Models of market integration in Central Asia – comparative performance

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by

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Abstract: The paper considers the problem of the integration of markets in Central Asia as a main factor of economic modernization. It first identifies the potential channels of reduction of transaction costs barriers between countries ("models of integration"). Second, it looks at the emergence of these channels, and identifies two main puzzles: success of centralization in individual countries vs. failing international cooperation among them and successful informal cooperation of companies and trade networks vs. deficits of intergovernmental concerted actions. Third, it looks at the impact of the relative success of emerging models of market integration for the balance of power in Central Asia.

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1. Introduction

Economic development and modernization in a country or region are closely related to the ability to support market integration, i.e. increasing interdependence of regional and sectoral markets, in this particular territory. Market integration is crucial for using the comparative advantages, and hence, for obtaining benefits of specialization. However, creating integrated markets even within national borders is not a trivial task. Large markets are necessarily based on increasing range of (impersonal) exchange, thus requiring a sufficient level of institutional development on both formal and informal levels. For many emerging economies deficit of formal regulatory framework and of trust in the society effectively restrict the size of markets. The problem is obviously of great importance for the countries of Central Asia. On the one hand, as Linn (2009) claims, Central Asia is lagging behind in terms of integration in the global economy, partly simply because of its landlocked geographic position, but partly because of general deficit of economic integration across Eurasia. On the other hand, as in the most post-Soviet countries, legal markets (as opposed, of course, to omnipresent shadow economy and bargaining on administrative markets) are a relatively recent phenomenon, thus of course often lacking the necessary institutional infrastructure.

Borders of market, as well as borders of organization, are determined by the level of transaction costs. Market disintegration usually results from high costs of interregional and international economic exchange; the nature of barriers between territories (which often coincide with formal international borders, but may in fact be quite different from them) varies, but may be related to bad protection of property rights and contracts, low level of trust, cultural differences, as well as formal protectionist measures implemented by the regional and national governments. Certainly, even if the costs are equal to zero, in a global economy there is no reason to automatically expect the intensity of economic interaction within this region to increase; transactions with outside regions – even in spite of possibly higher transaction costs – may be more attractive. However, the reduction of barriers is certainly necessary, although not sufficient condition for integration of markets. Hence, in order to explain the process of market integration one first has to identify the potential "channels" leading to reduction of cross-border transaction costs – both as result of intended institutional design and by-product of power struggles.[i] In what follows I will refer to these channels as "models of market integration".

The aim of this paper is to look at different approaches and attempts to support market integration in Central Asia from the point of view of power balance in the region. The paper considers different aspects of the market integration, both within and across national borders. It seems to be quite obvious for Central Asia that restricting attention to either international or internal affairs cannot provide a reasonable basis for the analysis; thus one has to apply a framework accounting for both aspects. In fact, 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). Generally speaking, it is possible to evaluate the models of market integration using two sets of criteria. First, one can look at their ability to create the *necessary preconditions* for market integration. Second, it can consider, whether these preconditions *turned out to be sufficient* to establish integrated markets – or at least to support a movement towards higher market integration. It is plausible, that necessary and sufficient may diverge significantly.

To start with, most Central Asian countries still lack internal interdependence of their markets.[ii] 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). Similar problems exist in other countries, like Tajikistan and Kyrgyz Republic. There is virtually no empirical research on market integration in Central Asian states; Brosig and Yahshilikov (2005) specifically looked at the integration of wheat markets across three grain trading spots, and claimed, that while the northern markets seem to be closely connected to each other, the link to Central Kazakhstan is much weaker. Anyway, it is certainly too farfetched to claim that there exists a system of integrated markets within Central Asian countries. In a similar way, the cross-border market integration. Even after the initial collapse of intra-regional trade in Central Asia (and in the post-Soviet world in general) in the early 1990s, it is possible to claim that the share of trade flows between Central Asian countries in their total turnover was slowly declining after 1999, currently reaching the level of less than 5%. To conclude, there seems to be no empirical evidence supporting strong market integration in the region.

