Post-Soviet countries in global and regional institutional competition: The case of Kazakhstan

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Post-Soviet Countries in Global and Regional Institutional Competition: The Case of Kazakhstan

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Abstract: The paper approaches the problem of differentiation of strategies implemented by individual countries in the institutional competition for foreign investments by looking at the experience of Kazakhstan. It basically focuses on the contradiction between political bias and political survival effects as driving forces for development and implementation of formal economic institutions. Kazakhstan demonstrates how the shift of relative importance of these two aspects significantly influenced the country's position in competing for FDI. Moreover, the paper looks at the relative importance of individual levels of institutional competition in a globalizing economy.

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1. Introduction

The development of new independent states in the post-Soviet Central Asia provided a variety of challenges from the point of view of both **traditional** and **untraditional security** issues. While the traditional security is directly related to the challenges of military nature, which are present for the most countries of the region, the untraditional security problems are often related to international economic competition – both global and regional – as a factor of regional development. In fact, two decades of independent development of the post-Soviet countries provide a huge variety of different economic and political responses to the changing international economic environment. Different countries pursue different policies towards foreign investors and international expansion of own businesses, economic openness and protection of markets. Obviously, these policies have an important impact on economic outcomes. The international economic competition again has many dimensions and can be perceived in various ways, which often differ across disciplines and fields of study. In fact, there are two main views on the problem, closely related to two distinct concepts of globalization. The first "geo-economic" approach, which experienced strong revival in recent years (as part of the discussion about the state wealth funds and the revival of the so-called "economic patriotism", see Klinova, 2008), looks at the economic opening up in terms of power imbalance and considers free markets an indirect instrument of domination. Obviously this concept has often been applied to intergovernmental bargaining over distribution of assets and construction of pipelines in the region.

The second approach looks at the free markets as *subjects* of power rather than *instruments*; in this case nation-states adjust their policies to the (personalized or even non-personalized) pressure from private business groups. This paper focuses on the second aspect of the problem, which, to our knowledge, has received less attention in the literature, and can be considered from the point of view of **institutional competition** theory, which has been thoroughly studied in economics. Institutional competition describes the economic policy-making as construction of "offers" on the market for institutions and economic policies, where governments compete for mobile factors of production adjusting economic policies and formal institutions in their jurisdictions. This view can be helpful to conceptualize the variety of policies of post-Soviet countries as a variety of strategies in the global and regional institutional competition. This paper applies this approach to studying the evolution of economic policy in Kazakhstan.

Kazakhstan constitutes a very interesting example for our analysis because of three reasons. First, throughout the independent development of the country, competition for foreign direct investments has played a significant role in the economic policy of Kazakhstan, probably even to a greater extend, than in many other developing countries. Second, Kazakhstan, as it will be shown bellow, used two quite different approaches to its positioning in the institutional competition during the last two decades. The differences between the strategies implemented in the 1990s and the 2000s provide us with the necessary variation for our analysis. Third, Kazakhstan has been involved in competition on two levels: the global institutional competition for capital of multinationals, which all developing countries experience, and the regional institutional competition within the post-Soviet space, which became especially important in the 2000s. The degree of involvement in both types of competition is to a certain extend endogenous, because it depends on, respectively, unilateral liberalization strategies and involvement in the process of regional economic integration. Finally, it is worth noticing that the "geo-economic" competition and institutional competition are complementary to each other, although we will not discuss it in our paper.

The paper is therefore organized as follows. The next section presents simple theoretical logic of our reasoning. The third section describes the varieties of strategies used by Kazakhstan as part of the institutional competition for mobile factors of production in the 1990s and the 2000s. The fourth section moves to a higher level of analysis, looking at the involvement of Kazakhstan in the design of meta-rules for institutional competition, i.e. economic integration in the post-Soviet space, aiming to understand how changes in institutional competition and internal political environment influences the shifts of position of Kazakhstan in this respect. Finally, the fifth section concludes.

2. Varieties of outcomes in institutional competition

Institutional competition constitutes a large area of research in social sciences (Vaubel, 2008). Basically, the literature includes six main perspectives on institutional competition among jurisdictions. The *Tiebout sorting* point of view assumes that institutional competition results in allocation of individuals in jurisdictions according to their heterogeneous preferences and thus improves the quality of institutions by ensuring, that they meet the preferences of the population, but also leads to the divergence of institutional systems (Wooders, 1999; Oates, 2006). The *institutional entrepreneurship* approach, based on the evolutionary economics reasoning, reaches the same conclusions, but stresses the role of learning and institutional innovations (Wohlgemuth, 2008). The *race to the bottom* point of view assumes that the individuals have homogenous preferences, and in the world of benevolent governments the institutional competition actually reduces the quality of institutions. For the regulatory competition it implies "zero regulation" equilibrium (though the outcomes may be different for product and process regulations with the latter being more susceptible to negative effects) (Scharpf, 1998). However, this view can also be generalized to the institutions like property rights and contract enforcement (Libman, 2008). This is also the prediction of the *negative convergence* point of view, which received relatively little attention in the literature (Oleinik, 2007). The difference between race to the bottom approach and the negative convergence approach is that the former stresses the role of preferences of mobile factors, while the latter focuses on mutual learning effects.[1] The *political economy* point of view, unlike race to the bottom and Tiebout sorting, assumes that governments are self-interested, and thus claims that institutional competition actually restraints their rent-seeking, thus improving the quality of institutions (Sinn, 1992). Finally, the *varieties of capitalism* point of view claims that institutions of individual countries are highly stable and their comparative advantages preserve the basic structure of economic order regardless of the mobility of factors (Hall and Soskice, 2001).

