that, in spite of weak formal integration (which is currently falling apart) the region currently exhibits a substantial degree of the bottom-up integration. Basically, there are four factors contributing to this process. First, Vahtra (2005), Crane et al. (2005), Libman and Kheyfets (2006) and Kuznetsov (2007) show, that since early 2000s Russian corporations have been increasingly present in the post-Soviet countries through takeovers, joint ventures and – recently – greenfield investments. The investment expansion of Russian business is only partly registered by official statistics, since informal channels and offshore schemes are actively employed. Traditionally three main sectors of expansion are oil and gas, metals and mining and telecom, although currently a much larger diversification is observed. Second, post-Soviet countries are closely linked by migration flows: once again, the main destination for the labor migration is still Russia (Tyuryukanova, 2005; Ivakhnyuk, 2006). Third, the post-Soviet space is still connected through a unity of infrastructure, e.g. in railroad and power utilities sectors, created in the Soviet times. Finally, there is still a significant (though permanently declining) degree of social integration in the post-Soviet world, manifesting itself in interpersonal networks and, above all, Russian as lingua franca for communication (Nasledie Evrazii, 2007). Hence, the regionalization in the post-Soviet space seems to be driven partly by the Soviet heritage (which may happen to be a “disappearing reality”), and partly by the logic of regionalization common for a typical geographical strategy of emerging multinationals (Davidson, 1980, Bell and Pennings, 1996). The post-Soviet regionalization seems to be

³ The success of particular regions in this form of “horizontal” competition may, nevertheless, just form a step towards formation of a more traditional “vertical” model of interaction between the center and the regions, as it happened e.g. in the early Argentina (Gibson and Faletti, 2004).

extremely asymmetric and clearly centered around Russia as the key market and key source of FDI in the region. Interestingly enough, there is no evidence of trade regionalization in the CIS (unlike, e.g., Africa, where informal integration is basically trade-driven), what can be attributed to the specifics of industrial structure of post-Soviet economies, where (mostly global) trade in commodities dominates the trade structure. Nevertheless, after significant decline of the 1990s the share of intraregional trade in the CIS reached a stable level; there is also evidence that the intraregional trade is still “too high” as opposed to gravity models predictions (Fidrmuc, Fidrmuc, 2001; Djankov, Freund, 2002, 2002a; Elborg-Voytek, 2003, de Sousa and Lamotte, 2007).⁴

From the point of view of this asymmetry regionalization in Central Asia seems to be a complex phenomenon. Theoretically, extraregional actors (like Russian corporations) could act as a driving force in the regionalization process. For example, in East Asia Japanese and (partly) U.S. multinationals seem to contribute to the development of informal regional structures (Dobson and Yue, 1997). However, it requires two additional conditions: first, companies are present in several countries of the region, and second, their businesses are linked to each other. To our knowledge, there are extremely few areas where both conditions are satisfied. Two fields where Russian FDI could potentially increase the degree of regional interdependence in the Central Asia are telecommunications and power utilities. Currently, the “Big Three” Russian mobile service providers are present in all five countries of the region (VimpelCom/Altimo in Kazakhstan, Kyrgyz Republic and Uzbekistan, MTS in Uzbekistan, Kyrgyz Republic, Turkmenistan and Tajikistan, and Megafon in Kyrgyz Republic) and have already been engaged in tough competition for the most attractive assets. In the power utilities the major player is the state-owned RAO UES (currently its successor Inter RAO UES, controlling foreign assets of the former power monopoly), which is present in Kazakhstan and Tajikistan, as well as potentially in Kyrgyz Republic. Given the fact that the energy systems of the post-Soviet countries are still intervened, common actors in energy sectors can significantly contribute to regionalization. However, one should be aware of the fact that the energy trade in the post-Soviet space decreased in the last few years, and that the modes of organization of power utilities in individual Central Asian countries differ substantially. A third field where Russian extraregional actors could potentially become

⁴ It means that the counterfactual trade between the countries of the region estimated according to the size of their GDP and geographical distance is lower, than the actual trade flows. This, however, still does not imply that the intraregional trade is dominant in the trade structure.

agents of regionalization is oil and gas; however, currently the presence of Russian corporations in these sectors is quite limited (although growing).

Finally, regionalization through external actors - like in the “Greater China” area - is sometimes explained by the “intermediary function” accepted by certain regions and countries “canalizing” foreign investments and trade in the region (Breslin, 2004). However, developed bilateral ties between Russia and post-Soviet countries make the use of these “intermediaries” less important. The situation is not unambiguously clear (Kuz'min, 2007): Russian investors are probably not as close to Kyrgyzstan, as those from Kazakhstan, but the “distance” is still relatively small. However, as we will show below, Kyrgyzstan and Kazakhstan seem to develop deep economic relations, which are not present elsewhere; in Tajikistan Russian investors are more important, than those from Kazakhstan. One could of course speculate as whether increasing presence of Chinese investors will contribute to establishment of the “gate regions” to support regionalization through external forces, but the outcome is yet to be seen.

3.2. Foreign direct investments

A more interesting question is whether one could expect any regionalization driven by the intraregional actors. It is clearly not the case in other regions of the CIS (for example, there is only vague evidence of some Ukrainian investment activity in Moldova – in particular, in Transdnistria, and of Azerbaijan – in Georgia). However, Central Asia is quite different, mostly because of the activity of private and semi-private businesses from *Kazakhstan*, which actively explore the Central Asian countries. Though main direction of investments for Kazakhstan is still Russia, it is increasingly present in the Central Asian region. As of September 30, 2007 Kyrgyz Republic ranks 13 in the overall outward investments of Kazakhstan with about 1.3% of total foreign investments of the country (US\$ 481 mln., including US\$ 240 mln. FDI). Uzbekistan ranks 20 with US\$ 199 mln. (FDI: US\$ 109 mln.), and Tajikistan ranks 21 with US\$ 188 mln. (FDI: US\$ 24 mln.). Hence, the countries seem to be of minor importance for the outward investment activity of Kazakhstan, with Russia, US, UK and British Virgin Islands (BVI) being the main targets for outward investments. However, one should take into account, that the Central Asian economies are relatively small, and hence even limited investment activity of Kazakhstan can become crucially important. Indeed, according to the investment statistics of the Kyrgyz Republic, Kazakhstan is currently the dominant source of FDI for Kyrgyzstan, accounting for about 50% of the total investment inflow (see *Figure 1*). Unfortunately, we do not have data on the FDI structure for Tajikistan and Uzbekistan. However, applying the Kazakhstan data on FDI

and total investments and national data from the balance of payment, one could establish, that for Q1-Q3 2007 Kazakhstan accounted for about 21% of total investments and about 4% of FDI inflow in the economy of Tajikistan (with Russia being the main investor accounting for about 40% of capital inflow).⁵ One should, however, be aware of the presence of indirect investment channels (e.g. via the BVI investments), which have not been captured by the statistics above.