Hence, the models of market integration certainly are not "sufficient" to reduce transaction-costs barriers – with one exception discussed in what follows. However, this is hardly surprising given the relatively low quality of economic institutions in Central Asia and in fact a short time horizon for the existence of legal markets. Nevertheless, the problem still remains: can one (given the performance of the models so far) at least expect that some of them have the *potential* to support market integration? The issue is surely relevant for research, but is also of importance for policy advice: political economy is finally about picking policy options *given the existing constraints of implementation* (Ilchmann and Uphoff, 1971). And from the point of view of the "necessary conditions" the models of integration seem to diverge significantly. This is exactly the problem which this paper aims to discuss.

2. Models of market integration

There are many patterns of human behavior resulting in emergence of integrated markets – as there is a multitude of models of market integration. For the purpose of this paper it is helpful to distinguish first between models based on governmental activity or on influence of private actors – I will refer to these two particular models as, respectively, **regionalism** and **regionalization**. Both terms were coined for the international relations discussion, but can in fact be easily adapted to similar context within individual countries. Governments reduce transaction costs barriers by establishing formal institutions (for example, protecting property rights or fighting restrictions on free trade), but also by providing physical infrastructure (like railroad network) in case it does not exist. The channels of influence of private actors are more subtle, and in fact depend upon the exact definition of these actors: certainly, large multinationals are different from informal trade networks. Private structures influence the market integration by supporting ex-post convergence of economic and political institutions (through both transmission of experience and practices through investments and establishment of trade networks; and "voting by feet" and institutional competition) and possibly even by providing substitutes to absent formal institutions supported by the government and restricting redistribution by individual governmental agents through collective action (Greif, 2006). Certainly, here the distinction is also not particularly clear, if one considers state-owned companies or businesses with close ties to public officials, what should be taken into consideration if Central Asia is discussed.

Regionalism is usually based on some kind of policy centralization, when certain aspects of economic policy are subject to a collective decision-making mechanism or even a supranational institution, rather than to the discretion of individual governments. Certainly, regionalism may result from unilateral liberalization measures; more important, however, is the fact that policy centralization is also not sufficient to integrate markets, since it may be used in order to establish redistribution schemes. One of the most centralized countries of the world – North Korea – exhibits also very low level of market integration in the areas where markets are permitted (Seliger, 2006). However, centralization is not without influence on market integration anyway. From this point of view, however, one has to distinguish between two forms of (de)centralization: the **formal** and the **informal** ones. Formal decentralization is based on the changes in the legal acts and official political structures; informal decentralization refers to shifts in power balance "beyond" the written constitutional texts.[iii] In fact, both formal and informal decentralization refer to different types of authority the centralized decision making is based upon.

Finally, for the case of regionalism it is useful to distinguish between international and intranational market integration. In an international context, market integration is mostly driven either by voluntary cooperation of countries with relatively similar power potential, or by the policy of the dominant player (as it was predicted by the theories of hegemonic stability). In the intranational case the driving force for integration is usually the policy of the central government, i.e. of a specialized agency with claim to authority over the whole territory of a country. There is of course no clear distinction between these two forms of market integration, as there is no unambiguous definition of a country: in fact, centralized agencies (like the EU) may become important in international integration, and coalitions of regions and dominant regions may play an even more important role in individual countries, then center-periphery relations. However, in the case of Central Asia the distinction seems to be reasonable, as the following empirical part will demonstrate. For the regionalization the distinction between international and intranational arena is rather that of choice of necessary unit for empirical analysis than that of possibly different mechanisms; however, it also can be useful in the context of this study.

Table 1: Framework for market integration

	Regionalism			Regionalization
	Formal policy centralization	Informal policy centralization	Unilateral liberalization	
International	Standard international regional economic integration	Hegemonic stability and international hierarchies	Open regionalism	Multinationals and business networks across national borders
Intranational	Modern centralized states	Pseudo-federalism		Multiregional companies and business networks within national borders

To conclude, the framework for understanding how different forces of market integration work together is summarized in *Table 1*.[iv] As I have shown, it is certainly difficult to obtain a clear mapping from the external conditions to the outcomes of market integration, since different policies of public and private agents may as well result in different outcomes; it makes the empirical considerations, however, even more interesting. Hence, the difference between performance in terms of "necessary" and "sufficient" conditions, as discussed in the introduction, becomes important. One should notice that the examples of market integration in the table are much more complex in reality, and usually include elements of several models, which thus should be understood as Weberian ideal types for analytical purposes. Therefore the most interesting question relates to how different forms of market integration influence each other. The advantage of Central Asia is that in this region different models of market integration have been implemented simultaneously, without clear pre-defined chances of success, given high economic interdependence and fragility of borders inherited from the Soviet past. Therefore one can observe the interaction of the models and make conclusions regarding their complementary or substitutive nature, as it will be done in the next section.