So, one obtains three convergence results (political economy, negative convergence and race to the bottom) and three divergence results (Tiebout sorting, institutional entrepreneurship and varieties of capitalism), as well as four efficient results (Tiebout sorting, institutional entrepreneurship, varieties of capitalism and political economy) and two inefficient result (race to the bottom and negative convergence). Inconclusive predictions of the theory match the huge variety of outcomes of institutional competition observed in reality. It is exactly the point where the sevenths perspective departs from: in analogy to the Ordoliberal point of view on market competition, institutional competition may be a function of the "meta-rules" governing the behavior of governments on the market for public goods, institutions and economic policies (Seliger, 1999). However, while in the analysis of markets for private goods the rule-setting function is left to an outside agent (the government), in the world of institutional competition rules are set by the competitors themselves, and, in fact, in a world without veil of ignorance in any form is also driven by the expectations for the ex-post outcomes of institutional competition for the particular country.

Interestingly enough, it is easy to obtain predictions for the outcomes of meta-rules design from at least several approaches. Tiebout sorting can in fact be easily adjusted to be used to study the formation, number and stability of jurisdictional structure instead of migration between existing jurisdictions, as it has been done in the literature (Demange and

[1] In fact, it is a very old idea. Adam Smith claimed that "there is no art which one government sooner learns of another than that of draining money from the pockets of the people".

Wooders, 2005). The simplified transformation of this theoretical literature suggests that the degree of decentralization (and thus, institutional competition) in an economy depends upon the trade-off between benefits of centralization and preference heterogeneity. Both political economy and tax race to the bottom point of views assume that the governments in order to avoid institutional competition will attempt to form a cartel on the market for institutions (for different reasons though: to protect rents or to improve welfare of their citizens respectively), which may be more or less stable (Eichenberger, 1994; Davis and Naughton, 2006). Finally, the varieties of capitalism point of view does not provide any general predictions for the design of meta-rules, but looks at the role of international bargaining trying to assess whether it is able to support the spread of particular varieties of capitalism (Callaghan, 2008). There is, to our knowledge, no literature predicting the endogenous meta-rules formation for two "learning-based" approaches: institutional entrepreneurship and negative convergence. In fact, following the evolutionary economics skeptical attitude towards monopolization of markets for private goods (which is especially pronounced in Austrian economics, cf. Rothbard, 2004), the endogenous meta-rules in a world of institutional entrepreneurship are unlikely to restrict institutional competition. In the negative convergence world a *de-facto* coalition of governments is possible; but, unlike race to the bottom or political economy points of view, it results rather from ex-post similarities in institutional environments than from attempts to restrict institutional competition.

Table 1 provides a highly stylized survey of the main approaches to institutional competition among jurisdictions. Although the differences between individual models are due to differences in assumptions, it is clear that in the real world for different regions and different institutions different outcomes are present, depending upon the type of institutions or region.

Table 1: Theory of institutional competition: an overview

Theory	**Driving force**	**Convergence of institutions**	**Efficient outcomes**	**Endogenous meta-rules for institutional competition**
Tiebout sorting	Sorting of individuals according to their preferences	No	Yes	Multi-jurisdictional structure determined by the trade-off between preference heterogeneity and benefits of centralization
Institutional entrepreneurship	Learning and institutional innovations	No	Yes	Free competition of institutions
Race to the bottom	Pressure from mobile factors owners	Yes	No	Unstable cartel of governments to restrict competition of institutions
Negative	Mutual learning by the	Yes	No	Coalition of governments due

convergence	governments			to ex-post similarities in the institutions
Political economy	Pressure from mobile factors owners	Yes	Yes	Unstable cartel of governments to restrict competition of institutions
Varieties of capitalism	Interaction of interest groups of mobile and immobile factors	No	Yes	Multilevel governance as an instrument to support particular varieties of capitalism

The outcomes of institutional competition are influenced not only by the meta-rules on the market for institutions, but also by internal decision-making structure in individual jurisdictions (Heine, 2006). The way how governments adjust their behavior in the world with mobile factors depends upon how internal politics is organized. The incentives from institutional competition are channeled by the political system. First, the perception of effects of institutional competition is non-trivial and often biased (Heinemann and Janeba, 2008). Second, the responses of political agents often depend from their interaction with each other. Obviously, internal political decision rules change a lot also in turn of institutional competition; therefore it is more reasonable to talk about co-evolution rather than unilateral influence. It is also important to distinguish between interests of different groups and agencies involved in the bargaining with foreign investors, which may have different aims and interests. Anyway, without understanding the decision-making mechanism in a particular jurisdiction it is hardly possible to predict the institutional competition outcomes. *Figure 1* provides a simple overview of the decision logic in this case. In the approaches with benevolent government the