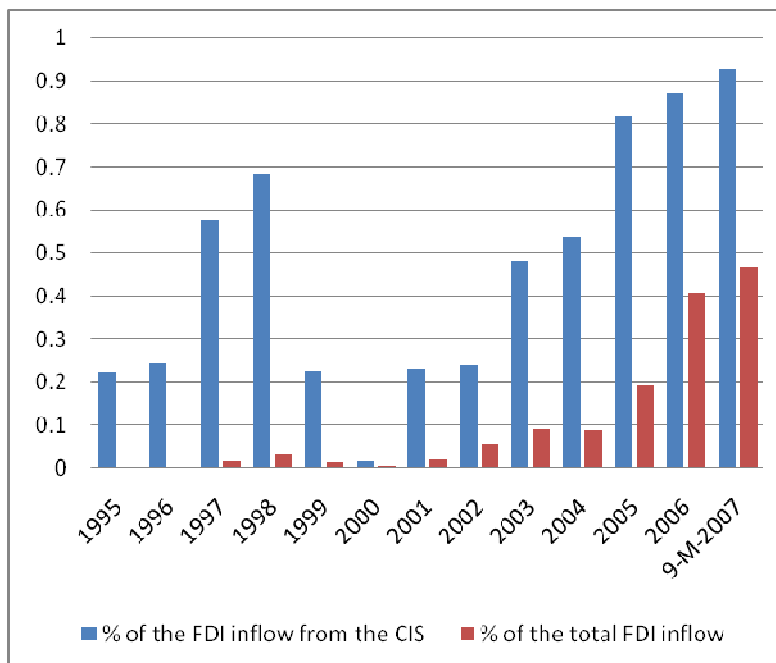


Figure 1: Share of Kazakhstan in the FDI inflow to Kyrgyz Republic

Source: governmental statistics of the Kyrgyz Republic

The low quality of statistical data makes the discussion of case studies of investment activity in the region necessary.⁶ In what follows we list the main investment projects of Kazakhstan in other countries of the region. Most projects we are aware of are implemented in Kyrgyz Republic; it could represent the quality of data bias, however, from our point of view, reflects the true predominance of Kyrgyzstan-Kazakhstan connection in the regionalization processes in Central Asia.

⁵ Surely, this indicator is extremely questionable. It is well known that direct comparison of outward and inward investment flows data from different statistical authorities of the CIS yields substantially different results (Vahtra, 2005); moreover, one faces the challenge of separating balance of payment statistics and methodology of statistical authorities, which also happen to be different.

⁶ The FDI data from the developing countries is generally very bad; it is also true for the post-Soviet space because of huge discrepancy in statistics of individual governments and role of offshors (see Libman and Kheyfets, 2006, for a detailed discussion); a specific problem is that the quality of data is really varying over time, making time series comparison problematic.

While distinguishing among the areas of FDI activity of Kazakhstan in the region, one should point out the *banking sector*. Successful economic reforms fostering market discipline and high standards allowed Kazakhstan to establish a well-functioning banking sector outperforming that of most other CIS countries (including, to a certain extent, Russia), allowing the banking sector to pursue an active expansion strategy abroad. Currently the main holdings of the banks of Kazakhstan in Central Asia include *Nacional'nyi Eksportno-Importnyi Bank* (Kyrgyz Republic) owned by *TuranAlem* (originally purchased by *Temirbank*), *Kazkommerzbank Kyrgyzstan* (Kyrgyz Republic) and *Kazkommerzbank Tajikistan* (Tajikistan) owned by *Kazkommerz*, *ATF Bank Kyrgyzstan* (Kyrgyz Republic) owned by *ATF Bank*, *FinanceCreditBank* (Kyrgyz Republic) owned by the *Seimar Alliance Financial Corporation* and *Khalyk Bank Kyrgyzstan* (Kyrgyz Republic) owned by *Kazakhstan People's Bank*. Investments from Kazakhstan account for about 30% of the capital of the banking system of Kyrgyzstan being the sole major foreign investor (Abalkina, 2007:43), and the share of the banks controlled by Kazakh banks may reach 50% of the market for banking services (Kuz'min, 2007). Nevertheless, the presence of the banks of Kazakhstan in other countries of Central Asia seems to be fairly limited. The state-owned *Development Bank of Kazakhstan* has a representative office in Uzbekistan.

There are several other sectors where investors from Kazakhstan achieved relative success. In Kyrgyz Republic one should definitively mention the tourist industry, in particular the recreation facilities in the Issyk-Kul region (UNDP, 2006:28). The data regarding this sector is fragmentary at best; however, the number of objects controlled by Kazakhstan could be significant. The most well-known deal is the agreement to pass four facilities to Kazakhstan signed in 2001 and ratified in 2008. Nevertheless, it probably covers only the top of the iceberg. In March 2008 Kazakhstan and Kyrgyz Republic announced its plan to construct a new road connecting Almaty and Cholpon-Ata at Issyk-Kul, which, however, is still very far from implementation. For sure a clear advantage is the geographic proximity of the region to Almaty, increasing the potential market for the tourist services for customers from Kazakhstan.