3. Models of market integration in Central Asia: necessary conditions

3.1. Internal centralization

As the starting point for the analysis consider the models of market integration related to regionalism, i.e. state-led reduction of transaction costs barriers. The option of unilateral opening does not seem to be really relevant for Central Asia – with possible exception of Kyrgyz Republic with its radical economic reforms in the early 1990s. In what follows I will focus on formal and informal policy centralization. Here, however, the situation seems to be quite different for international and internal power allocation. From the *formal* point of view, there has been both strong centralization *within* individual Central Asian countries and active attempts of cooperation *across* their borders. From the point of view of the formal decentralization, all countries of the Central Asian region are unitary: the heads of local administration are appointed by the central government; the governors act as representatives of the president and heads of regional executive, as well as often act as presidents of local legislatures (or propose the presidents, like in Uzbekistan). There are local elected councils at provincial and sub-provincial level, which are, however, virtually powerless and often dominated by the executive. Some Central Asian countries (Uzbekistan and Tajikistan) include territories with higher degree of autonomy, but even in this case their decision-making is limited. This system was established in most Central Asian countries immediately after independence, and in spite of several experiments with local self-governance in Kazakhstan and Kyrgyz Republic, basically did not change.

If one looks at the informal level of power relations, however, the situation seems to be quite different. Here Central Asian countries follow the pattern of a "decentralization-centralization" cycle, which has also been present in several other countries of the former Soviet Union.[v] Probably, the most straightforward example of this process is Kazakhstan. 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. 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. However, since 1999 economic boom and completion of the power concentration at the central level made the policy of recentralization possible. Indeed, the central government successfully restored control over informally decentralized regions using a variety of instruments – from changes in fiscal structure to re-drawing borders of regions, centralizing cash flows from natural resources and implementing more rigorous control over local officials (Cummings, 2000; Melvin, 2001; Jones Luong, 2004).

The situation in smaller countries of Central Asia varies from country to country, but also seems to be significantly more complicated, that the simple formal analysis would suggest. Jones Luong (2000) documents, regardless of the degree of de-facto decentralization, 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.[vi] In Kyrgyz Republic, weakness of the central state also provided substantial informal autonomy to the regions in the 1990s; however, unlike Kazakhstan, the central government remained relatively weak and there seems to be no process of recentralization present. In Tajikistan the decentralization cycle took, in a certain sense, extreme forms: in the early 1990s the contradictions between regional elites resulted in a civil war "between regions", which obviously led to the vacuum of power. Currently the increasing political stability seems to support the re-centralization trend, limiting the power of regional elites and increasing the impact of the center. However, several reports suggest that the central government still lacks control over vast areas of the territory because of poor infrastructure and severe economic conditions.

The most difficult case to assess is Uzbekistan: on the one hand, 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). However, traditional clans still remain important political-economic players establishing their clientele networks and creating the "tacit division of major industries and sectors" (Gaman-Golutvina, 2007). Some empirical observations indeed show the existence of the exchange of loyalty of regional elites against economic privileges, which is, moreover, obviously different in rich and poor regions (therefore providing background for asymmetric decentralization, see Markovitz, 2008). 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.

3.2. International policy coordination

If one looks at the international policy coordination, the situation until the early 2000s seems to be relatively similar to the internal one. On the one hand, Central Asian countries have been quite active in terms of creating of regional networks of integration agreements, which currently covers a variety of institutions with different modes of functioning and responsibilities. First, countries of the region (and, particularly, Kazakhstan, but also Kyrgyz Republic and Tajikistan) belong to the main proponents of the so-called post-Soviet integration process, based on closer economic cooperation of the former Soviet republics. Thus, the countries of the region participate in the Economic Union of the CIS Countries, Eurasian Development Bank and Eurasian Economic Community. Second, Central Asia is actively involved in regional integration in the "greater Central Asia" area, covering both former Soviet republics and other countries: examples include Economic Cooperation Organization, as well as the projects of SPECA, CSATTF and CARES, established by international organizations (UNECE and ADB, respectively). Third, Central Asian countries belong to the Shanghai Cooperation Organization, which also includes a substantial economic agenda (Linn and Pidufala, 2009).