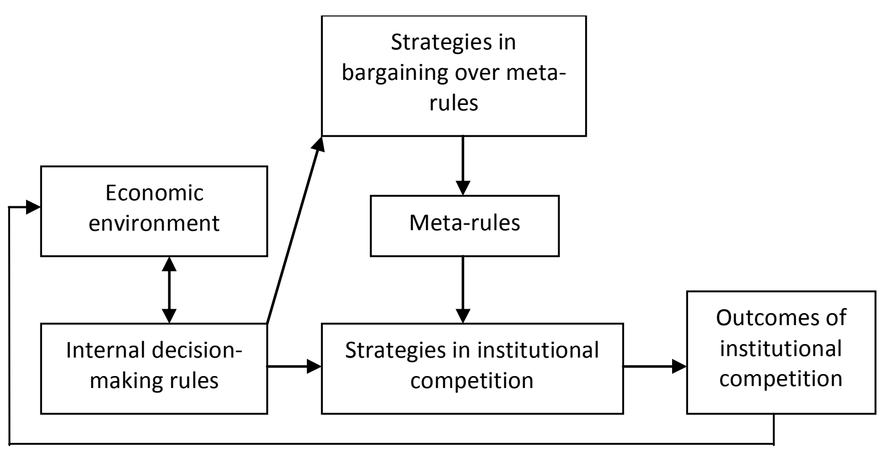

Figure 1: Internal institutions and competition among jurisdictions

3. Competition for foreign investments: political bias vs. political survival

3.1. Basic ideas

In this paper we look at a very simple trade-off relating strategies in institutional competition to the internal politics: the interaction between **political bias** and **political survival**. On the one hand, the ability of regional governments to extract rents from individual policies is different (the similar idea in economics of conflict is referred to as political bias effect, cf. Jackson and Morelli, 2007). For example, the behavior of a modern government, which receives its revenue from taxes, is different from that of a medieval government or government in a country with captured firms, which receives its main revenues from private economic activity (Volckart, 2002). For the first the capital inflow means unambiguous increase of revenue; for the second there is a trade-off between positive effects of capital inflow on the economy and negative effects of potential competition for privileged firms. The relative weight of the latter may become especially large in resource economies, if the global commodities prices are high and the resource sector is captured. On the other hand, the decisions of the political actors are driven by the logic of their survival and increase of power, both due to the internal and international political competition.

Kazakhstan belongs to the group of the resource-extracting countries; the importance of oil and gas and mining and metals sectors in its economy is substantial. From this point of view, given the relatively small population and unattractive geographical position of a landlocked country, natural resources constituted the main reason for Kazakhstan to be attractive for the foreign investors. Therefore the choice of strategy in the global institutional competition for Kazakhstan referred specifically to designing the institutional environment for multinationals in these sectors. On the other hand, the government with access to natural resources is likely to generate substantial revenues on the world markets, without entry of new companies and development of domestic economy. Hence, the political bias effect in these economies is clearly in favor of blocking access for multinationals. Throughout the last two decades the contradictions between political bias and political survival logics seem to have dominated the choice of policies implemented by the country in this area.

In the early 1990s probably the main goal for the government of Kazakhstan was to ensure stability of the country: in the set of the "triple transition" problems (Offe, 1991) the nation-building was probably even more important than economic and political reforms. It is obvious given the multi-ethnic structure of Kazakhstan (with a very large Russian minority) and the absence of strong separatist movements in the country during the Soviet period. In Kazakhstan the concentration of political power was substantially higher and the opposition was weaker, than in Russia or Ukraine; the support of the president has also been stronger. However, the main problem the political elite faced was a significant deficit of "international legitimacy": the country had to demonstrate its ability to persist as an independent state both to its own citizen and to international community. Moreover, the 1990s were the period of relatively weak performance of commodities markets. In the contest of the economic crisis of the first half of the 1990s there was also a problem of critical deficit of investments required even not for development but primarily for simple survival of the country's economic system. Thus, the predominant strategy in the institutional competition became to provide attractive conditions for large multinationals, also by fostering economic reforms.

In the 2000s the situation changed: the political stability of the country increased substantially, but also the global markets entered the hype period. Hence, the effect of political bias became more pronounced. As in the majority of other post-Soviet countries, the political elites of Kazakhstan had well-established connections with a number of privileged business groups. While in the 1990s their ability to access the attractive assets was limited (because of the preferential treatment provided to the multinationals), in the second half of 2000s the rents obviously outweighed the risks for legitimacy and the positive effects of foreign investors for the economy: the country therefore entered the period of re-nationalization. The next two sections describe the problem in greater details.

3.2. The 1990s: political survival logic

In the 1990s Kazakhstan indeed achieved substantial success in terms of attracting FDI as opposed to other post-Soviet countries. In this period it ranked second after Russia among FDI recipients in the CIS (see *Figure 2*) and indeed outperformed Russia according to FDI per capita (see *Table 2* and *Figure 3*) and FDI in percent of GDP indicators (see *Table 3*).

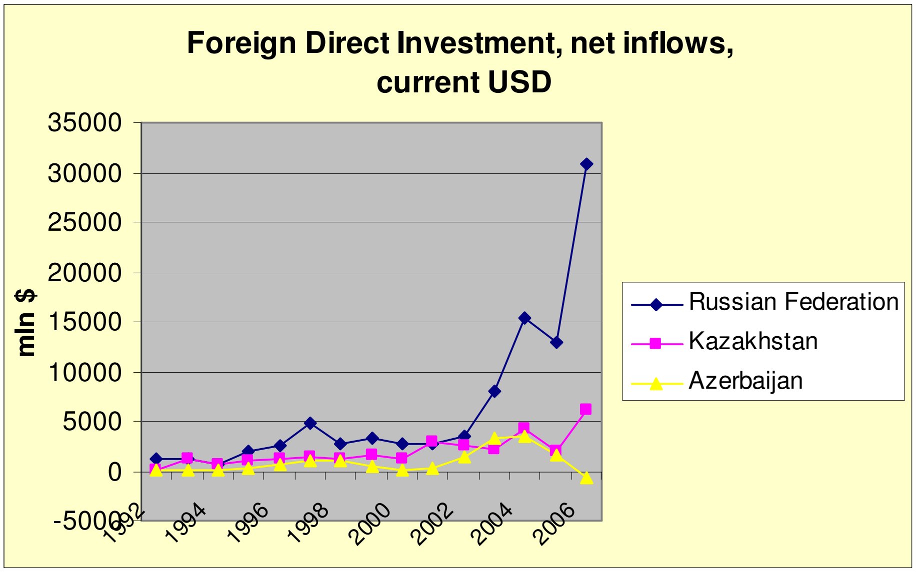

Figure 2: Foreign direct investments, net inflows, current USD

Source: The World Bank Group, 2008.