Further sectors of the investments from Kazakhstan include mining, construction and media industries, as well as real estate. In Kyrgyz Republic Kazakh companies control the Kant Cement and Slate Plant, maize syrup plant, two concrete plants, Tokmok Brick Plant, Kadamjai Stibium Plant, Tokmok Wool Processing Plant, *Kyrgyzenergoremont* in Bishkek, and participate in the development of gold deposits at Jeruy (*Visor Holding*) and Taldy Bulak (*Sammergold*). In Tajikistan *KazInvestMineral* acquired the Adrasman mining complex in

2006 for US\$ 3.2 mln. In the field of gas supply Kazakhstan's state owned *KazTransGaz* and Kyrgyz *Kyrgyzgaz* established a joint stock company *KyrKazGaz* in 2004 to operate the gas pipelines to the North of Kyrgyzstan and the South of Kazakhstan. As in the CIS in general, the dominant instrument is still acquisition of existing assets, though there is increasing presence of greenfield investments (like the recently initiated project of a ferrosilicoaluminium plant in Tash-Kumar (Kyrgyz Republic) for US\$ 100 mln.) Finally, Kazakhstan seems to be extremely interested in power utilities in Kyrgyz Republic and Tajikistan (in January 2008 Kazakhstan declared its plans to participate in the reconstruction of the Kambarada Power Plant in Kyrgyzstan, and in February – in the reconstruction of the Rogun Power Plant in Tajikistan); however, any perspectives in this field are still vague, especially given active position of Russian *RAO UES* in the area. The investment activity seems to be driven by both relatively cheap labor (as opposed to Kazakhstan) and access to natural resources. Access to markets seems to be less important in this sector (unlike banking services).

The opposite direction of investments from Uzbekistan, Tajikistan and Kyrgyz Republic to Kazakhstan seems to be insignificant. In the first 9 months of 2007 Uzbekistan accounted for about 0.004% of total FDI inflow to Kazakhstan (or 11% from the CIS),⁷ and Kyrgyz Republic for .008% (or about 22% from the CIS). There is no data on investment activity of Tajikistan, as well as cross-border investments in Central Asia beyond Kazakhstan. To conclude, it looks like the Central Asian regionalization is as asymmetric, as the regionalization process in the CIS in general, with Kazakhstan as the main source of outward investments and Kyrgyz Republic as the main recipient of FDI. In Tajikistan investments from Kazakhstan are important but less active, than those of Russia (in the Kyrgyz Republic the situation is exactly the opposite). Uzbekistan and (especially) Turkmenistan are much less active in the development of intraregional investment ties.

3.3. Interregional trade

In case of the intraregional trade the situation is similar to the CIS in general. Regional concentration of exports is characteristic to a certain extend for the Kyrgyz Republic mostly because of its close economic ties to Kazakhstan. On the other hand, Tajikistan and Kyrgyz

⁷ There are currently 96 enterprises with Kazakh investments functioning in Uzbekistan, including trade, construction, light industry, metals and food industry, and 715 small and medium enterprises with Uzbek investments in Kazakhstan, including trade, manufacturing, food industry, construction materials, glass, services and real estate operations (RIA Novosti, 2008, April 21). However, the quality of these data is very low and is hardly helpful for understanding the scope of international cooperation.

Republic experience a certain degree of concentration of imports in the region. An additional factor potentially supporting the regionalization is that Central Asian countries share a number of common problems of infrastructure, in particular for energy trade and water supply, where their economies are closely linked to each other (Vinokurov, 2007). Even if the value of trade is small, its importance for the development is crucial. However, in spite of relatively low international trade, it seems likely that individual markets for consumer goods in the region are highly integrated. Grafe et al. (2005) show that the impact of border on price variation between Kazakhstan, Kyrgyz Republic and Uzbekistan is relatively small and practically equivalent to the intranational price variation between individual regions. It, however, does not imply that internal markets are integrated – only that the border effect for disintegration is less relevant. Therefore one could probably assume that the integration on the level of small business networks is much higher, than for commodities (which play the crucial role in determining the structure of trade statistics presented above). Spechler (2000:7) claims that “with all the problems, informal trade among the Central Asian countries appears to be working reasonably well”. Informal trade seems to be important for countries like Tajikistan (Olimova et al., 2006) and even Turkmenistan in spite of strong trade restrictions (in particular across the border with Uzbekistan) (Badykova, 2006). One should however bear in mind that the emerging informal trade networks often span outside the Central Asian region over the whole Eurasian continent (Evers and Kaiser, 2000; Kaiser, 2002).

Finally, the last issue to be considered is the labor migration in Central Asia. Once again, Kazakhstan acts partly as a regional leader attracting migrants (although Russia still remains the most important partner for the majority of the CIS countries from the point of view of migration – although there is an increasing evidence of competition between these two countries for the labor force). As in case of the FDI activity, increasing labor migration in Kazakhstan is also a relatively recent phenomenon, directly related to the economic success of the country in the last half decade. The main countries of origin for labor migration to Kazakhstan are Uzbekistan and Kyrgyz Republic; the migration is partly driven by a relatively large ethnic Kazakh minority in Uzbekistan. Although Kazakhstan implements a policy of privileged ethnic immigration of the *oralman* (ethnic Kazakhs), there seems to be a significant flow of illegal labor migration exceeding the official migration. The number of labor migrants from Uzbekistan in Southern Kazakhstan (which seems to be the most attractive region for migration inflows) varies between 200,000 and 1 million; however, the any data is likely to be extremely biased and is to be considered with great caution. Some authors point out the existence of labor migration from Uzbekistan to Kyrgyz Republic,

generating a remittance flow, but it seems to be relatively small (Mogilevsky, 2004:27). The migration flows have a heavy impact on both legal and illegal monetary flows of migrant remittances (Sadovskaya, 2006). In case of Tajikistan Russia remains the absolutely dominant country from the point of view of labor migration. Hence, for informal trade and migration the “microregionalization” involving selected regions and areas of the countries is probably relevant (however, one should not forget, that Southern Kazakhstan is not only geographically close to other countries of the region, but has also a relatively high level of economic development).