Finally, there have been several attempts to foster integration among Central Asian countries. The first project involving the countries of Central Asia was the Central Asian Union, established by Kazakhstan, Kyrgyz Republic and Uzbekistan in 1994. In 1998 Tajikistan was formally admitted to the Union, and in 2001 the structure was renamed as the Organization of Central Asian Cooperation (OCAC). After Russia joined the OCAC, the organization was merged with the EAEC (which seemed to be a reasonable decision, given the relatively short participation of Uzbekistan in the EAEC, which made the membership of both structures completely overlapping). However, the idea of a Central Asian Union is still part of the agenda of the main players in the region. While the old OCAC failed to function also because of the rivalry between Kazakhstan and Uzbekistan, in the new round of negotiations Kazakhstan became the main promoter of the institutionalized regional integration. In 2007 Kazakhstan and Kyrgyz Republic agreed on establishing an institutional framework for the bilateral agreement between these two countries – an initiative considered to be the first step towards a new regional integration project. Tajikistan is also considered to be a potential partner in the new structure (Zhugan, 2007).

However, as in case of internal centralization, for the international policy coordination the distinction between formal and informal interaction becomes really important. In the 1990s in fact both international and internal policy coordination seem to follow the same pattern. The well-developed formal institutional framework contradicted the de-facto decentralization within the countries and absence of international cooperation between countries. There seems to be very little – if any – concerted action of countries in terms of economic policy; even the simplest form of cooperation – that necessary to maintain effective free-trade areas, which exist in the region on both multilateral and bilateral level (Kort and Dragneva, 2006), or to support coordination in the crucial common pool resources like water or electricity – seems to face substantial difficulties. However, unlike internal decentralization, which in most cases was replaced by higher centralization in turn of the "decentralization-centralization" cycle, the international policy coordination seems to be as limited now as it was ten years ago. One should notice that already in the 1990s the countries more successful in terms of internal centralization (Uzbekistan and Turkmenistan) were also less interested in developing international cooperation. However, in the 2000s the divergence became obvious: the development of the "necessary" preconditions for market integration in the domestic and in the international framework diverged substantially.

3.3. Regionalization

If one looks at the market integration driven by private actors, the situation, however, seems to differ substantially. It is particularly relevant for the international dimension: the virtually absent real regionalism (with an abundance of formal regionalism projects without any steps towards implementation) since mid-2000s co-exists with relatively vivid regionalization process. There are two main driving forces to be mentioned. First, Central Asian regionalization is based on increasing activities of multinationals from Kazakhstan, which became one of the main centers of the outward FDI in the post-Soviet space (compatible to Russia). This process is particularly important for Kyrgyz Republic and – to some extend – to Tajikistan, where, however, Russian investors remain the dominant group. Even according to official statistical data, Kazakhstan is currently the leading foreign investor in Kyrgyz Republic; its share in the FDI inflow increased from 8.9% in 2004 over 19.2% in 2005, 40.7% in 2006 and 41.8% in 2007 to 51.1% in 2008. However, a well-known feature of investment interaction in Central Asia and in the post-Soviet world in general is that the statistical data only partly captures the investment flows (Libman and Kheyfets, 2006) – hence, the investment interdependence may be even higher (Libman, 2009).

An over-optimistic assessment of the regionalization process in Central Asia would be premature. The current financial crisis, which seems to have an enormous impact on post-Soviet economies, is likely to shift the investment flows in the region. It is particularly important for Kazakhstan, which based its international investment expansion on a large and well-developed banking sector, which also turns out to be the most vulnerable element of the economy of the country during the crisis. It is also clear that the international activity of multinationals from Kazakhstan depended heavily on the economic growth in this country, which demonstrated enormous performance since 2000, but also suffered a lot during the crisis. Hence, the next few years should demonstrate whether the model of interaction described in this paper will survive.