Table 2: Foreign direct investment, net inflow (BoP), current USD per capita.

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Armenia	1284.1	0.0	2.4	7.8	5.5	16.5	70.8	39.4	33.8	22.8	36.3	39.8	72.3	85.6	114.1
Azerbaijan	0.3	0.1	0.0	42.9	80.8	142.2	129.3	63.9	16.1	27.9	170.4	399.0	428.1	200.2	-68.8
Belarus	0.7	1.7	1.0	1.4	10.3	34.8	20.2	44.2	11.9	9.6	24.9	17.4	16.7	31.2	36.4
Georgia	…	0.0	1.6	1.2	1.1	49.6	54.9	17.2	27.8	23.5	34.7	73.3	109.0	101.2	239.1
Kazakhstan	6.1	77.9	41.0	61.0	73.0	86.2	76.4	106.3	86.2	190.8	174.3	140.3	276.9	139.6	401.3
Kyrgyz Republic	…	2.2	8.4	20.9	10.1	17.7	22.8	9.1	-0.5	1.0	0.9	9.0	34.4	8.3	35.1
Moldova	3.9	3.2	2.6	5.9	5.5	18.3	17.7	9.0	30.8	13.3	20.8	18.5	21.8	50.9	63.1
Russian Federation	7.8	8.2	4.7	13.9	17.5	33.0	18.8	22.6	18.6	18.8	23.8	55.0	107.4	90.0	216.3
Tajikistan	1.6	1.6	2.1	1.7	3.1	3.0	5.0	1.1	3.8	1.5	5.7	5.0	42.1	8.3	51.0
Turkmenistan	…	19.8	25.1	55.6	25.3	24.9	14.1	28.1	28.0	37.2	21.6	21.3	-3.2	12.7	149.2
Ukraine	3.8	…	3.1	5.2	10.2	12.3	14.8	10.0	12.1	16.3	14.4	29.8	36.1	165.8	119.9
Uzbekistan	0.4	2.2	3.3	-1.1	3.9	7.1	5.8	5.0	3.0	3.3	2.6	2.7	0.0	1.7	6.2

Source: The World Bank Group, 2008; original accounts.

Table 3: Foreign direct investment, net inflow (% of GDP)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Armenia	348.2	0.0	0.6	1.7	1.1	3.2	11.7	6.6	5.5	3.3	4.7	4.3	6.1	5.3	5.4
Azerbaijan	0.0	0.0	0.3	10.8	19.7	28.1	23.0	11.1	2.5	4.0	22.3	45.1	41.0	12.7	-2.8
Belarus	0.0	0.1	0.1	0.1	0.7	2.5	1.3	3.7	0.9	0.8	1.7	1.0	0.7	1.0	1.0
Georgia	…	0.0	0.3	0.2	0.2	6.9	7.3	2.9	4.3	3.4	4.7	8.4	9.6	7.1	13.7
Kazakhstan	0.4	5.4	3.1	4.7	5.4	6.0	5.2	9.4	7.0	12.8	10.5	6.8	9.6	3.5	7.6

Kyrgyz Republic	…	0.5	2.3	5.8	2.6	4.7	6.6	3.6	-0.2	0.3	0.3	2.4	7.9	1.7	6.5
Moldova	0.7	0.6	0.7	1.5	1.4	4.1	4.6	3.2	9.9	3.7	5.1	3.7	3.3	6.6	7.1
Russian Federation	0.3	0.3	0.2	0.5	0.7	1.2	1.0	1.7	1.0	0.9	1.0	1.8	2.6	1.7	3.1
Tajikistan	0.5	0.5	0.9	0.8	1.7	2.0	2.3	0.6	2.4	0.9	2.9	2.0	13.1	2.4	12.0
Turkmenistan	…	2.5	4.0	9.4	4.5	4.4	2.4	5.1	4.3	4.8	2.2	1.7	-0.2	0.8	7.0
Ukraine	0.3	…	0.3	0.6	1.2	1.2	1.8	1.6	1.9	2.1	1.6	2.8	2.6	9.1	5.2
Uzbekistan	0.1	0.4	0.6	-0.2	0.6	1.1	0.9	0.7	0.5	0.7	0.7	0.7	0.0	0.3	1.0

Source: The World Bank Group, 2008; original accounts.

The annual growth rate of the net inflow of FDI to Kazakh economy from 1992 to 2002 varied from almost -20% in 1994 to more than 1200% in 1993. In the contest of the trend of FDI dynamics to Kazakhstan, stable growth of investment inflow in 1995-1997 is most essential. As opposed to Russia, Kazakhstan experienced limited decline in FDI after the crisis of 1998, since it had smaller negative effect on Kazakh economy (see *Figure 2*). As a result, in 2002 Kazakhstan outperformed Russia by at least 8 times by net foreign direct investment per capita (see *Figure 3*).