To conclude, one indeed can observe certain features of regionalization in Central Asia, but their impact is rather limited. There is some evidence of increasing presence of business groups from Kazakhstan in Kyrgyz Republic, which increased dramatically in the last years. The main driving force of regionalization is the banking sector; recently public structures (like *KazTransGaz* or *Kazyna*, currently developing a joint investment fund with Kyrgyzstan⁸) also became increasingly important. Even as opposed to the regionalization via FDI of Russian corporations in the CIS, which basically started in 2000, the regionalization via FDI of businesses from Kazakhstan in Central Asia is still a very recent phenomenon with only few years of experience and strongly depends on economic performance of Kazakhstan. However, a significant driving force for integration seems to be formed by informal networks interconnecting Kazakhstan, Kyrgyz Republic and Uzbekistan and only partly visible for official statistics. In this case regionalization is a much older phenomenon embedded in the traditional economic ties in the region. Moreover, it seems to be by far more developed, than in the CIS in general (with only few exceptions involving separatist regions like Transdnistria, Abkhazia, Southern Osetia and Nagorny Karabakh, which also rely on informal trade).

Thus, Central Asia combines both “investment regionalization model” of South East Asia and the CIS (Kazakhstan and Kyrgyz Republic) and “informal trade regionalization model” of West Africa and South Asia (Kazakhstan, Kyrgyz Republic and Uzbekistan). Given the significant size of the shadow economy in Kazakhstan (Schneider (2007) estimates it at 44.6% of official GDP for 2004/05), Kyrgyz Republic (40.6%) and Uzbekistan (35.4%), the role of informal trade can be significant, though diminishing given rapid economic growth in the region (especially in Kazakhstan). Less reliable estimates of shadow economy in Tajikistan exceed 60% of official GDP (Lenta.ru, 2007, June 27); however, the participation

⁸ A similar fund was established with Tajikistan

of the country in the regionalization processes is significantly smaller and the relative impact of Russia as an extraregional economic partner higher than for other countries. The role of Turkmenistan in the regionalization processes is negligibly small.

4. Informal governance and institutions

The main question to be discussed, however, is not just to establish the existence of informal regionalization and decentralization, but also to understand its institutional implications. Regionalization often occurs at the corners of development spectrum: it can become crucially important for economies at the low level of development, substituting for the deficit of the rule of law, but it can also follow from high development, with high governance capacity of non-governmental agents. In both cases effects of regionalization on institutions can differ. For example, in Medieval Europe merchant guilds effectively supported the de-facto integration of the economic space and overcame the low development of formal institutions (Greif, 2006), but also engaged in redistributive activities and market monopolization (Ogilvie, 2007). Decentralization, though often considered an attractive option to increase the quality of institutions, may have a negative effect on economic performance, depending upon the specific form and instruments of decentralization and the framework institutions determining the interplay of the center and the periphery in the particular decentralization scheme (Treisman, 2007). In a world of non- or semi-democratic governments and informal relations the effects of decentralization should be revisited.

4.1. Decentralization

Unfortunately, the experience so far has been dismal: there is no evidence that even limited decentralization and devolution of power to local municipal self-governing institutions improved the functioning of the public administration. It is possible to distinguish among four main factors making the experience of decentralization problematic: the informal nature of political property rights, interventions into economic autonomy of individuals and businesses, expansion of public authority through decentralization and decentralization with lacking intraregional infrastructure. In what follows I discuss these factors in greater detail. Of course, it does not mean that decentralization is unable to have a positive effect on the quality of public administration: it rather suggests that decentralization *per se* in the existing institutional environment is unable to generate new incentives for public officials.

As mentioned above, the predominance of informal practices and institutions constitutes an important problem for the public administration. The informal decentralization,

by its nature implies the continuing use of informal instruments. It does not imply that the informal decentralization is unable to have positive economic effects on *economic development*: inefficient public service can be effectively substituted by informal practices of public officials. This is exactly the logic of the contested “grease the wheel” corruption theory: under certain circumstances, if the administration and legal system are highly inefficient, informal channels like corruption can help avoiding publicly created barriers and thus become growth-enhancing (Dreher, Gassebner, 2007). Competition between corrupt local governments in a decentralized environment can either establish a “race to the bottom” from the point of view of corruption like it is reported in India or increase the interest of governments in executing the “helping hand” policies for regional industry, as it may have happened with the TVE experience in China. Finally, the impact of inefficient administration on growth differs in different political regimes; Aidt et al. (2008) claim that corruption has a negative effect on growth in high accountability regime and no effect in low accountability regime. There is certain evidence of growth-enhancing policies of local governors in Kazakhstan: in particular the example of the former governor of Semei Galymzhan Zhakiyanov is worth mentioning. Nevertheless, it has nothing to do with better public administration; on the contrary, these practices just conserve the inefficiencies in the bureaucracy. Finally, one should not forget, that the informal decentralization was caused by the *weakness* of the central state: the re-centralization phase is therefore likely to include policy measures directed against more successful regional leaders (once again, Galymzhan Zhakiyanov is a good example: the provincial governor and wealthy businessman was sentenced to prison). In fact, the very practices of informal decentralization, which per definition are semi-legal, give the central government the pressure instrument against local governments.

Decentralization, however, as already mentioned, does not necessarily mean growth-enhancing policies. Given a particular framework of formal and informal institutions, it just creates additional possibilities for rent-seeking. In this case public administration remains bad. One of the factors determining the quality of public administration in semi-autocracies, as mentioned above, is the desire to use “hostage-taking” to control potential opposition. McMann (2006) studies this problem from the point of view of the “economic autonomy” reasoning. In order to actively participate in the political processes and to oppose the incumbent, citizens and businesses have to achieve certain degree of economic autonomy; the semi-democratic incumbent therefore tries to restrict the economic independence of its subjects. Regional governments are often quite successful in managing economic autonomy

of individuals and small enterprises, which actually form the basis for the democracy: thus political systems in different regions become different. McMann (2006) documents the use of these instruments in less democratic regions of Kyrgyz Republic (as well as Russia). Hence, the negative effects of the political system on the quality of public administration may exist not only at the national, but also at the local level.