The second element of the cross-border regionalization in Central Asia is based on a much more stable foundation (although profited a lot from economic growth of the last decade), since its basic elements could be found even in the archaic economies – the existence of informal trade networks, once again, only partly covered by statistics. 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). An additional force supporting the regionalization and the development of informal networks in the region is labor migration: Kazakhstan, once again, acts partly as a regional leader attracting migrants and even competing with Russia in this respect (Schmitz, 2009:15). The informal trade networks seem to be somehow valid as well in terms of “sufficient” conditions for market integration: 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.

The regionalization within individual countries in Central Asia is even more difficult to assess than the cross-border regionalization. One could certainly expect this process to be present in Kazakhstan, where the economy is dominated by large business groups.[vii] Moreover, since the most attractive export commodities (oil and metals) have been held by foreign investors (although their positions seem to be significantly weakened now, see Libman and Ushkalova, 2009), one could theoretically observe a stronger interest of domestic business groups to explore internal market. However, unlike Russia, where regionalization indeed became a significant factor supporting reduction of transaction-costs barriers (Libman, 2007), there is at least currently no empirical evidence supporting that for Kazakhstan; there is even less information regarding other countries of the region. [viii]

To conclude, different channels of market integration seem to provide different outcomes in terms of "necessary" potential. Given the limited information on domestic regionalization and virtually absent unilateral liberalization, the most interesting comparison could be reduced to two pairs of models. In the international context, it seems to be puzzling that the regionalization outperforms regionalism so significantly. Comparing international and internal models, the really interesting puzzle is why in de-facto recentralization of 2000s after the period of informal decentralization in the 1990s was not accompanied by respective increase of international policy coordination. Finally, one may be wondering whether regionalization and centralization influence each other. The next section deals specifically with these three issues.

4. Divergence of models of integration

4.1. International policy coordination and centralization

As the starting point in the discussion consider the interrelation of international policy coordination and centralization. On the one hand, different channels of market integration can be treated as independent observations in the sample. In this case, similar institutional, economic and political environment should generate similar outcomes in terms of effectiveness. Since all models are implemented in the same region with long history of interdependence of all countries, it is reasonable to assume that the environment for these models (even if one is considering international and domestic dimensions). The question is thus to find differences in terms of development of integration model, which could explain the divergence. The alternative point of view implies that models of integration, once implemented in the same region, are interrelated. In this case one can claim that one model may turn out to be successful exactly *because* the other failed. In the first case one faces the classical MSDO situation (most similar with different outcomes). In the second case the very comparison of the models seems to be unreasonable: it makes more sense to look at them as a whole in order to understand their interrelations.

Independence assumption: For the models of government-led integration in Central Asia the difference between these two approaches is straightforward. On the one hand, one could expect, that similar environment is likely to support both centralization *within* the country *and* international policy coordination. Hence, the research objective is to look for *differences* in the environment. One specific distinction seems to be at hand: while in the international relations one considers negotiations between sovereign states, i.e. government with well-established political property rights, in the domestic decentralization process political property rights of regional elites have mostly been of informal nature. It is clear that under changing economic environment (the start of economic growth of the 2000s) it is easier to re-define the informal property rights than to change the formal institutions – and therefore the internal power balance is likely to be less stable, than the international one.

However, this claim does not really resolve the puzzle, but rather replaces it with an alternative one: why did regional elites on all Central Asian countries (even in cases when their autonomy was established in a civil war) did not protect their autonomy through establishing formal political property rights? On the other hand, the protection of political property rights in international relations is never perfect. In fact, there are multiple border disputes between Central Asian countries. The borders between countries in the region are weak at best (Olcott and Malashenko, 2000) and often artificially set by the Soviet "nation delimination" – and to a certain extend "nation creation" politics (Abashin, 2007; Farrant, 2006). "National histories" created in individual countries often treat their common history in a completely different fashion (Gorak, 2009; Shnirelman, 2009). Just to provide one example of international relations in the region: in the 1990s Uzbekistan placed minefields at the border of then-unstable Tajikistan, in fact positioning them on the Tajikistan territory (Vardomskiy, 2009). So why did the international political property rights survive all changes in the economic development of the region over the last two decades?