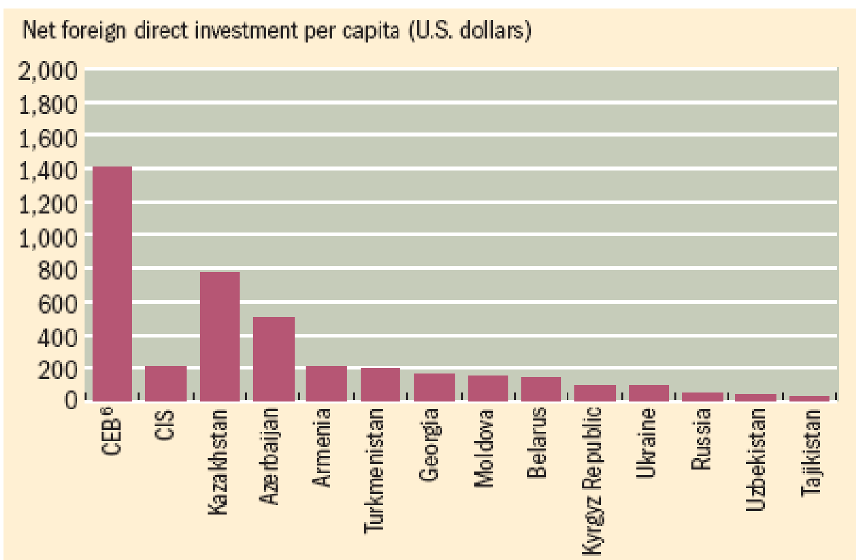

Figure 3: Net foreign direct investments per capita, 2002

Source: Finance and Development, 2003

FDI flow was predominantly directed to most competitive sectors of Kazakh economy – mining, metallurgy, power production. For example, in 1993 72.5% of FDI in Kazakhstan was concentrated in oil sector, which accounted for 62.2% in 1994. In 1995 33.1% of the FDI was invested in mining, 20% - in oil, 16.6% - in production of basic metals. In 1996 32.8% of FDI was directed in production of basic metals (23.3% - in manufacture of basic precious and nonferrous metals), 20% - in petroleum (UNCTAD WID Country Profile: Kazakhstan, 2008, see *Table 4*).

Table 4: Industrial structure of FDI to Kazakhstan in 1993-2002s.

Sector/industry	**FDI, mln USD**	**% of total FDI flows**
Total	14642.9	100
Primary	9119.3	62.3
Agriculture. hunting. forestry and fishing	11.7	0.1
Mining. quarrying and petroleum	9107.7	62.2
Mining and quarrying	408.7	2.8
Mining of uranium and thorium ores	30.9	0.2
Mining of coal and lignite. extraction of peat	3.2	0.0
Mining of metal ores	363.3	2.5
Other mining and quarrying	11.22	0.1
Petroleum	8699.1	59.4
Secondary	1329	9.1
Food. beverages and tobacco	434.8	3.0
Textiles. clothing and leather	1.7	0.0
Wood and wood products	10.9	0.1
Coke. petroleum products and nuclear fuel	201	1.4
Chemicals and chemical products	83.3	0.6
Rubber and plastic products	4.1	0.0
Non-metallic mineral products	20.3	0.1
Metal and metal products	492	3.4
Basic metals	491.4	3.4
Manufacture of basic iron and steel	39.2	0.3
Manufacture of basic precious and nonferrous metals	452.5	3.1
Fabricated metal products	0.6	0.0
Machinery and equipment	4.9	0.0
Electrical and electronic equipment	72.9	0.5
Motor vehicles and other transport equipment	0.8	0.0
Other manufacturing	1.82	0.0
Tertiary	3832.4	26.2
Electricity. gas and water	349.9	2.4
Construction	84	0.6
Trade	145.3	1.0
Hotels and restaurants	21.5	0.1
Transport. storage and communications	345.3	2.4
Finance	252.5	1.7
Business activities	2507.5	17.1
Public administration and defence	126.4	0.9
Unspecified	362	2.5

Source: UNCTAD WID Country Profile: Kazakhstan, 2008. P.18. Original accounts.

As a result in the beginning of 2000s foreign investors played a key role in several crucial industries, like oil extraction, power utilities and metallurgical sectors. The total number of FDI stocks in 2002 accounted for 15353.8 mln. USD (UNCTAD WID Country

Profile: Kazakhstan, 2008). Under some estimates, companies with major foreign ownership represented 40% of the Kazakhstan's industrial potential and 50% of its foreign trade in the early 2000s (Akhmetova, 2002). Indeed, although there have been many cases of opportunistic behaviour of the government trying to reformulate the previous agreements by tax policy or new requirements to social responsibility of foreign investors (CVEI, 2003, p.121), the influence of multinationals on Kazakhstan's economic policy remained substantial. A particular feature of Kazakhstan as opposed to most other post-Soviet countries has been the access of foreign investors to key "strategic" resources, which were usually reserved for own oligarchs (Ukraine, Russia) or state-owned companies (Uzbekistan, Turkmenistan).

How did the FDI inflow correlate with economic reforms? The first impression is that the Kazakhstan indeed implemented a more consequent policy of developing market institutions than other post-Soviet countries. Kazakhstan is now the "exemplary" country for liberal reforms in the CIS (like the Kyrgyz Republic in the first half of the 1990s), especially since the share of public enterprises in its economy is smaller, than in Russia after the start of the re-nationalization in the mid-2000s. The Kazakhstan's experience of economic reforms is often cited in the Russian discussion of directions of economic policy as a model. The government of the republic offered unique guarantees for the foreign investors, e.g. introduced the production sharing agreement (as the first in the post-Soviet states). Unlike Russia, foreign investors were considered as the priority group, which received access to the majority of more attractive assets. In the second half of 1990s foreign investment to Kazakhstan was regulated by complex system of national legislative acts – Foreign Investment Act (1994), Act of Governmental Support of Direct Investments (1997), Investment Funds Act (1997), several Edicts of the President etc. According to these acts, the foreign investors were entitled to treatment not worse than domestic ones; there were no restrictions on investment to key sectors of economy; in case of change of national legislation hampering foreign investors, legislation valid in the moment of investment continues to act for 10 years after investment transaction. Kazakhstan also offered customs privilege, government natural grants and some tax remissions for the foreign investors.