Moreover, decentralization may have a greater effect on the borders between state and society rather than on the internal organization of bureaucracy per se. Therefore it broadens the sphere of inefficiencies created by bad public administration. Noori (2006) provides evidence in favor of this statement studying the Mahalla Initiative in Uzbekistan. So far I have described Uzbekistan as probably the least decentralized country in the region due to its political regime. However, shortly after independence Uzbekistan started a program aiming to delegate administration of critical public services to local communities (*mahalla*) - an originally non-governmental institution, which received substantial public support (Mahalla Fund). Although the initiative was actively supported by the international NGOs due to both the secular status and the grassroots democracy organization of the mahalla, in the early 2000s, Noori (2006) claims, that mahalla just turned into an additional coercive instrument of the state. On the one hand, the Mahalla Initiative merged the community-based institutions with the state, thus decreasing the ability of the society for self-organization – a practice similar to that of the Soviet government. On the other hand, there is evidence that mahalla did not improve the quality of the public services for the population.

Finally, many positive effects expected from decentralization are related to the opportunity of active factor flows across regional borders (for example, it is the necessary precondition of any interjurisdictional competition). This condition, which is straightforward in the developed world or even in Ukraine or European part of Russia, is very uncertain in Central Asia. It is particularly problematic for Kazakhstan: large dimensions of the country and poor quality of transportation (in particular, railroads) have been a severe problem for the economic development of the country (Ekspert Kazakhstan, 2007). Moreover, the countries of Central Asia – in particular Kazakhstan as the largest country, but also in Uzbekistan and Kyrgyz Republic – are characterized by severe territorial disparities, which seem to increase over time (UNDP, 2005; Ufer and Troschke, 2006). In this environment interjurisdictional competition is likely to suffer from agglomeration effects, providing additional benefits to selected regions and reducing the pressure on their policies, thus creating a market failure in the market for institutions and economic policies.

4.2. Integration

The effects of regionalization can be both strengthening the market-enhancing institutions and conserving the inefficient institutional structure. However, these effects also differ for the “investment driven” regionalization and “informal trade” regionalization. From the point of view of the investment driven regionalization two arguments should be mentioned. First, investment driven regionalization (as well as developed labor migration) strengthens institutional competition, i.e. competition between countries for mobile factors of production by establishing legal environment and economic policies. Institutional competition is often considered to be an efficient tool of taming the Leviathanic rent-seeking government and of revealing the preferences for institutions through the evolutionary learning process (Vaubel, 2008). Second, multinationals are likely to act as channels of transmission of best practices and knowledge between countries, thus supporting the diffusion of efficient institutions. In a similar way, best practices can be important through the networks of labor migration.

Unfortunately, both positive effects are not unambiguous. On the one hand, institutional competition is not necessarily driven by demand for good institutions. In fact, the literature on the post-Soviet transition established a variety of factors leading to inefficient equilibria supported by the demand for bad institutions. Reasons for these “institutional traps” include redistribution effects, learning costs, deficit of trust, as well as interaction between formal and informal institutions. This is definitively related to the emergence and stability of the “clan capitalism” (Kosals, 2006) in the post-Soviet world. The main question is actually not whether demand for bad institutions really exists, but rather whether it is permanent (i.e. constitutes a stable equilibrium) or temporary (and after a certain period of development should be replaced by demand for good institutions). Havrylyshin (2007:17) refers to this discussion as “transition inevitable” and “transition frozen” school of thoughts and claims, that “the debate ... will certainly go on for some time to come”. From the point of view of regionalization in the CIS space the results are ambiguous: both factors of demand for good institutions and demand for bad institutions seem to be present (Libman, 2007), see also the Appendix.

From the point of view of the Central Asian countries the problem is as ambiguous, as in the CIS in general. Actually, it receives an additional dimension given relatively high degree of political instability in several countries of the region (like Kyrgyz Republic and Tajikistan). It is clear that the increase of investments from Kazakhstan and Russia does not necessarily coincide with stronger demand for transparency and general rules in the Hayekian

sense. In fact, demand for privileged relations with regional authorities may be more important, and the “threshold level” of demand for institutions necessary to enter the market for the post-Soviet companies is not so high anyway. Hence, foreign investments may well support inefficient equilibria. For sure they support the semi-authoritarian regimes in the countries of Central Asia, which, in turn, are one of the main factors of the existing low quality of governance (Libman, 2007a).⁹ However, the alternative to this support may be not market-enhancing reforms (like in the countries of the Western flank of the CIS), but chaos and disorder. The second channel of the impact of informal integration on economic institutions seems to be even more important in the region. In fact, in spite of its own institutional deficits, Kazakhstan can become an important source of “good practices” for the countries of the region. Once again, unlike the Western flank of the CIS, there are hardly any viable alternatives (like investments of multinationals from developed countries). Nevertheless, this transmission of good practices is per se limited by the quality of institutions in the country of origin of investments, making the very issue of institutional advancements crucially dependant from reforms in the leading country. Given the extremely short experience of the investment led regionalization in the region, it is still difficult to make any conclusions.¹⁰

The effects of informal trade regionalization are also not unambiguous. As already mentioned, most forms of the informal regionalization appear in an environment of weak formal institutions; to a certain extent, they serve as an instrument of overcoming this problem. From this point of view informal trade networks serve as a natural instrument of establishing an order for economic transactions. However, in this case their advantages and disadvantages are similar to the general discussion on the role of informal economy: on the one hand, it overcomes the deficits of formal rules and makes economic transactions possible, but on the other hands, informal rules are less efficient (e.g. because of their personalized nature vis-à-vis formal abstract rules) and, more importantly, establish behavioral patterns preventing introduction of formal rules in the future. A possible strategy in compatible with the ideas of Hernando de Soto is to develop formal rules consistent with informal rules, but it is always a difficult task (also from the point of view of incentive-compatibility for political decision makers). Therefore the existence of informal trade regionalization may constitute a

⁹ Moreover, as already noticed, strengthening these regimes can effectively result in a hold up of foreign assets and decline of regionalization in general.

¹⁰ It is definitively necessary to differentiate between different groups of businesses and their strategies. The shift from demand for bad institutions to demand for good institutions is likely to depend upon these differences. Similar points are valid for Central Asia. Our paper therefore provides a rather simplified view, which is, however, helpful for the basic hypotheses development.

constraint optimum in a given environment, but is able to become an obstacle for the development of efficient reforms in the future.