Informality of internal political property rights: The most important issue of informal decentralization is that it may act as a "substitute" for formal bargaining for both regional and central elites. 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. In fact, 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 in Uzbekistan, Tajikistan and Kyrgyz Republic) this factor is particularly significant. The regional elites face a contradiction between "formalizing" their political property rights now and therefore increasing the stability of the current position, and decreasing size of the "pie" in the future, if they are able to gain control in the center – simply because in a decentralized country central authority is less important. The solution to this trade-off may as well imply absence of formal decentralization, if the expected utility of potential "prize" at the central level is high enough (Libman, 2009a).

There are also several other factors to be mentioned. First, it may just be more convenient and "simple" option, given the decades of experience of informal bargaining in the region, and hence preferred by elites just because of path dependence factors. From this point of view the survival of old Soviet *nomenklatura* in the elites of the new independent states may have contributed to the predominantly informal patterns of decentralization. Second, informality is strongly supported by the central government. Formal 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.[ix] There are certain similarities between this argument and discussions in economics of transition. 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). The problem of "spontaneous development of demand for property rights", as mentioned, 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. On the other hand, there is of course a possibility that informal decentralization leads to demand for formal decentralization from the side of strong regions (because of the factors described above), but here the main problem is the time horizon and "myopic" behavior of regional leaders and the offers of the central government in the bargaining process. 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.

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 limit the readiness of strong central governments to experiment with formal decentralization (or create extreme limits for these experiments).

Stability of international political property rights: It seems reasonable to mention two potential factors of stability of international property rights. First, stability of international political property rights may be a result of informal consensus of regional leaders, based on the need to protect their power basis. In this case the explanation is similar to that of the stability of African borders. Indeed, some observers claim that this kind of informal consensus may exist in Central Asia (Allison, 2008), where regional cooperation takes form of joint support of autocratic political leaders. On the other hand, stability may also result from the complexity of power relations in Central Asia. The multitude of potential players, as well as the complexity of relations among them (Kazantsev, 2008) may also act as medium de-facto supporting stability of international political property rights.

Interdependence assumption: An alternative explanation for the observed divergence of internal and international development may be simply the existence of interdependence between these two processes. In fact, one can argue that exactly the *success* of centralization within country makes international cooperation less likely. 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, and in this case “centralization” through “delegation of power” on international level, i.e. international policy coordination, is less attractive for national autocrats. Moreover, centralization restricts the ability of regions to implement autonomous measures in international politics, hence, once again, removing at least one possible channel for international policy coordination. Hence, 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. There seems to be a paradoxical reverse connection between increasing centralization in individual countries and "centralization" (i.e. delegation of authorities through international cooperation) at the international level.

4.2. Regionalization and regionalism

In order to understand how regionalism and regionalization are interrelated, one has to clearly distinguish among two aspects of regionalization described above: informal trade networks and "investment led" regionalization based on large multionationals. From the point of view of the later, 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*.[x] 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 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.

4.3. Decentralization and regionalization

The final aspect to be considered is the interaction between decentralization and regionalization. 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): first, the rents from the regions increase, and second, even for (possible) constant rents, the threat of secession also goes up (Friedman, 1977). 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. This is yet additional argument for central governments to support centralization in a world of informal integration – particularly in Central Asia, where, as already mentioned, borders are relatively weak.

One should not forget that there is also an additional aspect of decentralization in a world with weak democratic institutions – it often results in increasing provincial protectionism. This form of protectionism does not only hamper the internal trade, but may be problematic for trade between countries: for example, there are some claims that market access of countries of southern Central Asia to Russian markets was seriously impeded by the protectionist measures of regions in Kazakhstan in the 1990s, making transit through this country significantly more expensive (Kuang, 2009). From this point of view a different conclusion could be possible – re-centralization might be also helpful for expansion of informal trade.

6. Implications for the balance of power in the region

The discussion so far revealed at least several factors, which may be able to influence the allocation of power in the region. First, re-centralization is certainly strongly interrelated with strengthening internal political power of elites, hence, reducing their desire to cooperate. Second, regionalization, on the other hand, supports cooperation serving as a potential source of "soft power" (which is certainly evident in case of Kazakhstan and Kyrgyz Republic). Third, regionalization, on the other hand, creates incentives for demand for decentralization, which, given the nature of Central Asian internal politics, is likely to result in reduced supply of decentralization, and therefore support further re-centralization.