Kazakhstan carried out a successful banking reform, including the privatization of practically all banking structures (except the development bank), even the National Savings Bank, the improvement of quality of the banking system leading to significant reduction of number of banks (by four times from 1993 to 2002), a relatively early introduction of the IFRS/IAS, deposit insurance system (1999) and opening the financial services market for foreign investors. The reforms of the natural monopolies were based on the maximally possible development of a competitive environment by clear division of the monopoly and markets components. Since 1998 an energy market based on private generation companies, mostly private distribution networks and public long-distance network (*KEGOC*). The pension system of Kazakhstan is based not on the redistribution, but on the accumulation principle. The housing and communal services have been privatized.

Kazakhstan`s success in liberal reforms was recognized by international organizations and rating agencies: Kazakhstan was the first CIS country that received investment rating from international rating agency Moody's in 2002 and later in 2004 from Standard & Poor's and Fitch. In October 2000 the European Union raised Kazakhstan to the status of the market economy.

It goes without saying, however, that the impact of multinationals on reforms was not unambiguous. On the one hand, it is obvious that foreign managers and experts provide (even unconsciously, but also often as part of the corporate policy) examples of behavior and implement (or support) rules consistent with the better practices from their home countries. From this point of view consistent liberalization and increasing presence of multinationals were obviously mutually reinforcing. However, foreign companies in economies with high capture level tend to pay significant unofficial payments to the bureaucrats (Hellman, Jones, Kaufmann, 2000). Similar processes were observed in Kazakhstan (Olcott, 2002). The things become even more complicated if one takes into account the de-facto decentralization in Kazakhstan, which the country experienced until early 2000s, which made regional regulations and regional protection even more important for foreign investors (Jones Luong, 2004). Nevertheless, the policy of Kazakhstan in the 1990s seems to be relatively close to the political economy logic of the institutional competition: the government restricted its rent seeking appetites to support capital inflow from abroad and implemented a wide range of economic reforms to improve institutional quality of the economy.

3.3. The 2000s: political bias logic

The 2000s witnessed a significant transformation of both external environment and the political situation in the country. The consolidation of political regime and the clear international legitimacy seem to make the problem of political survival less pronounced for the existing elite (at least supporting FDI could not contribute to it any further). On the other hand, the commodities markets situation improved significantly, creating large rents for those controlling hydrocarbons and metals. While multinationals indeed received access to the main assets in the 1990s, the government still established a network of privileged private, public and semi-private firms. During the late 1990s-2000s this network was consolidated and developed: first by creation of KazMunaiGaz controlling public stakes in oil and gas projects; then by establishment of Samruk holding, which includes all state-owned strategic assets, and finally by merger of Samruk and the state-owned investment fund Kazyna. The accumulation of financial resources by domestic investors dispersed the dependency on foreign capital observed in 1990s. In this situation the political bias is likely to receive relative attention as opposed to political survival logic, and the environment is likely to become more hostile to foreign investors.

The empirical observations are indeed consistent with the predictions. In 2002 the government announced its intention to revise the conditions of existing contracts regulating the status of foreign investors. In 2003 the first conflict over the expenditures plan of Tengizchevronoil was resolved by the president, indicating, however, the increasing interventionism of the government. In 2004 the government received the priority right to purchase the shares in oil extraction projects if they are sold by their current owner. Moreover, additional restrictions on the share of foreign investors in selected industries (in particular, telecom) were introduced. In 2005 this regulation was expanded in order to include holding companies. Finally, in 2007 the parliament allowed the government to revise the conditions of contracts, if the actions of foreign investors significantly change the economic interests of Kazakhstan and threaten the national security. In February 2008 the government stopped any negotiations with respect to the production sharing agreements, although it would be too farfetched to claim that the protectionism in Kazakhstan reached the level of Russia or Venezuela: for example, in 2008 the foreign investors received additional benefits (vis-à-vis Kazmunaigaz) through new regulation of export duties on oil.

The clear benchmark in the government-business relations was the Kashagan conflict in 2007. Kashagan, one of the largest oil fields in the republic, was explored by the Agip KCO international consortium. In 1998 the government sold its share to Inpex Nord and Philipps Petroleum and was able to enter the group only in 2005 at extremely high costs. After the new delay of commissioning was announced, the government requested an increase of the share of Kazmunaigaz in the project. The authorities used all possible means to support their claim, including accusations in customs, fire-control and environmental regulations, as well as amendments to the existing legislation. In January 2008 the partners of Agip KCO (Eni, Total, Shell and ExxonMobile) had to agree to increase the share of Kazmunaigaz according to the requests of the government from 8.3% to 16.8%. In June 2008 Kazmunaigaz purchased 51% of the shares of Mangistaumunaigaz from Central Asia Petroleum. Mangistaumunaigaz owns Kazakhstan`s first-rate oil-processing plant in Pavlodar and system of filling stations Gelios, thus the government of republic received the means of influence on the dynamics of internal gas price. However, Kashagan is not the only example of expanding public interventions. The Karachaganak Petroleum Operating consortium (oil and gas) was accused of violations of tax and environmental regulations. In 2007 about 100 contracts with foreign investors were cancelled. The public sector, however, expands not only in oil and gas, but also in power utilities and mining sectors. For example, in 2007 the government attacked the American AES with assets in the coal extraction (for example, an antitrust accusation against AES included fines comparable to the overall 10-years investments made by the group in the economy of Kazakhstan). In June 2008 a partial re-nationalization of the non-ferrous metals group Kazakhmys was implemented (the government rendered 7.7% of the shares of Eurasian corporation of natural resources to Kazakhmys in exchange for 15% of the shares of the latter).