5. Interplay of formal and informal institutions

5.1. Formal and informal decentralization

The processes of formal and informal institutional shifts are endogenous to each other. Therefore a final problem to be considered in this paper is the *interaction* between informal decentralization and regionalization and their formal counterparts, as well as decentralization and regional integration in general. As mentioned above, informal decentralization observed in several countries of the region throughout the 1990s, is likely to result from authority migration and reflect the relative bargaining power of the center and the regions. The most important issue of informal decentralization is that it may act as a “substitute” for formal bargaining for both regional and central elites. First, it may just be more convenient and “simple” option, given the decades of experience of informal bargaining in the region, and hence be preferred by elites just because of path dependence factors. Second, since opting-out (and secession) is not an option and the sides *have to* interact with each other, if there is high uncertainty about present and future bargaining power, informality allowing for re-negotiation of the contracts may be more attractive. Third, existence of “national-level” political interests and ambitions of regional leaders (e.g. in Kazakhstan in the 1990s) may as well prevent them from demanding more formal decentralization. In a world where regional interests are especially important for national-level politics (as claimed above) this factor is particularly important. Fourth, decentralization obviously reduces the ability of the central government to gain back the lost influence. As already mentioned, informal decentralization is very close to the general approach of semi-authoritarian regimes to maintain power monopoly in presence of limited resources. At the stage of informal re-centralization (Kazakhstan, Tajikistan and Uzbekistan) formal decentralization may become especially problematic, because it may trigger undesired informal power redistribution. Therefore the experience of informal decentralization in the past will be limit the readiness of strong central governments to experiment with formal decentralization (or create extreme limits for these experiments).

There is however a possibility that informal decentralization leads to demand for formal decentralization from the side of strong regions. Formal decentralization in a country with high informal decentralization is similar to gaining formal property rights in an economy where informal property rights dominate (notice, that since all countries are de-jure highly centralized, no protection of formal “property rights” of the center is necessary even if the

central government is weak). As mentioned above, the problem of “spontaneous development of demand for property rights” is far from being resolved in the post-Soviet world. Similar logic may be attributed to regional governments. Therefore even strong regional leads may prefer low formal decentralization (because of the factors described above). Anyway, the current re-centralization phase in major countries of the region makes this question hypothetical, with the only exception of Kyrgyz Republic, where the involvement of regional elites in central politics seems to prevent them from demanding formal devolution.

5.2. Formal and informal integration

Once again, investment led and informal trade regionalization can have different influence on the regionalism in Central Asia. From the point of view of the former, the most often stated argument is that economic dominance of Kazakhstan based on the investment expansion of its corporations can become a factor supporting formal regionalism in its current form (once again, with Kazakhstan as the main actor). Regionalization can become an additional leverage mechanism. The increasing attention of the Kazakhstan government to the FDI activity in the Kyrgyz Republic confirms that at least these expectations are present at the level of the political decision makers. Nevertheless, international experience shows, that the asymmetric regionalization can have different impact on regionalism: while in Mexico the development of *maquiladoras* actually supported the formation of NAFTA, in the CIS significant presence of Russian investors in Ukraine did not support any formal integration between these two countries.

Considering the link between investment-led regionalization and regionalism, one should not forget the potential importance of political institutions in the regional integration processes. As noted, most countries of the region are semi-authoritarian regimes, where governments use the design of economic institutions to restrict potential opposition. It is well known in the literature on international integration, that non-democracies are less likely to participate in the regional economic integration than democracies (Mansfield et al., 2002). In fact, that is what one can observe in Central Asia: in fact, the less democratic countries of the region (Turkmenistan and – to a lower extend – Uzbekistan) are also less likely to become part of integration agreements. The main problem is the issue of commitment: in a political system based on informal power balances it is extremely difficult to provide any commitment to an external actor, yet alone to give up part of the sovereignty (what is per definition implied by the regionalization). A question is of course whether regionalization can overcome these obstacles. Basically, there are two factors to be taken into consideration. First, regional

cooperation can take form of the development of *international hierarchies* (Lake, 2007), and in this case is less dependent from the issue of democracy. An important aspect from this point of view is not just the *existence* of asymmetries, but the *scope* of asymmetries. Weak asymmetry can in fact be even quite dangerous for regionalism: it increases mistrust, but does not provide any instruments for leverage. In fact, the political elites in Kyrgyz Republic have been quite cautious with respect to any potential integration with Kazakhstan. However, high political instability is a clear factor increasing the asymmetries and also the demand for international hierarchies. Second, the question is whether there is a clear link between investment expansion and governmental policies. Once again, in case of Russian investments in Ukraine businesses basically ignore the regionalism dimension. However, given a relatively high influence of consolidated political leadership in Kazakhstan on its business groups, one could in fact expect that the government will be able to influence the investment decisions following the logic of international politics. Hence, one can actually expect that in case of Kazakhstan and Kyrgyz Republic *regionalization could support formal regionalism*.¹¹ The main question is to certain extend: *can Kazakhstan win where Russia* (also using informal regionalization as an instrument of control for the first half of the 2000s) *lost*?

Obviously, the scope of these projects mostly covers Kazakhstan and Kyrgyz Republic, and maybe Tajikistan (where the position of Russia is crucial). Uzbekistan has been quite reluctant to support regionalism in Central Asia (Bohr, 2004; Kuz'min, 2008), and in the current situation seems to prefer Russia to Kazakhstan as the main source of FDI, designing its investment policies respectively (Abalkina et al., 2007). The latter fact raises an important issue of *competition between Central Asian regionalism projects and broader projects* (with participation of Russia – EAEC – or China – Shanghai Cooperation Organization). And in this context development of regionalization can also be quite important: on the one hand, strong economic interconnections can make regional integration within Central Asia a priority; but on the other hand, it is possible, that at least some actors try to off-balance economic influence of Kazakhstan by the political influence of other actors (e.g. Russia). Theoretically, it is also reasonable to claim that *the development of Central Asian regionalism is able to reinforce the regionalization*, reducing the degree of political uncertainty and removing existing borders. The crucial factor is here whether the regionalism will move from

¹¹ It is important to notice, that the main players in the economy of Kazakhstan are, though highly connected to the government, still *private businesses*. There is no trend towards wide-scope nationalization in Kazakhstan, as it was observed in Russia. This is an additional argument in favor of the regionalism projects: in case of dominance of state-owned enterprises regionalization can effectively become just another form of intergovernmental contacts, making any form of further cooperation meaningless (Vinokurov, 2007a).

rhetoric to implementation. The effects of pure rhetoric (as it has been so far in the field of regionalism in Central Asia) are ambiguous: it can both create necessary framework for public support of investment expansion (what seems to be the case for Kazakhstan-Kyrgyz Republic dyad (Kuz'min, 2008)), but also introduce political tensions in purely economic relations.