Hence, there seem to be two forces at play, each of them with partly contradicting effects. Stronger regionalization provides instruments of "soft power", which can be used to create a more hierarchical structure of the region (by the way, similar instruments of "soft power" seem to be implemented by external actors like Russia and China). But, on the other hand, stronger regionalization combined with re-centralization increases the control of national elites over their territory, and hence reduces their readiness to accept even partial reduction of their decision space – therefore a transition towards more "horizontal" system of international relations in the region. Moreover, in this case re-centralization can, at least in the long run, undermine regionalization. For the last trend the relations between Tajikistan and

Russia are exemplarily: while Russia played an important role in stabilization of current political regime in Tajikistan in exchange for close economic and political ties, once achieving sufficient degree of stability, immediately limited access of Russian investors to its economy (the representative case of RUSAL's participation in the reconstruction of Rogun Power Plant).

To sum up, there are basically two chains of causality: (1) Regionalization (economic growth) and re-centralization → stronger elites → lower desire to cooperate → restrictions on regionalization, and (2) Regionalization → soft power → increasing concentration of power in the region → more formal cooperation (and even more regionalization?). The real question thus depends on the speed of two processes – internal re-allocation of power between central and regional elites, on the one hand, and regionalization, on the other. In case of relations between Kazakhstan and Kyrgyz Republic the latter obviously outperforms the former (especially because Kyrgyz Republic basically did not enter the "re-centralization" part of the cycle, and also because of the differences between these countries in terms of state capacity, see Cummings and Norgaard, 2004); however, in case of relations between Uzbekistan and Kazakhstan the domestic concentration of power develops much faster than any form of regionalization (especially given the absence of open markets in Uzbekistan). Current economic crisis, however, which seems to have a profound impact on the economy of Kazakhstan and its ability to expand abroad, may shift these trends. Nevertheless, the contradicting relation between (mutually interdependent) re-centralization within the countries and regionalization across their borders may play an important role in the development of the emerging power balance in Central Asia.

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[i] Emergence of institutions as unintended results of intended action has been crucial for the Hayekian analysis of economic evolution. A focus on institutions as by-products of contest for power forms the core of what one may call "neorealist" approach to institutional change (Amable and Palombarini, 2009). Since the preferences are never directly observable (and even revealed preferences based on observations of choices are difficult to deduce in intransparent political settings), the analysis of by-products of power struggles has clear benefits for research.

[ii] It should be noted, that the necessary precondition for the very consideration of the problem of market integration is, of course, the implementation of economic reforms, turning markets into (more or less) important media of coordination in the economy. In Turkmenistan the economy remained under governmental control, which seems to be even stronger, than in the Soviet Union (since for Turkmenistan 1990s in fact indicated the transition from weakening authoritarianism of the USSR to quasi-totalitarian system); in Uzbekistan market reforms also played a much smaller role, than in other countries.

[iii] 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).

[iv] It is difficult to find an example for intranational unilateral liberalization, since most modern states at least formally declare their desire to maintain free movement of goods and factors of production within their territory.

[v] For example, in Russia the period of 1990s was characterized by substantial decentralization. To be more precise, 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 a similar way, 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, in the mid 1990s in Ukraine and in the 2000s in Russia the central governments effectively regained control over regional politics – though in Ukraine the process seems to be reversed by the orange revolution in the mid 2000s.

[vi] 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.

[vii] A very short account of the development of government-business relations in Kazakhstan looks as follows: in the 1990s the corporate landscape was dominated by influential domestic companies, mostly with strong informal ties to political elites, but also (unlike most other CIS countries) by foreign multinationals, which in fact gained access to the most attractive assets in the economy. The early 2000s became the period of conflicts between domestic business and the government, not dissimilar to the Russian experience, which, as in Russia, resulted in strengthening the power of the political elites and were mostly resolved through a new round of informal bargaining rather than development of new formal rules. For example, M. Abliazov, an influential businessman and politician, was first sentenced to prison, but later released and subsequently appointed president of one of the largest banks in Kazakhstan, TuranAlem. Interestingly, he lost this position during the re-nationalization of the bank during the crisis of 2008/09, to a certain extend setting a mark of final transition between models of government-business relations: from informal dominance in relations with domestic companies and open doors to multinationals in the 1990s to gradual expansion of the government in the second half of the 2000s, which did not take the forms of re-nationalization, like in Russia, but still implies the extensive growth of public sector, stronger control over public assets and particularly increasing obstacles for activity of previously powerful multinationals. During the second half of the 1990s domestic business in Kazakhstan, as in all post-Soviet countries, moved from complete dominance of informal relations to a more institutionalized form of governance. In Russia this process was facilitated by the generational change at the top of the business community from founders to hired managers – a process, which, according to several reports, is reversed by the current crisis of 2008-2009 (when the companies start cutting hired management and replacing them by shareholders in order to optimize the cost structure). We are not aware of similar evidence from Kazakhstan, but in this case a stronger force was the process of internationalization and also impact of multinationals. Nevertheless, the crisis of 2007-2009 hit the economy of Kazakhstan very hard (due to the significantly more developed financial institutions, than in most other countries of the CIS), and may imply changes in the government-business relations model.