The lack of progress in improvement of investment climate in Kazakhstan in recent years was recognized by many international organizations. According to the World Bank's *Doing Business 2009: Country profile for Kazakhstan*, Investor Protection Index for the republic is 5.7 (1 to 10, the higher the score, the greater the investor protection) for last 3 years, however the rank changed from 49 to 53 during the year. For instance, the value of this index for Kyrgyz Republic is 7.7 (ranked 11), for Russia – 5.0 (ranked 88).

To conclude, the political bias effect seems to dominate the political survival effect in Kazakhstan in the 2000s. It is however important to mention, that the shift of strategy is at least partly endogenous to the strategy implemented in the 1990s. Certainly, the positive development of global markets was necessary to ensure revenues for the privileged firms and was outside of the scope of control of the government. However, the reduction of importance of political survival effect is certainly an outcome of capital inflow. By investing in Kazakhstan multinationals at the same time support and strengthen the existing regime, at least, indirectly through improving economic situation, but also directly through participating in corruption networks and contributing to the formation of international legitimacy (see Bayulgen, 2005). In a phase of high commodity prices even significant expropriation threat still allows profitable investments; hence, businesses cannot credibly commit to "punish" the government in case of expropriation. On the other hand, given increasing political power of the regime, the political elite have an increasing incentive to appropriate the investments. Hence, the political survival logic seems to make place for political bias.

4. Global vs. regional institutional competition: strategy options and incentives

While political bias vs. political survival logic seems to explain at least part of the evolution of the strategies of Kazakhstan towards institutional competition, yet another significant dimension seems to be the changing *level* of institutional competition, which has a pronounced impact on both available strategy options (through the meta-rules) and also on incentives of agents. The competition for FDI can take place either on the *global* level, where the key players are multinationals from developed world, and the sample of competitors includes a wide range of countries (though the relevant "reference group" for Kazakhstan mostly includes the developing world), or on the *regional* level, implying competition for mobile resources originating from the post-Soviet space (in particular, Russian businesses). There is of course an *intermediate* level of competition: for example, it implies Russia and Kazakhstan competing for investments from third parties, which are, however, specifically locked to the post-Soviet space (for example, due to some specific geographical advantages it provides).

Kazakhstan has always been (at least, at the rhetoric level) one of the greatest proponents of regional integration in the post-Soviet space. However, the active participation in the regional integration talks in the 1990s did not actually result in the increasing presence of Russian multinationals in the country. In fact, Kazakhstan significantly underperformed in terms of attracting Russian FDI as opposed to Ukraine (with quite skeptical attitude towards regional integration) and even small countries like Armenia or Moldova (see *Figure 4*). The simple reason for that is that unilateral opening up towards large multinationals automatically put the recently established Russian corporations at a disadvantage. That is why their participation in the resource extraction consortia and the large-scale privatization has been extremely limited. Another reason is that the main businesses facilities in Kazakhstan usually have their "twins" in Russia. In the terms of abundance of enterprises open for purchase inside Russia and limited financial resources, Kazakhstan`s assets were simply less attractive for emerging Russian business groups. However, the situation changed dramatically in the mid-2000s, when the institutional competition between post-Soviet countries at the regional level became more intense. First of all, Russian corporations matured and therefore were more likely to compete at international level. Simultaneously potential of investment inside Russia decreased sharply. At the same time countries of the region entered a period of rapid growth, generating substantial capital flows worth competing. There are several aspects of this contest, which also imply different consequences for the quality of institutions.

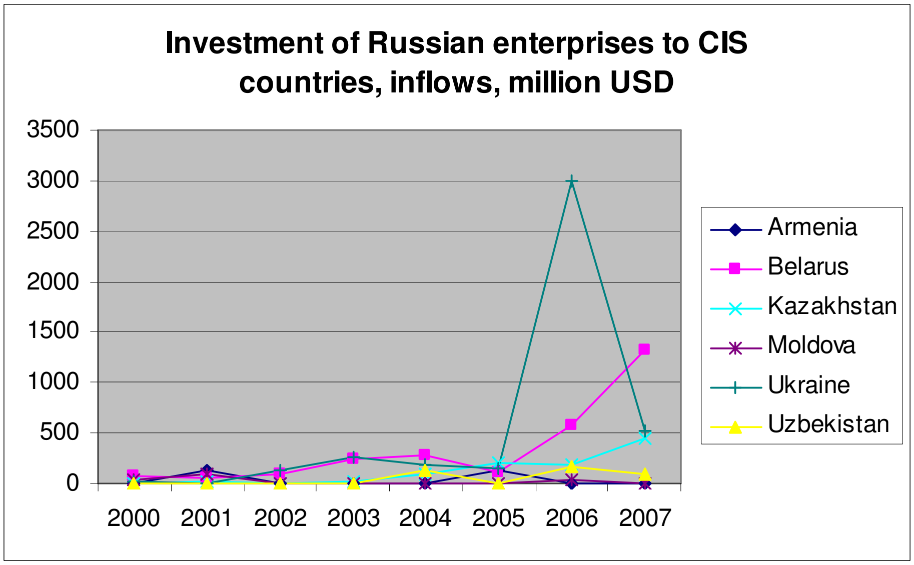

Figure 4: Investment of Russian enterprises to CIS countries, inflows, million USD

Source: Investment in Russia, 2008.