From the point of view of informal trade one can hardly expect any clear effects of regionalization on regionalism and vice versa. Informal trade supports the persistence of social integration and cross-border interpersonal networks, necessary for any integration project. On the other hand, increasing intergovernmental cooperation could theoretically shift the patterns of informal trade to formal trade by creating well-protected property rights and restricting rent-seeking of public officials through removing additional options for their decision-making (it is actually implied by any economic liberalization). From this point of view the very existence of *informal trade* is based on the lack of *formal framework for cooperation* – once again, very similar to the issue of the informal economy in general. Whether this degree of cooperation (and of quality of governance in general) can be achieved, is questionable. A reasonable point often mentioned by sociologists is that the real puzzle is not why some people prefer *informal structures*, but why there are people choosing the *formalization* of their transactions (Paneyakh, 2008). In a region with decades-old traditions of informal economy (in fact, flourishing even under late Soviet regime) even changes of formal institutions may have no effect on behavioral patterns for the actors.

5.3. Decentralization and integration

The final aspect to be considered is the interaction between decentralization and regional economic integration. Does the existence of informal trade and development of FDI flows in Central Asia support or prevent formal (or informal) decentralization? And how does the informal decentralization (if present) influence the integration? Basically, the interaction between decentralization and regional integration should be considered from two points of view. On the one hand, from the point of view of the demand for decentralization, regional integration reduces the costs of autonomy and hence acts as a trigger for stronger decentralization. Unsurprisingly, political decentralization and economic integration are interrelated (Alesina and Spolaore, 2003). On the other hand, regional integration reduces the desire of central government to provide decentralization (supply side): the rents from the regions increase, and the threat of secession also goes up. China, as mentioned, may be a good example of these policies, though the opposite view is also present (Zheng, 2006). The

outcome may depend on the relative bargaining potential of both sides. In the countries experiencing stronger centralization (like Kazakhstan and Uzbekistan) the supply-side motive may become predominant (one may talk about “supply-driven markets for decentralization”). From this point of view development of informal cross-border linkages just creates an additional argument for central governments to restrict decentralization. On the other hand, countries with weak central government may experience stronger devolution. It may be especially applicable for Kyrgyz Republic. Moreover, in Central Asia the concerns for territorial integrity are present in the political agenda of most countries: the borders between them are weak at best (Olcott and Malashenko, 2000) and often artificially set by the Soviet “nation delimitation” – and to a certain extent “nation creation” politics (Farrant, 2006). This is yet additional argument for central governments to support centralization in a world of informal integration.

On the other hand, it is possible to claim that the increasing (or constantly high) centralization of political authority in Uzbekistan, Kazakhstan and Tajikistan may become a factor limiting the development of regional integration. In a non- or semi-authoritarian political system central elites are unlikely to restrict their power in form of international agreements, if possible (therefore the ability of non-democracies to establish formal integration is very limited, if there are no strong power asymmetries). Centralization of the spatial order of authority in these countries means as well increasing concentration of political power – which, in turns, makes the existence of international cooperation less likely. There seems to be a paradoxical connection between increasing centralization in individual countries and “centralization” (i.e. delegation of authorities through international cooperation) at the international level.

6. Conclusion

In spite of the widely recognized need for cross-border cooperation in Central Asia, the last fifteen years provided evidence for extremely low degree of top-down regionalism. Although integration rhetoric has been used quite often (especially in Kazakhstan), there is no sign of any more or less important integration achievements. Most countries prefer designing their policy unilaterally, leading to numerous conflicts, especially in the field of common pool resources (like water or energy). Similarly, the issue of decentralization remains a permanent topic of discussion in the expert of political community, followed by extremely limited political measures. That is why it is interesting to look at yet another dimension of regional integration and decentralization, taking informal relations between governments and activity

of non-governmental agents into account. From this perspective, different insights are possible.

Although all Central Asian countries are formally highly centralized, some of them experienced a period of significant de-facto decentralization in the 1990s, followed by the re-centralization in the 2000s. Kazakhstan seems to be the most prominent example of this trend. Moreover, regional political identities play an important role in both politics and bureaucracy. Nevertheless, the attempt to improve the quality of public administration by decentralization and devolution in the region seems to be unsuccessful. The very informal nature of decentralization makes its effects questionable. Moreover, a typical feature of semi-authoritarian regimes is institutional pseudomorphism: institutions are likely to have a completely different function than officially declared. In this case governments are able to guarantee their power even without resorting to coercion. The example of the Mahalla Initiative in Uzbekistan demonstrates that it may be true for institutions of decentralization, which in fact can become a “hidden channel” of expansion of state influence. Moreover, the very presence of informal decentralization as an option seems to limit the development of formal decentralization; the development pattern of internal decentralization has a negative impact on the international cooperation in the region.

Analogously, regionalization seems to play an important role in the Central Asian region. Basically, it takes two forms. First, countries of the region seem to be interconnected by the networks of informal trade, based on the long-term past experience. Second, recent economic success of Kazakhstan has allowed this country to become an important center for development of regional multinationals and FDI, particularly important for Kyrgyz Republic, as well as act as a center of attraction for labor migration. The patterns of regionalization seem to be heavily influenced by the development of institutions in Central Asian countries. In particular, the model of more liberal reforms combined with still-persistent links between influential business groups and politics seems to be a “success combination” for the multinationals from Kazakhstan (as opposed to Uzbekistan). The impact of regionalization on institutional development is, however, ambiguous: on the one hand, it can serve as a link for transmission of “best practices” and reinforce better property rights, but on the other hand, the positive impact is limited by institutional deficits for the economy of Kazakhstan. Finally, in Central Asia regionalization *could* potentially support the regionalism development, though the expectations are also unclear.