[viii] The problem is probably part of the general discussion of the influence of private business on the emergence of "good" institutions in the post-Soviet space. There are basically three channels to be discussed: direct power asymmetries and design of institutions by incumbents; institutions as by-product of power struggles and influence of inconsistency of institutions on the overall institutional quality. The key parameter of discussion is the so-called demand for bad institutions: large businesses support inefficient institutional equilibria due to a variety of reasons. This situation may also be considered from the point of view of development of integrated markets: demand for bad institutions may also be associated with demand for provincial protectionism. The simple existence of demand for bad institutions in the early 1990s is hardly debated in the modern literature (and in fact at least for Russia there *is* evidence of demand for provincial protectionism from business groups). Nevertheless, the account of possible changes of business preferences remains one of the key issues for transition studies. 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". Anyway, depending upon the answer to this question, two alternative approaches could be deduced. The first is that the demand for good institutions theory assumes *important changes in business' preferences towards good institutions* at later stages of transition as opposed to the early asset-stripping period: private corporations become interested in improvements of institutional environment. Hence, *improving the quality of institutions* is possible if business groups are powerful. Similar results could be expected if the driving force of institutional transition is the powerful multinationals, which may be free from the demand for bad institutions bias. According to the second approach, since business still prefers bad institutions, the main source of institutional innovations is the state (i.e., political actors), which forces private businesses to accept new rules (if it is able to do so). In this case, however, political economics considerations should be taken into account. Analogous to the "demand for bad institutions" vs. "demand for good institutions" contradiction, one can formulate the "autonomous government" vs. "rent-seeking government" contradiction. The impartial government approach claims that relatively strong government is free from potential interest groups pressure and hence produces better institutions. The particular definition of impartiality is subject to debate: the older view focuses on the *independence* of government from the redistributive desires of interest groups, which makes it able to implement economic reforms (see also Kjaer and Hansen, 2002, for critical discussion of relation of state capacity and governmental autonomy), while the more recent ideas focus on *impartiality* of the government in the long run (Rothstein and Teorell, 2008). The opposite point of view claims that governments which are independent are rarely impartial and usually just use their power to extract rents. Even in this case powerful government is able to trigger better institutions, if one follows the logic of the "stationary bandit" argument in the sense of McGuire and Olson (1996), i.e. existence of higher benefits from economic growth, than from more intensive redistribution. This argument is, however, strongly linked to the time horizon of the dictators, which is usually claimed to be very short in the post-Soviet space. In Kazakhstan and Uzbekistan, with more stable political regimes, time horizon may be longer; however, as Chaturvedi and Muenster (2009) claim, even in this case a model of conflict between the dictator and his

successor may generate more extractive policies of the former if the shadow of the future is long enough. From this point of view the increasing power of the autonomous government, if it is not rent-seeking or if it behaves as Olsonian stationary bandit, may support promotion of good institutions and hence integration of markets.

[ix] It has long been noticed that corruption and graft (as well as all kinds of informal connections) may in fact strengthen the administrative hierarchy, serving as an additional institute of control (see Darden, 2008). Informal decentralization is per definition based on informal networks and very often involves the emergence of extremely corrupt regimes – and hence, be in vested interest of central government as a tool for potential re-centralization. In fact, in this case informal decentralization seems to undermine itself, because it creates an additional tool (corruption networks) which can be used to strengthen the formal hierarchy.

[x] 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, 2007).