On the one hand, the competition between Russia and Kazakhstan partly takes form of classical political economy competition, where Kazakhstan attempts to improve the quality of institutions to make the country more attractive for foreign capital. The establishment of the Regional Financial Center Almaty (RCFA) is an obvious attempt to attract capital from other CIS countries by providing favorable conditions. Yet another area where competition follows very much the political economy predictions is the competition for mobile labor. It is well-known that Russia has been an important point of attraction for labor migration from Central Asian countries. Recently, however, Kazakhstan became more important for labor migrants. 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. 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. The improving economic conditions and the weakness of xenophobic sentiments so popular in modern Russia make Kazakhstan an attractive country for migrants.

However, the effects of institutional competition seem to be quite different if it comes to foreign direct investments of Russian multinationals. It is true that in the 2000s Russian business finally consolidated the strength necessary to carry out it expansion abroad. What is, however, even more important is that the businesses from Russia seem to at least partly be able to “seize the day” with stronger governmental regulations and less friendly attitude towards well-established multinationals. A good example is the conflict between the Canadian

PetroKazakhstan and the Russian LUKoil over the Turgai Petroleum joint venture. The government actively intervened in the disagreement, mostly against PetroKazakhstan, though not entirely in favor of Lukoil; however, the Russian company succeeded in using the contradictions between foreign investors and the government to expand in Kazakhstan. Once again, Russian businesses proved themselves extremely capable to achieve success in "dirty water".[2] In fact, the "triumph" period of Russian businesses was relatively short and inconclusive; for example, in 2007 the Russian Access Industries was also among the companies with coal extracting assets suffering from state pressure. However, one can also look at the problem from another side: probably, the presence of Russian companies willing and able to work in a less transparent and more hostile environment made the very transition from the "political survival" to "political bias" strategy more likely!

There are good reasons to believe that institutional competition in the post-Soviet space is plagued by the demand for bad institutions (Libman, 2008). However, the regional level of institutional competition seems to be quite specific not only in terms of agents competing, but also instruments of competition. One should be aware, that although there seem to be some targeted attempts of Kazakhstan to make the country more attractive for capital and labor from the CIS, the main competitor – Russia – is hardly pursuing the same strategy. Moreover, Kazakhstan seems at least partly to benefit from capital flight from Russia caused by the decisions of former "oligarchs" to cut their business in Russia: for example, in 2005 Millhouse capital announced it plans to increase its presence in the oil and gas sector of Kazakhstan. If engaged in direct competition with Kazakhstan, Russia is using quite specific instruments of competition, far from predictions of the political economy model. There is at least one specific example at the intermediate level of competition – the contest between Russia and Kazakhstan for the Lufthansa Cargo main transit airport. In spite of the well-established regional integration infrastructure and good political regulations, Russia executed any pressure possible to force Lufthansa to remove its base from Astana to Krasnoyarsk (mostly through threats to revoke its license for trans-Siberian flights). Obviously, Russia's position in institutional competition is motivated by a kind of "California effect": since the economic potential of the post-Soviet countries is highly asymmetric, Russia feels relatively limited pressure to "catch up" with potential competitors from the CIS. Hence, the shift to the regional level of institutional competition reduces the incentives to improve institutions not only because they are less required by the demand side, but also because the

[2] Yet another example is the recent study of Transparency International (2008), which lists Russian corporations among the multinationals most likely to pay bribes to the local governments.

major competitor does not really try to improve its position (or does it through non-market protectionist interventions). On the global level the situation is obviously quite different. Nevertheless, the financial crisis 2008-2009 may impose significant adjustments to the regional level of institutional competition in the post-Soviet world.

5. Conclusion

The institutional competition perspective, complementary to the better explored geo-economic competition perspective, is certainly able to provide additional insights regarding the development of economic policies in the post-Soviet space. Basically, this paper considered two main channels of influence of institutional competition on the quality of economic institution.

First, institutional competition crucially depends upon the internal decision-making rules, which can be simplified to the "political bias" vs. "political survival" trade-off. We have demonstrated that the initial deficit of international legitimacy and economic crisis created a strong political survival effect, which resulted in improved economic institutions and progress of reforms. However, in the environment of institutional competition with substantial capital inflow from abroad, this equilibrium happened to be not self-sustaining; in fact, the same global institutional competition, which created incentives for improving the quality of institutions, combined with changes on the global commodities markets, eroded the basis for investment-friendly policies in Kazakhstan and supported the greater political bias effect. From this point of view, positive short-term effects of institutional competition in developing countries can be counteracted by long-term deficits of creating larger opportunities for rent-seeking. It is important to notice, that the problem is not just the moral hazard in presence of sunk costs: it is rather the overall positive externalities, which are created by investors supporting economic growth, than the pure ability to expropriate investors after they lose mobility, which drive the changes in governmental behavior.

Secondly, we looked at the interaction of different *levels* of institutional competition. The literature usually restricts its attention to just one "market for public policies and institutions", assuming its homogeneity. But in the world of non-zero costs of mobility and information asymmetry it is reasonable to assume that different regional markets for institutions will have different properties. This conclusion is trivial; however, the most interesting part is that the same country can "move between" markets, thus using a specific opportunity of institutional arbitrage. The paper does not provide clear evidence of endogenous shift of Kazakhstan from global to regional market for institutions; however, it is possible that changing attitude towards Russian investors was at least one attempt to shift the attention between markets. Further research of this shift, as well as of the relation between endogenous and exogenous factors and the impact of "geo-economic" and traditional political competition is still required.

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