Since we are dealing with a relatively recent process, it is difficult to make clear predictions regarding the future of the regionalization in Central Asia. Probably, there is no

reason to expect any decline of cross-border informal trade, given lack of reforms in poor quality of governance in most countries of the region. It is the economic prosperity and freedom which could effectively shift the patterns of trade to the formal sector – but there is no reason to expect these changes. On the other hand, the development of other forms of regionalization – FDI expansion from Kazakhstan and increasing labor migration to this country – crucially depends on economic performance of Kazakhstan. Recent turbulences related to the global financial crisis, which seem to have a significant impact on the banking system of Kazakhstan (the driving force of FDI regionalization!), raise some questions regarding the viability of the model. Therefore the coming few years could be quite interesting from the point of view of informal regional integration in Central Asia.

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Appendix: Interjurisdictional Competition and Demand for Institutions

In what follows I will sketch several arguments explaining the potential impact of the interjurisdictional competition on the quality of institutions in presence of demand for bad institutions. First I assume the demand for bad institutions as given, and demonstrate its impact on the results of institutional completion. Second, I examine the factors underlying the demand for bad institutions in an economy and check their changes in an environment of institutional competition.

There are two main explanations for the effects of the interjurisdictional competition. First, institutional competition increases of power of mobile corporations and individuals (Beck (2002) calls it “exit power”), as “exit” or a threat of “exit” is an additional instrument to influence the economic policy. That means, that the resulting institutions surviving in the institutional competition will be more adequate to demand (see, e.g. Vanberg (2000)). If individuals and corporations prefer low-quality institutions, they will have a better opportunity to enforce it under the institutional competition, e.g., they can “punish” a government introducing better institutions, or, in turn, support a jurisdiction with a lower quality of institutions by investing into its economy. That is why the jurisdictions with low quality of institutions do not require making any changes.

The preference for low quality institutions, as mentioned above, can be based on asset stripping. That is why a possibility to export capital abroad is even an additional factor supporting demand for “bad” institutions. An inefficient equilibrium resulting from the open economy includes asset stripping, large capital flight (or “exit”) and low quality of institutions. The same individuals, who use the “exit” option to secure their wealth gained from assets in the jurisdiction with low quality of institutions, support with their “voice” option the “bad” institutions (see Mummert and Mummert, 2000).

Second, the “exit” of efficient companies can strengthen the “voice” of inefficient companies. After most efficient companies leave the country, the remaining inefficient ones become the main income source for politicians and bureaucrats (legally and illegally) and get a larger impact on the politic decisions. This effect exists, if, for example, two jurisdictions with “bad” institutions and “bad” reputation of the government and with “good” institutions and “good” reputation compete.

Moreover, the institutional competition is only one of the instruments controlling the government’s behaviour, as the political competition among countries can be an additional argument to improve quality of institutions as well. The governments seek not only rents, but also try to get more power in international relations. Especially the European experience shows, that the political competition can be a factor fostering economic growth and supporting the innovations in institutional systems (Leipold, 1997). Due to higher interdependence of national economies the political competition increases in an open economy and the economic component of the national power in world politics becomes more important. However, even if the government is be interested in institutional innovations, the existence of demand for “bad” institutions can become a factor preventing necessary institutional change and supporting lock-ins.

The discussed analysis is static, as it takes demand for “bad” institutions for granted. But the free mobility of factors between jurisdictions can induce changes not only on the supply side of the market for institutions, but also on the demand side. These changes are outlined in what follows

I start with the first reason for demand for inefficient institutions (the redistribution possibilities). Obviously the redistribution rents depend upon the general productivity of a jurisdiction (like the distribution of a pie depends upon the size of the pie). If the gross product of the jurisdiction declines, the rents go down, and it changes the preference for “bad” institutions. As there is only a limited number of agents receiving redistribution rents, the other actors can chose “exit” with the resulting decrease of production.

If the exit costs are lower for richer actors, the second effect of the interjurisdictional competition described above (“sorting” individuals under jurisdictions by their preferences) does not function. However, the first effect (the exit power) becomes even stronger, as only individuals with preferences for “bad” institutions can use “exit” to enforce their will. The assumption that the product of the jurisdiction depends upon the number of its citizen is also partly unrealistic. The main production factor may be not labour, but capital, and, as already noticed, the capital is redistributed unequally. To sum up, the higher the inequality, the lower positive effects of

interjurisdictional competition.

The second factor changing the demand side behaviour is the increasing economic competition resulting from the interdependence of markets. The environment for institutional competition implies not only free cross-border capital flows, but also free flows of goods. Since the competitiveness of national companies depends upon the quality of institutions in their home country, to improve their competitiveness, they will vote in favour of better institutions and a kind of indirect competition among institutions arises (Kerber and Budzinski, 2004). This competition is different to the “direct” competition among jurisdictions, as the reference criterion is not the preferences of the demand side, but the success in international competition.

A factor weakening the logics of this “competition among institutions via competition among companies” is the presence of additional competition advantages in the country with weaker institutions. An example of these additional competition advantages is a (quasi) monopolistic position on a market of commodities, like oil or metals. This factor doesn't stand forever, especially because of scientific and technical progress, but in a short and even middle term companies can soften the negative competition effects. They compare the losses from low competitiveness with losses in form of lost rents and additional costs for learning new institutions and decide, whether they support institutional changes or not.

Third, as the demand for bad institutions sometimes results from information asymmetry, learning effects are to be considered. The theoretical background for the discussion is concept of yardstick competition. Information about the quality of institutions and outcomes of policies in other jurisdictions is relevant for individuals' decisions to support or to reject a similar institution in their own jurisdiction. Individuals can learn from experience of other jurisdictions. But if individuals do not trust their government, they will believe to be swindled even if the government (or other politicians in the political process) offers better institutions, especially because of impossibility of the direct and complete import of institutions as the political situation may differ and the presence of non-expected and indirect effects of institutions incorporated in different systems of rules.

Summarizing the main points, the interjurisdictional competition can influence the demand side and reduce the demand for bad institutions. But the high inequality, presence of unique competition factors like natural resources and low trust make the interjurisdictional competition less efficient.